

**Justifying the application of the theory of efficient breach
specifically within the context of commercial contracting**

Liam David Kilvington

Doctor of Philosophy

University of York

York Law School

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Abstract

This thesis provides a functional, and justifiable application of the theory of the efficient breach of contract within the commercial context. Limiting the theory's application in this way is the primary original contribution. This is because the theory of efficient breach has not been explicitly applied solely to the commercial setting previously. This is legitimate because the underlying intention behind commercial contracting is profit generation. As such, maximising the wealth which flows from commercial contracts will be the focus of the parties involved. An additional original contribution is that this thesis represents the first major discussion of efficient breach which applies the theory to English law.

This thesis also makes additional contributions. A definition of "commercial" in a contract law context is established to frame the discussion that is to follow. It is then outlined that the fundamental structure of English contract law will remain the same whether a dispute concerns a commercial, or a non-commercial contract. However, there is a difference in the approach of the court where rights are pursued for commercial, profit driven reasons in contrast with rights that are of a personal nature. Next, it is set out that in English law, promise is not the basis of contract. As such, the efficient breach of commercial contracts cannot be discounted based on issues of morality which are linked to promise breaking. Numerous other criticisms which have been directed at efficient breach are also discounted.

Ultimately, a legitimate formulation of the efficient breach of commercial contracts is outlined. This iteration is permissive, rather than mandatory. It provides efficient optionality, meaning that where a party has the opportunity to breach efficiently, it will not necessarily take place. However, should a party choose to breach, they will be justified. This is a departure from more prescriptive approaches.

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Author's Declaration

I declare that this thesis is a presentation of original work and I am the sole author. This work has not previously been presented for an award at this, or any other, University. All sources are acknowledged as References.

I can confirm that this thesis is under 120,000 words (including references, excluding bibliography and figures/tables). The law in the thesis is correct as of September 2018.

Chapter 1

Introduction

1.1 Precis

This thesis will make the case for the legitimacy of efficient breach within the commercial contracting context meaning that in this setting, a party may breach a contract and pay damages where it is cost effective to do so. An instrumentalist approach which encourages contract rules which aim to maximise wealth will be proposed. This is legitimate on the basis that the underlying intention behind commercial contracting is, on all sides, profit generation. Importantly, the claim is not that an efficient breach should take place, only that it could should breaching parties deem it to be attractive.

Broadly, there are two major original contributions which this thesis makes. First, that efficient breach is being discussed in the commercial context. This means that the ultimate claim is that the efficient breach of commercial contracts is legitimate. The commercial limitation is applied in order to focus this discussion. This will make carrying out the analysis far more manageable than would be the case should it extend to all contract forms. Also, it is appropriate as a result of the underlying profit generation intent which is exhibited by parties to commercial contracts. This makes the commercial setting the natural environment in which to apply the theory of efficient breach. This approach is original on the basis that the theory of efficient breach has not been explicitly applied to the commercial setting. There are some passing references made to business contracts, or market settings within contract law literature.¹ However, no scholars have outlined a functional theory of efficient breach on the basis that it is legitimate in the commercial setting.

¹ See for example John H Barton, 'The Economic Basis of Damages for Breach of Contract' (1972) 1 The Journal of Legal Studies 277, 300; See also Daniel A Farber, 'Contract Law and Modern Economic Theory' (1983) 78 Northwestern University Law Review 303, 338; Alan Schwartz and Robert E Scott, 'Contract

Second, this is the first major discussion of efficient breach which applies the theory to English law. Most of the relevant literature has emerged from the American schools of law and economics.² There are some passing references to efficient breach made within some English literature.³ However, there is no full, in depth analysis of this type which is available. This thesis will provide that. There will of course be references to American literature; however, at all times the primary focus will be the English law of contract.

A number of additional contributions are also provided. A definition of “commercial” in a contract law context will be established in order to frame this discussion effectively. This is achieved through reference to the construction and interpretation of commercial contracts, as well as relevant case law. Other areas of the law which make a commercial distinction will also be considered. It will be outlined that a commercial party will generally carry out an organised business activity with the intention of generating a profit. Additionally, that commercial contracts feature only commercial parties.

Next, it will be set out that the structure of English contract law will remain fundamentally the same whether a dispute concerns a commercial, or a non-commercial contract. There is, however, a difference in the approach of the court where rights are pursued for commercial, profit driven reasons.⁴ This is in contrast with rights that are personal in nature.⁵

It will then be demonstrated that in English law, promise is not, and thus should not be considered to form the basis of contract. Rather, it functions in order to provide a method by which a party may seek an enforceable remedy following breach. Also, that in any contract it is the consequences of entering into it which provides the reason for doing so. The case will be made that an act

Theory and the Limits of Contract Law’ (2003) 113 Yale Law Journal 541, 546; Daniel Markovits and Alan Schwartz ‘The Expectation Remedy Revisited’ (2012) 98 Virginia Law Review 1093, 1097.

² See 5.2 The Economic Analysis of Law.

³ See for example Jonathan Morgan, *Contract Law Minimalism* (CUP 2013) 44; See also Neil Andrews, Malcolm Clark, Andrew Tettenborn and Graham Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (2nd edn, Sweet & Maxwell 2017) 397; Gregory Klass, ‘Efficient Breach’ in Gregory Klass, George Letsas and Prince Saprai (eds) *The Philosophical Foundations of Contract Law* (OUP 2014); Donald Harris, David Campbell and Roger Halson, *Remedies in Contract and Tort* (2nd edn, CUP 2005) 11; Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 154.

⁴ See 3.3 The Commercial Distinction in Contract Law.

⁵ See 3.4 Personal Contracts and the “Holiday” Cases.

consequentialist approach is legitimate here because commercial contracts exist primarily to generate a profit.⁶ This means that the efficient breach of commercial contracts cannot be discounted based on issues of morality which are linked to promise breaking.

The claim will be made that in commercial contracting, efficiency may legitimately be judged based on wealth maximisation, which is assessed based on monetary value, as well as by utilising the Kaldor-Hicks criterion (featuring the caveat that actual compensation must be paid). Also, that a simple approach where efficient breach is defined as involving breaching a contract's terms where it is cost effective to do so. This involves comparing the costs of performance with the costs of breach and the paying compensatory damages in line with the expectation measure.

Numerous criticisms that have been directed at efficient breach will also be discounted. This will be done using a thematic approach consisting of four categories including potential clashes with existing legal doctrines, a resistance to instrumentalist approaches to the law, issues relating to commercial practices and questions regarding the theory's practical application.⁷

Finally, a formulation of efficient breach which differs from the classic Holmes inspired iteration will be outlined.⁸ This is in the sense that it is limited to solely commercial contracting, rather than all forms of contract. Because the intention of commercial contracting is profit production, maximising the wealth which flows from them will be the focus of the parties involved. This will mean that the rational decision maker paradigm may be applied to them. Further, monetary damages will be shown to be legitimate in this setting because value can be assessed objectively based on market value. Ultimately, the approach to efficient breach which will be presented will be permissive, rather than mandatory. The suggestion is that where a party has the opportunity to breach efficiently, it does not necessarily have to take place. However, should a party choose to breach, they will be

⁶ See 4.3.1 Understanding Contract Law.

⁷ See Chapter 6.

⁸ Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995.

justified in doing so. It will also be noted that the law's approach in limiting the available remedy to expectation damages within commercial contract disputes, in practicality, condones the breach.

1.2 The Conceptual Framework of this Thesis

This thesis adopts a specific approach to advancing the case for the legitimacy of the efficient breach of commercial contracts. Most notable is the focus is on the English legal system. In addition, a number of existing concepts including efficient breach, the Kaldor-Hicks criterion, and wealth maximisation are discussed. However, on occasion, these concepts are interpreted, as well as applied slightly differently than is the norm.

1.2.1 Focus on the English Legal System

This thesis places focus on the English Legal system. English contract law is an appropriate realm for this discussion on the basis that the UK is a major centre for the hearing of commercial disputes. This is based on the expertise available within the English court system.⁹ Also, a large volume of English contract law emanates from the commercial sector. This is likely due to their higher value and thus, the greater willingness to litigate of the parties involved. In addition, the approach that the courts adopt in terms of dealing with English contract cases is appropriate based on the commercial distinction that will be highlighted.¹⁰

Next, other areas of English law, which include tax law, the law of partnership, company law and patent law, are utilised in order to develop a functional definition of a commercial contract that is a natural fit with existing legal doctrine. It is acknowledged that other approaches could be drawn on to achieve this. For example, one could look to the US Uniform Commercial Code for inspiration.

⁹ See 2.3 The Commercial Court.

¹⁰ See 3.3 The Commercial Distinction in Contract Law.

However, for the purposes of this study, which is focused solely on English Law, it is more appropriate to draw on existing legal doctrine within this jurisdiction to ensure consistency and coherence.

1.2.2 Efficient Breach

In its simplest terms, the theory of efficient breach sets out that breach of contract will be justifiable where it will result in a more economically efficient outcome. The case is often made that it stems from the suggestion that ‘the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else’.¹¹ A breach of contract will be desirable where the position of the breaching party is preferable, after the payment of expectation damages, to that which would have come about through performance. This could apply where an opportunity arises to increase profit, or to reduce losses. This thesis will provide a justification for the efficient breach of contracts agreed between solely commercial parties for the purpose profit generation. This will not apply to other forms of contract, agreed between different forms of contracting party.

1.2.3 The Kaldor-Hicks Criterion

The Kaldor-Hicks Criterion outlines that where there is scope ‘to make everybody better off than before, or at any rate to make some people better off without making anybody worse off ... if all those who suffer as a result are fully compensated for their loss, the rest of the community will still be better off than before’.¹² As such, it assumes that that monetary compensation can effectively repair any damage caused when one party’s position improves whilst another’s is simultaneously diminished.¹³ However, in its classic form there is no fixed requirement that compensation must

¹¹ Oliver Wendell Holmes, ‘The Path of the Law’ (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995.

¹² N Kaldor, ‘Welfare Propositions of Economics and Interpersonal Comparisons of Utility’ (1939) 49 The Economic Journal 549, 550.

¹³ See John Black, Nigar Hashimzade, and Gareth Myles, *A Dictionary of Economics* (OUP 2012).

actually be paid.¹⁴ The view is that when compensation could be paid, total value has been increased. Therefore, overall efficiency is achieved. In this case, the production of wealth is separate from its distribution. This thesis proceeds on the basis that the Kaldor-Hicks criterion may be applied, but that actual payment of compensation must take place in the event of an efficient breach. This is an important caveat to keep in mind.

1.2.4 Wealth Maximisation

This thesis takes the position that it is legitimate to utilise wealth maximisation as a measure in the case of the efficient breach of a commercial contract. Here, “wealth” is considered to denote a specific, measurable approach to assessing value. This is based on monetary value and is concerned with ‘what people are willing to pay for something rather than on the happiness they would derive from having it’.¹⁵ This approach differs from alternate approaches that consider wealth as synonymous with other measures such as “welfare”, or “utility”. These could concern the ‘pleasures, satisfactions, or preferences of the actor’,¹⁶ and would require ‘the aggregation of all of the subjective goods of individuals and it considers as best the outcome in which the total of individual satisfactions is maximized’.¹⁷ The justification for approaching “wealth” in this more specific, measurable way where monetary value is used is the fact that the primary reason for the existence of commercial contracts, and the underlying intention of the parties to those contracts is the production of profit. Thus, placing focus on monetary value is legitimate in this context. However, it is acknowledged that assessing wealth in this way may not be appropriate in other settings.

¹⁴ N Kaldor, ‘Welfare Propositions of Economics and Interpersonal Comparisons of Utility’ (1939) 49 *The Economic Journal* 549, 550.

¹⁵ RA Posner, *The Economics of Justice* (Harvard University Press 1983) 60.

¹⁶ Ernest J Weinrib, ‘Utilitarianism, Economics and Legal Theory’ (1980) 30 *University of Toronto Law Journal* 307, 309.

¹⁷ *ibid.*

1.3 Methodology and Research Questions

In any original research project the methodology that is to be applied is a key consideration. Choosing an appropriate methodological approach is essential in order to achieve the required results. That being said, it is important to keep in mind that no methodology is watertight. It has been noted that ‘research methods texts, often remain quiet about the imperfect path of the research process’.¹⁸ Further, that ‘while there are unquestionably norms and best practices for research methods, analysis, and interpretation’,¹⁹ it is the case that ambiguity and difficulty can, in fact, be categorised as elements that are essential within the research process.²⁰

Broadly, this thesis will apply the theory of efficient breach to the commercial contracting context. With that in mind, all aspects of the analysis which take place must be viewed through a commercial lens. This is the primary methodological approach which is to be applied and is a fundamental element of the justification which is being put forth. This will involve adopting an approach that can be defined as broadly doctrinal throughout.²¹ That being said, the approach will vary slightly from chapter to chapter in order to meet their individual needs. This is essential because no singular methodological approach would be suitable throughout. Other approaches will include the historical,²² the philosophical,²³ and the economic.²⁴ Six questions will be addressed across six substantive chapters.

¹⁸ Simon Halliday and Patrick D Schmidt, *Conducting law and society research: Reflections on methods and practices* (CUP 2009) 2.

¹⁹ *ibid.*, 5-6.

²⁰ *ibid.*

²¹ See Jenny Steele, ‘Doctrinal Approaches’ in Simon Halliday, *An Introduction to the Study of Law* (W Green 2012); See also Terry Hutchinson, ‘Doctrinal Research: Researching the Jury’ in Dawn Watkins and Mandy Burton, *Research Methods in Law* (2nd edn, Routledge 2013) 13.

²² See TT Arvind, ‘Historical Approaches’ in Simon Halliday, *An Introduction to the Study of Law* (W Green 2012); See also Philip Handler, ‘Legal History’ in Dawn Watkins and Mandy Burton, *Research Methods in Law* (2nd edn, Routledge 2013) 103.

²³ See for example Jules L Coleman, *The practice of principle: In defence of a pragmatist approach to legal theory* (OUP 2003) 156.

²⁴ Albert Sanchez-Graells, ‘Economic analysis of law, or economically informed legal research’ in Dawn Watkins and Mandy Burton, *Research Methods in Law* (2nd edn, Routledge 2013) 170.

What is a commercial contract?

In order to limit this analysis of efficient breach to commercial contracts, the essential first step is to clearly set out the parameters of such contracts. While this may seem straightforward, it is the case that no clear, functional, and widely accepted definition of a ‘commercial contract’ exists within contract law scholarship. It is essential to answer this question as it forms the basis of the platform upon which the justification of efficient breach that this thesis advances is built. The issues at hand include what a commercial contract looks like, as well as the types of party who will enter into them. A functional definition of “commercial” will be established. This will be applied to define a commercial party as one who carries out business activity with the primary intention of generating profit, as well to outline the parameters of a commercial contract, namely a contract which is agreed between solely commercial parties for the purpose of generating profit. Again, this definition is not intended to be all-encompassing and applicable in all settings. The intention is simply to identify the characteristics embodied by an archetypal commercial contract in order to ground the analysis of efficient breach that follows.

In terms of methodological approach, a variety of areas of English law which make a commercial distinction will be investigated. In this respect, it will be classically doctrinal. Case law, statute, as well as relevant academic literature will be investigated in order to inform the definition. This will be achieved by identifying common themes which are indicative of a commercial party. Areas of interest will include tax law, the law of partnership, company law and patent law. Contracts entered into by government bodies will also be discussed as they may enter contracts of a commercial and non-commercial nature. Finally, Mutuels, Co-operatives, Social Enterprises and Community Interest Companies will be considered. This approach is to be adopted because there is no clear, functional definition of ‘commercial’ or ‘commercial contract’ within contract law. Utilising characteristics that are evident within other areas of English law allows a definition that can be applied to contract law to be reverse engineered. As a result, the definition will naturally be in line with other areas of English law which make a commercial distinction. This definition will be carried forward throughout the remainder of this thesis.

Why are commercial contracts treated differently to non-commercial contracts?

Having identified the existence of a commercial distinction in contract law, as well as having defined it, the intention here is to assess why it exists. Contracts which fit the description noted in chapter 2 will be analysed. The reasoning behind why commercial parties are treated differently by English contract law will be set out. This is important because it is not enough to simply acknowledge that there is a commercial distinction within contract law. In order to build a justification for efficient breach in the commercial contracting context, it is vital to understand why the commercial distinction exists. This is because the existence of this distinction is a major factor in terms of legitimising the similar approach that will be applied to efficient breach. By setting out that the existing distinction is functional, as well as legitimate, applying a similar approach to efficient breach will not be problematic. With this in mind, the rationale behind why commercial contracts are treated differently to other forms of contract within English law will be extracted based on the wording provided by the courts. The assertion is that in deciding contract cases, the courts will consider the type of right which is being pursued. They will also account for the reasons behind that pursuit. The difference concerns whether a right is being pursued for commercial, profit driven reasons or, for reasons of an individual or personal nature. This will inform judicial decision-making. However, judges are bound by precedent and must follow the previous decisions of higher courts, adhering to the reasoning provided.

Once again, the methodological approach which will be adopted is doctrinal in nature. The focus is on the relevant case law, specifically the reasoning adopted by the courts in coming to their decisions. Literature regarding the decision making of the judiciary, as well as legal realism, will also be considered. This is necessary in order to assess the types of influence which may have an impact on the decision making of the courts. Finally, material which emanates from trust law will be contrasted with commercial contract law to further highlight the distinction. This approach is logical on the basis that the rationale for any decisions reached by the court should be contained within the judgment that is provided. It is necessary to understand how these decisions are reached if they, and

the rationale behind them, are to be utilised. Other methods could have been adopted in this respect. For example, an approach based on collecting qualitative data from relevant parties through the use of questionnaires could be suggested. However, this is both unrealistic, and unnecessary here. This is because the concern is solely how commercial disputes are treated by the courts within the case law that is discussed. Once the reasoning behind the commercial distinction is set out, as well as shown to be legitimate, it will then be possible to move on to discuss the more efficient breach specific issues at hand.

Is English contract law based on promising?

With the commercial distinction, along with the rationale behind that distinction outlined and justified, it is possible to move on to discuss more substantive, as well as theoretical issues. Here the intention is to assess whether the English system of contract law is, in fact, directly influenced by the act of promising. This is required in order to outline that any moral impermissibility issues which arise from promise breaking should not be applied to contract law. This is important because efficient breach is built on the assertion that breach of contract is legitimate in this setting. This is in contrast with the attitude of promissory theorists. In answering this question it will be concluded that it is incorrect to suggest that the promise principle forms the basis of contractual enforceability in English law. This is as a result of the domain in which contracting operates. In addition, it will be set out that the application of the theory of efficient breach to commercial contracts requires that the consequentialist approach is adopted. This is justifiable because the consequences which will flow from entering into a contractual agreement provide the reason for doing so. Resultantly, the assertion is that an efficient breach in the context of commercial contracting cannot be discounted based on issues of morality which arise from promise breaking.

The approach which will be adopted here is a hybrid between doctrinal, historical and philosophical. The development of English contract law will be investigated in order to assess whether the promise principle played a part in its genesis. This includes considering material on legal history as well as

older case law. The role of philosophy within the law will also be considered. This is necessary in order to allow the moral components which relate to promising to be properly understood. In addition, the development of contract law elsewhere will be assessed. This is important in order to highlight the specific characteristics of English contract law by providing a clear contrast. This methodological approach is appropriate on the basis that it allows a variety of key components relating to the role of promising in contract law to be fully investigated. Once it has been demonstrated that English contract law is practically detached from promising, it will be possible to move on to analyse the theory of efficient breach in more detail.

What is an efficient breach?

Having set out the existence of, as well as the rationale behind the commercial distinction in English contract law, as well as outlining that concerns raised by promissory theorists regarding breach of contract are inapplicable, the next step is to deal with the specifics of an efficient breach. The focus here is to outline the specifics of an efficient breach, as well to outline an appropriate definition for efficient breach in the commercial context. This is essential because to justify the theory, it must be understood, as well as defined in context. It will be set out that it is most appropriate to only utilise economic principles only in suitable settings within contract law. Further, that commercial contracting is such a setting. This will mean that within the commercial contract context, efficiency may legitimately be judged based on wealth maximisation where monetary value is the measure, as well as the Kaldor-Hicks criterion featuring the caveat that compensation must be paid. Additionally, a simple approach to characterising an efficient breach as a breach of contractual terms on the basis that it is more cost effective to do so will be set out. This will take into account the cost of performance, compared with the cost of breach (namely the payment of compensatory damages) and may be adopted either to reduce losses, or to maximise total gains.

Once again, the approach will be one of a doctrinal nature. Relevant literature will be analysed in order to outline the characteristics of an efficient. Primarily, this is contained within literature on the

economic analysis of law, though there are additional sources which will be noted. English case law examples of an efficient breach will also be considered before looking toward key concepts within economics. These include Pareto optimality, the Kaldor-Hicks criterion, welfare maximisation, utilitarianism, economic efficiency and wealth maximisation. Other elements, such as the application of a cost-benefit analysis, limits imposed by bounded rationality, as well as behavioural economics, will also be discussed. Finally, literature relating to measures of damages will be considered. Focus will be on the expectation measure as this is a key element of an efficient breach. This approach is legitimate on the basis that efficient breach has a wealth of literature, produced over a number of decades based around it. By investigating this literature, it will be possible to provide an appropriate definition of efficient breach which can be applied to commercial contracting.

Do the criticisms directed at efficient breach derail it?

After outlining the parameters of the definition of efficient breach that is to be utilised, that definition will be applied in order to deal with some of the theory's major criticisms. The focus here is to assess whether or not a variety of criticisms which have been directed at the theory are capable of derailing its application to commercial contracts. This is important as attempts to justify efficient breach in any form have been raised consistently. By dealing with these issues, it will be possible to outline why this approach is functional. It will be set out that there is the potential for, as well as evidence of efficient breach in English contract law. Further, that none of these criticisms successfully derail the theory of efficient breach with respect to commercial contracts.

The approach here is again one which may be categorised as broadly doctrinal. It involves considering literature which has been critical of the theory of efficient breach. This is necessary in order to set out that they are inapplicable within the commercial contract setting. A variety of critical approaches will be discussed. They will be grouped into four categories, including clashes with existing legal doctrines, issues with instrumentalist approaches, concerns regarding commercial practices and questions regarding the theory's practical application. Grouping them in this way is a

novel approach to adopt. In each individual case the criticism will be explained before setting out why they are inapplicable in the given context. Ultimately, each of them will be shown to be ineffective in negating the application and functionality of the theory of efficient breach within commercial contracts.

When and where may efficient breach function?

With the groundwork regarding the commercial distinction and its rationale, moral issues relating to promise breaking outlining the parameters of an efficient breach, as well as dealing with its major criticisms done, it is possible to outline a functional theory of efficient breach within commercial contracting. The intention here is to set out the circumstances and context in which efficient breach may function legitimately. Ultimately this is the key question which this thesis seeks to answer in asserting that commercial contracting provides an appropriate setting. The conclusion that will be reached is that when a party is presented with the opportunity to breach efficiently, this will not necessarily mean that breach must take place. However, should a party opt to breach they will be justified in doing so, both in terms of the relevant party's choice to breach efficiently, and also, to the law's approach in limiting the available remedy to expectation damages which effectively condones the breach. Further, that efficient breach requires that a damage award reflects the expectation interest in order to provide adequate compensation.

Once again, the approach will be broadly doctrinal as it will build on the questions which were answered previously. Having provided the required grounding regarding the commercial lens, it will be possible to outline the specifics of a legitimate efficient breach in the commercial context. This will be achieved by applying the theory to that setting. This will allow the rational decision maker paradigm, a feature within both economics, and law and economics, to be applied to the parties to a commercial contract. This is due to the underlying intention to generate profit which drives their decisions to enter into commercial contracts.

1.4 The Structure of this Thesis

The thesis consists of seven subsequent chapters which seek to address the six questions noted above. This will set out the grounding upon which the claims made regarding efficient breach will sit before outlining how it may function within commercial contracting. Each chapter is a necessary step towards outlining that efficient breach is legitimate within the realm of commercial contracting.

1.4.1 Chapter 2: The Commercial Distinction in English Contract Law

The first step is to set out that there is a commercial distinction within English contract law. This is a key element as the theory of efficient breach that will be outlined relies on that very distinction. The original contribution which chapter 2 makes is providing a functional definition of “commercial” as well as “commercial contract”. However, it is not intended to be all-encompassing or applicable in all settings. The aim is simply to identify the characteristics embodied by an archetypal commercial contract in order to ground the analysis of efficient breach that follows later in this thesis. This is required because currently no appropriate definition is evident within contract law. This is despite numerous references to commercial contracts, a large quantity of commercial law literature, as well as frequent use of the wording. The existence of a commercial distinction in contract law will be demonstrated through reference to the construction and interpretation of commercial contracts, as well as relevant case law.

The boundaries of what is commercial will be defined by analysing other areas of the law which make a similar distinction. These include tax law, the law of partnership, company law and patent law. This is done in order to identify common themes which could inform a contract specific definition. Forms of contract which are not commercial in nature will then be considered. These include consumer contracts and personal contracts. This is necessary in order to outline reasons why they are non-commercial to further inform the boundaries of the definition. Situations where the

boundary is less clear will then be considered briefly. These include includes contracts entered into by government bodies, which are able to enter into contracts of both a commercial and non-commercial nature. Mutuals, Co-operatives, Social Enterprises and Community Interest Companies will also be discussed. This discussion acknowledges that this blurred line between commercial, and non-commercial exists in some cases. However, this is not problematic as the definition of commercial that is being advanced in this thesis is not intended to be an all-encompassing one which could be applied in all settings.

1.4.2 Chapter 3: The Rationale behind the Commercial Distinction in English Contract Law

The second step involves outlining why the distinction that is highlighted in chapter 2 exists. The original contribution which chapter 3 provides comes in setting out the rationale which lies behind this commercial distinction, based on the reasoning provided by the courts. The discussion will establish why the commercial distinction exists based on that reasoning. There could be other reasons which exist; however, this chapter will focus specifically on the court's reasoning. The distinction is of a functional, rather than a linguistic nature on the basis that commercial contracts are repeatedly referenced but are not defined. The fact that commercial contracts are treated differently to non-commercial contracts highlights that the distinction functions despite the lack of an express definition. As well as focusing on the court's decisions, literature on judicial decision making, as well as the work of the Legal Realists, will also be discussed. However, it is important to note that that judges are bound by precedent and must follow the rulings of previous courts, adhering to the reasoning provided. This is a key feature of the English common law system.

By investigating the relevant decisions, the reasoning for this distinction can be outlined on the face of the wording that is provided. The suggestion is that the contract law vehicle remains the same whether a contract is commercial or non-commercial. However, the type of right which is pursued can lead the court to look beyond established legal doctrine. This allows the courts to shape the law

based on the reasoning which informs the pursuit of a contractual right. The difference is that where a right is being pursued for commercial, profit driven reasons, the court's decisions may be informed by commercial intent, customs and practices and commercial reasonableness. This can be contrasted with personal rights which are pursued in order to facilitate pleasure or enjoyment. It will also be set out that this trend can be seen in equity. Proprietary estoppel and the application of fiduciary duties will be discussed in order to illustrate this.

The conclusion is that courts will consider the rights which are being pursued, as well as the reasons behind that pursuit, in order to decide contract cases. The wording used by the courts in commercial and non-commercial cases allows the reasons why commercial contracts are treated as distinct to be extracted.

1.4.3 Chapter 4: An Argument against Promise as the Basis of English Contract Law: Allaying Concerns Regarding Efficient Breach in the Commercial Contracting Context

The third step is to begin to build on the commercial distinction, as well as the rationale for that distinction that is covered in chapters 2 and 3. Chapter 4's original contribution is setting out that promise does not form the basis of English contract law. The potential moral issues surrounding an efficient breach of contract will be dealt with here. The case will be made for the legitimacy of an act consequentialist attitude towards breach of contract in the commercial context. This requires that the consequences of performance are compared with the consequences of breach in order to decide on the appropriate course of action. It will be set out that promises and contracts are fundamentally different concepts. They serve different purposes based on the domain in which they operate.

Investigating the historical development of English contract law reveals a genesis which does not involve promise, but one which grew from tortious roots through trespass, debt, covenant and assumpsit. To provide additional context, the development of contract law elsewhere (including Roman law, the development of medieval European contract law and canon law) will be considered.

It is clear that English contract law developed in a different way to that of continental Europe where the approach is more in line with holding promise to be a foundational principle. It will also be set out that claims that the laws of Europe were imported into English law in the 19th century are unlikely to be correct due to the process of English legal education which took place at that time. The contrast between contract and equity in respect of the formalities which, whilst they are a pre-requisite in contract, are not in equity, will then be noted. Finally, the approach to providing remedies for breach of trust will also be considered. This will demonstrate that in English law, contract and promise are distinct entities.

The claim is that English contract law is consequentialist in a positive sense. However, the normative question of whether this should be the case must also be dealt with. Promissory theories of contracting align with a broadly deontological approach. However, there is a flaw within deontological ideology in that it is at best difficult, and at worst impossible to judge whether or not the consequences of an action are positive or negative without taking account of the consequences. Also, that claims which relate to the wrongs involved in breaking promises are based predominantly on their virtuous nature. While these virtues may seem intuitive, it seems odd that they should form the basis of contractual liability without providing the reasoning why.

1.4.4 Chapter 5: The Economic Analysis of Law and the Theory of Efficient Breach

The fourth step is to outline the parameters of the theory of efficient breach that will be applied. These are based on the groundwork regarding the commercial distinction and issues relating to promissory theories of contract that have preceded it. As such, chapter 5 will set up the original analysis of efficient breach which is to follow. It serves primarily as a literature review which grounds the claims regarding the legitimacy of the efficient breach of commercial contracts. The economic analysis of law will be introduced before moving on to analyse the idea of efficiency. This includes a discussion of Pareto Optimality, the Kaldor-Hicks criterion, welfare maximisation and

utilitarianism, economic efficiency and finally wealth maximisation. Efficiency's role within a decision making process which includes the carrying out of a cost-benefit analysis, the limits imposed by bounded rationality, as well as the flaws with the homo-economicus model noted within behavioural economics, is then set out.

The claim is that wealth maximisation, where monetary value is the measure, and the Kaldor-Hicks criterion, featuring the caveat that compensation must be paid, may legitimately inform decisions relating to the breach of commercial contracts. This is due to the profit producing intent which underpins them. There will also be a note on the issues which stem from a pursuit of efficiency flagging up that the legal process may have a value which goes beyond it. Despite this, it will be set out that efficiency can be of use in appropriate settings, and that commercial contracting is such a setting. The theory of efficient breach will then be introduced. In the simplest terms, this involves breaching a contract's terms where it is cost effective to do so. This takes into account the cost of performance and the cost of paying compensatory damages following breach. Such an approach may be used to both maximise gains or to reduce losses. Finally, the process by which damages for breach of contract are measured will be discussed. This will focus on the expectation measure which seeks to place a claimant into the equivalent position to that which they would have been in had performance taken place in so far as is possible. It will be set out that a simple approach to defining an efficient breach will be adopted. This involves the breach of a commercial contract's terms where it is more cost effective to do so. This will take into account the total cost of performance vs breach and the payment of compensatory damages and may be done either to reduce loss, or to maximise gain.

1.4.5 Chapter 6: Criticisms of the Theory of Efficient Breach

Chapter 6 will analyse a number of the criticisms which have been directed at the theory of efficient breach. A novel, thematic approach, which features four categories of criticism will be adopted. The

first category concerns potential clashes with existing legal doctrines including issues relating to awards of damages, a perceived likeness with a variety of torts, potential infringement on property rights and the role of a duty of good faith in commercial contracting. A contrast with trust law in terms of execution and remedies will also be discussed. The second category concerns issues relating to the application of instrumentalist approaches to the law. This includes the suggested moral impermissibility of breach of contract as well as the potential that moral practices could be corroded. Third, are issues regarding clashes with existing commercial practice. These include commercial reality and the impact of relational contracting and the suggestion that efficient breach would negatively impact the commercial system. The fourth category concerns potential clashes relating to the practical application of the theory of efficient breach. This includes a discussion of whether efficient breach is possible, the flaws that are evident in some of the current literature on efficient breach, bounded rationality, transaction costs and pre-risk predictions. Once these criticisms of efficient breach have been shown to be ineffective, it will then be possible to move on to make the case for the application of the theory within the commercial context in chapter 7.

1.4.6 Chapter 7: Making the Case for Efficient Breach in a Commercial Context

Chapter 7 will set out an original formulation of efficient breach which differs from the classic Holmes inspired iteration that ‘the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else’.²⁵ This formulation differs in the sense that it is limited to solely commercial contracting, rather than all forms of contract. As a result, the claim is that efficient breach is theoretically sound when it is considered within this context. This allows the rational decision maker paradigm to be applied to parties to a commercial contract. It will be set out that monetary damages are legitimate within this setting. This is based on factors which include the fact that these transactions will generally take place in a market where replacements may

²⁵ Holmes (n 6) 995.

be acquired. This will mean that value can be assessed objectively based on market value. They will also tend to involve money or an equivalent. In addition, the existence of a market for a replacement will mean that damages will be preferred to specific performance. Furthermore, any intangible losses which are inherently difficult to quantify will not be considered. This is standard practice within commercial contracting, simplifying the calculation process. An additional element is that a permissive, rather than a mandatory approach will be presented. It provides what can be described as efficient optionality. This will mean that when a party has the opportunity to breach efficiently, it is not a prerequisite that it must take place. The claim is simply that where a party chooses to breach, they will be justified in doing so. This justification applies to the relevant party's choice to breach efficiently, and also, to the law's approach in limiting the available remedy to expectation damages which effectively condones the breach. Further, that in a commercial context, an instrumentalist approach to efficient breach is legitimate due to the underlying profit generation intent displayed by commercial parties. It follows that the wealth maximisation approach can be applied here. It will be outlined that this approach will allow parties the flexibility to adapt to unforeseen contingencies, but will not require that a breach must take place in pursuit of efficiency. Other factors, including protecting existing relationships or a reputation within a particular industry, could play a role. This could mean that the decision to perform or to attempt to renegotiate the agreement could be made. Two existing defences of efficient breach will also be discussed. They include the defence based on unforeseen contingencies raised by Shavell,²⁶ as well as the Dual Performance Hypothesis presented by Markovits and Schwartz.²⁷ This will be considered in order to highlight that this approach is original in comparison. This is based on the commercial distinction which is applied. Finally, it will be set out that this approach to efficient breach is justifiable both epistemically, and normatively. The epistemic element concerns the non-prescriptive nature of the approach, whilst the normative element

²⁶ See Steven Shavell, 'Is Breach of Contract Immoral?' (2006) 56 *Emory Law Journal* 439; See also Steven Shavell, 'Why Breach of Contract may not be Immoral given the Incompleteness of Contracts' (2009) 107 *Michigan Law Review* 1569.

²⁷ See Daniel Markovits and Alan Schwartz 'The Myth of Efficient Breach: New Defenses of the Expectation Interest' (2011) 97 *Virginia Law Review* 1939; See also Daniel Markovits and Alan Schwartz 'The Expectation Remedy Revisited' (2012) 98 *Virginia Law Review* 1093.

concerns issues relating to maximising utility and individual autonomy. Again, this is an original approach to take to the theory of efficient breach.

1.4.7 Chapter 8: Conclusion

Chapter 8 will recap the conclusions that will be reached in setting out that efficient breach within the commercial contracting context is legitimate. First, it will reiterate the claim that a commercial party will be involved in an organised business activity with the intention to create profit. This will generally be carried out as part of a party's trade, profession or vocation. This is often in business forms such as sole traders, partnerships or companies. Further, that a commercial contract will feature only commercial parties and will exist for the purposes of generating a profit.

Second, it will be clear that the fundamental structure of English contract law remains the same should a dispute be in relation to a commercial or non-commercial contract. They will, however, be interpreted differently by the courts. This is based on the reasoning behind a party's pursuit of a particular right. Where the intention is commercially minded, the court may take factors such as commercial reasonableness, as well as industry customs and practices, into account. Where the intention is non-commercial and a right is being pursued for personal reasons such as pleasure or enjoyment, the court will account for that. This could include considering personal preferences ahead of what would be commercially reasonable.

Third, claims that the promise principle forms the basis of English contract law will be shown to be incorrect. This is based on its historical development, as well as the specific domain it operates within. It is also clear that the consequences which flow from a contractual agreement provide the reasons for entering into it. What this means is that within commercial contracting, an approach which is based on consequentialism is legitimate. This means that the theory of efficient breach cannot be discounted based on moral issues which arise from promise breaking.

Fourth, that a simplistic approach to defining an efficient breach should be adopted. This characterises it as breaching the terms of a contract where it is more cost effective to do so and involves accounting for the total cost of performance compared with the costs of breach and the payment of compensatory damages. Importantly, this approach can be utilised to both reduce loss, or to maximise total gain. In addition, that in the context of commercial contracting, it is legitimate to utilise wealth maximisation, where monetary value is the measure, as well as the Kaldor-Hicks criterion, featuring the caveat that compensation must be paid.

Fifth, it will be set out that a number of criticisms which have been directed at the theory of efficient breach relating to potential clashes with existing legal doctrines, a resistance to instrumentalist approaches to the law, issues relating to commercial practices, and questions regarding the theory's practical application, do not derail its legitimacy with respect to commercial contracts.

Finally, it will be clear that efficient breach may function legitimately within the sphere of commercial contracting. This is on the basis that the primary intention behind those contracts is profit production. This means that maximising the wealth which flows from them is the legitimate focus of the parties involved. This allows the rational decision maker paradigm to be applied to parties to a commercial contract. It will be set out that the use of monetary damages which reflect the expectation interest is legitimate here. It is of note that, in this case, damage awards can be objectively assessed based on market value as transactions will generally take place in a market where replacements may be acquired. This will also mean that damages will be preferred to specific performance and that any intangible losses which are difficult to quantify will not be considered. The approach that will be presented will be permissive, rather than mandatory, meaning that when a party has the opportunity to breach efficiently, it is not a prerequisite that it must take place. However, it will be justified should it be preferred. This can be described as efficient optionality. It will be set out that an instrumentalist approach to efficient breach may be applied here. Again, this is due to the underlying profit generation intent displayed by commercial parties. This means that an approach based on wealth maximisation can be utilised. This formulation of efficient breach allows parties the flexibility to adapt to unforeseen contingencies. However, it does not require that a breach must take place. The

decision to perform or to attempt to renegotiate the agreement could be made should it suit an individual party's preferences. However, should they choose to breach in pursuit of efficiency, it will be justifiable. It will be made clear that this approach to efficient breach is epistemically, and normatively justifiable. The epistemic element concerns the non-prescriptive nature of the approach. The normative element concerns issues relating to maximising utility and individual autonomy.

Chapter 2

The Commercial Distinction in English Contract Law

2.1 Introduction

The first step in the process of justifying the theory of efficient breach in the context of commercial contracts is to outline the characteristics that this particular subset of contracts feature. By setting out what it means to be “commercial”, it will be possible to apply that definition in order to identify commercial contracts. This is important because currently no appropriate definition exists within contract law, despite numerous references to commercial contracts, a large volume of commercial law literature, as well as frequent use of the wording. However, this definition is not intended to be all-encompassing and thus, is not applicable in all settings. The focus is to identify the characteristics embodied by an archetypal commercial contract in order to ground the analysis of efficient breach that is to follow.

To distinguish commercial contracts, the meaning of “commercial” in a contract law context must be established. Currently, no satisfactory definition is provided. This is despite consistent references to commercial contracts, a large quantity of commercial law literature, and frequent use of the wording within legal literature generally. Attempts to define the characteristics of what is “commercial” are few, and those that do exist are unsatisfactory.¹ This results from a lack of specificity in terms of the parties who are categorised as “commercial”, and the agreements which they enter into. Further, terms associated with the commercial sphere are used interchangeably. The result is the problem of circularity. Substitution of words such as “business”, “trade”, and

¹ HW Disney, *The Elements of Commercial Law* (Macdonald 1931) 1: ‘Commercial law is an expression incapable of strict definition, but is used to comprehend all that portion of the law of England which is more especially concerned with commerce, trade and business’; HC Gutteridge ‘Contract and Commercial Law’ (1935) 51 LQR 91: ‘Commercial law can be defined as the special rules which apply to contracts for the sale of goods and to such contracts as are ancillary thereto’; Roy Goode and Ewan McKendrick, *Goode on Commercial Law* (4th edn, Penguin 2010) 8: ‘Commercial Law is that branch of law which is concerned with rights and duties arising from the supply of goods and services in the way of trade’; Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 22: ‘Commercial agreements are taken to be those where participants do not act as consumers, but in the course of business’; Nigel Blackaby, Constantine Partasides, Alan Redfern and Martin Hunter, *Redfern & Hunter on International Arbitration* (6th edn, OUP 2015) Section 1.38 notes the UNCITRAL Model Law on International Commercial Arbitration 1985 with amendments as adopted in 2006 Article 1(1): “‘Commercial’ should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road’.

“commerce” occurs frequently. The issue is that the same questions which exist around defining “commercial” could be asked of the terms which are perceived to be synonymous with it. This is problematic as a lack of clarity in terms of categorising what constitutes the “commercial” sector is evident. As such, circularity will be avoided in developing a modern definition of “commercial” in a contract law context.

It will be demonstrated that a commercial distinction is made within contract law. This will be achieved by referring to the construction and interpretation of commercial contracts as well as to relevant case law. It will then be necessary to define the characteristics of what “commercial” means. Various approaches could be utilised in this respect. One could look to historical accounts which chart the development of merchant law and suggest that a commercial party would be a member of the “merchant class”. It could also be suggested that commercial matters are those which are heard by the commercial court. However, it seems more appropriate to look toward current practices within the commercial sector. This is because what is sought is a definition which functions in a modern context.

Various areas of English law which make a commercial distinction will be investigated. These include tax law, the law of partnership, company law and patent law. The common themes which are shared by these areas of law which will then inform a contract specific definition will be assessed. Forms of contract not considered to be of a commercial nature will then be analysed. These include consumer contracts, as well as a note on personal contracts. This is done to outline the reasons why such contracts are not commercial in nature, which is based in part on the parties involved. The focus is placed on these areas of English law because the intention is to develop a definition of “commercial” which is a natural fit within the English legal system. It is acknowledged that other approaches could be drawn from. For example, one could look to the US Uniform Commercial Code. However, for the purposes of this study, which is focused solely on English Law, it is more appropriate to draw on existing legal doctrine within this jurisdiction.

The next area that will be discussed includes examples of situations where the boundary between commercial and non-commercial is less clear. This includes contracts entered into by government bodies, which are able to enter into contracts of both a commercial and non-commercial nature. Mutuals, Co-operatives, Social Enterprises and Community Interest Companies will also be discussed. These can be seen to occupy a grey area between purely profit-oriented bodies, and those which act not for profit, often with a social purpose, charities for example. This discussion is carried out simply to acknowledge that this blurred line exists in some cases. This is not problematic as the definition of commercial that is being advanced in this thesis is not intended to be an all-encompassing one which could be applied in all settings.

It will be concluded that a commercial contract requires that the parties act with an overarching business activity in mind. This applies both in a general sense, as well as with respect to the contract in question. This activity will be carried out with the intention of generating a profit. Again, this distinction also applies to the contract in question. A combination of these requirements will signal a commercial intent lies behind the contract in question. Establishing this definition is key as it will be applied in order to identify commercial contracts throughout this thesis.

2.2 The Commercial Distinction in Contract Law

Here the intention is to outline that a commercial distinction exists within contract law in a general sense. Once this has been established, it will be possible to move on to analyse that distinction in more depth. Commercial contracts are frequently referred to within contract law literature but remain undefined. It is suggested that ‘the most important of this type of division is between commercial and non-commercial contracts’.² Also, that ‘commercial contracts can be described as those which are made between two or more parties who are in business for the purposes of trade’.³ This is perhaps the closest thing to a working definition which exists within contract law literature. It suggests that the major distinguishing factor between commercial and non-commercial contracts is the overriding intentions of the parties involved.

On commercial contract law generally, Morgan notes the need to facilitate ‘a suitable legal framework for trade’,⁴ to ‘provide workable rules for business-to-business transactions’,⁵ as well as to ‘serve the needs of business’.⁶ However, it is unclear why this type of contracting party would be commercial in nature. References to commercial contracts are made in *Benjamin’s Sale of Goods* on subjects including mistake,⁷ a seller’s right to retender,⁸ as well as rejection.⁹ *McGregor on Damages* notes “commercial contracts” in reference to mental distress,¹⁰ the lease of land,¹¹ contracts of employment,¹² and the measure of damages in contract and tort.¹³ Commercial contracts have also

² Hugh G Beale, *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 1-101.

³ *ibid.*

⁴ Jonathan Morgan, *Contract Law Minimalism* (CUP 2013) xiii.

⁵ *ibid.*, 89.

⁶ *ibid.*, 91.

⁷ Michael Bridge, *Benjamin’s Sale of Goods* (10th edn, Sweet & Maxwell 2017) 3-016.

⁸ *ibid.*, 12-032.

⁹ *ibid.*, 12-065.

¹⁰ The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 5-023.

¹¹ *ibid.*, 9-050.

¹² *ibid.*, 9-060.

¹³ *ibid.*, 24-008.

been considered with reference to classification of terms.¹⁴ They are also noted within literature on law and economics.¹⁵ This is not an exhaustive list of references to commercial contracts. It would be impossible to catalogue here every reference to commercial contracts that does not adequately define them.¹⁶

What will follow is a discussion of various strands of contract law literature. This includes the construction and interpretation of commercial contracts as well as some of the relevant case law. This will further highlight that a distinction between commercial and non-commercial contracts exists within modern contract law. This contribution is significant because the fact that commercial contracts are treated as distinct requires an effective method of identifying them.

2.2.1 The Construction and Interpretation of Commercial Contracts

Carter suggests that ‘primacy is given to commercial purpose – objectively determined – rather than specific rules’.¹⁷ *Fiona Trust & Holding Corp v Privalov*¹⁸ is cited as support, outlining that the intention of the parties are interpreted based not only on the words used within the agreement, but also with the commercial background in mind. Also, parties ‘are assumed to have entered into agreements to achieve some rational commercial purpose and an understanding of this purpose will influence the way in which one interprets their language’.¹⁹ Additionally, that ‘in relation to desired result, construction is “commercial” in the sense that the conclusions reached seek to mirror the conclusions which the reasonable commercial person would reach in relation to the contract at issue’.²⁰ Assessing what amounts to “commercial sense” is said to include taking account of ‘the words used ... the document in which they are set, the nature of the transaction, and the legal factual matrix’.²¹ References to what is commercially reasonable or commercially sensible within contract

¹⁴ Ewan McKendrick, ‘Contract: In General’ in Andrew Burrows (ed) *English Private Law* (OUP 2013) 587.

¹⁵ See for example RA Posner, ‘The Law and Economics of Contract Interpretation’ [2005] 83 *Texas Law Review* 1581, 1611; See also P Burrows and C G Vejanovski, *The Economic Approach to Law* (Butterworths 1981) 48.

¹⁶ See G Cordero-Moss, *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (CUP 2011); See also S Vogenauer and J Kleinheisterkamp, *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* 2nd edn (OUP 2015); P Burrows and CG Vejanovski, *The Economic Approach to Law* (Butterworths 1981) 48.

¹⁷ JW Carter, *The Construction of Commercial Contracts* (Hart 2012) 16.

¹⁸ [2007] UKHL 40; [2007] 4 All ER 951.

¹⁹ *ibid* [5] (Lord Hoffmann).

²⁰ Carter (n 17) 16.

²¹ Sir Robert Goff, ‘Commercial Contracts and the Commercial Court’ [1984] LMCLQ 382, 388.

case law are numerous.²² These cases also refer to the likely interpretation of an agreement by a reasonable commercial person.

*Antaios Compania Naviera SA v Salen Rederierna AB*²³ highlights that ‘if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense’.²⁴ If it can be concluded based on the available background information that an error has been made regarding language, judges are not forced to attribute an intention to a party that was clearly unintended.²⁵ It seems that ‘in the case of commercial contracts, the restriction on the use of background has been quietly dropped’.²⁶ They ‘are construed in the light of all the background which could reasonably have been expected to have been available to the parties in order to ascertain what would objectively have been understood to be their intention’.²⁷ Mitchell notes that such an approach to the interpretation of commercial contracts ‘recognizes that commercial contracting takes place against a normatively rich background ... which provides potentially relevant evidence of the parties’ intentions and gives another layer of meaning to their agreement’.²⁸ Additionally, Posner suggests that when doubt exists regarding the intentions of the parties, ‘the best, the most cost-efficient, way to resolve their dispute is not to take testimony and conduct a trial; it is to use commercial or economic common sense to figure out how, in all likelihood, the parties would have provided for the contingency’.²⁹

It appears then that when analysing those contracts that are considered to be of a commercial nature, one must be aware of the way they will be interpreted. This will likely include taking account of the context in which the agreement was made as well as what is considered to be commercially reasonable. It is clear that commercial contracts are in this sense considered to sit in a category of their own. However, the issue of effectively defining the characteristics of what constitutes a commercial contract remains.

²² See for example *Rainy Sky SA and others v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900 [14] (Lord Clarke); See also *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 771 (Lord Steyn); *Society of Lloyd’s v Robinson* [1999] 1 WLR 756, 763 (Lord Steyn).

²³ [1985] AC 191.

²⁴ *ibid*, 201 (Lord Diplock).

²⁵ See *Investors Compensation Scheme LTD v West Bromwich Building Society* [1998] 1 WLR 896, 913 (Lord Hoffmann).

²⁶ *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 779 (Lord Hoffmann).

²⁷ *ibid*.

²⁸ Catherine Mitchell, ‘Obligations in Commercial Contracts: A Matter of Law or Interpretation?’ (2012) *Current Legal Problems* 1, 17.

²⁹ Posner (n 15) 1605.

2.2.2 Case Law References to Commercial Contracts

That contracts categorised as being commercial in nature are treated as distinct from others is supported by case law evidence. In *Ruxley Electronics and Construction Ltd v Forsyth*³⁰ Lord Mustill noted that where a ‘contract is designed to fulfil a purely commercial purpose, the loss will very often consist only of the monetary detriment brought about by the breach of contract’.³¹ Note that the focus here is the quantifiable consequences of the breach, rather than the legal consequences. However, it was set out that ‘these remedies are not exhaustive, for the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure’.³² This approach of considering a wider range of losses in non-commercial cases highlights the difference between a purely commercial contract, and one which is intended to secure other types of interest. Note also *The Rozeel*³³ which directed that ‘in a commercial context a plaintiff will not recover damages on a “cost of cure” basis if that cost is disproportionate to the financial consequences of the deficiency’.³⁴ This demonstrates a distinction from non-commercial contracts in that the key consideration is whether a remedy is appropriate in a commercial sense. As we will see later, other approaches to quantification may be adopted where it is deemed commercially appropriate. In this case the appropriate method was to quantify the reduction in commercial value.³⁵ In *Southampton Container Terminals Ltd v Hansa Schiffahrts GmbH (The Maersk Colombo)*³⁶ the appropriate valuation was deemed to be resale value. In *Sealace Shipping Co Ltd v Oceanvoice Ltd (The Alecos M)*³⁷ scrap value was utilised in this respect.

2.2.2.1 Good Faith in Commercial Contracting

*Yam Seng Pte Limited v International Trade Corporation Limited*³⁸ highlighted the distinction between commercial and non-commercial contracts with respect to good faith in contractual dealing. The concern was whether duties which can apply in ‘contracts of employment and contracts between partners or others whose relationship is characterised as a fiduciary one’³⁹ could extend to commercial contracts. It was noted that it was doubtful whether ‘English law has reached the stage

³⁰ [1996] AC 344; [1995] 3 WLR 118.

³¹ *ibid*, 360 (Lord Mustill).

³² *ibid*.

³³ [1994] CLC 168.

³⁴ *ibid*, 176 (Phillips J).

³⁵ *ibid*, 175 (Phillips J).

³⁶ [2001] EWCA Civ 717

³⁷ [1991] 1 Lloyd’s Rep 120.

³⁸ [2013] EWHC 111 (QB); [2013] 1 CLC 662.

³⁹ *ibid* [131] (Leggatt J).

... where it is ready to recognise a requirement of good faith as a duty implied by law, even as a default rule, into all commercial contracts'.⁴⁰ However, there was said to 'be no difficulty, following the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties'.⁴¹ The key point is that the distinction between commercial and non-commercial contracts was directly acknowledged by the court.

2.2.2.2 Time for Delivery

*The Naxos*⁴² concerned time for delivery and its importance in commercial contracts. Lord Ackner referenced a previous decision of a lower court which had outlined that 'time of delivery is of the greatest importance in commercial contracts and contracts in the sugar trade are no exception'.⁴³ *Thunderbird Industries Llc v Simoco Digital UK Limited*⁴⁴ also highlighted that 'in relation to stipulated delivery times contained in commercial contracts, time is presumed to be of the essence'.⁴⁵ Interestingly in *United Scientific Holdings Ltd v Burnley Borough Council*⁴⁶ it was noted that 'some stipulations in commercial contracts as to the time when something must be done by one of the parties or some event must occur, time is of the essence; in others it is not'.⁴⁷ *Bunge Corporation New York v Tradax Export SA Panama*⁴⁸ was also cited as support for this principle. Note though that the wording in this case refers to mercantile contracts. Again, direct references to commercial contracts as a separate category of contract are evident.

2.2.2.3 Restraint of Trade

*Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*⁴⁹ outlined that a distinction will exist between contracts which regulate normal commercial relations and those that are in restraint of trade.⁵⁰ As such, this will does not apply to 'commercial contracts for the regulation and promotion

⁴⁰ *ibid.*

⁴¹ *ibid.*

⁴² *Cie Commerciale Sucres et Denrees v C Czarnikow Ltd (The Naxos)* [1990] 1 WLR 1337.

⁴³ *ibid.*, 1343 (Lord Ackner).

⁴⁴ [2004] EWHC 209 (Ch); [2004] 1 BCLC 541.

⁴⁵ *ibid* [14] (Patten J).

⁴⁶ [1978] AC 904.

⁴⁷ *ibid.*, 924 (Lord Diplock).

⁴⁸ [1981] 1 WLR 711.

⁴⁹ [1968] AC 269; [1967] 2 WLR 871.

⁵⁰ *ibid.*, 327 (Lord Pearce).

of trade during the existence of the contract, provided that any prevention of work outside the contract ... is directed towards the absorption of the parties' services and not their sterilisation'.⁵¹ The ruling in *Esso* was cited in *Schroeder Music Publishing Co Ltd v Macaulay*,⁵² as well as in *One Money Mail Limited v Ria Financial Services*.⁵³ This demonstrates that in certain commercial settings clauses which would usually be in restraint of trade will be allowed on the basis that they are commercially reasonable.

2.2.2.4 Mental Distress

Claims for damages for mental distress will not be successful in commercial contract cases. This was demonstrated in *Hayes v James & Charles Dodd*.⁵⁴ Also, *Johnson v Unisys Ltd*⁵⁵ outlines that in the context of a commercial contract 'non-pecuniary loss such as mental suffering consequent on breach is not within the contemplation of the parties and is accordingly too remote'.⁵⁶ This is different to the approach that is taken in personal contracts and is perhaps the clearest example of the difference which exists in respect of commercial and non-commercial contracts.

2.2.2.5 Equitable Relief against Forfeiture

*Sport Internationaal Bussum BV and Others v Inter-Footwear Ltd*⁵⁷ set out that in a claim for equitable relief against forfeiture 'the jurisdiction never was, and never has been up to now, extended to ordinary commercial contracts unconnected with interests in land'.⁵⁸ This ruling made direct reference to commercial contracts as a separate category and also, the fact that the claim was 'not based on any pressing consideration of legal policy but simply on an appeal to sympathy for what is considered to be a hardship arising from strict adherence to a bargain which is concluded with its eyes open'.⁵⁹ This is of note as it highlights the reasoning adopted by Lord Oliver who took account of the commercial norm of entering into an agreement freely, with open eyes and by doing so, accepting the risks involved.

⁵¹ *ibid*, 328 (Lord Pearce).

⁵² [1974] 1 WLR 1308.

⁵³ [2015] EWCA Civ 1084.

⁵⁴ [1990] 2 All ER 815.

⁵⁵ [2001] UKHL 13; [2003] 1 AC 518.

⁵⁶ *ibid* [70] (Lord Millet).

⁵⁷ *Sport Internationaal Bussum BV and Others v Inter-Footwear Ltd* [1984] 1 WLR 776.

⁵⁸ *ibid*, 788 (Lord Oliver).

⁵⁹ *ibid*.

2.2.2.6 State Immunity

A State will be immune from the jurisdiction of UK courts except in certain circumstances.⁶⁰ In the case of a commercial transaction entered into by a State this immunity will not apply.⁶¹ Greenwood notes that ‘it follows that when such a State is sued for breach of a commercial contract, it should not be able to rely on its sovereign character by arguing that the breach was a political act’.⁶² This is also the case under the Vienna Convention which concerns similar immunity for an individual diplomatic agent.⁶³ *Trendtex Trading Corporation v Central Bank of Nigeria*⁶⁴ confirmed that English courts would be required to acknowledge this approach in respect of commercial transactions. Also *The United States of America v Nolan*⁶⁵ outlined expressly that immunity from potential liability will not be available in the case of an act which is commercial in nature.⁶⁶

2.2.2.7 Late Payment of Commercial Debts

The late payment of commercial debts should be regulated differently based on the negative effect such activity could have on the liquidity and financial management of undertakings.⁶⁷ Statutory interest will be payable on any such debts.⁶⁸ Note that the Late Payment of Commercial Debts Regulations 2002/1674 amends the Late Payment of Commercial Debts (Interest) Act 1998. In *Sempre Metals Limited v Her Majesty’s Commissioners of Inland Revenue*⁶⁹ Lord Mance noted that that:

[T]he Arbitration Act 1996 conferred a discretionary power on arbitration tribunals to award, unless the parties had otherwise agreed, simple or compound interest on sums awarded in the arbitration and the Late Payment of Commercial Debts (Interest) Act 1998 provided, in certain circumstances, a right to simple interest on certain commercial debts.⁷⁰

⁶⁰ State Immunity Act 1978, s 1(1).

⁶¹ *ibid*, s 3.

⁶² Christopher Greenwood, ‘Sovereign immunity and Commercial Contracts’ (1983) 4 BLR 265, 267.

⁶³ Vienna Convention on Diplomatic Relations 1961, Article 31 s 1(c).

⁶⁴ [1977] QB 529.

⁶⁵ [2015] UKSC 63; [2016] AC 463.

⁶⁶ *ibid* [12] (Lord Mance).

⁶⁷ Council Directive 2011/7/EC of 16 February 2011 On combating late payment in commercial transactions (3).

⁶⁸ Late Payment of Commercial Debts (Interest) Act 1998, s 1.

⁶⁹ [2007] UKHL 34; [2008] 1 AC 561.

⁷⁰ *ibid* [221] (Lord Mance).

2.2.2.8 Conclusion

There are far more examples than those noted above which distinguish between commercial and non-commercial contracts. The intention was to highlight the existence of the commercial distinction in contract law. While it is clear that a distinction is made, the characteristics of commercial contracts remain undefined. It is therefore necessary to develop a functional definition of what is meant by commercial in a contract law sense. It is clear that the need for a party to act in pursuit of profit will be of importance, as was noted explicitly in *Ruxley* and *Johnson v Unisys Ltd*.⁷¹ It is also evident that the commercial nature of an agreement will inform the way which the courts will reach their decisions. A recurring theme is the use of a standard of reasonableness, which is in turn informed by commercial norms. Examples of this are particularly clear in relation to quantification of loss,⁷² time for delivery,⁷³ and restraint of trade.⁷⁴ Another obvious distinction relates to claims for non-pecuniary losses such as mental distress.⁷⁵ Now that the existence of the commercial distinction in contract law has been established, it will be possible to move on to discuss the content of that distinction, as well as to set about providing a legitimate definition of both “commercial”, and “commercial contract”.

2.3 The Commercial Court

With the existence of a commercial distinction in contract law confirmed, it is now possible to move on to deal with the obvious issue which exists regarding their definition. It could be suggested that commercial disputes will be those dealt with by the Commercial Court.⁷⁶ The Commercial Court is governed by the Civil Procedure Rules. These outline that a “commercial claim” means any claim arising out of the transaction of trade and commerce’.⁷⁷ These may include a business document or contract, the export or import of goods, insurance and re-insurance and the purchase and sale of commodities.⁷⁸ The mercantile court will hear cases which relate to ‘a commercial or business matter

⁷¹ *Ruxley* (n 30); *Johnson* (n 55).

⁷² See *The Rozel* (n 33) 175 (Phillips J); See also *The Maersk Colombo* (n 36); *The Alecos M* (n 37).

⁷³ See *The Naxos* (n 42); See also *Thunderbird Industries Llc v Simoco Digital UK Limited* (n 44); *United Scientific Holdings Ltd v Burnley Borough Council* (n 46); *Bunge Corp v Tradax Export SA* (n 48);

⁷⁴ See *Esso Petroleum Co Ltd* (n 49); See also *Schroeder Music Publishing Co Ltd v Macaulay* (n 52); *One Money Mail Limited v Ria Financial Services* (n 53).

⁷⁵ See *Hayes v James & Charles Dodd* (n 54); See also *Johnson v Unisys Ltd* (n 55) [70] (Lord Millet).

⁷⁶ Sir Geoffrey Vos, *Civil Procedure White Book* (Sweet & Maxwell 2018) Section 1 Court Guides, 1B Queen’s Bench Guide, 1.6.7: ‘The Commercial Court (being a constituent part of the Queen’s Bench Division) deals with commercial claims, i.e. any claim arising out of the transaction of trade and commerce. Its proceedings are subject to Part 58 of the Rules and to the Part 58 Practice Direction’.

⁷⁷ CPR 58.1(2).

⁷⁸ CPR 58.1(2).

in a broad sense'.⁷⁹ Claims in the mercantile court do not require that they are heard in London's Commercial Court. They are typically of a lower value than claims in the commercial court.⁸⁰

When a party wishes to bring a claim before the Commercial Court it must make an application before a claim form is provided to a Commercial Court judge.⁸¹ This must be supported by evidence.⁸² Should the relevant judge consider 'that the proceedings should not be brought in the commercial list, he may adjourn the application to be heard by a master or by a judge who is not a Commercial Court judge'.⁸³ Those which proceed in the Commercial Court are placed on a specialist list known as the commercial list, over which a judge of the Commercial Court will preside.⁸⁴ A Commercial Court Judge has the capacity to order a claim to be transferred from the commercial list to another specialist list.⁸⁵ For example, a case can be transferred to one of the mercantile courts or the London mercantile court should it be deemed necessary.⁸⁶ A case could be transferred to the commercial list, though it is directed that this can take place for limited purposes only.⁸⁷ These purposes are not expanded upon. Any decision to allow a transfer will be made by a Commercial Court judge.⁸⁸ It therefore appears that a commercial judge assigned the responsibility of making these decisions holds the power to decide whether a dispute is of a commercial nature. Guidance on how judges make such decisions is not provided. This gives the court and (and the particular judge) great freedom to decide on the suitability of claims as they see fit. Retaining this freedom and control could very well be something that the Commercial Court and its judges are keen to do.

In order to provide some idea of how these judges exercise their discretion the relevant case law has been analysed. The key case in respect of a transfer to or from the commercial court is *Southern Rock Insurance Co Ltd v Brightside Group Ltd and Another*.⁸⁹ This concerned a proposed transfer from the Chancery Division in Bristol to London's Commercial Court. In this case the application for transfer was refused because the expertise of judges in the Commercial Court was not considered to be essential. It was set out that the suitability of the commercial court is based on 'whether there are issues involved which would particularly benefit from the experience and expertise of judges in this court as compared with that of judges in the Chancery Division'.⁹⁰ Further, that 'other matters, such

⁷⁹ CPR 59.1(2)a.

⁸⁰ See <<https://www.justice.gov.uk/courts/rcj-rolls-building/mercantile-court/why-have-mercantile-courts>> accessed 24 September 2018.

⁸¹ PD 58.3.1.

⁸² PD 58.3.2.

⁸³ PD 58.3.3.

⁸⁴ CPR 58.2.

⁸⁵ CPR 58.4(2) directs that 'rule 30.5 applies to claims in the commercial list, except that a Commercial Court judge may order a claim to be transferred to any other specialist list'; CPR 30.5(2) outlines that 'a judge dealing with claims in a specialist list may order proceedings to be transferred to or from that list'.

⁸⁶ The Admiralty and Commercial Courts Guide (10th edn, 2017) Section B13.

⁸⁷ *ibid*, Section B13.3.

⁸⁸ *Civil Procedure White Book* (n 76): Section 2 Specialist Proceedings, 2A Commercial Court, 4.1(1).

⁸⁹ [2015] EWHC 757 (Comm).

⁹⁰ *ibid* [4] (Leggatt J).

as relative expedition and cost insofar as those are material; but the primary focus ... must be on the subject matter of the case'.⁹¹ *Breyer Group v Department of Energy and Climate Change*⁹² applied the reasoning in *Southern Rock Insurance Co Ltd v Brightside Group Ltd and Another*.⁹³ It is noted that part 58 of the civil procedure rules define a commercial claim as 'any claim arising out of the transaction of trade and commerce'.⁹⁴ Further that the claim was 'not a dispute between traders or businesses'.⁹⁵ Rather it was 'a dispute between a number of businesses and the Government',⁹⁶ making it a public law claim. In dismissing the application to transfer the case it was set out that whilst there was a 'Commercial Court flavour'⁹⁷ to the case, there was doubt that the issues at hand would 'benefit from the experience and expertise of judges in this court'.⁹⁸ Further, that if there was a difference, it would not be significant.⁹⁹ The application was dismissed as the court was 'wholly unpersuaded that the Commercial Court would be a significantly more suitable court for the trial of this public law claim'.¹⁰⁰ Finally, in *Pantheon v Chandler Hargreaves*¹⁰¹ both the commercial court and the chancery division were said to be appropriate. The view was that speed and efficiency were the relevant factors in deciding whether to allow the transfer. It was outlined that 'a judge of the commercial court will have ... the relevant expertise to deal more efficiently with the matters which are raised and the issues which are raised in this action'.¹⁰² These cases illustrate that sole discretion is afforded to the presiding judge in interpreting the guidance provided in the civil procedure rules.¹⁰³

There is evidence of claims which would appear to be of a commercial nature being heard elsewhere. For example, claims concerning construction disputes are commonly heard in the county court or the Technology and Construction Court.¹⁰⁴ Also, intellectual property cases are heard in the Intellectual Property Enterprise Court or, should the value of damages claimed be above £500,000, the Chancery Division.¹⁰⁵ It should also be noted that the Commercial Bar Association whose members are specialist commercial lawyers representing their clients within the Commercial Court do not attempt to define a commercial party or commercial claim.¹⁰⁶

⁹¹ *ibid.*

⁹² [2016] EWHC 763 (Comm).

⁹³ *Southern Rock Insurance Co Ltd v Brightside Group Ltd and Another* (n 89).

⁹⁴ *Breyer Group v Department of Energy and Climate Change* (n 92) [8] (Teare J).

⁹⁵ *ibid* [9] (Teare J).

⁹⁶ *ibid.*

⁹⁷ *ibid* [13] (Teare J).

⁹⁸ *ibid.*

⁹⁹ *ibid.*

¹⁰⁰ *ibid* [14] (Teare J).

¹⁰¹ (1989) 139 NLJ 329.

¹⁰² *ibid* (Glidewell LJ).

¹⁰³ CPR 58.1.

¹⁰⁴ See <<https://www.justice.gov.uk/courts/rcj-rolls-building/technology-and-construction-court>> accessed 24 September 2018.

¹⁰⁵ See <<http://www.justice.gov.uk/courts/rcj-rolls-building/chancery-division>> accessed 24 September 2018.

¹⁰⁶ See <<http://www.combar.com>> accessed 24 September 2018.

What is offered regarding the Commercial Court is not particularly useful in providing a functional definition of what is commercial. What could amount to a commercial claim is broad and open ended. It appears that the approach is based on the assumption that a Commercial Court judge will know what one looks like and act accordingly. This suggests that in terms of identifying such a claim is not based on any specific guidelines which have been set out. The characteristics of a party that may bring a claim are not outlined. As such, it is clear that asserting that a commercial claim (that would be brought by a commercial party) is one which is heard in the Commercial Court does not effectively characterise them. With this in mind, it is now necessary to analyse other areas which may shed light on the commercial distinction in contract law.

2.4 Commercial History

The next area of interest with regard to the need to shed light on the commercial distinction in contract law is the history of commercial law in England which has developed over a number of centuries. The key issue that is to be addressed is whether or not there are any principles which can be utilised and applied in order to define the characteristics of what it means to be “commercial”. Legal historians have asserted that commercial law is informed by the customs and practices of the merchant community, predominantly the merchant community of continental Europe. This became known as the “Law Merchant” or “Lex Mercatoria”¹⁰⁷ and developed in Europe as ‘the diversity of international commerce diminished the self-regulating capacity of a merchant regime’.¹⁰⁸ Its intention was to provide merchants with a uniform legal system to resolve disputes based upon mercantile interests.¹⁰⁹ Note that ‘to be a merchant was to possess a special status’.¹¹⁰ This increasingly international system ‘was more than just a result of the commercial revolution. It was a prerequisite for the rapid development of trade’.¹¹¹ During the reign of Edward I it was seen as body of law which differed from the common law whereby ‘within certain limits it was for the merchants themselves to declare this law’.¹¹² The suggestion is that this system ‘took a more liberal and modern view of contractual obligations than that which was taken by the common law’.¹¹³ The division between the highly technical English common law and the Law Merchant proved problematic. The

¹⁰⁷ See FW Maitland, *Select Pleas in Manorial and other Seignorial Courts* (1889) 2 Selden Society.

¹⁰⁸ Leon E Trakman, *The Law Merchant: The Evolution of Commercial Law* (Fred B Rothman & Co 1983) 10.

¹⁰⁹ *ibid*, 13.

¹¹⁰ Frederic Rockwell Sanborn, *Origins of the Early Maritime and Commercial Law* (WS Hein American Historical Association, reprint, 1930) 182.

¹¹¹ Bruce L Benson, ‘The Spontaneous Evolution of Commercial Law’ (1989) 55 *Southern Economic Journal* 644, 648.

¹¹² Maitland (n 107) 132.

¹¹³ *ibid*.

solution was allowing merchants to rely upon their own trade customs as exceptions to the common law.

There is also evidence of merchant customs being incorporated into the common law. As early as the Tudor times ‘merchants began to transfer their allegiance to the King’s Bench, and the King’s Bench encouraged them by upsetting judgments of municipal courts on technical grounds’.¹¹⁴ The issues raised in commercial disputes were often sophisticated in nature. As such ‘the use of special juries enabled them to be determined by experts who knew the relevant usages without the need to turn them into law’.¹¹⁵ This approach is likely to have resulted from Lord Mansfield’s ‘response to pressure from the city for the formulation of clear rules of mercantile law’.¹¹⁶ Before reaching decisions Mansfield began consulting with city merchants, though this technique was not completely radical. Hale CJ is said to have consulted with the merchant community during the 1660s and 1670s.¹¹⁷ In addition, there is evidence of what is termed the “custom of merchants” being taken into account by the courts in the 17th and 18th centuries.¹¹⁸ Lord Mansfield worked to develop ‘co-operation with city juries into a continuous programme for settling questions of commercial law in the King’s Bench upon motions after trial’.¹¹⁹ He has been credited with laying ‘the foundation of the modern commercial system’.¹²⁰ He was active in attempting to formalise a uniform commercial law in Europe, encouraging ‘the citation of writings current on the continent, the works of natural lawyers such as Grotius, Pufendorf, Heineccius and Vattel, and the standard international text books on commercial law’.¹²¹ It is suggested that this type of approach was essential for international trade as in the absence of ‘clear and understandable laws, alien merchants would not have been willing to carry on trade at near the level that arose during the eleventh, twelfth and subsequent centuries’.¹²²

*Pillans and Rose v Van Mierop and Hopkins*¹²³ concerned letters of credit. Here Lord Mansfield stated that it was ‘almost implied, that there must be some consideration’.¹²⁴ Ibbetson has noted that ‘this could be generalized into a rule that, so far as merchants were concerned, enforceable contracts could be made without consideration’.¹²⁵ Another example of the dilution of the need for

¹¹⁴ JH Baker, *An Introduction to English Legal History* (4th edn, OUP 2011) 26.

¹¹⁵ *ibid.*, 351.

¹¹⁶ *ibid.*

¹¹⁷ *ibid.*

¹¹⁸ Noted in JH Baker and SFC Milsom, *Sources of English Legal History: Private Law to 1750* (2nd edn, OUP 2010). Includes: *Woodford v Wyatt* (1626) HLS MS 106, fo 263 (Exchequer Chamber); *Browne v London* (1671) KB 27/1919, m 523; *Sarsfield v Witherley* (1689) KB 27/2056, mm 645–646; *Clerke v Martin* (1702) 2 Ld Raym 757; *Martin v Sitwell* (1691) 1 Show KB 156, Holt KB 25.

¹¹⁹ Baker (n 114) 351.

¹²⁰ Lord Irvine, ‘The Law: An Engine for Trade’ (2001) 64 MLR 333, 335.

¹²¹ Baker (n 114) 351; See also S Todd Lowry, ‘Lord Mansfield and the Law Merchant: Law and Economics in the Eighteenth Century’ (1973) 7 *Journal of Economic Issues* 605, 609.

¹²² Benson (n 111) 648.

¹²³ (1765) 3 Burrow 1663.

¹²⁴ *ibid.*, 1666.

¹²⁵ David Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2006) 205. Notes *Pillans and Rose v Van Mierop and Hopkins* (1765) 3 Burr 1663, 1669.

consideration came in the form of the bill of exchange which were used ‘primarily in transnational commerce but increasingly found in more domestic inland contexts in the eighteenth century’.¹²⁶ Utilising this merchant custom allowed ‘that acceptors should be liable on bills’¹²⁷ without needing to demonstrate the existence of any consideration. Lord Irvine, citing *Woodward v Rowe*¹²⁸ suggested that by the end of the seventeenth century ‘bills of exchange had become such a central feature of commercial transactions that they were finally recognised by the common law’.¹²⁹

In summary, there been a historical distinction made between parties considered commercial in nature (the merchant classes) and those who are not. What this demonstrates is that the norms and practices of merchants were incorporated into contract law where it was deemed appropriate. This allowed that agreements between the merchant classes could be governed based on their own system of rules and shared understandings. This highlights that the merchant classes were in this respect treated differently to the wider public. While it does appear that the merchant classes have in the past possessed seemingly commercial characteristics, utilising such a distinction in the present day would be flawed. This is because what constitutes a commercial party now goes beyond being categorised as a member of the merchant class. This terminology has become outdated. Commercial parties could well operate in industries beyond simply trade, as was the case in the historical accounts noted above.¹³⁰ Examples could include parties to contracts concerning construction or intellectual property. Therefore it is necessary to use an alternate approach to craft a modern definition which will incorporate this expansion in terms of the characteristics of the parties which it covers. This will be the focus of the remainder of this chapter.

2.5 Areas of the Law which make a Commercial Distinction

With the existence of the commercial distinction in contract law identified, commercial contracts must now be defined. To craft a modern, contract law specific definition of “commercial”, elements from other areas of the law which distinguish commercial from non-commercial have been investigated. Elements of English law including tax law, the law of partnership and company law offer useful guidance in terms of identifying any common themes which could also exist within contract law. This methodology offers a way to develop a definition of “commercial” providing guidance required to reverse engineer a definition for a term which, despite widespread use, is not

¹²⁶ *ibid*, 204.

¹²⁷ *ibid*, 205.

¹²⁸ (1666) 2 Keb 105.

¹²⁹ Irvine (n 120) 339.

¹³⁰ This should not be confused with the broader definition of ‘trader’ provided in the Consumer Rights Act 2015 s 2(2): ‘A person acting for purposes relating to that person's trade, business, craft or profession, whether acting personally or through another person acting in the trader's name or on the trader's behalf’.

clearly outlined. Again, the focus is on English law because the intention is to develop a definition of “commercial” which is a natural fit within the English legal system.

2.5.1 Tax Law

The first area of interest is the commercial distinction in tax law. Tax liability applies to the majority of the population.¹³¹ In UK tax law a distinction is made when assessing the liability of parties acting in a business capacity. The concern here is not the politics, policies or economic rationale behind tax law. Only the elements of tax which apply to profits made in the course of business will be considered.

There are a variety of interrelated terms which are used to identify tax subjects. These include “person”, “entity”, “body of persons” and “company”.¹³² Liberal use of “entity” within tax legislation is particularly unclear. It is used ‘in numerous places, but without definition. These uses suggest that an individual is not an “entity”, but that a company or corporation is’.¹³³ This lack of clarity could be problematic in developing a definition for what is commercial in a tax law sense. With this in mind the different types of business form will be outlined before moving on to analyse the problematic terms “trade”, “profession” and “vocation”. Finally the key issue of profit will be discussed.

2.5.1.1 Business Structures

The first issue for discussion with respect to the commercial distinction in tax law are the business structures utilised in the UK and how tax law applies to them.¹³⁴ The simplest form are sole traders who:

¹³¹ See generally David W Williams and Geoffrey Morse, *Principles of Tax Law* (6th ed, Sweet and Maxwell 2008); See also John Tiley and Glen Loutzenhiser, *Revenue law: introduction to UK tax law; income tax; capital gains tax; inheritance tax* (7th edn, Hart 2012); Peter Harris, *Corporate Tax Law* (CUP 2013); Peter Harris, ‘Company, person, body of person, entity: what’s the difference and why?’ (2011) 2 *British Tax Review* 188; Reuven Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law* (OUP 2011).

¹³² Peter Harris, ‘Company, person, body of person, entity: what’s the difference and why?’ (2011) 2 *British Tax Review* 188.

¹³³ Peter Harris, *Corporate Tax Law* (CUP 2013) 20.

¹³⁴ HMRC outline the legal structures which can be utilised for business purposes. <<https://www.gov.uk/business-legal-structures/overview>> accessed 24 September 2018.

[A]re not regulated by any special legal provisions regarding legal form and the business has no separate legal personality ... the business and personal assets of a sole trader do not need to be kept separate (although accounts are required for tax purposes for profits at a de minimis level).¹³⁵

A sole trader takes on personal liability for any debts accrued through their business activity. Their personal and business assets are mixed in the eyes of the law.

Next is the concept of a partnership which can be ‘governed by purely oral or written agreements and can arise quite informally’.¹³⁶ The law specific to partnerships will be returned to. For now it will be considered briefly regarding how tax law applies to partnerships. Generally ‘partners remain liable to the full extent of their personal assets and these may well be mixed with their business assets’.¹³⁷ In a limited partnership, the liability of a partner extends only to the value of their initial investment, not to personal assets. The Limited Liability Partnership (LLP) is a hybrid form offering partners limited liability. LLPs ‘are called “partnerships”, but are given corporate personality ... Therefore, limited liability partnerships seem to fall outside the definition of “partnerships” in the Partnership Act 1890’.¹³⁸ It is outlined that ‘references to a firm or partnership include a limited liability partnership in relation to which subsection (1) applies’.¹³⁹

Last is the company. Note that company law will be discussed in greater depth later. A limited company must be registered under the Companies Act 2006 and must fulfil various requirements set out therein. Once incorporated, a company will have its own legal personality separate from its shareholders. A key feature of this is limited liability in respect of the debts undertaken by shareholders. Under the Income Tax Act 2007, company means ‘any body corporate or unincorporated association, but does not include a partnership, a local authority or a local authority association’.¹⁴⁰ This wording is mirrored in the Corporation Tax Act 2010.¹⁴¹ With these business structures identified, it will now be possible to move on to discuss the impact which tax liability has on them.

¹³⁵ J Freedman and C Crawford, ‘Small Business Taxation’ in J Mirrlees et al (eds), *Dimensions of Tax Design: The Mirrlees Review* (Oxford University 2010) 1041.

¹³⁶ *ibid*, 1042.

¹³⁷ *ibid*.

¹³⁸ Harris (n 133) 28.

¹³⁹ Income Tax (Trading and Other Income) Act 2005, s 863 (2)(a).

¹⁴⁰ Income Tax Act 2007, s 992(1).

¹⁴¹ Corporation Tax Act 2010, s 1121.

2.5.1.2 “Trade”, “Profession” or “Vocation”

One may assert that when businesses fall into categories noted above, they are distinguishable from the general public when assessing tax liability because it will be applied to the profits they generate. The deciding factor is the activity they carry out and whether it is focused on profit generation. The Income Tax (Trading and Other Income) Act 2005 (ITTOIA) outlines that ‘income tax is charged on the profits of a trade, profession or vocation’.¹⁴² Also the provisions of Chapter 2 of the ITTOIA ‘apply to professions and vocations as they apply to trades’.¹⁴³ The Corporation Tax Act 2009 states that ‘the charge to corporation tax on income applies to the profits of a trade’.¹⁴⁴ Focus is therefore on the terms “trade”, “profession” and “vocation”, suggesting that if a course of dealing is done in that capacity, any profits will be taxable.

The Income Tax Act 2007 defines “trade” as ‘any venture in the nature of trade’.¹⁴⁵ This is unclear, as is highlighted in *Ransom v Higgs*.¹⁴⁶ Lord Reid noted that ‘the Income Tax Acts have never defined trade or trading farther than to provide that trade includes every trade, manufacture, adventure or concern in the nature of trade’.¹⁴⁷ Furthermore:

‘[T]rade’ has or has had a variety of meanings or shades of meaning ... it is sometimes used to denote any mercantile operation but it is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services.¹⁴⁸

Additionally Lord Wilberforce suggested that trade ‘cannot be precisely defined, but certain characteristics can be identified which trade normally has’.¹⁴⁹ It will normally involve ‘the exchange of goods, or of services, for reward ... there must be something which the trade offers to provide by way of business’.¹⁵⁰

¹⁴² Income Tax (Trading and Other Income) Act 2005, s 5.

¹⁴³ *ibid*, s 32.

¹⁴⁴ Corporation Tax Act 2009, s 35.

¹⁴⁵ Income Tax Act 2007, s 989.

¹⁴⁶ [1974] 1 WLR 1594.

¹⁴⁷ *ibid*, 1600 (Lord Reid).

¹⁴⁸ *ibid*.

¹⁴⁹ *ibid*, 1610 (Lord Wilberforce).

¹⁵⁰ *ibid*, 1611 (Lord Wilberforce).

Whilst a distinction is made between a profession, a vocation and a trade, no definition for ‘profession’ or ‘vocation’ is provided by statute. *Commissioners of Inland Revenue v Maxse*¹⁵¹ suggests that a profession will involve:

[A]n occupation requiring either purely intellectual skill, or of manual skill controlled, as in painting and sculpture, or surgery, by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production or sale or arrangements for the production or sale of commodities’.¹⁵²

The terms “profession” and “vocation” were used interchangeably in *Higgs v Olivier*.¹⁵³ The contention related to whether profits were generated as a result of the taxpayer’s profession or vocation as an actor.¹⁵⁴ It seems that distinguishing between “profession”, “vocation” and “trade” is unnecessary for tax purposes. Satisfying any one will lead to tax liability on any profit that is produced. With this in mind it is clear that profit production is the key factor.

2.5.1.3 Profit Production

Intention to create profit is useful in indicating the presence of a trade, profession or vocation. In *Torbell Investments Ltd and others v Williams*¹⁵⁵ certain ‘transactions were undertaken ... with a genuine view to making a profit and were therefore ... trading transactions’.¹⁵⁶ A transaction featuring a genuine intent to generate profit will qualify as a trade. In *Griffiths v J P Harrison (Watford) Ltd*¹⁵⁷ the form which profit took was assessed. Viscount Simonds outlined that ‘a dealer may seek his profit ... otherwise than by an enhanced price on a re-sale, as by a declaration of dividend, a repayment on a reduction of capital or on a liquidation of the company whose shares he has bought’.¹⁵⁸ Further, it was ‘immaterial, so long as the transaction is not a sham ... what may be the fiscal result or the ulterior fiscal object of the transaction’.¹⁵⁹ Therefore if a course of dealing is carried out without fraudulent intention, the generation of a profit may take a form apart from enhancing the value of goods through re-sale. In *Lupton v FA & AB Ltd*¹⁶⁰ a taxpayer acted with the intention of securing a tax advantage, rather than generating a profit. It was held that because the

¹⁵¹ [1919] 1 KB 647.

¹⁵² *ibid*, 657 (Scrutton LJ).

¹⁵³ [1952] Ch 311.

¹⁵⁴ *ibid*, 320.

¹⁵⁵ [1986] STC 397.

¹⁵⁶ *ibid*.

¹⁵⁷ [1963] AC 1.

¹⁵⁸ *ibid*, 12 (Viscount Simonds).

¹⁵⁹ *ibid*.

¹⁶⁰ [1972] AC 634.

transaction in question did not amount to dealing in stocks and shares, it could not be considered to form part of the trading activity of one who purports to be a dealer in stocks and shares. This suggests that legitimate business intent, or attempt to generate a legitimate profit is the deciding factor in assessing whether a transaction is of a trade nature. The importance of a pursuit of profit through trading activity is demonstrated further where a business attempts to claim tax relief following a trading loss. This is demonstrated by sections 66 and 74 of the Income Tax Act 2007. Both place restrictions on tax relief being made available for trading losses unless said trade is of a commercial nature. Whilst the term “commercial” is once more undefined, there is clear evidence of its link to a need for a legitimate pursuit of profit within Tax Law.

2.5.1.4 Conclusion

Investigating the nature by which tax is applied to the profits of business activity in the UK provides a useful model which will aid in developing a functional definition of “commercial” which can be applied to contract law. While tax liability is universal in one form or another, a distinction is made when it is applied to profits. There are recurring themes in Tax Law regarding the characteristics of parties of a potentially “commercial” nature. First, if one of the categories of business form, namely sole traders, partnerships (including LLPs) and companies is utilised, it will be distinct from members of the public for tax purposes. Second, any trading activity should be carried out with the intention of producing a profit. This also suggests that the specific activity is in itself a key distinguishing factor in this regard.

Tax liability will be applied to the profits accrued through a trade, profession or vocation. This profit production motive is the key factor in terms of assessing and applying any tax liability and sets these business forms apart from members of the public for example. Combinations of these themes are characteristics indicative of a party of a commercial nature, engaging in an activity with a commercial intent for the purposes of assessing tax liability. Therefore, it is reasonable to assert that these are characteristics which could apply to a commercial party in a contract law sense. The next step is to assess whether this is consistent across other areas of the law.

2.5.2 The Law of Partnership

The next area of interest with regard to a commercial distinction is the law of partnership. Partnership was noted briefly earlier but will now be analysed more fully.¹⁶¹ This will be useful as partnerships exist with the intention of carrying out a business activity to produce a profit, a characteristic which suggests that they are of a “commercial” nature. In English law there are three categories of partnership. First, the general partnership governed by The Partnership Act 1890. Second is the limited partnership created by the Limited Partnerships Act 1907 but which are subject to the provisions in the Partnership Act 1890. Third is the limited liability partnership governed by the Limited Liability Partnerships Act 2000.

A partnership is defined in Section 1 of the Partnership Act 1890. One must display three important characteristics. There must exist ‘(1) a business (2) which is carried on by two or more persons in common (3) with “a view of profit”’.¹⁶² *Rolls v Miller*¹⁶³ outlines that the word ‘business’ can mean ‘almost anything which is an occupation, as distinguished from a pleasure’.¹⁶⁴ In *Town Investments Ltd v Department of the Environment*¹⁶⁵ Lord Diplock suggested that ‘the word “business” is an etymological chameleon; it suits its meaning to the context in which it is found’.¹⁶⁶ As such, ‘business’ will be likely to apply to ‘every trade, occupation, or profession’.¹⁶⁷ The suggestion is that the term occupation ‘must be construed *eiusdem generis* and coupled with the words “with a view to a profit” in s 1(1) of the Act, so that some sort of commercial activity is essential’.¹⁶⁸ This reference to commercial activity is a clear acknowledgment of the relevance of partnership law in terms of any attempt to develop a modern definition of what is commercial.

2.5.2.1 Profit Production

Based on the prior discussion regarding tax a law, it appears that profit production is a key issue regarding the commercial distinction. It is the case that a partnership should operate with the intention

¹⁶¹ See Generally Nathaniel Lindley, *Lindley & Banks on Partnership*, (RC l’anson Banks ed, 19th edn Sweet and Maxwell 2015); See also Mark Blackett-Ord and Sarah Haren, *Partnership Law* (5th edn, Bloomsbury Professional 2015); Geoffrey Morse, *Partnership Law* (7th edn, OUP 2010); Michael Twomey, *Partnership Law* (Butterworths 2000).

¹⁶² *ibid*, para 2-01.

¹⁶³ (1884) 27 Ch D 71.

¹⁶⁴ *ibid*, 88 (Lindley LJ).

¹⁶⁵ [1978] AC 359.

¹⁶⁶ *ibid*, 383 (Lord Diplock).

¹⁶⁷ Partnership Act 1890, s45.

¹⁶⁸ Mark Blackett-Ord, *Partnership Law* (3rd edn, Tottel 2007) 25.

of producing profit.¹⁶⁹ That this profit may ‘be shared by the parties to the agreement, is the grand characteristic of every partnership, and is the leading feature of nearly every definition of the term’.¹⁷⁰ It is suggested that ‘the intention to make a profit (even if a profit is not actually realised) lies at the very heart of the partnership relation’.¹⁷¹ There may be scenarios where pursuit of profit is not the primary focus of a partnership. In such cases one must question if there is any genuine view to generating a profit. For example, where a partnership exists featuring ‘some other predominant motive, e.g. tax avoidance, but there is also a real, albeit ancillary, profit element, it may be permissible to infer that the business is being carried on “with a view of profit”’.¹⁷² Therefore, where it can be demonstrated that:

[T]he sole reason for the creation of a partnership was to give a particular partner the ‘benefit’ of, say, a tax loss, when there was no contemplation in the parties’ minds that a profit ... would be derived from carrying on the relevant business, the partnership could not in any real sense be said to have been formed ‘with a view of profit’.¹⁷³

In addition, any activity should be carried out with a business intention in mind. This may sound obvious, however Lord Millet in *Khan and Another v Miah and Others*¹⁷⁴ outlined that trading need not have commenced but that ‘persons who agree to carry on a business activity as a joint venture do not become partners until they actually embark on the activity in question’.¹⁷⁵ The issue was ‘whether the parties had done enough to be found to have commenced the joint enterprise in which they had agreed to engage’,¹⁷⁶ rather than whether they had commenced trading. This decision is noted in *Ilott v Williams*.¹⁷⁷ Here it was ruled that ‘it was not necessary to find actual trading. What was required was a carrying on of business’.¹⁷⁸ Furthermore, that ‘preparatory work ... forms part of the carrying on of business and the fact that there is no actual trading does not mean that the business cannot be carried on “with a view of profit”’.¹⁷⁹

On the partner’s right to share in profits, it is suggested that ‘even where there is a genuine view of profit, a partnership will only exist if the profits are intended to be realised for the common benefit of the participants’.¹⁸⁰ Not sharing profits does not bar an individual from being a partner. This is

¹⁶⁹ Partnership Act 1890, s 1(1).

¹⁷⁰ Nathaniel Lindley, *A treatise on the law of partnership* (5th edn, CH Edson & Co 1888) 1; See also the Partnership Act 1890, s 2(3).

¹⁷¹ Lindley (n 161) para 2-07.

¹⁷² *ibid*, para 2-08.

¹⁷³ *ibid*.

¹⁷⁴ [2000] 1 WLR 2123.

¹⁷⁵ *ibid*, 2127 (Lord Millet).

¹⁷⁶ *ibid*, 2128 (Lord Millet).

¹⁷⁷ [2013] EWCA Civ 645.

¹⁷⁸ *ibid* [14] (Arden LJ).

¹⁷⁹ *ibid* [15] (Arden LJ).

¹⁸⁰ Lindley (n 161) para 2-09.

demonstrated in *M Young Legal Associates Ltd v Zahid*.¹⁸¹ Here Lord Justice Wilson stated that “in order to be partners, it was necessary for persons to carry on a business in common with a view to profit and not that they should also share it”.¹⁸² *Hodson v Hodson*¹⁸³ demonstrated that ‘where a partner in a business waived her right to receive her share in the profits for period of time it was ruled that her position as a partner was unaffected’.¹⁸⁴ The importance of entitlement to a share was highlighted in *Ilott v Williams*.¹⁸⁵ Here the claimant ‘following receipt of a notice of removal ... was no longer entitled to a share of the profits under the terms of the Side Letter in respect of the then current, or any subsequent, financial year’.¹⁸⁶ Therefore, they were no longer considered a partner.

2.5.2.2 Conclusion

The law of partnership has provided useful guidance on terms of developing a definition for what is “commercial”. Partnerships require the carrying on of business activity which is said to involve a trade, occupation or profession, including any preparatory activity. This should be carried out with a view to producing a profit, coupled with a partner’s right to share in that profit. The right to receive is distinct from the actual receipt of a proportion of any profit produced. As such, ‘there must always be a view of profit ... but, as was made abundantly clear by the Court of Appeal in *M Young Legal Associates v Zahid* and in *Hodson v Hodson*, a sharing of profits between the partners is not a necessary ingredient’.¹⁸⁷ The combination of an organised business activity, as well as the pursuit of profit are characteristics that are indicative of what a commercial party does. Again, it also appears that the profit production intent behind the activity in question is a key distinguishing factor. This suggests that the transaction, as well as its overriding purpose is an important consideration.

2.5.3 Company Law

The next area of interest regarding the relevance of profit production to a commercial distinction is company law. The company form was noted during the discussion on Tax Law. It will now be

¹⁸¹ [2006] EWCA Civ 613.

¹⁸² *ibid* [25] (Wilson LJ).

¹⁸³ [2010] PNLR 8.

¹⁸⁴ *ibid* [38] (Rimer LJ).

¹⁸⁵ [2013] EWCA Civ 645.

¹⁸⁶ *ibid* [38] (Arden LJ).

¹⁸⁷ Lindley (n 161) para 2-13.

considered in more detail.¹⁸⁸ This will provide a useful model as a company will generally exist with the intention of carrying out a business activity to produce a profit. These are characteristics which suggest a commercial nature. That a company displays characteristics which are indicative of a commercial party could be considered to be quite obvious. That is assuming that all relevant requirements set out in the Companies Act 2006 are complied with. There is a caveat in that not all bodies which are companies and governed by the 2006 Act will necessarily be commercial in nature. Not for profit organisations and charities are examples of this. A charity is defined within the Charities Act¹⁸⁹ while the Finance Act 2010 defines a “charitable company” as a charity that is a body of persons.¹⁹⁰ They must operate for charitable purposes, the meaning of which is contained in the Charities Act 2011.¹⁹¹ A charity cannot operate with the predominant intention of producing a profit. There are exemptions made regarding trading profits produced by a corporate charity.¹⁹² The profits of charitable trades will be exempt from corporation tax if ‘the trade is exercised in the course of carrying out a primary purpose of the charitable company’¹⁹³ or ‘the work in connection with the trade is mainly carried out by beneficiaries of the charitable company’.¹⁹⁴

2.5.3.1 Separate Legal Personality

It is reasonable to assert that if a business entity is afforded a separate legal personality, and is not a charity, it is likely to be of a commercial nature.¹⁹⁵ This is because these entities exist to engage in organised business practice with the intention of producing a profit. Once incorporated, a company will have its own legal personality separate from that of its shareholders providing them with limited liability. There are advantages to separate legal personality which include facilitating perpetual succession, the right to own property, the ability to sue and be sued and most notably limited liability. Easterbrook and Fischel assert that ‘limited liability is a distinguishing feature of corporate law – perhaps the distinguishing feature’.¹⁹⁶ Through protecting shareholders, business enterprise is

¹⁸⁸ See Generally Alan Dignam and John Lowry, *Company Law* (9th edn, OUP 2016); See also Brenda Hannigan, *Company Law* (4th edn, OUP 2015); Paul Davies, *Introduction to Company Law* (2nd edn, OUP 2015); Derek French, Stephen Mayson, and Christopher Ryan, Mayson, *French & Ryan on Company Law* (33rd edn, OUP 2016); Ben Pettet, *Company Law* (2nd edn, Pearson 2005).

¹⁸⁹ Charities Act 2011, s 1.

¹⁹⁰ Finance Act 2010, s 1(2).

¹⁹¹ Charities Act 2011, s 2.

¹⁹² Corporation Tax Act 2010, s 478-480.

¹⁹³ *ibid*, s 479.

¹⁹⁴ *ibid*.

¹⁹⁵ The same will apply to a Limited Liability Partnership for example.

¹⁹⁶ Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 40.

facilitated by reducing the risks to potential investors. This allows the company to pursue profit with that investment as a resource.

2.5.3.2 Conclusion

If a body operates as a company, governed by the Companies Act 2006, it is likely to be commercial in nature assuming that it is operating with the primary intention of producing a profit (unlike a charity or a not for profit organisation). The separate legal personality afforded to a company which features the limited liability of its members is further evidence of this. The evidence of an organised business activity combined with pursuit of profit are characteristics that can be said to be indicative of a commercial party. Like in tax law as well as the law of partnership, it is reasonable to assert that these are characteristics which are likely to apply in terms of defining a “commercial” party in a contract law context.

2.5.4 Patent Law

The final area in which the relevance of profit production regarding a commercial distinction is to be assessed is patent law. This distinction comes in the form of an exception to patent protection. It exists to balance the needs of society (through encouraging innovation) with protecting the interests of inventors. The UK Patent system was introduced as early as 1623 by the Statute of Monopolies to reward parties for the creation of useful inventions.¹⁹⁷ This is because when a reward cannot be provided by the market, the view was that the State should intervene by providing a temporary monopoly.¹⁹⁸ The system is ‘strongly marked by commercial sensitivity at all levels, both in its legislative infrastructure and in its judicial application’.¹⁹⁹ It provides limited property rights in that the originator can exclude others from their intellectual property. However, this is not in totality as would be the case with physical property.²⁰⁰

The Patents Act 1977 outlines that:

¹⁹⁷ The Statute of Monopolies 1623, s 6.

¹⁹⁸ See HI Dutton, *The Patent System and Inventive Activity During the Industrial Revolution 1750-1852* (Manchester University Press 1984) 18.

¹⁹⁹ Lord Irvine (n 120) 346.

²⁰⁰ See RA Posner, ‘Intellectual Property: The Law and Economics Approach’ (2005) 19 *Journal of Economic Perspectives* 57, 58.

(3) A patent shall not be granted for an invention the commercial exploitation of which would be contrary to public policy or morality.²⁰¹

Also that:

An act which, apart from this subsection, would constitute an infringement of a patent for an invention shall not do so if—

(a) it is done privately and for purposes which are not commercial

(b) here the invention is a process, he uses the process or he offers it for use in the United Kingdom when he knows, or it is obvious to a reasonable person in the circumstances, that its use there without the consent of the proprietor would be an infringement of the patent.²⁰²

Patent protection has industrial and commercial implications.²⁰³ This is particularly important within the chemical and pharmaceutical industries where it could a number of years ‘before a patentee can get any remuneration in respect of his invention’.²⁰⁴ It has been suggested that it could be ‘as much as ten years before a pharmaceutical patent can bring any return’.²⁰⁵

UK patent laws allow actions which would normally infringe upon patent protections when they are done privately, for non-commercial or experimental purposes.²⁰⁶ In the event that an experimental trial is of a mixed nature (part research and part commercial) the English courts favour a narrow approach, considering such use to be infringing.²⁰⁷ This is demonstrated by *Monsanto v Stauffer*²⁰⁸ where the limitation under the Patents Act ‘would exclude tests or trials having as their purpose achieving or extending the commercial acceptance of some commercial embodiment of the patented invention’.²⁰⁹ *Auchincloss v Agricultural & Veterinary Supplies Ltd*²¹⁰ followed the ruling in *Monsanto*. The sample in question was used in order ‘to obtain official approval; not to discover something unknown or to test a hypothesis’.²¹¹ As a result it ‘was not done for experimental purposes and therefore section 60(5)(b) does not apply’.²¹²

²⁰¹ Patents Act 1977, s 1(3).

²⁰² Patents Act 1977, s 60 (5).

²⁰³ See HL Deb 9 May 1977, vol 383, col 100: ‘The extension of the terms of patents has very important industrial and commercial implications to many manufacturers in this country’.

²⁰⁴ HL Deb 9 May 1977, vol 383, col 100.

²⁰⁵ *ibid.*

²⁰⁶ Patents Act 1977, s 60(5).

²⁰⁷ See K Iles, ‘Comparative Analysis of the Impact of Experimental Use Exemptions in Patent Law on Incentives to Innovate’ (2005) 4 *Northwestern Journal of Technology and Intellectual Property* 61, 77.

²⁰⁸ [1985] RPC 515.

²⁰⁹ *ibid.*, 522 (Falconer J); See also Patents Act 1977, s 60(5).

²¹⁰ [1999] RPC 397.

²¹¹ *ibid.*, 405 (Aldous LJ).

²¹² *ibid.*

The continental approach has not been consistent with that of UK courts. A more relaxed approach to assessing what amounts to commercial use is preferred despite the similarity in the wording of the relevant legislation. The Community Patent Convention states that:

‘The rights conferred by a Community patent shall not extend to:

(a) acts done privately and for non-commercial purposes;

(b) acts done for experimental purposes relating to the subject-matter of the patented invention’.²¹³

Additionally, the German Patents Act provides an exemption for acts which are carried out privately for a non-commercial purpose, as well as for acts which are carried out for experimental purposes.²¹⁴

*Klinische Versuche II*²¹⁵ demonstrates this relaxed approach as ‘the court was aware of the economic reality that clinical research involving pharmaceuticals would ... be based on commercial considerations because of the high costs of such R&D’.²¹⁶ As such, it was:

[I]mpossible to stipulate that research activities which are concerned with the research and further development of technology would be impermissible if they are at the same time undertaken with the additional, or even overwhelming, motivation of using the results of the tests to prepare for commercial exploitation.²¹⁷

The interests of the public were also noted in terms of continuing development of technology which patent law strives for.²¹⁸

2.5.4.1 Conclusion

The existence of a distinction in terms of commercial exploitation exception in patent law is intended to balance the needs of society through encouraging innovation with the need to protect the interests of inventors. Despite obvious differences in application, featuring a harder line approach taken by UK courts compared to those on the continent, the overriding intention behind the commercial exemption remains the same. Removing the potential for exempt research and development to be exploited for profit by others until the expiry of its patent intends to protect the interests of inventors. By giving acts that are done for non-commercial purposes an exemption from normal patent

²¹³ Community Patent Convention 76/76/EEC of 18 May 1976 for the European patent for the common market [1976] OJ L129/30, Article 31.

²¹⁴ Patent Act 1981 (Germany) Section 11.

²¹⁵ [1998] RPC 423.

²¹⁶ K Iles (n 207) 79.

²¹⁷ *Klinische Versuche II* (n 215) 425.

²¹⁸ *ibid*, 436.

protections, the law facilitates research and development of existing technologies. It can therefore be inferred that an intention to exploit their creation for profit is a determining factor in terms of what is commercial activity within patent law. Again, this discussion further illustrates that the intention to produce profit is a key determining factor when seeking to apply a commercial distinction regarding a particular activity. With this, alongside the conclusions reached regarding tax law, the law of partnership, and company law in mind, it is clear that a profit production intention is key when identifying a commercial activity in these areas. It therefore seems intuitive that the same could be said for contract law.

2.6 Contracts which are not commercial in nature

Having outlined that profit production is a key feature within the commercial distinction in various areas of the law, the next step is to set out the type of contract which by definition cannot be commercial in nature. This is done in order to add breadth to the discussion regarding the characteristics of a commercial contract by outlining the types of contract which are excluded from that group. It is not realistic to discuss each type of contract which is not of a commercial nature here. This would be both time consuming and unnecessary for the purposes of this discussion. Only a select number of contract forms will be discussed. These include an analysis of consumer contracts as well as a brief note on “personal” contracts.

2.6.1 Consumer Contracts

It was outlined in *Makdessi v Cavendish Square Holdings BV*²¹⁹ that the Consumer Rights Act ‘has no bearing on commercial contracts’.²²⁰ Consumer transactions contrast with ‘the archetypal arm’s-length contract on which both contract law and neoclassical economics focus’.²²¹ They ‘are not the product of negotiations between two parties ... these contracts are unilaterally drafted by sellers and mass-marketed to consumers, together with the products and services that these sellers offer’.²²² Whilst it is true that not all consumer contracts are standard form in nature and that some are concluded following negotiations between the parties, it still appears that there is an unequal

²¹⁹ *Makdessi v Cavendish Square Holdings BV* [2015] UKSC 67; [2016] AC 1172.

²²⁰ *ibid* [260] (Lord Hodge).

²²¹ Oren Bar-Gill, ‘Consumer Transactions’ in Eyal Zamir and Doron Teichman (eds), *Behavioural Economics and the Law* (OUP 2014) 465.

²²² *ibid*.

bargaining relationship between those parties.²²³ As a result of this imbalance and a perceived vulnerability, consumers are afforded statutory protections. They are in this respect treated as distinct from other types of contracting party. A selection of these statutory protections including the relevant EU Council Directive, the Consumer Rights Act 2015, the Unfair Contract Terms Act 1977 and the Consumer Insurance (Disclosure and Representations) Act 2012 will now be discussed.

2.6.1.1 The EU Position

Under the EU Council Directive 2005/29/EC which concerns unfair business-to-consumer commercial practices in the internal market, a “consumer” is said to mean ‘any natural person who, in commercial practices ... is acting for purposes which are outside his trade, business, craft or profession’.²²⁴ Consumer protection is prominent within this directive, specifically the importance of not allowing the economic behaviour of consumers to be distorted.²²⁵

2.6.1.2 The Consumer Rights Act 2015

Consumer protection was a major influence behind the Consumer Rights Act 2015.²²⁶ It outlines that “consumer” will mean ‘an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession’²²⁷ covering contracts and notices noted in Section 61 of the act. This amends the definition of “consumer”,²²⁸ “consumer contract”,²²⁹ and “consumer notice”²³⁰ used in the Unfair Contract Terms Act 1977 (UCTA) as well as replacing the Unfair Terms in Consumer Contracts Regulations 1999 (UTCC) in its entirety. A consumer is therefore assumed to be distinct from a commercial party. A consumer contract refers to a ‘contract between a trader and a consumer’.²³¹ *Overy v Paypal (Europe) Limited*²³² outlined that:

²²³ RA Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) 496.

²²⁴ Council Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC [2005] OJ L 149/22. Article 2(a).

²²⁵ *ibid.*

²²⁶ For a contrast with the Sale of Goods Act 1979 see Ewan McKendrick, ‘Sale of Goods’ in Andrew Burrows (ed) *Principles of English Commercial Law* (OUP 2015) 54.

²²⁷ Consumer Rights Act 2015, s 2(3).

²²⁸ Unfair Contract Terms Act 1977, s 12 amended by Consumer Rights Act 2015, s 2(3).

²²⁹ *ibid.*, s 61(3).

²³⁰ *ibid.*, s 61(7).

²³¹ Consumer Rights Act 2015, s 61(1).

²³² [2012] EWHC 2659 (QB).

[A] contract would be treated as having been concluded by a person for a purpose which could be regarded as being outside his trade or profession only if any business purpose was insignificant or negligible and the contract satisfied an individual's own needs in terms of private consumption.²³³

Judge Hegarty QC cited *Benincasa v Dentalkit Srl*²³⁴ and *Gruber v Bay Wa AG*²³⁵ as support here.

It is accepted that consumers rarely read small print within contracts. The suggestion is that practices such as 'labelling a hyper-link as "terms and condition"' is sufficient to ensure that most consumers do not read the document'.²³⁶ With such issues in mind, recommendations were made to reform the UTCC as it was suggested that it required 'significant legal expertise to navigate, and even then the outcome is unpredictable'.²³⁷ The need for certainty appeared universal as 'all consumer groups agreed with the need for reform, as did the majority of businesses and business groups, public bodies, judges and lawyers'.²³⁸ It was agreed that 'all small print terms should be assessable for fairness'.²³⁹ This recommendation was made referencing *Gut Springenheide GmbH and Another v Oberkreisdirektor des Kreises Steinfurt—AMT für Lebensmittelüberwachung*²⁴⁰ that the "Average Consumer Test" should be applied.²⁴¹ Additionally that 'if the meaning of a term is in doubt a court will follow the interpretation most favourable to the consumer'.²⁴² This highlights the importance of protecting the consumer.

There were economic influences informing the Consumer Rights Act which included ensuring that the competitiveness of the market was not undermined.²⁴³ Also, relying on the insights of behavioural economists, it was noted that consumers may ignore remote or contingent charges, even if they are prominent.²⁴⁴ This is at odds with classic economic theory which assumes that consumers when presented with appropriate information will make rational decisions. It was accepted that consumers are rational only to a point and that while their behavioural biases are to all intents and purposes irrational, it was noted that they are predictable.²⁴⁵

²³³ *ibid* [169] (Judge Hegarty QC).

²³⁴ (C-269/95) [1997] ECR I-3767.

²³⁵ (C-464/01) [2006] QB 204.

²³⁶ Law Commission, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills Summary* (2013) s 16.

²³⁷ *ibid*, s 14.

²³⁸ *ibid*, para 2.17.

²³⁹ *ibid*, s 16.

²⁴⁰ [1998] ECR I-4657.

²⁴¹ Under this test a consumer is believed to be 'reasonably well informed, reasonably observant and circumspect'. See Law Commission, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills Summary* (2013) s 19(2).

²⁴² Law Commission, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills* (2013) para 1.24.

²⁴³ *ibid*, para 2.39.

²⁴⁴ *ibid*, para 3.41.

²⁴⁵ S Huck, J Zhou and C Duke, *Consumer Behavioural Biases in Competition* (OFT1324) (May 2011).

2.6.1.3 The Unfair Contract Terms Act 1977

The Unfair Contract Terms Act 1977 (UCTA) was primarily intended to provide consumer protection in contractual dealing. The consumer element of UCTA has since been repealed by the Consumer Rights Act 2015 noted above.²⁴⁶ UCTA was said to represent ‘a great advance in consumer protection but it recognises economic realities’.²⁴⁷ UCTA concerns small print contract clauses referring to future liabilities for negligence or breach of contract for example.²⁴⁸ Such terms are often said to operate against the public interest.²⁴⁹ These clauses were said to have been introduced in a way that ‘the party affected by them remaining ignorant of their presence or import until it is too late’.²⁵⁰ An affected party would “be unable to appreciate what he may lose by accepting it ... he may not have sufficient bargaining strength to refuse to accept it’.²⁵¹ Guarding against such clauses demonstrates the public interest concerns in terms of consumer protection behind UCTA.

It is noteworthy that UCTA offers protection to parties who are not deemed to be dealing as consumers. These are parties who deal on another party’s written standard terms of business and/or as customers while the other party ‘deals in the course of business’.²⁵² The extent to which protection under UCTA should be afforded to businesses has been a point of contention. The conclusion being that such parties ‘should not have the same protection as private purchasers as they are often in a better position to protect themselves and may often deal on special trade terms’.²⁵³

2.6.1.4 The Consumer Insurance (Disclosure and Representations) Act 2012

The Consumer Insurance (Disclosure and Representations) Act 2012 outlines that a Consumer Insurance Contract is one agreed between ‘an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession’²⁵⁴ and a party ‘who carries on the business of insurance and who becomes a party to the contract by way of that business’.²⁵⁵ A consumer can be categorised as a party who does not act, nor purports to act in a

²⁴⁶ This includes Unfair Contract Terms Act 1977 s 5 ‘Guarantee’ of consumer goods; s 12 ‘Dealing as consumer’; s 18 Unreasonable indemnity clauses in consumer contracts; s 19 ‘Guarantee’ of consumer goods (For Scotland).

²⁴⁷ HL Deb 26 October 1977, vol 386, col 1135.

²⁴⁸ See Elizabeth MacDonald, *Exemption Clauses and Unfair Terms* (2nd edn, Tottel 2006).

²⁴⁹ Law Commission, *Exemption Clauses Second Report* (Law Com No 69, 1975) para 11.

²⁵⁰ *ibid.*

²⁵¹ *ibid.*

²⁵² See Unfair Contract Terms Act 1977, s 3(1); s 17(2).

²⁵³ Richard Kidner ‘Who Deals as a Consumer’ (1987) 38 NILQ 46, 47.

²⁵⁴ Consumer Insurance (Disclosure and Representations) Act 2012, s 1.

²⁵⁵ *ibid.*

business or professional capacity. Their actions will not form a part, or have any link to their individual trade, business, or profession. A consumer contract requires that a consumer enters into it with a party acting in a professional or business capacity. These parties feature characteristics which are indicative of a commercial party in that they offer goods or services with the intention of generating a profit. A prime example is consumer insurance contracts. Additionally, any goods that are supplied as per the contract should be of a type which would normally have a private or personal use. Much like the characteristics of a consumer contracts offered within the Consumer Rights Act, there certain inferences that can be made. These include that a consumer contract (in this case an insurance contract) cannot be a commercial contract due to the nature of the parties involved. This again suggests that a commercial contract will be agreed between parties who are acting in a business capacity.²⁵⁶ There is also clear of evidence within the legislation noted above that to offer effective protection to the consumer is paramount.²⁵⁷ This further demonstrates the distinction made between a party dealing as a consumer and others. As was noted earlier, the purpose of discussing what constitutes a consumer is that if the relevant requirements are met, the party in question cannot be considered to be of a commercial nature.

2.6.1.5 Conclusion

There are conclusions which can be drawn regarding consumer contracts. First, that a consumer is treated as distinct from other contracting parties. Evidence includes the definitions of “consumer” offered in EU Council Directive 2005/29/EC, the Consumer Rights Act 2015 and the Consumer Insurance (Disclosure and Representations) Act 2012. These definitions refer to an individual acting outside his/her trade, craft or profession. That these parties will be acting in this way suggests that motive behind their actions will not be the production of profit. Also of note is the perception that a consumer requires statutory protection when they enter into any contractual dealing. These protections are only afforded to consumers and are not relevant to commercial contracts.²⁵⁸ As such, a consumer acting in that capacity cannot be a “commercial” party. Second, that a consumer contract will be entered into by a consumer and a party who is acting in a business or trade sense with the primary intention of generating a profit. It can therefore be inferred that a commercial contract would be likely to be agreed between multiple commercial parties.

²⁵⁶ *ibid.*

²⁵⁷ See the Consumer Rights Act 2015, Unfair Contract Terms Act 1977 and Consumer Insurance (Disclosure and Representations) Act 2012.

²⁵⁸ See *Makdessi* (n 219) [260] (Lord Hodge).

2.6.2 Personal Contracts

Contracts that are categorised as personal in nature offer further examples of non-commercial contracts. Two clear examples of such contracts being treated distinct from a commercial contract include contracts of employment and certain types of contract for the sale of goods. These types of contract will now be discussed.

2.6.2.1 Contracts of Employment

A contract of employment will be for ‘service or apprenticeship, whether express or implied, and (if it is express) whether oral or in writing’.²⁵⁹ Its relevance is that an employee will mean ‘an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment’.²⁶⁰ *Johnson v Unisys Ltd*²⁶¹ set out that ‘contracts of employment are no longer regarded as purely commercial contracts entered into between free and equal agents’.²⁶² This referred to ‘ordinary commercial contracts entered into by both parties with a view of profit’.²⁶³ This reference is in itself illustrative with respect to the nature of the parties to a commercial contract.

Much like in consumer contracts, the contrast in bargaining position of the contracting parties is important. In employment contracts, one of the parties (the employee) is in fact not necessarily free and equal. There exists an imbalance in terms of bargaining position, unlike in the classic commercial contract. It is also noteworthy that employment contracts are entered into by the employee, not with the intention of generating a profit, but to earn a wage. This wage will be subject to standard income tax, unlike profits which as we have seen, are taxed differently.

²⁵⁹ Employment Rights Act 1996, s 230(2); See also Simon Honeyball, *Honeyball & Bowers’ Textbook on Employment Law* (14th edn, OUP 2016) 47; Astra Emir, *Selwyn’s Law of Employment* (19th edn, OUP 2016) 36; David Cabrelli, *Employment Law in Context* (2nd edn, OUP 2016) 145; Ian Smith and Aaron Baker, *Smith & Wood’s Employment Law* (12th edn, OUP 2015) 37; Stephen Taylor and Astra Emir, *Employment Law: An Introduction* (4th edn, OUP 2015) 161.

²⁶⁰ *ibid*, s 230(1).

²⁶¹ [2001] UKHL 13; [2003] 1 AC 518.

²⁶² *ibid* [77] (Lord Millet).

²⁶³ *ibid* [70] (Lord Millet).

2.6.2.2 Contracts for the Sale of Goods

Contracts for the sale of goods are governed by standard contract law rules.²⁶⁴ It will include any contract where a seller ‘transfers or agrees to transfer the property in goods to the buyer for a money consideration’.²⁶⁵ They can be formed in writing, verbally, through a combination of the two as well as being by the conduct of the parties.²⁶⁶ *Payzu Ltd v Saunders*²⁶⁷ demonstrated that there exists a difference between commercial contracts, and a contract for the sale of goods specifically in respect of offers following a default. This is the only issue that is being raised in this regard. This is because it is accepted that contracts for the sale of goods could exist between commercial parties.

It was noted that ‘in certain cases of personal service it may be unreasonable to expect a plaintiff to consider an offer from the other party who has grossly injured him; but in commercial contracts it is generally reasonable to accept an offer from the party in default’.²⁶⁸ Such an offer intends to salvage commercial value from a transaction. In this respect, the individual interests of a non-commercial party to a contract for the sale of goods lead to it being treated differently to a contract of a commercial nature, such as one which concerns the sale of goods between two commercial parties.

2.6.2.3 Conclusion

Contracts of employment and certain contracts for the sale of goods offer two clear examples of contracts being treated as commercially distinct. This is based on the need to protect employees in employment contracts, as well as to consider the individual interests of parties to service contracts regarding offers following default. The important point is that non-commercial parties are afforded additional protection, or consideration than would be the case for commercial parties.

2.7 The Boundary Cases

Having considered the commercial distinction in other areas of the law, as well as contracts that not commercial in nature, the next area that will be discussed briefly are some examples of situations

²⁶⁴ See Ewan McKendrick, ‘Sale of Goods’ in Andrew Burrows (ed) *Principles of English Commercial Law* (OUP 2015) 56.

²⁶⁵ Sale of Goods Act 1979 s 2(1).

²⁶⁶ See Sale of Goods Act 1979 s 4(1).

²⁶⁷ [1919] 2 KB 581.

²⁶⁸ *ibid*, 589 (Banks LJ).

where the boundary between commercial and non-commercial is less clear. This is done to acknowledge that this blurred line exists in some cases. However, it is again important to highlight that the definition of commercial being advanced in this thesis is not intended to be an all-encompassing one that could be applied in all settings. Its intention is simply to frame the discussion of efficient breach that is to follow by outlining the characteristics of an archetypal commercial contract.

2.7.1 Government Power to enter into Contracts

Governments have the ability to enter into contracts of a commercial, as well as a non-commercial nature. It appears that any suggestion that private law concerns only private interests, while public law concerns the interests of the State are invalid. This is because the State may enter into legal relations within private law.²⁶⁹ Limitations are placed on the government's contracting capability through the doctrine of ultra vires in order to safeguard against abuses of power. This is due to 'the tendency of governments to engage in commercial activities and to use contracts as a means of achieving public objectives'.²⁷⁰ Under the State Immunity Act 1978, a State will be immune from a UK court's jurisdiction except in certain circumstances.²⁷¹ One of these exceptions concerns commercial transactions.²⁷² There was a growing belief in the UK that where a State was to engage in ordinary commercial activity, that State should be in the same legal position as any other party. The State Immunity Act was a reaction to this.²⁷³ The European Convention on State Immunity 1972 outlines that similar requirements be placed on governments when entering into commercial dealings.²⁷⁴ The current state of play is that in the event that a State breaches a commercial contract and is subsequently sued, it 'should not be able to rely on its sovereign character by arguing that the breach was a political act'.²⁷⁵

What amounts to a commercial transaction under the State Immunity Act includes contracts for the supply of goods or services, a loan or other provision of finance in respect of that type of transaction as well as any other transaction of a commercial, industrial, professional or similar nature which the State enters outside its sovereign authority.²⁷⁶ However, it is important to note that a government body, while operating in what could be described as a broadly commercial manner will not

²⁶⁹ See Hans Kelsen, *General Theory of Law and State* (Russel and Russel 1961) 206-207.

²⁷⁰ Nicholas Seddon, *Government Contracts: Federal, State and Local* (5th edn, Federation Press 2013) 56.

²⁷¹ State Immunity Act 1978, s 1(1).

²⁷² *ibid*, s 3(1)(a).

²⁷³ See Christopher Greenwood, 'Sovereign immunity and Commercial Contracts' (1983) 4 BLR, 265.

²⁷⁴ European Convention on State Immunity, May 16, 1972, 74- European Treaty Series No. 74, Article 7(1).

²⁷⁵ Greenwood (n 276) 267.

²⁷⁶ State Immunity Act 1978, s 3(3).

necessarily fulfil the criteria which this thesis' definition of a commercial party requires. This is because a government body will focus more on factors such as facilitating public services rather than producing a profit.

2.7.2 Charities

Charities were discussed briefly earlier.²⁷⁷ This was on the basis that incorporated charities will in part be governed by the Companies Act 2006. To recap, a charity is defined within the Charities Act,²⁷⁸ and must operate for charitable purposes.²⁷⁹ It is generally the case that a charity cannot operate with the profit production focus, though some exceptions to this rule exist in the context of corporate charities.²⁸⁰ These exceptions concern the tax liabilities that can be applied to profits that these charities produce.²⁸¹ These profits could result from fundraising activities intended to further the ability of these organisations to carry on their charitable purpose.

2.7.3 Mutuels, Co-operatives, Social Enterprises and Community Interest Companies

Unlike charities, Mutuels, Co-operatives, Social Enterprises and Community Interest Companies (CICs) can be seen to sit in the niche between classically commercial entities, and charities. This is on the basis that there are no restrictions placed upon these bodies actively seeking to produce a profit as a primary objective. However, limits are placed on the use of any profit.

Mutuels will take one of two forms; Co-operative Societies and Community Benefit Societies. They are 'owned by, and run for, the benefit of its members, who are actively and directly involved in the business',²⁸² are required to carry on their business without the primary objective of producing profits in order to pay interest, dividends or bonuses.²⁸³ Co-operatives, which are defined as 'an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically-controlled enterprise',²⁸⁴ must use the

²⁷⁷ 2.5.3 Company Law.

²⁷⁸ Charities Act 2011, s 1.

²⁷⁹ *ibid*, s 2.

²⁸⁰ Corporation Tax Act 2010, s 478-480.

²⁸¹ *ibid*, s 479.

²⁸² Department for Business Innovation and Skills, A Guide to Mutual Ownership Models, November 2011, 2. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31678/11-1401-guide-mutual-ownership-models.pdf> accessed 24 September 2018.

²⁸³ Co-operative and Community Benefit Societies Act 2014, s 2(3).

²⁸⁴ As defined by the International Co-operative Alliance. <<http://ica.coop/en>> accessed 24 September 2018.

majority of their profits in order to support their social objectives.²⁸⁵ A social enterprise is defined as an ‘operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders ... and uses its profits primarily to achieve social objectives’.²⁸⁶ It appears that ‘the main feature of social enterprises is that they run a commercial activity for a social purpose and are less focused on how they use their profits’.²⁸⁷ Again focus is placed on the use of any profit, rather than its production. A CIC functions to ‘provide a benefit to the community they serve. They are not strictly ‘not for profit’, and CICs can, and do, deliver returns to investors ... the purpose of CIC is primarily one of community benefit rather than private profit’.²⁸⁸ They are governed by the Companies Act 2006, Community Interest Company Regulations 2005 and the Companies (Audit, Investigations and Community Enterprise) Act 2004. They must benefit a section of the community.²⁸⁹ They must use 65% of their profits to serve the community or for reinvestment into the company itself.²⁹⁰

The limitations or requirements that apply to any profits that Mutuals, Co-operatives, Social Enterprises and Community Interest Companies generate, as well as the overarching purpose behind their existence creates a lack of clarity regarding whether they are commercial in nature. As such, if the intention were to provide an all-encompassing definition of what it means to act in a commercial manner, these bodies would need to be analysed in far more depth. However, this is not a necessity here. As such, it is sufficient to note that a blurred line with respect to commercial and non-commercial activity exists in some cases.

2.7.4 Conclusion

While there is potential for this definition of commercial to have a wider application, this is beyond the scope of this thesis. The purpose of this definition is simply to frame the discussion of efficient

²⁸⁵ Department for Business Innovation and Skills, A Guide to Mutual Ownership Models, November 2011, p 4. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31678/11-1401-guide-mutual-ownership-models.pdf> accessed 24 September 2018.

²⁸⁶ Communication from the Commission, ‘Social Business Initiative Creating a Favourable Climate for Social Enterprises, Key Stakeholders in the Social Economy and Innovation’, COM(2011) 682

²⁸⁷ *ibid.*, 270-271.

²⁸⁸ Office of the Regulator of Community Interest Companies: Information and guidance notes May 2016 1.1. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480471/12-1333-community-interest-companies-guidance-chapter-1-introduction.pdf> accessed 24 September 2018.

²⁸⁹ Community Interest Company Regulations 2005, s 5: ‘For the purposes of the community interest test, any group of individuals may constitute a section of the community if— (a) they share a common characteristic which distinguishes them from other members of the community; and (b) a reasonable person might consider that they constitute a section of the community’.

²⁹⁰ Office of the Regulator of Community Interest Companies: Information and guidance notes Chapter 6.4: <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/416360/14-1089-community-interest-companies-chapter-6-the-asset-lock.pdf> accessed 24 September 2018.

breach that will follow in subsequent chapters. It seeks only to outline the characteristics of an archetypal commercial contract. With that in mind, it is unnecessary to analyse potential boundary cases in great depth. However, should an attempt be made to provide an all-encompassing definition of what it means to be commercial, these, as well as other types of boundary cases would need to be analysed in detail.

2.8 Overall Conclusion

The intention of this chapter was to develop a modern definition of what is commercial in a contract law sense. This definition is not all-encompassing and is not intended to be applicable in all settings. The intention was simply to identify the characteristics embodied by an archetypal commercial contract in order to ground the analysis of efficient breach that is to follow.

It was first demonstrated that a commercial distinction exists within contract law despite being unsatisfactorily defined. This was done through reference to relevant case law.²⁹¹ It was then necessary to characterise what commercial is perceived to mean. First, the Commercial Court was investigated; however, any offerings were overly broad in scope. Legal history, namely the development of what has been termed commercial law was the next area of interest. Whilst it was evident that a commercial party has historically been treated as distinct from the general public, the characteristics of such a party (a member of the merchant class) were outdated. This is due to the wider range of parties which are considered to be of a commercial nature today. With this in mind, a modern, functional definition was required.

To develop a modern, functional definition of “commercial”, themes which other areas of the law demonstrate in making a commercial distinction were identified. This allowed them to be applied to contract law. The first area of interest was tax law. Whilst tax liability is in many respects universal, a distinction is made when it is applied to profits. Tax law suggests that there are particular characteristics shared by parties which are of a commercial nature. These include that a business form (sole traders, partnerships and companies) is utilised. Next, any trading activity, profession or vocation should be carried out with the intention of producing a profit. That this activity should be carried out with the intention of producing a profit also suggests that the specific activity is in itself a key distinguishing factor in this regard. Tax liability will be applied to that profit. A combination of these characteristics is indicative of a party of a commercial nature.

²⁹¹ See for example *Ruxley Electronics and Construction Ltd v Forsyth* (n 30).

The Law of Partnership offered another useful model. Partnerships require the carrying on of business activity involving a trade, occupation or profession, including any preparatory activity. Also, this activity should be carried out with a view to producing a profit, coupled with a partner's right to share in that profit. Again, it appears that the profit production intent behind the activity in question is a key distinguishing factor suggesting that the transaction itself, as well as its overriding purpose is an important consideration. The combination of an organised activity and the pursuit of profit through a particular activity are characteristics that can, like in tax law, be said to be indicative of a commercial party.

Company Law was another source of guidance. It is asserted that if a body operates as a company, governed by the Companies Act 2006, and assuming it is operating with the primary intention of producing a profit (unlike a charity or not for profit organisation) it will be likely to be commercial in nature. Again, it appears that evidence of an organised business activity taking place, combined with the pursuit of profit are characteristics which are indicative of a commercial party. This is consistent with the conclusions drawn from tax law as well as the law of partnership.

The commercial exception in patent law was also discussed. This exception exists to balance the needs of society in the form of innovation, with the profit driven interest of inventors. It appears that the right to exploit an invention for profit is a major factor in assessing what will constitute commercial activity. Again, this discussion further illustrated that the intention to produce profit through a particular activity is a key determining factor when seeking to apply a commercial distinction.

Having identified the importance of the profit production intention, the next step was to discount the types of contract which could not be considered to be commercial in nature. Consumer contracts were investigated with this in mind. A consumer is distinct from other contracting parties based on the definitions offered in the Consumer Rights Act 2015 and the Consumer Insurance (Disclosure and Representations) Act 2012. A consumer requires statutory protection when entering into a contractual dealing. An individual acting in a consumer capacity cannot be considered to be a commercial party. A consumer contract (of which a Consumer Insurance Contract is an example) will exist between a consumer and a party acting in a business or trade sense. The other forms of contract which were discounted were those considered to be of a personal nature. These included contracts of employment and non-commercial contracts for the sale of goods. This related to the way which parties that were seemingly non-commercial in nature were treated. With this in mind, it seems appropriate to assert that a commercial contract will take place between only commercial parties.

This assertion is supported by the decision in *Johnson v Unisys Ltd*²⁹² where it was noted that ordinarily, commercial contracts exist between parties seeking to generate a profit.²⁹³

Next, a potential middle ground between commercial, and non-commercial was discussed. This included considering contracts entered into by government bodies, the role of charities, as well as Mutuels, Co-operatives, Social Enterprises and Community Interest Companies. This was done in order to highlight that on occasion, the boundary between commercial, and non-commercial activity can be unclear. If it were the case that an all-encompassing definition of what it means to be commercial was being advanced, these, as well as other types of boundary cases would need to be analysed in detail. However, the purpose of this definition is to frame the discussion of efficient breach that follows. As such, the intention was simply to outline the characteristics of an archetypal commercial contract. With that in mind, it is unnecessary to analyse potential boundary cases in depth.

In terms of overall conclusions, it appears that a commercial contract requires that the parties act with an overarching business activity in mind. This applies both in a general sense, as well as with respect to the activity (in this case a contract) in question. This will be done with the intention of generating a profit and will customarily take place as part of a party's trade, profession or vocation, often through business forms such as sole traders, partnerships or companies. In addition, the assertion is that a commercial contract will feature only commercial parties. This is the definition that will be carried forward and applied throughout this thesis as it seeks to justify the legitimacy of the efficient breach of commercial contracts.

²⁹² [2001] UKHL 13; [2003] 1 AC 518.

²⁹³ *ibid* [70] (Lord Millet).

Chapter 3

The Rationale behind the Commercial Distinction in English Contract Law

3.1 Introduction

The intention of this chapter is to develop on the conclusions reached in chapter 2 regarding the existence of a commercial distinction in English contract law. Discussion will go beyond whether a commercial contract is treated differently. It will seek to establish the reasons why this is the case. This chapter will investigate the reasoning provided by the courts for this commercial distinction in contract law in order to outline why cases are decided the way they are. There may well be other reasons which are in operation; however, this chapter will focus specifically on the reasoning which is provided by the courts. The original contribution which this chapter will provide is setting out the rationale behind the commercial distinction in contract law, based on the reasoning provided by the courts. The distinction appears to be of a functional, rather than a linguistic nature in the sense that while commercial contracts are repeatedly referenced, they are not adequately defined. This was highlighted in chapter 2. The fact that commercial contracts are treated differently to non-commercial contracts demonstrates that the distinction functions despite the absence of an express definition.

Because commercial contracts are treated as distinct by the court, there could be a perception that judges are effectively acting as legislators. With this in mind, literature on judicial decision-making, as well as the work of the Legal Realists will be considered. The Legal Realists suggested that the decision-making of judges is informed by more than the law itself and that they could consider issues such as context, prevalent social norms, as well as their personal moral philosophies. The commercial contract distinction could therefore suggest that the claims of the Legal Realists may carry some weight. However, it is important to be aware that judges are bound by precedent. They must follow the rulings of previous courts and adhere to the reasoning contained therein. This is a key feature of the English common law system. The point that is to be developed moving forward is that there is an accepted commercial distinction which is applied within contract law. This is evident within the case law. Because of this distinction, judges, while being bound by previous decisions will rightly continue to uphold this context based distinction regarding the outcomes of commercial disputes. It is the rulings of the English courts in relevant commercial and non-commercial cases that will form the key component of this chapter. By assessing the decisions of the English courts, the reasoning for this distinction can be set out based on the wording provided.

The suggestion is that while contract law as a vehicle remains fundamentally the same whether a contract is commercial or otherwise, the type of right that is being pursued can lead the court to look beyond established legal doctrine. This is done to allow them to shape the law based on the reasoning that informs the pursuit of a contractual right. The difference lies where a right is being pursued for commercial, profit driven reasons. In these cases, the court's decisions may be informed by factors such as commercial intent, customs and practices as well as commercial reasonableness.¹ With this in mind, it is set out that:

[M]odern principles of construction require the court to have regard to the commercial background, the context of the contract and the circumstances of the parties, and to consider whether, against that background and in that context, to give the words a particular or restricted meaning would lead to an apparently unreasonable and unfair result.²

Further, in *Wickman Machine Tool Sales Ltd v L Schuler AG*³ Lord Reid noted that 'the more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear'.⁴ Finally, Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich Building Society Ltd*⁵ set out five principles which relate to contractual interpretation.⁶ In *Hillas & Co Ltd v Arcos Ltd*⁷ a standard of reasonableness was utilised in order to adopt an objective standard for assessing the quality of goods (in this case timber). In *Baird Textile Holdings Ltd v Marks & Spencer Plc*⁸ which concerned a longstanding relationship with no written agreement in place, it was ruled that because there were 'no objective criteria by which the court could assess what would be reasonable either as to quantity or price',⁹ a contract between the two parties could not be implied. Contrast this with a personal right which will be pursued in order to create pleasure or enjoyment.¹⁰ This trend can also be seen in equity where, like in contract, the court will look to utilise equitable mechanisms based on the reasoning behind a claim being brought. This reasoning is based on whether the claim is of a commercial or

¹ See JW Carter, *The Construction of Commercial Contracts* (Hart 2012) 16; See also Sir Robert Goff, 'Commercial Contracts and the Commercial Court' [1984] LMCLQ 382, 388; Hugh G Beale (ed) *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 1-051 and 2-150; Edwin Peel, *The Law on Contract* (14th edn, Sweet & Maxwell 2015) 207-208.

² *Cargill International SA and Another v Bangladesh Sugar and Food Industries Corporation* [1998] 1 WLR 461, 468 (Potter LJ).

³ [1974] AC 235.

⁴ *ibid*, 251 (Lord Reid).

⁵ [1998] 1 WLR 896.

⁶ *ibid*, 912-913 (Lord Hoffmann).

⁷ (1932) 147 LT 503.

⁸ [2001] EWCA Civ 274; [2002] 1 All ER (Comm) 737.

⁹ *ibid*, 795 per (Morritt VC).

¹⁰ See for example *Diesen v Samson* (1971) SLT 49; *Jarvis v Swans Tours* [1973] QB 233; *Jackson v Horizon Holidays* [1975] 1 WLR 1468 (CA) 1472; *Watts v Morrow* [1991] 1 WLR 1421; *Farley v Skinner* [2001] UKHL 49; [2002] 2 AC 732.

non-commercial nature. Proprietary estoppel and the application of fiduciary duties will also be analysed to demonstrate this.

It will be concluded that in deciding contract cases, the courts will consider the type of right which is being pursued, as well as the reasons behind that pursuit. The difference lies where a right is being pursued for commercial, profit driven reasons or alternatively, for reasons of an individual or personal nature. This will inform judicial decision-making. However, judges are bound by precedent. They must follow the previous decisions of higher courts, adhering to the reasoning provided for those decisions. As such, it is important to base any inferences regarding the commercial distinction in contract law on the reasoning provided in the judgments. This reasoning will be extracted from the relevant rulings. It is the wording that is used in both commercial and non-commercial cases which has allowed the reasoning behind treating commercial contracts as distinct to be inferred. Ultimately, it is profit maximisation which will inspire an efficient breach of contract. As such, this will be the base from which the analysis which follows will proceed. It is important to make clear that no claims which are made with this in mind are intended to extend to contracts within the non-commercial context which may or may not be similarly inspired.

3.2 Judicial Decision-Making and Legal Realism

The first point of interest is the way which judges reach their decisions. This is because if commercial contracts are being treated as distinct by the courts, it is important to consider the role of the judiciary as well as their approach to decision-making. This is done because an understanding of this approach will ground the analysis of the relevant case law that is to follow. The classic model of judicial decision-making has been described as a product of rational choice theory where ‘the judge is a rational actor who reasons logically from facts, previous decisions, statutes, and constitutions to reach a decision’.¹¹ Any decision will flow naturally from a body of law and would therefore be consistent irrespective of the judge who makes it. However, there has been doubt cast over this model. For example, Landes and Posner suggest that ‘legal precedents are more accurately described as inputs into the production of judge-made rules of law than as the rules themselves’.¹² If this were the case, precedent would only constitute a contributing element to the law, rather than being the law in itself.

¹¹ John N Drobak and Douglass C North, ‘Understanding Judicial Decision-Making: The Importance of Constraints on Non-Rational Deliberations’ (2008) 26 Washington Journal of Law and Policy 131.

¹² WM Landes and RA Posner, ‘Legal Precedent: A Theoretical and Empirical Analysis’ (1976) 19 The Journal of Law and Economics 249, 250.

3.2.1 Influences on Judicial Decision-Making

There is a suggestion that the belief systems of judges will have an unavoidable influence upon how they reach decisions. For example, Holmes set out that ‘the very considerations which judges most rarely mention, and always with apology, are the secret root from which the law draws all the juices of life’.¹³ The belief systems of judges are effectively hidden and will influence their decisions in ‘an unconscious and unexplainable way’.¹⁴ Further, that the potential for this to take place is facilitated by the indeterminate nature of the judicial decision-making process.¹⁵ Issues may arise because despite being able to identify that the beliefs of individual judges play a part, those beliefs cannot be explained with precision or detail.¹⁶ Further, that “institutional devices” act as a shield of sorts, insulating judges from inside or outside influences and allows them the facility to ‘decide disputes based on their “sincere” ideological preferences and values’.¹⁷ The claim is that it is human nature to be influenced by unconscious beliefs and preferences, and that judges are no different in this respect. With this in mind, it would be impossible to know with absolute certainty the thought process of an individual judge. However, it is noted that ‘in order to conduct a serious discussion of the judicial practice, we must understand the mental processes that drive it, and appreciate their strengths, their flaws, and their limitations’.¹⁸

Judges may also be influenced by their environment. In a study based on criminal trial courts in the US state of Iowa, Gibson suggested that ‘there is a moderately strong “role-playing” linkage between judges’ sentencing decisions and environmental attributes’.¹⁹ Also, three key variables which impact on the link between sentencing and environment are noted. These include ‘increased contact with the constituency, fear of electoral sanction, and the role orientation of the judge’.²⁰ Gibson concludes that ‘sentencing decisions, because of their salience to mass publics and the high degree of discretion allowed by law, may be the most susceptible to influence the local community’.²¹

Kozinski suggests that judges possess a considerable level of discretion regarding the decision-making process. This includes ‘making findings of fact, interpreting language in the Constitution, statutes and regulations; determining whether officials of the executive branch have abused their

¹³ Oliver Wendell Holmes Jr, *The Common Law* (Little, Brown, and Company 1881) 31; See also Drobak and North (n 11) 139.

¹⁴ Drobak and North (n 11)138.

¹⁵ *ibid*, 139.

¹⁶ *ibid*, 140.

¹⁷ Pablo T Spiller and Rafael Gely, ‘Strategic Judicial Decision-making’ in Gregory A Caldeira, R Daniel Kelemen and Keith E Whittington (eds) *The Oxford Handbook of Law and Politics* (OUP 2008) 39. Cites Jeffrey Segal and Harold Spaeth, *The Supreme Court and the Attitudinal Model Revisited* (CUP 2002) 82.

¹⁸ Dan Simon, ‘A Psychological Model of Judicial Decision Making’ (1998) 30 Rutgers Law Journal 1, 142.

¹⁹ James L Gibson, ‘Environmental Constraints on the Behavior of Judges: A Representational Model of Judicial Decision Making’ (1980) 14 Law and Society Review 343, 367.

²⁰ *ibid*, 368.

²¹ *ibid*, 368-369.

discretion; and, fashioning remedies for violations of the law, including fairly sweeping powers to grant injunctive relief'.²² However, it is stressed that this discretion is subject to constraints and that judges are not able to simply act as they see fit. Three factors are highlighted (though it is acknowledged that there are more) including the judge's own self-respect, the influence of a judge's colleagues and the political system.²³

D'Amato has been critical of the suggestion that the law is the product of the actions of judges, rather than a body of rules or principles.²⁴ He had previously set out that the idea that there is no law until it is set out as part of judicial decision is in conflict with the ordinary meaning of law. This ordinary meaning is as a mechanism whereby the behaviour of society can be shaped, modified, channelled or controlled.²⁵ In line with HLA Hart, it is set out that law has an internal aspect in that it guides members of society in making conscious decisions about whether to comply with rules.²⁶

3.2.2 Legal Realism

This approach was developed by the American Legal Realists and was at its most popular in the early 20th century.²⁷ Its source is the work of Oliver Wendell Holmes.²⁸ It has been set out that 'American legal realism is not a systematic philosophy of law but a way of looking at legal rules and legal processes'.²⁹ Karl Llewellyn noted a distrust of legal rules in terms of describing why courts decide cases in the way that they do.³⁰ Further, Jerome Frank suggested that because a judge is human, and because a human will normally arrive at a decision without working through a formal process of reasoning, it will be the case that 'judicial judgments, like other judgments, doubtless, in most cases,

²² Alex Kozinski, 'What I Ate for Breakfast and Other Mysteries of Judicial Decision Making' (1993) 26 Loyola of Los Angeles Law Review 993, 994.

²³ *ibid.*

²⁴ See Anthony D'Amato, 'Legal Realism Explains Nothing' (2009) 1 Jurisprudence Review 1; See also RA Posner, *The Problems of Jurisprudence* (Harvard University Press 1993) 21.

²⁵ See Anthony D'Amato, 'The Limits of Legal Realism' (1978) 87 The Yale Law Journal 468, 478;

²⁶ *ibid.*; See also HLA Hart, *The Concept of Law* (3rd edn, OUP 2012) 88.

²⁷ The list of American Legal Realists includes: Karl Llewellyn, 'Some Realism About Realism-Responding to Dean Pound' (1931) 44 Harvard Law Review 1222; Karl Llewellyn, *The Common Law Tradition: Deciding Appeals* (Little, Brown and Company 1960); Karl Llewellyn, 'Remarks on the Theory of Appellate Decisions and the Rules or Canons about how Statutes are to be Construed' (1950) 3 Vanderbilt Law Review 395; Karl Llewellyn, *The Bramble Bush: The Classic Lectures on the Law and Law School* (OUP 2008); Jerome Frank, *Law and the Modern Mind* (Transaction Publishers 2009); Underhill Moore and Theodore S Hope Jr 'An Institutional Approach to the Law of Commercial Banking' (1929) 38 Yale Law Journal 703; Herman Oliphant, 'A Return to Stare Decisis' (1928) 14 American Bar Association Journal 71; Leon Green and Max Radin, 'Statutory Interpretation' (1930) 43 Harvard Law Review 863.

²⁸ See Oliver Wendell Holmes Jr 'The Path of the Law' (1897) 10 Harvard Law Review 457; Holmes (n 13).

²⁹ Harry W Jones, 'Law and Morality in the Perspective of Legal Realism' (1961) 61 Columbia Law Review 799.

³⁰ Llewellyn (n 27) 1237.

are worked out backward from conclusions tentatively formulated'.³¹ A realist approach is not one that sets out the way in which the law should be approached, but one that suggests that there is potential for judges to interpret it with a broader scope of issues in mind. These could include context and non-legal norms, as well as the beliefs and preferences of individual judges. The approach can be summarised as one where reasons that are not legal, such as fairness, or commercial practices, can be utilised to explain the decision of the courts.³²

On the realist movement generally, Hart set out that 'the courts regard legal rules not as predictions, but as standards to be followed in decision, determinate enough, in spite of their open texture, to limit, though not to exclude, their discretion'.³³ This suggests that where the law is in fact indeterminate, it is the role of the judiciary to use their discretion to reach an appropriate decision which is in line with the existing law. While this approach acknowledges some characteristics of the realist approach, it stops short of accepting that judges have unlimited discretion in terms of their decision-making powers. In contrast, Dworkin's view was that 'it remains the judge's duty, even in hard cases, to discover what the rights of the parties are, not to invent new rights retrospectively'.³⁴ This has been characterised to mean that 'the duty of the judge is always to discover the law that already exists in every case'.³⁵ While this could be interpreted to mean that a judge must simply locate the relevant law, others perceive it to leave open the door for a level of legitimate interpretation to take place. This has been characterised to mean that judges should 'search for the (relevant portion of) the soundest theory of the settled law'.³⁶ This requires them to 'search for the most cogent principles and theories which can be thought of as embodied in the relevant authoritative materials and ... decide according to such principles and theories'.³⁷ In this way, rather than creating new law, judges would be facilitating its evolution.

It is suggested that a 'realist theory of adjudication is based on a belief that judges care about outcomes, but that legal doctrine also exerts an influence on legal decisions because judges feel the need to justify their conclusions in acceptable legal terms'.³⁸ This leads to the assertion that while judges are bound by the law, the law does not itself fully explain their decision-making.³⁹ The judges own concerns about their standing and reputation are considered to be of importance here. For example, with the individual preferences of the judiciary in mind, Miceli and Cosgel suggest that this

³¹ Jerome Frank, *Law and the Modern Mind* (Transaction Publishers 2009) 109.

³² Brian Leiter 'Legal Realism and Legal Positivism Reconsidered' (2001) 111 *Ethics* 278, 285.

³³ HLA Hart, *The Concept of Law* (3rd edn, OUP 2012) 147.

³⁴ Ronald Dworkin, *Taking Rights Seriously* (Harvard University Press 1978) 81.

³⁵ Leiter (n 32) 116.

³⁶ Andrew Altman, 'Legal Realism, Critical Legal Studies, and Dworkin' (1986) 15 *Philosophy and Public Affairs* 205, 232.

³⁷ *ibid.*

³⁸ Matthew C Stephenson 'Legal Realism for Economists' (2009) 23 *Journal of Economic Perspectives* 191, 208.

³⁹ Grant Gilmore, 'Legal Realism: Its Cause and Cure' (1961) 70 *Yale Law Journal* 1037, 1038.

‘can both restrain judicial discretion (the Landes and Posner argument), but also inspire it if future judges are expected to be persuaded by a decision and follow it, thereby enhancing the authoring judge’s reputation’.⁴⁰ They argue that in considering following precedent, judges will look to balance private utility (a personal view on how a case should be decided) and reputational utility (the expectation of how a decision would be received by observers such as other judges or lawyers for example).⁴¹ Harnay and Marciano note that judicial behaviour cannot be understood based solely on individual beliefs or preferences. They set out that that attention should also be afforded to interdependence between judges as well as professional conformity.⁴²

Focus was placed on commercial dealings by the Realists. They suggested that, in these cases, judges would enforce the norms of the prevailing commercial culture, or look to reach a decision which would be socio-economically appropriate.⁴³ Herman Oliphant set out that judges should ‘respond to the stimulus of the facts in the concrete cases before them rather than to the stimulus of over general and outworn abstractions in opinions and treatises’.⁴⁴ This would allow legal doctrines to be restated ‘in ways that were more fact-specific, and thus more descriptive of the relevant grounds of decision’.⁴⁵ In this case, judges would ‘look to the “normal” practices in the existing business culture in deciding what the right outcome is (that is, the judges treat normal economic practice as the normative benchmark for decision)’.⁴⁶ The suggestion of the Realists was that rather than attempting to impose economic and social philosophy, judges are in fact simply sensitive to non-legal norms. These may include the customs and practice of commercial parties such as merchants and banks.⁴⁷ This type of approach is one which appears to be in line with the way in which commercial contracts are treated differently by the courts. If the judgments provided acknowledge that such norms have influenced the reasoning behind them, their impact will be clear.

As a final note, the Realist approach should not be conceived as judges simply acting as unchecked legislators. The case has, however, been made that it would be impossible to know the internal decision-making processes of individual judges. This could mean that they may well be influenced by non-legal factors in reaching decisions. Despite this, it has been set out that a judge who attempts to act as a legislator of sorts will, in fact, be ‘stealthily undermining public confidence in the rule of

⁴⁰ Thomas J Miceli and Metin M Cosgel, ‘Reputation and Judicial Decision Making’ (1994) 23 *The Journal of Behavior and Organization* 31, 33.

⁴¹ *ibid*, 49.

⁴² Sophie Harnay and Alain Marciano, ‘Judicial Conformity Versus Dissidence: An Economic Analysis of Judicial Precedent’ (2004) 23 *International Review of Law and Economics* 405, 406.

⁴³ Brian Leiter, ‘Toward a Naturalized Jurisprudence’ (1997) 76 *Texas Law Review* 267, 281.

⁴⁴ Herman Oliphant, ‘A Return to Stare Decisis’ (1928) 14 *American Bar Association Journal* 71, 75.

⁴⁵ Brian Leiter, ‘Legal Realism and Legal Doctrine’ (2015) 163 *University of Pennsylvania Law Review* 1975, 1978.

⁴⁶ Brian Leiter ‘Legal Formalism and Legal Realism: What is the Issue?’ (2010) 16 *Legal Theory* 111, 112.

⁴⁷ *ibid*, 119. Cites Karl Llewellyn, *The Common Law Tradition: Deciding Appeals* (Little, Brown and Company 1960) 122 and Underhill Moore and Theodore S Hope Jr ‘An Institutional Approach to the Law of Commercial Banking’ (1929) 38 *Yale Law Journal* 703.

law'.⁴⁸ This is because law has an existence which extends beyond the courtroom. Judges must respect this 'by trying, with each decision, to give further specificity and concreteness to the noble conception'.⁴⁹ With this in mind, it has been suggested that a success of the realists was in facilitating flexibility. More specifically, this allowed adjustments to be made to the law in order to resolve social conflict.⁵⁰

3.2.3 Conclusion

It is evident that there is the potential that non-legal norms could factor into judicial decision-making in commercial cases. However, it is important to keep in mind that in a common law legal system, the importance of precedent cannot be discounted. This is on the basis that judges are bound by precedent and thus must follow the rulings of previous courts. They are also required to adhere to the reasoning which is within these rulings. The point of interest is that there is an accepted commercial distinction which is applied within contract law. This distinction is evident within the relevant case law. Based on this, judges, bound by previous decisions, will continue to uphold this context based distinction regarding commercial disputes.

The remainder of this chapter will build on this conclusion and focus on the relevant case law. This is because despite the questions surrounding judicial decision-making which have been flagged up, the judges in UK courts are bound by precedent. As such, judges must follow the rulings of previous higher courts and adhere to the reasoning which has been provided. This is a key feature of the English common law system. While there is scope for discretion to play a part in judicial decision-making, this is tempered by a need to act within the boundaries set out by previous decisions and their reasoning. By assessing the decisions of the English courts, the reasoning for this distinction on the face of the wording provided can be set out.

3.3 The Commercial Distinction in Contract Law

Having confirmed that commercial contracts are distinct, as well as the fact that judges, bound by precedent, and thus, the existing commercial distinction in contract law, it is now appropriate to establish the rationale (as it is set out by the courts) behind that distinction. This is important because awareness that the courts will treat a commercial contract differently without understanding why,

⁴⁸ D'Amato (n 24) 19.

⁴⁹ *ibid*, 20.

⁵⁰ Gilmore (n 39) 1048.

will not provide any level of certainty or predictability. It appears that the courts are willing to look beyond established legal doctrine to shape the law.⁵¹ The same vehicle, namely contract law, is utilised to pursue certain rights in both commercial and non-commercial contract cases. The difference is the type of right being pursued, and the reasons behind pursuing it. A divide exists where the contract in question is entered into purely for profit, as is the case in commercial contracting. This is in contrast with agreements intended to facilitate personal enjoyment. There is a tendency to treat commercial cases differently based on the parties' focus on financial gain. With this in mind it has been noted that when we are dealing with commercial contract disputes 'we can probably assume that any interests of the plaintiff which may be infringed by a breach will be, in one sense or another, financial'.⁵² To flag up some of the examples of commercial contracts being distinguished, some of the case law noted in chapter 2 will be revisited briefly. The intention is to analyse why in each case the distinction is made, rather than simply highlighting that it is. The cases which will be discussed concern market value, commercial reasonableness and context, time for delivery and restraint of trade.

3.3.1 Damages Based on Market Value

The first point of interest is the way in which damages will be assessed within commercial cases. This will provide a grounding for not only the remainder of this chapter, but also, this thesis as a whole. This is because, as will become clear, the calculation, and payment of damages is a key consideration within this thesis as its primary focus is outlining the legitimacy of the efficient breach of commercial contracts. In commercial cases, the court will make an award to reflect what has been lost. This will be based on the relevant market value of a good or service.⁵³ In *The Rozel*⁵⁴ it was ruled that where the cost of a remedy outweighs its actual impact, it would not make commercial sense to effect that remedy. Damages were valued based upon any reduction in commercial value.⁵⁵ It was set out that 'if the cost of remedying the defect is disproportionate to the impact of the defect on operating costs, it will not make commercial sense to effect the repair'.⁵⁶ In short, any costs which may be recovered must represent a reasonable expenditure. This will be assessed based on the

⁵¹ See for example *Milner v Carnival Plc* [2010] EWCA Civ 389; [2010] 3 All ER 701; *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344; *Channel Island Ferries Ltd v Cenargo Navigation Ltd (The Rozel)* [1994] CLC 168. These cases, as well as further examples will be discussed later.

⁵² Hugh Beale, 'Exceptional Measures of Damages in Contract' in Peter Birks (ed), *Wrongs and Remedies in the Twenty-First Century* (Reprint edn, Clarendon 2006) 220.

⁵³ See Donald Harris, David Campbell and Roger Halson, *Remedies in Contract and Tort* (2nd edn, CUP 2005) 82; See also Andrew Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP 2004) 188-191.

⁵⁴ [1994] CLC 168.

⁵⁵ *ibid*, 175 (Phillips J).

⁵⁶ *ibid*.

commercial implications which the breach of contract in question has had.⁵⁷ In *The Maersk Colombo*,⁵⁸ which concerned damage to a quayside crane, the court sought to compensate for the claimant's true loss. It was ruled that it was unreasonable in the circumstances to value damages at the level of a replacement. This was on the basis that this would amount to a value which was in excess of the actual loss suffered. The claimant had never contemplated replacing the crane in question. As such, any award for the replacement value rather than the resale value would be unreasonable. Finally, in *The Alecos M*⁵⁹ a ship was sold on the understanding that it would come with a spare propeller. On delivery, the propeller was missing. It was set out that the claimant was entitled to the commercial value of the missing propeller. Further, because there was, in fact, no available market for the sale of spare propellers, it was ruled that 'commercial value of this spare propeller on this ship was no more than its scrap value'.⁶⁰

3.3.2 Commercial Reasonableness

The next point to note is that commercial contracts are assumed to be underpinned by a rational commercial purpose and are often said to follow business common sense.⁶¹ This will inform the way that they will be interpreted by the courts. In cases concerning commercial contracts, the background and the context in which contract was agreed will often be used.⁶² This plays into the contextual approach which is applied and illustrates the types of factor which influence the commercial distinction in contract law. For example, *Antaios Compania Naviera SA v Salen Rederierna AB*⁶³ highlights that 'if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense'.⁶⁴ In *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd*,⁶⁵ Lord Steyn set

⁵⁷ *ibid.*

⁵⁸ *Southampton Container Terminals Ltd v Hansa Schiffahrts GmbH (The Maersk Colombo)* [2001] EWCA Civ 717.

⁵⁹ *Sealace Shipping Co Ltd v Oceanvoice Ltd (The Alecos M)* [1991] 1 Lloyd's Rep 120.

⁶⁰ *ibid.*, 120 (Neill LJ).

⁶¹ See *Fiona Trust & Holding Corp v Privalov* [2007] UKHL 40; [2007] Business Law Review 1719 [5]: Lord Hoffmann set out that 'Businessmen in particular are assumed to have entered into agreements to achieve some rational commercial purpose and an understanding of this purpose will influence the way in which one interprets their language'; See also *Antaios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191, 201: Here Lord Diplock discusses the interpretation of contracts in line with business commonsense.

⁶² Sir Robert Goff, 'Commercial Contracts and the Commercial Court' [1984] LMCLQ 382, 388; See also Catherine Mitchell, 'Obligations in Commercial Contracts: A Matter of Law or Interpretation?' (2012) Current Legal Problems 1, 17; *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 779.

⁶³ [1985] AC 191.

⁶⁴ *ibid.*, 201 (Lord Diplock).

⁶⁵ [1997] AC 749.

out that when ‘determining the meaning of the language of a commercial contract ... the law therefore generally favours a commercially sensible construction’.⁶⁶ The reasoning was ‘that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them’.⁶⁷ Based on this, Mitchell notes that a literal meaning may not be relied on where ‘a reasonable person would understand that the contract communicated something different to its strict literal meaning’.⁶⁸ In *Society of Lloyd’s v Robinson*,⁶⁹ Lord Steyn further set out that ‘loyalty to the text of a commercial contract, instrument, or document read in its contextual setting is the paramount principle of interpretation’.⁷⁰ However, he went on to note that in ‘interpreting the meaning of the language of a commercial document the court ought generally to favour a commercially sensible construction’.⁷¹ This was because commercial construction was thought ‘likely to give effect to the intention of the parties’.⁷² This should reflect the interpretation of a reasonable commercial person.⁷³ Finally, in *Rainy Sky SA and others v Kookmin Bank*,⁷⁴ Lord Clarke noted that ‘the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant’.⁷⁵ Also, that ‘the relevant reasonable person is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract’.⁷⁶ Again, it is suggested that ‘if a term is capable of bearing two meanings, a commercially sensible result is to be preferred over a commercially “absurd” one’.⁷⁷ Also, that ‘if “commercial reasonableness” cannot be understood as encapsulating a single or universal standard or particular reasoning technique, then this must be because contract context plays a large role in these determinations about commercial reasonableness’.⁷⁸ The key takeaway point is that what is reasonable, in a specifically commercial sense, will feature in the court’s approach to deciding them.

⁶⁶ *ibid*, 771 (Lord Steyn).

⁶⁷ *ibid*.

⁶⁸ Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 41.

⁶⁹ 1 WLR 756.

⁷⁰ *ibid*, 763 (Lord Steyn).

⁷¹ *ibid*.

⁷² *ibid*.

⁷³ *ibid*.

⁷⁴ [2011] UKSC 50; [2011] 1 WLR 2900.

⁷⁵ *ibid* [14] (Lord Clarke).

⁷⁶ *ibid*.

⁷⁷ Mitchell (n 68) 115.

⁷⁸ *ibid*.

3.3.3 Time for Delivery

Moving on from the discussion of commercial reasonableness, the next point of interest is a more specific example which relates to the commercial distinction in contract law. *The Naxos*⁷⁹ concerned time for delivery and its importance in commercial contracts. Lord Ackner set out that ‘time of delivery is of the greatest importance in commercial contracts and contracts in the sugar trade are no exception’.⁸⁰ The need to avoid ‘a wholly unreasonable and commercially quite undesirable situation’⁸¹ as well as ‘to provide certainty which is such an indispensable ingredient of mercantile contracts’⁸² was noted. In *Thunderbird Industries Llc v Simoco Digital UK Limited*,⁸³ it was ruled that ‘in relation to stipulated delivery times contained in commercial contracts, time is presumed to be of the essence’.⁸⁴ Further, it was noted that neither party contested ‘that it would be right to attribute or include no term as to delivery in a contract of this kind. The commercial context in which the contract was negotiated makes that a perverse construction’.⁸⁵ Interestingly, in *United Scientific Holdings Ltd v Burnley Borough Council*⁸⁶ Lord Diplock noted that ‘some stipulations in commercial contracts as to the time when something must be done by one of the parties or some event must occur, time is of the essence; in others it is not’.⁸⁷ However, in *Bunge Corporation New York v Tradax Export SA Panama*,⁸⁸ the House of Lords confirmed that stipulations as to time in mercantile contracts would generally be regarded as provisions making time of the essence. These particular requirements with regard to time for delivery illustrate the fact that in commercial contracts, requirements may differ to those which may feature in non-commercial contracts. Again, this is based on the context in which they exist.

3.3.4 Restraint of Trade

Following on from time for delivery, and additional specific example of the commercial distinction within contract law will now be analysed. This comes in the form of restraint of trade. *Esso Petroleum Co Ltd v Harper’s Garage (Stourport) Ltd*⁸⁹ outlined that a distinction will exist between contracts

⁷⁹ *Cie Commerciale Sucres et Denrees v C Czarnikow Ltd (The Naxos)* [1990] 1 WLR 1337.

⁸⁰ *ibid*, 1343 (Lord Ackner).

⁸¹ *ibid*, 1344 (Lord Ackner).

⁸² *ibid*, 1348 (Lord Ackner).

⁸³ [2004] EWHC 209 (Ch).

⁸⁴ *ibid* [14] (Patten J).

⁸⁵ *ibid* [11] (Patten J).

⁸⁶ [1978] AC 904.

⁸⁷ *ibid*, 924 (Lord Diplock).

⁸⁸ [1981] 1 WLR 711.

⁸⁹ [1968] AC 269.

which regulate normal commercial relations and those which are in restraint of trade.⁹⁰ It was noted that:

[T]he doctrine does not apply to ordinary commercial contracts for the regulation and promotion of trade during the existence of the contract, provided that any prevention of work outside the contract, viewed as a whole, is directed towards the absorption of the parties' services and not their sterilisation.⁹¹

Further, that:

[S]omewhere there must be a line between those contracts which are in restraint of trade and whose reasonableness can, therefore, be considered by the courts and those contracts which merely regulate the normal commercial relations between the parties and are, therefore, free from doctrine.⁹²

Finally, Lord Wilberforce outlined that reasonableness was a key consideration in relation to restraint of trade cases and that this would be 'interpreted in relation to commercial practice and common sense'.⁹³

This brief discussion of restraint of trade provides additional evidence of the existence of the commercial distinction in contract law. Additionally, this takes into account the importance of commercial reasonableness noted earlier.

3.3.5 Conclusion

Based on the decisions noted above, it can be inferred that in purely commercial disputes, the courts will be influenced by the fact that the parties involved are primarily seeking a financial gain. This will affect the way which damages are calculated. Any award for damages will be based on the commercial value which is reasonable in the circumstances. For example, this could be based on the cost of a replacement, the reduction in value,⁹⁴ the resale value,⁹⁵ or scrap value.⁹⁶ A major contributing factor to the decision-making process of judges in commercial cases is commercial reasonableness. This will be applied both to the calculation of damages, as well as to the

⁹⁰ *ibid*, 327 (Lord Pearce).

⁹¹ *ibid*, 328 (Lord Pearce).

⁹² *ibid*, 327 (Lord Pearce).

⁹³ *ibid*, 333 (Lord Wilberforce).

⁹⁴ *The Rozel* (n 54).

⁹⁵ *The Maersk Colombo* (n 58).

⁹⁶ *The Alecos M* (n 59).

interpretation of the contract's terms.⁹⁷ A prime example of this are cases which concern time for delivery,⁹⁸ and contracts which are potentially in restraint of trade where the courts took a more contextual approach, showing sensitivity to commercial reasonableness, as well as commercial norms and practices.⁹⁹

3.4 Personal Contracts and the “Holiday” Cases

Having set out the existence of the commercial distinction in chapter 2, as well as outlining some of its characteristics in the first part of this chapter, the next step is to move on to discuss one of the clear differences between commercial, and non-commercial contracts. This concerns the varying approach to the provision of compensation for non-pecuniary losses. This is relevant to the major claim which this thesis makes in the sense that the payment of damages for the efficient breach of commercial contracts will be shown to be simplified due to the fact that (often intangible) non-pecuniary losses are not compensated.

Johnson v Unisys Ltd set out that in the context of a commercial contract, ‘non-pecuniary loss ... is not within the contemplation of the parties and is accordingly too remote’.¹⁰⁰ This differs from the approach that is adopted regarding personal contracts. These ‘have as their object the provision of enjoyment, comfort, peace of mind or other non-pecuniary personal or family benefits’.¹⁰¹ As such, ‘the avoidance of just such non-pecuniary injury can be said to be a principal object of the contract’.¹⁰² A personal contract may have sentimental or emotional inspiration, though this is not always the case. In a commercial setting, such an intent would appear to be illogical and (or) costly and, as such, would not be considered commercially rational by a court. This will influence how they will treat a dispute in the sense that damages will be assessed based on commercial value. Non-pecuniary losses will not be considered.¹⁰³ With this in mind, personal contracts, and more specifically the way in which they are distinct from commercial contracts, will now be discussed. This is not to suggest that any contract which is non-commercial in nature will be a personal contract, only that the case law in this area is of use in illustrating the way in which the courts will assess awards for damages following a breach.

⁹⁷ See *Antaios Compania Naviera SA v Salen Rederierna AB* (n 63); *Mannai Investment Co Ltd* (n 65); *Society of Lloyd's v Robinson* (n 69); *Rainy Sky* (n 74).

⁹⁸ *The Naxos* (n 79); *Thunderbird Industries Llc v Simoco Digital UK Limited* (n 83).

⁹⁹ See *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* (n 89).

¹⁰⁰ *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518 [70] (Lord Millet).

¹⁰¹ *ibid.*

¹⁰² *ibid.*

¹⁰³ *ibid.*

Generally, damage awards for distress, disappointment, or loss of amenity stemming from a breach of contract are limited. They will not be available unless the aim of the contract was to prevent distress, create enjoyment or provide a particular amenity.¹⁰⁴ Any claim for damages for such losses would be outside the primary profit generation function of commercial contracting. The position regarding the relaxation of this limitation on damages is demonstrated by the case law. Examples are the “holiday” cases where a breach of contract in terms of providing a holiday of a standard which was advertised resulted in a damage award for distress or disappointment.¹⁰⁵ These contracts are not considered commercial because they do not meet the criteria set out in chapter 2. They are not entered into by purely commercial parties, carrying out organised business activity with the specific intention of generating a profit. In *Milner v Carnival Plc*,¹⁰⁶ the relevant considerations for assessing a damage award were set out. These include compensation for pecuniary loss,¹⁰⁷ compensation for consequential pecuniary loss,¹⁰⁸ compensation for physical inconvenience and discomfort,¹⁰⁹ and compensation for mental distress.¹¹⁰ In *Jarvis v Swans Tours Ltd*,¹¹¹ ‘the plaintiff was entitled to be compensated for his disappointment and distress at the loss of the entertainment and facilities for enjoyment which he had been promised’.¹¹² Further, it was outlined that when a ‘contracting party breaks his contract, damages can be given for the disappointment, the distress, the upset and frustration caused by the breach’.¹¹³ Note also that the ruling in *Jarvis v Swans Tours Ltd*¹¹⁴ is referenced by Lord Denning in *Jackson v Horizon Holidays*.¹¹⁵

*Watts v Morrow*¹¹⁶ set out that when:

[T]he very object of a contract is to provide pleasure, relaxation, peace of mind or freedom from molestation, damages will be awarded if the fruit of the contract is not provided or if

¹⁰⁴ See Hugh G Beale (ed), *Chitty on Contracts*, 32nd edn (Sweet & Maxwell 2015) Para 26-003.

¹⁰⁵ *ibid*, Para 26-144; Adam Kramer, *The Law of Contract Damages* (2nd edn, Hart 2017) 527; *Jarvis v Swans Tours Ltd* [1973] QB 233; *Watts v Morrow* [1991] 1 WLR 1421, 1446; *Farley v Skinner* [2001] UKHL 49; [2002] 2 AC 732; *Diesen v Samson* (1971) SLT 49. Other cases which are not discussed here include *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468; *Jackson v Chrysler Acceptances Ltd* [1978] RTR 474; *Kemp v Intasun Holidays Ltd* [1987] 2 FTLR 234.

¹⁰⁶ [2010] EWCA Civ 389; [2010] 3 All ER 701.

¹⁰⁷ *ibid* [29] (Ward LJ): ‘The loss here is the monetary difference between what was bought and what was supplied. The task is to assess the amount by which the advertised holiday turned out to be less in money terms than the customer had paid for it’.

¹⁰⁸ *ibid* [30] (Ward LJ): ‘This would cover out of pocket expenses such as the cost of alternative accommodation, the cost of alternative travel arrangements and so forth’.

¹⁰⁹ *ibid* [31] (Ward LJ): ‘It has long been established that damages for personal inconvenience “where it is sufficiently serious” is recoverable’.

¹¹⁰ *ibid* [32].

¹¹¹ *Jarvis v Swans Tours Ltd* [1973] QB 233.

¹¹² *ibid*, 233 (Denning LJ).

¹¹³ *ibid*, 238 (Denning LJ); See also *Archer v Brown* [1985] QB 401, 402.

¹¹⁴ *ibid*.

¹¹⁵ [1975] 1 WLR 1468 (CA) 1472.

¹¹⁶ [1991] 1 WLR. 1421.

the contrary result is procured instead. If the law did not cater for this exceptional category of case it would be defective.¹¹⁷

In addition, *Farley v Skinner*¹¹⁸ notes *Watts v Morrow*¹¹⁹ in setting out that contracts that are intended to provide pleasure and enjoyment are ‘not the product of Victorian contract theory but the result of evolutionary developments in case law from the 1970s’.¹²⁰ *Jarvis v Swans Tours* is also noted here.¹²¹ Finally, *Diesen v Samson*¹²² concerned a contract for wedding photography. Here it was ruled that because the contract was not of a commercial nature, compensation could be awarded for damage to ‘personal, social and family interests’.¹²³ The claimant’s ability to enjoy viewing wedding photographs had ‘been permanently denied her by the defender’s breach of contract’.¹²⁴ As such, a damage award was made. It is noted that in order to avoid a floodgates issue ‘it might be necessary to find a filter to cut out trifling claims’.¹²⁵ The suggestion is that ‘it would be enough to allow claims in principle but to keep the awards very low except in serious cases’.¹²⁶ Further, it is urged that any ‘damages for disappointment and vexation etc be awarded in any case in which such a loss on a serious scale was a natural and probable consequence of the breach and could not be avoided by the plaintiff taking reasonable steps’.¹²⁷

The key takeaway point is that an award for damages in the case of a personal contract may take into account loss of amenity. This could include disappointment, distress and loss of enjoyment. This is not the case in commercial contract disputes where damages are assessed based on commercial value.¹²⁸ This demonstrates a clear separation between the reasoning adopted by judges in commercial contract cases and those which are non-commercial. While the remedy which is utilised is the same, the way in which the award is calculated differs. In the case of non-commercial contracts it may take account of losses beyond market value. This is further evidence of the way in which the court treat the pursuit of rights of a personal nature differently to those which are profit driven. This plays into the overarching theme of this thesis as it is this type of approach that would be applied in terms of compensating losses arising from the efficient breach of a commercial contract.

¹¹⁷ *ibid*, 1446 (Bingham LJ).

¹¹⁸ *Farley v Skinner* [2001] UKHL 49.

¹¹⁹ *Watts v Morrow* (n 116).

¹²⁰ *Farley v Skinner* (n 118) [19] (Lord Bingham).

¹²¹ *ibid* [89] (Lord Scott).

¹²² *Diesen v Samson* (1971) SLT 49.

¹²³ *ibid* (Sheriff-Substitute JM Peterson).

¹²⁴ *ibid*, 50 (Sheriff-Substitute JM Peterson).

¹²⁵ Beale (n 52) 225.

¹²⁶ *ibid*.

¹²⁷ *ibid*, 226.

¹²⁸ See for example *The Rozel* (n 54); See also *The Maersk Colombo* (n 58); *The Alecos M* (n 59).

3.5 The approach in *Ruxley v Forsyth*

Following on from the discussion regarding the types of loss which will be compensated in personal contract type cases, the next point of interest is a particular case which has relevance in an illustrative sense. *Ruxley Electronics & Constructions Ltd v Forsyth*¹²⁹ concerned a contract for the construction of a swimming pool to certain specifications. These specifications were the required depth of the pool, in order to allow that an individual could dive into the water safely. The pool was found to be safe for diving, despite being built to a smaller depth than was specified. The claimant contended that this would not be the case should he wish to install a diving board. This was not his original intention. The claimant looked to claim damages to allow for the pool to be rebuilt to those original specifications.¹³⁰ The relevance which this case has in terms of assessing why the commercial distinction exists becomes evident on examination of its facts. The norm in cases concerning building work is to assess an award of damages based on the cost of cure. However, this does not apply when the cost would be unreasonable.¹³¹ Here the commercial value of a swimming pool was unaffected by being built to different specifications than were requested. This was added to the fact that the cost of reinstatement (demolishing and rebuilding the pool) was deemed to be unreasonable.

This decision has been noted consistently in subsequent case law. In *AXA Insurance UK Plc v Cunningham Lindsey United Kingdom*,¹³² the importance of a standard of reasonableness in assessing an award of damages was noted.¹³³ This approach, specifically the judgment of Lord Jauncey was followed in *The Baltic Surveyor*,¹³⁴ *The Maersk Colombo*,¹³⁵ and *London Fire and Emergency Planning Authority v Halcrow Gilbert Associates Ltd*.¹³⁶ The approach, based on actual loss, rather than the cost of repairs and was noted in *Chetwynd v Tunmore*.¹³⁷ This case concerned a claim for damages to carry out restoration work on a collection of ponds. Here it was set out that ‘it would be out of all proportion to award £224,000 for the immediate revetment works when, over a period of three to five years, the banks would be restored in any event if the Ponds were full’.¹³⁸ It was deemed appropriate to make an award to reflect ‘the current loss of value in the Fishery rather than the revetment costs’.¹³⁹

¹²⁹ [1996] 1 AC 344.

¹³⁰ *ibid*.

¹³¹ Andrew Burrows and Edwin Peel, *Commercial Remedies: Current Issues and Problems* (2008 Reprint edn, OUP) 10.

¹³² [2007] EWHC 3023 (TCC).

¹³³ *ibid* [258] (Akenhead J).

¹³⁴ *Voaden v Champion (The Baltic Surveyor)* [2002] EWCA Civ 89 [77] (Rix LJ).

¹³⁵ *The Maersk Colombo* (n 58) [55]-[56] (Clarke LJ).

¹³⁶ [2007] EWHC 2546 (TCC) [90].

¹³⁷ [2016] EWHC 156 (QB).

¹³⁸ *ibid* [144] (Judge Reddihough).

¹³⁹ *ibid*.

3.5.1 The Standard of Reasonableness

The commercial standard of reasonableness was noted earlier. Here, the area of interest concerns the application of a standard of reasonableness in dealing with a claim for reinstatement. It has been suggested that the main significance of the *Ruxley* decision is confirming that despite damages for the cost of cure being the norm in cases concerning building contracts, an award for this value is not recoverable if their valuation is unreasonable.¹⁴⁰ Further, that the standard is an objective test where there is ‘no suggestion that the plaintiff himself should be the arbiter’.¹⁴¹ However, the suggestion is that the reasonable person utilised in this test ‘would be one who, like the plaintiff, had bargained for the defendant’s promises and who also had the plaintiff’s tastes and needs’.¹⁴² The risk of potential double compensation is also highlighted in that a scenario could arise where ‘the plaintiff might well end up with both the benefits of an effectively sufficient performance and a sum by way of damages which no reasonable person would spend on cure’.¹⁴³ It is suggested that any questions of whether the court should concern itself with the use of an award of damages could be allayed ‘if the objective reasonableness test were to be enlarged to include the question whether, and to what extent, a reasonable person in the position of the plaintiff, having his tastes and needs, would spend the damages award in effecting the cure’.¹⁴⁴ It follows that assessing a reasonable measure of damages would be based on the cost of carrying out repairs and the benefit which would be derived from it.¹⁴⁵

The case concerned a non-commercial contract. However, this type of approach is more common in damage claims stemming from commercial contracts.¹⁴⁶ It is the way that the court utilised this standard which is of note. An award for reinstatement was not enforced due to its cost being unreasonable. The reasons for this included first, that the commercial value of the pool was unaffected.¹⁴⁷ Second, that imposing these costs on the construction firm would be unreasonable as ‘the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered’.¹⁴⁸ Finally, the true intent of Mr Forsyth was considered. It has been suggested that while ‘the courts may award damages measured by a cost of cure that is higher than the difference in value but will not do so where the claimant has not cured and does not intend to cure’.¹⁴⁹ While it is accepted that the court would not usually be concerned by the plaintiff’s use of any damages, it was set out that ‘it

¹⁴⁰ Brian Coote, ‘Contract Damages, Ruxley, and the Performance Interest’ (1997) 56 *The Cambridge Law Journal* 537, 559.

¹⁴¹ *ibid.*

¹⁴² *ibid.*

¹⁴³ *ibid.*, 561.

¹⁴⁴ *ibid.*, 563.

¹⁴⁵ Ewan McKendrick, *Contract Law: Text, Cases and Materials* (8th edn, OUP 2018) 821.

¹⁴⁶ See *The Rozel* (n 54); See also *The Maersk Colombo* (n 58).

¹⁴⁷ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 353 (Lord Bridge).

¹⁴⁸ *ibid.*, 361 (Lord Mustill).

¹⁴⁹ Andrew Burrows, *Principles of English Commercial Law* (OUP 2015) 332.

does not follow that intention is not relevant to reasonableness, at least in those cases where the plaintiff does not intend to reinstate'.¹⁵⁰ It is noted that in cases where rebuilding was genuinely intended, recovery of damages for reinstatement would be more likely.¹⁵¹ Further, that the decision suggests that a 'sensible approach to the question of cost of correction damages: they will be awarded only if the plaintiff has a genuine interest in the performance being as stipulated and if correction of the defect is reasonable. If correction is not reasonable a sum for loss of amenity may be given'.¹⁵² The fact that the court applied reasoning which would be more commonly seen within commercial contracting demonstrates that the discretion of judges plays a key part in their decision-making. Note also that the normal approach in commercial cases would be to adopt the diminution in value approach.¹⁵³ However, this approach was said to be inappropriate and damages were awarded for loss of amenity.

The award was made to reflect the personal value of what the claimant had lost.¹⁵⁴ This demonstrated that 'the enjoyment of an amenity has a quantifiable value quite separate from the cost of performance and from the economic losses caused by a breach'.¹⁵⁵ Also, that 'where a difference in value amounting to less than the cost of cure has been awarded, the loss of amenity will be permanent and general damages ought therefore to be no less than they would have been in a case like *Ruxley* where there was no difference in value at all'.¹⁵⁶ Note also *The Baltic Surveyor* which set out that this is 'perhaps the best example of the courts awarding a head of damages called 'loss of amenity' outside personal injury'.¹⁵⁷ The ruling in *Addis v Gramophone Co Ltd*¹⁵⁸ is also relevant. Here it was set out that 'in claims for breach of contract, the plaintiff cannot recover damages for his injured feelings'.¹⁵⁹ However, this rule can be subject to certain exceptions, one of which is when the overriding intention of the contract is to provide pleasure.¹⁶⁰ What we can see is the willingness of the court to exercise their discretion and balance commercial reality and commercial reasonableness with personal interests. This is clear based on the damage award for loss of amenity where commercial value was unaffected, in preference for reinstatement which was said to be unreasonable based on cost.¹⁶¹

¹⁵⁰ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 372 (Lord Lloyd).

¹⁵¹ See Beale (n 52) 228; See also *Tito v Waddell* [1977] Ch 106, 332-333.

¹⁵² *ibid.*, 229.

¹⁵³ *The Rozel* (n 54) 175.

¹⁵⁴ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 374 (Lord Lloyd).

¹⁵⁵ Coote (n 140) 568.

¹⁵⁶ *ibid.*

¹⁵⁷ *The Baltic Surveyor* (n 134) 89 [97] (Rix LJ).

¹⁵⁸ [1909] AC 488.

¹⁵⁹ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 374 (Lord Lloyd); See also, *Addis v Gramophone Co Ltd* [1909] AC 488, 491.

¹⁶⁰ *ibid.*

¹⁶¹ See *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 353.

3.5.2 Loss of Amenity and the Consumer Surplus

The next point of interest is the fact that *Ruxley* featured compensation for loss of amenity. Awards for loss of amenity are problematic because as Friedmann noted, the court was ‘required to appraise an element that has no market price in order to provide an adequate remedy’.¹⁶² Further, that this development is based on the requirement ‘that the plaintiff’s performance interest should be respected’.¹⁶³ Lord Mustill set out that ‘the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure’.¹⁶⁴ The suggestion is that in doing this he effectively admitted that:

[I]f the claimant bargains for something which has a particular value for him, even though it may have no real value to another person, then the law can include that in its assessment of damages, although it cannot be valued on a scientific basis given that it is an intangible loss which has to be translated into economic terms for the purposes of an award of damages.¹⁶⁵

This is known as the consumer surplus. As Bowen notes, consumer surplus is an economic concept, but one which has an impact on damages for non-pecuniary claims following a breach of contract.¹⁶⁶ It concerns ‘those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure’.¹⁶⁷ It is ‘the amount greater than the relative market price that a consumer is willing to pay for a good or service in order to secure certain conditions specific to the consumer’.¹⁶⁸ This is assessed based on ‘the personal, subjective gain which the claimant expected to receive from full performance—an advantage not measured by any increase in the market value of his property’.¹⁶⁹ There is potential for uncertainty regarding the consumer surplus. It is, in a legal sense, not completely analogous with the consumer surplus in an economic sense. This is because in economics it concerns the difference between the amount which consumers are willing to pay for a resource, and what they actually pay for it.

In *Ruxley* there was ‘a “consumer surplus” beyond the cost to him of building the pool to the specified depth: it was a subjective, even idiosyncratic benefit to him to have that depth in his pool—an advantage not measured by any increase in the market value of his property’.¹⁷⁰ The suggestion is

¹⁶² Daniel Friedmann, ‘The Performance Interest in Contract Damages’ (1995) 111 *Law Quarterly Review* 628, 650.

¹⁶³ *ibid.*

¹⁶⁴ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 360 (Lord Mustill).

¹⁶⁵ *Burrows and Peel* (n 131) 12.

¹⁶⁶ AJ Bowen, ‘Watts v Morrow and the Consumer Surplus’ (2003) *Scots Law Times* 1.

¹⁶⁷ D Harris, A Ogus and J Phillips, ‘Contract Remedies and the Consumer Surplus’ (1979) 95 *LQR* 58.

¹⁶⁸ Stephanie Mullen, ‘Damages for Breach of Contract: Quantifying the Lost Consumer Surplus’ (2016) 36 *Oxford Journal of Legal Studies* 83, 84.

¹⁶⁹ *Beal* (n 104) 26-145.

¹⁷⁰ Michael Bridge, *Benjamin’s Sale of Goods* (10th edn, Sweet & Maxwell 2017) 17-071.

that an award for this subjective value which goes beyond market price in some case is made possible based on the ruling.¹⁷¹ Lord Mustill adopted this approach which has a ‘broader impact in that it would appear to be applicable in any case in which a consumer puts a higher value on performance than the market value’.¹⁷² However, there was acknowledgement that it is difficult to precisely quantify the consumer surplus ‘because it represents a personal, subjective and non-monetary gain’.¹⁷³ Despite this, where a consumer surplus can be said to exist, it should be compensated.¹⁷⁴ It is suggested that ‘their Lordships were eager to see the victim of the breach of contract with some degree of recovery once they had decided, rightly, that for pecuniary loss he was entitled, with reinstatement unreasonable and value undiminished, to only nominal damages’.¹⁷⁵ Further, the same reasoning was adopted in *Freeman v Niroomand*.¹⁷⁶ It was set out that in the case of a building contract:

[D]amages are not limited to the diminution in value of the property or the cost of reinstatement, but may be awarded in an intermediate figure to reflect the loss of amenity or convenience suffered by the householder, or simply the personal and intangible loss which arises from the fact that he has not obtained what he wanted and what he expressly contracted for, the so-called ‘consumer surplus’.¹⁷⁷

The issue which consistently arises is accurately calculating the consumer surplus. There has been an attempt to set out a methodology for the accurate quantification of the consumer surplus using a cost-benefit analysis.¹⁷⁸ A full analysis of whether this type of approach would be justifiable is not required here. It is sufficient to outline that the consumer surplus, despite its difficulties in terms of quantification, is something that should be compensated where it is required. *Ruxley* is said to demonstrate that ‘the enjoyment of an amenity has a quantifiable value quite separate from the cost of performance and from the economic losses caused by a breach’.¹⁷⁹ Further, that even where cost of cure damages are awarded, ‘there could still be loss of amenity until such time as the cure could reasonably be completed’.¹⁸⁰ It has been set out that the decision simply demonstrates that loss of amenity can be compensated. It should not be taken to indicate an approach to valuing damages for loss of amenity.¹⁸¹ Bowen makes the claim that Lord Mustill extends the reach of the consumer

¹⁷¹ Coote (n 140) 566.

¹⁷² McKendrick (n 145) 625.

¹⁷³ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) 360-361 (Lord Mustill).

¹⁷⁴ *ibid.*, 361; See also Mullen (n 168) 99.

¹⁷⁵ The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 31-021.

¹⁷⁶ (1996) 52 Con LR 116.

¹⁷⁷ *ibid.*

¹⁷⁸ See Mullen (n 168) 86.

¹⁷⁹ Coote (n 140) 568.

¹⁸⁰ *ibid.*

¹⁸¹ McKendrick (n 145) 624.

surplus to commercial cases.¹⁸² However, it has been made clear throughout that this was not a commercial case. This is based on the definition of commercial contracts which is being utilised as it featured one only commercial party. It is true it highlights that commercial cases are treated differently, however, suggesting that it was itself a commercial case is wide of the mark.

3.5.3 Conclusion

*Ruxley Electronics & Constructions Ltd v Forsyth*¹⁸³ demonstrates two key elements with regard to the commercial distinction in contract law. The first is that a standard of reasonableness will be viewed differently in a non-commercial case. The classic method of assessing damages in construction cases based on diminution in commercial value will not be the default approach. However, it is important to note that the full cost of reinstatement will not be awarded where it would be unreasonable to do so.¹⁸⁴ The second is that in non-commercial cases, damages for non-pecuniary losses such as loss of amenity may be awarded.¹⁸⁵ Further, that the value of the consumer surplus may well factor into this calculation.¹⁸⁶ The relevance of these conclusions with respect to the overarching intention of this thesis are that they confirm the fact that the assessment of awards of damages will vary between commercial, and non-commercial disputes. Because the focus is to make the case for the efficient breach of commercial contracts, this is an important consideration as it is the commercial approach that will be applied. Issues such as compensating for loss of amenity, or for the consumer surplus will not feature.

3.6 A similar approach in Equity

At this point it has been set out that disputes that concern commercial contracts will be treated differently to those of a non-commercial nature. This is in respect of the types of loss that will be compensated and appears to be based on the type of interest that is being protected, or enforced. The next issue for discussion concerns highlighting a contrast with the approach that is adopted with respect to the commercial distinction.

¹⁸² Bowen (n 166) 2.

¹⁸³ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129).

¹⁸⁴ *ibid*, 361 (Lord Mustill).

¹⁸⁵ *ibid*, 374 (Lord Lloyd).

¹⁸⁶ *ibid*, 360-361 (Lord Mustill).

English law also makes a distinction between the commercial and the non-commercial in equity. This is demonstrated clearly within the relevant case law. In *Royal Bank of Scotland Plc v Etridge*,¹⁸⁷ Lord Nicholls outlined that different considerations will be applied ‘where the relationship between the debtor and guarantor is commercial’.¹⁸⁸ This was because parties who are engaged in business practice ‘can be regarded as capable of looking after themselves and understanding the risks involved’.¹⁸⁹ In this case, risk stemmed from the act of acting as a guarantor. The ruling in *Stack v Dowden*¹⁹⁰ made it clear that context is at all times paramount. This shows that a case in a domestic context will be treated differently from one in a commercial setting. Baroness Hale highlighted that ‘an outcome which might seem just in a purely commercial transaction may appear highly unjust in a transaction between husband and wife or cohabitant and cohabitant’.¹⁹¹ The cases of *Pettitt v Pettitt*¹⁹² and *Gissing v Gissing*¹⁹³ were also noted here. It was outlined that both ‘contain vivid illustrations of how difficult it is to apply simple assumptions to the complicated, inter-dependent and often-changing arrangements made between married couples’.¹⁹⁴ Further, that ‘in law, “context is everything” and the domestic context is very different from the commercial world. Each case will turn on its own facts. Many more factors than financial contributions may be relevant to divining the parties’ true intentions’.¹⁹⁵ The key point is that the relationship which may exist in a domestic context is both multi-faceted and changeable.

The assumption that commercial parties act predominantly in pursuit of profit and engage with one another in pursuit of this clearly cannot be applied in a domestic context (a marital relationship for example). It appears that the court is interested in the relationship between the parties to a dispute, rather than the subject matter in question. While we will see that any line between commerce and equity may on occasion be blurred in the sense that equitable principles may at times have a role to play, it must be said that a line does exist. This relates to the triggers which will lead to equity’s intervention. While equity can be seen as universally applicable, this is only the case when the relevant requirements are triggered. Further, it seems that in certain cases, such as commercial relationships, it is more difficult to bring about equity’s intervention. The reasoning behind the commercial distinction in equity can, like in contract, be inferred based on the case law.

¹⁸⁷ [2001] UKHL 44; [2002] 2 AC 773.

¹⁸⁸ *ibid* [88] (Lord Nicholls).

¹⁸⁹ *ibid*.

¹⁹⁰ [2005] EWCA Civ 857.

¹⁹¹ *ibid* [42] (Baroness Hale).

¹⁹² [1970] AC 777.

¹⁹³ [1971] AC 886.

¹⁹⁴ *Stack v Dowden* (n 190) [42] (Baroness Hale).

¹⁹⁵ *ibid* [69] (Baroness Hale).

3.6.1 Proprietary Estoppel

The cases which will now be discussed initially concern whether it was appropriate to apply proprietary estoppel. In *Thorner v Major*¹⁹⁶ Lord Walker set out the key elements which must exist for a successful claim in proprietary estoppel. These include ‘a representation or assurance made to the claimant; reliance on it by the claimant; and detriment to the claimant in consequence of his (reasonable) reliance’.¹⁹⁷ Proprietary estoppel will be ‘applicable where one party knowingly encourages another to act, or acquiesces in the other’s actions, to her detriment in the belief that she has, or will have some property right in against the first party’.¹⁹⁸ Estoppel’s flexible nature which offers the potential for unpredictability has been said to be inappropriate in a commercial context.¹⁹⁹ This is because the essential features of the commercial sphere, namely certainty and predictability could be undermined. It has been described as ‘a back-up device, a helping hand within the law where more formal principles cause injustice’.²⁰⁰ Further, *Cobbe v Yeoman’s Row Management Ltd*²⁰¹ set out that the courts should be wary of allowing uncertainty to enter into the realm of commercial agreements.²⁰²

Lord Neuberger has set out that:

[T]he message from the House of Lords is that it is simply not for the courts to go galumphing in, wielding some Denningsque sword of justice, to rescue a miscalculating, improvident or optimistic property developer from the commercially unattractive, or even ruthless, actions of a property owner, which are lawful at common law.²⁰³

Further, where a party is aware that they have ‘no legally enforceable right, is easier to accept in the context of a commercial and arm’s length relationship than in a domestic or familial context’.²⁰⁴ This is because, in a commercial setting, a decision to proceed without a contract in place ‘normally arises from the parties, with easy access to legal advice, considering themselves better off, or at least choosing to take a risk, rather than being bound’.²⁰⁵ He suggests that in order to establish a claim in proprietary estoppel, a claimant is required to demonstrate that ‘he acted in the belief that he has something which can be characterised as a legal right – at least in a commercial arm’s length

¹⁹⁶ *Thorner v Major* [2009] UKHL 18; [2009] 1 WLR 776 [29] (Lord Walker).

¹⁹⁷ *ibid*; See also John McGhee (ed) *Snell’s Equity* (33rd edn Sweet and Maxwell 2015) Para 12-033.

¹⁹⁸ Jamie Glistler and James Lee, *Hanbury and Martin: Modern Equity* (20th edn, Sweet and Maxwell 2015) 873.

¹⁹⁹ Elizabeth Cooke, *The Modern Law of Estoppel* (OUP 2000) 166.

²⁰⁰ *ibid*.

²⁰¹ [2008] 1 WLR 1752.

²⁰² *ibid* [81].

²⁰³ Lord Neuberger, ‘The Stuffing of Minerva’s Owl? Taxonomy and Taxidermy in Equity’ (2009) 68 *Cambridge Law Journal* 537, 541.

²⁰⁴ *ibid*, 542.

²⁰⁵ *ibid*.

context'.²⁰⁶ Further, that the current state of affairs where 'proprietary estoppel will not often assist a claimant in a commercial context ... is probably all to the good'.²⁰⁷ This is because certainty and clarity are of particular importance in the commercial context. As such, judges should not seek to utilise equitable mechanisms which could introduce uncertainty where it is not legitimate to do so.²⁰⁸ It is also worth noting *Motivate Publishing FZ LLC v Hello Ltd*²⁰⁹ which set out that:

[A]ny business in that situation knows it is at risk unless the licence is actually renewed. It was no doubt a sensible business decision for Motivate to enter into contracts for the forthcoming year, but until the renewal had actually been agreed, it was or should have been a decision based on weighing up the risks.²¹⁰

Further, that the claimant's actions had been founded on an assumption relating to this. The defendant was ruled to not be the cause of this assumption.²¹¹ This highlights that commercial parties are assumed to act in line with business common sense. Here a commercial risk was taken, and further, this risk was based on an assumption which was not induced by the defendant. This comes down to bad business practice on the part of the claimant.

There is a view that 'this does not mean ... that the underlying requirements of the claim differ in the commercial context'.²¹² The reason appears to be that in the event that a divide be explicitly referred to, 'it would be necessary to determine the necessarily unstable line between commercial and other cases'.²¹³ This offers further evidence of the blurred line which exists between equity and commerce. Further, we can see a general unwillingness to define what is commercial in equity, much like in contract. It is suggested that there exists the potential that a claim for estoppel made in a commercial context could be successful where a party is assured that a contract is not required by 'a man of his word'.²¹⁴

Generally, a commercial transaction made without a contract is unlikely to be successful in a claim for proprietary estoppel. This is because a contract provides a vehicle for risk moderation in commercial transactions. It functions as insurance against the risk of breach. As Lord Walker set out in *Cobbe v Yeoman's Row Management Ltd*,²¹⁵ a commercial risk was taken with eyes wide open, and the result was unfortunate.²¹⁶ This risk could have been allayed had a contractual agreement

²⁰⁶ *ibid.*

²⁰⁷ *ibid.*

²⁰⁸ *ibid.*

²⁰⁹ [2015] EWHC 1554 (Ch).

²¹⁰ *ibid* [74] (Birss J).

²¹¹ *ibid* [75] (Birss J).

²¹² John McGhee (ed) *Snell's Equity* (33rd edn Sweet and Maxwell 2015) Para 12-041.

²¹³ *ibid.*

²¹⁴ *Ibid*; See also *Lloyd v Dugdale* [2001] EWCA Civ 1754.

²¹⁵ [2008] 1 WLR 1752.

²¹⁶ *Cobbe v Yeoman's Row Management Ltd* (n 201) [91] (Walker LJ).

existed. There must exist ‘exceptional circumstances before a commercial player’s decision to act on the basis of a non-contractual promise can be regarded as reasonable and hence not unduly risky’.²¹⁷ With this in mind, there is suggestion that the decision was made based on the absence of a formality assurance rather than its commercial nature.²¹⁸ Whether this is the case seems irrelevant as it is noted that ‘in commercial contexts, the “formality assurance” is more difficult to establish and so unconscionability is less likely to exist’.²¹⁹ In *Thorner v Major*, the decision in *Cobbe v Yeoman’s Row Management Ltd* was noted to highlight the contrast between the approach of equity to commercial and non-commercial cases. It was outlined that ‘the relationship between the parties in that case was entirely arm’s length and commercial, and the person raising the estoppel was a highly experienced businessman’.²²⁰ While there was potential to enter into a contractual agreement in future, the parties had made a conscious decision not to. Both knew that they were not legally bound.²²¹ The fact that this was expressly acknowledged suggests that the determining factor was the commercial nature of the dispute. The issue of formality assurance seems tangential. In contrast, the ruling in *Thorner v Major* was in favour of proprietary estoppel due to the domestic context in which it was being considered. The importance of weighing up the requirement of certainty of outcomes in commercial dealings, and the need to uphold the fundamental aims of equity was the key consideration. The question is why is this distinction made? In terms of the application of proprietary estoppel, one can infer that the court’s reasoning came down to the type of interest which is being pursued or protected. In brief, *Thorner v Major* concerned a right of a personal nature, while *Cobbe v Yeoman’s Row Management Ltd* concerned an attempt to facilitate commercial gain.

It has been suggested that the approach in *Motivate Publishing FZ LLC v Hello Ltd*²²² ‘makes clear that a court will be slow to interfere with commercial relationships and invoke the promise principle, even where such a relationship is long-standing’.²²³ The ruling in *Baird Textile Holdings Ltd v Marks & Spencer Plc*²²⁴ is cited as additional support. Here, Lord Mance set out that ‘the law should not be ready to seek to fetter business relationships with its own view of what might represent appropriate business conduct, when parties have not chosen, or have not been willing or able, to do so in any identifiable legal terms themselves’.²²⁵ Further, regarding a potential requirement for a belief of the existence legal right in order to raise an estoppel in commercial cases, it is suggested that the court’s

²¹⁷ Elise Bant and Michael Bryan, ‘Fact, Future and Fiction: Risk and Reasonable Reliance in Estoppel’ (2015) *Oxford Journal of Legal Studies* 1, 19.

²¹⁸ Martin Dixon, ‘Confining and defining proprietary estoppel: the role of unconscionability’ (2010) 30 *Legal Studies* 408, 418.

²¹⁹ *ibid*, 418.

²²⁰ *Thorner v Major* (n 196) [96].

²²¹ *ibid* [96] (Lord Neuberger).

²²² *Motivate Publishing FZ LLC v Hello Ltd* (n 209).

²²³ Adam Shaw-Mellors, ‘Proprietary Estoppel and the Enforcement of Promises’ (2015) 6 *The Conveyancer and Property Lawyer* 529, 533.

²²⁴ [2001] EWCA Civ 274; [2002] 1 All ER (Comm) 737.

²²⁵ *ibid* 737 [94] (Mance LJ).

approach in *Motivate Publishing FZ LLC v Hello Ltd* ‘shows that a higher threshold can nevertheless be imposed in the commercial context through the approach taken in *Thorner* without the need to introduce such a “mistaken belief” requirement’.²²⁶ If this is the case then the task at hand would be to analyse the relationship between the parties. This would mean that the underlying principles which apply to raising proprietary estoppel will remain the same but that the commercial context will be a relevant consideration.²²⁷

There has been some suggestion in Australia that these differences should be considered in assessing the reasonableness of any assumption which is made. Also, that this is a matter of context. *Doueihi v Construction Technologies Australia Pty Ltd*²²⁸ demonstrates that the reasonableness of any reliance will depend on the relationship which exists between the parties. Of course, that a relationship is of a commercial nature would contribute to this.²²⁹ Also, in *EK Nominees v Woolworths*²³⁰ it was ruled that EK Nominees were able to expect to be informed of any new proposal relating to a lease. It was held that Woolworths had acted unconscionably in denying EK Nominees’ assumption that the two parties would enter into an agreement for a lease. The result was that EK Nominees was entitled to damages for wasted expenditure. Also, that a representation from Woolworths relating to entering an agreement in future gave rise to an estoppel. This provided EK Nominees with compensation for any expenditure in reliance.²³¹

The doubt over whether a dispute in a commercial context acts as an absolute bar to raising an estoppel is not problematic for the purposes of this discussion. Simply outlining that the commercial nature of a dispute is a consideration, sufficiently demonstrates that on some level they are considered as distinct disputes in a domestic or family context. The fact that a dispute arising in a commercial context will make it far less likely that the courts will allow proprietary estoppel to be raised, illustrates that distinction.

3.6.2 Fiduciary Duties

To provide an additional equitable example, the role of fiduciary duties will now be considered. A fiduciary has been characterised as an individual ‘who owes fiduciary duties, and a fiduciary relationship is a relationship between two or more persons in which one, the fiduciary, owes fiduciary

²²⁶ *Shaw-Mellors* (n 223) 533.

²²⁷ *ibid*, 534.

²²⁸ [2016] NSWCA 105.

²²⁹ *ibid* [175]-[178].

²³⁰ *EK Nominees v Woolworths* [2006] NSWSC 1172; See also Robert Angyal SC, ‘Equitable Estoppel: What must the party asserting an estoppel have been induced to believe by the defendant?’ (2015) 89 Australian Law Journal 220, 224-225.

²³¹ *ibid*.

duties to the other (or others)'.²³² The primary role of a fiduciary is to act for the interests of another, rather than their own or equally, the interests of a third party.²³³ The paradigm example of a fiduciary relationship is that which exists between a trustee and a beneficiary.²³⁴ A fiduciary must act in good faith and with loyalty.²³⁵ It was set out in *Bristol & West Building Society v Mothew*²³⁶ that:

- (i) A fiduciary must act in good faith; (ii) he must not make an unauthorised profit out of his trust; (iii) he must not place himself in a position where his duty and his interest may conflict; (iv) he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.²³⁷

In *Sinclair Investments Ltd v Versailles Trade Finance*,²³⁸ fiduciary obligations, specifically the issue of loyalty was discussed. Lord Millet's appraisal in *Bristol and West Building Society v Mothew* that 'a fiduciary who acts for two principals with potentially conflicting interests without the informed consent of both is in breach of the obligation of undivided loyalty'²³⁹ was noted here.

There is some potential for fiduciary obligations to have a role in certain commercial relationships. This will depend on the surrounding circumstances of the relationship and whether the expectation that one party will act as a fiduciary 'is not inappropriate, then fiduciary duties can and will arise notwithstanding that it is a commercial relationship'.²⁴⁰ Such a relationship would be one whereby a party could legitimately expect another to 'act in that other's interests or ... in their joint interests, to the exclusion of his own several interest'.²⁴¹ This is likely to be the case in relationships such as trusts, agency, partnerships and joint ventures.²⁴² These would 'require a pre-existing relationship with a voluntary undertaking by the fiduciary'.²⁴³ As Conaglen notes, 'company directors act in a commercial context yet owe fiduciary duties to the company, and lawyers and agents frequently act in commercial contexts while owing fiduciary duties to their principals'.²⁴⁴ With this in mind, it is set out that the 'view that fiduciary duties arise when it is legitimate to expect that they will do so provides a means of reconciling these apparently inconsistent perspectives of the appropriateness of

²³² McGhee (n 212) Para 7-003.

²³³ See for example *Arklow investments v Maclean* [2000] 1 WLR 594, 598.

²³⁴ See McGhee (n 212) Para 7-004.

²³⁵ *ibid*, Para 7-008.

²³⁶ [1998] Ch 1.

²³⁷ *ibid*, 18.

²³⁸ *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2012] Ch 453.

²³⁹ *Bristol and West Building Society v Mothew* (n 236) 18.

²⁴⁰ Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart 2011) 267.

²⁴¹ Paul Finn 'Fiduciary Law and the Modern Commercial World' in Ewan McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (OUP 2003 reprint) 9.

²⁴² See A Mason 'The place of equity and equitable remedies in the contemporary common law world' (1994) 110 Law Quarterly Review 238, 245; See also Steven White 'Commercial Relationships and the Burgeoning Fiduciary Principle' (2000) 9 Griffith Law Review 98, 99; A Mason, 'The Place of Equity and Equitable Remedies in the Contemporary Common Law World' (1994) 110 LQR 238, 245.

²⁴³ James Edelman, 'When do Fiduciary Duties Arise?' (2010) 126 LQR 302, 310.

²⁴⁴ Conaglen (n 240) 267.

fiduciary duties in commercial settings'.²⁴⁵ It will be rare for a fiduciary relationship to regulate the contracts entered into by individuals for the overriding reason of a dealing that does not itself form a fiduciary relationship. This is because fiduciary principles 'impose obligations of a different character from ordinary contractual obligations, and they do so with reference to the nature of the relationship between the parties'.²⁴⁶ While many commercial relationships involve a reliance on one party by another, it is important to keep in mind that 'high expectations do not necessarily lead to equitable remedies'.²⁴⁷

A fiduciary must not exploit the relationship for individual gain (by making a secret profit for example). This is said to be what distinguishes a fiduciary relationship from a commercial one.²⁴⁸ It has been made clear that it is important 'not to impose fiduciary obligations on parties to a purely commercial relationship who deal with each other at arms' length and can be expected to look after their own interests'.²⁴⁹ Commercial contracting seems at odds with this principle because the overriding intention of parties is to pursue personal gain in the form of profit.²⁵⁰ An important case on this subject where an agent was liable for account of profit is *Boardman v Phipps*.²⁵¹ Here the agent had in fact placed themselves in a position of a fiduciary nature which presented the agent with an opportunity to make a profit for themselves. By not receiving 'fully informed consent'²⁵² they were in breach of their fiduciary duty.²⁵³

A further example are cases concerning retention of title clauses. Here unpaid sellers retain title in goods until payment all money due to them is paid. They may include all-monies clauses (where property passes when all money is paid), proceeds clauses (where the seller owns the proceeds of sale from the goods supplies) and products clauses (these impact the ownership of items to which the relevant goods are incorporated or added to doing the process of manufacture).²⁵⁴ In *Aluminium Industrie Vaassen BV v Romalpa Aluminium*,²⁵⁵ a fiduciary relationship was deemed to exist because

²⁴⁵ *ibid.*

²⁴⁶ TT Arvind, 'Contract Transactions and Equity' in LA Di Matteo (ed), *Commercial Contract Law: Transatlantic Perspectives* (CUP 2014) 165; See Also *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, 99 where Lord Mustill outlined that 'the essence of a fiduciary relationship is that it creates obligations of a different character from those deriving from the contract itself'.

²⁴⁷ *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, 98.

²⁴⁸ See PJ Millet, 'Equity's place in the law of commerce' (1998) 114 *Law Quarterly Review* 214, 222.

²⁴⁹ *ibid.*, 217-18.

²⁵⁰ See Arvind (n 246) 164: 'Understanding of the contractual context that marks the principal divide between the contractual and equity-based approaches to transactional problems'.

²⁵¹ *Boardman v Phipps* [1967] 2 AC 46.

²⁵² *ibid.*, 109 (Hodson LJ).

²⁵³ The extent of the no profit rule is discussed in Jamie Glister and James Lee, *Hanbury and Martin: Modern Equity* (20th edn, Sweet and Maxwell 2015) 599.

²⁵⁴ See Duncan Sheehan, *The Principles of Personal Property Law* (Hart 2011) 317.

²⁵⁵ [1976] 1 WLR 676: Retention of title clauses are often referred to as "Romalpa" clauses following this case; See also James Davey and Cliona Kelly, 'Romalpa and Contractual Innovation' (2015) 42 *Journal of Law and Society* 358, 370-375.

of the particular conditions of sale. As a result, an obligation was implied into the contract that required the defendants to account for the proceeds of any sub-sales.

The claim is that ‘compelling a commercial party to act not in what he considers to be his interest but in what an honest person would consider the best interests of another sits uncomfortably with what theorists generally believe the role of law in commerce should be about’.²⁵⁶ That is acting in one’s own best interest and a general assumption that parties to the contract will be acting in pursuit of profit. Like the reasoning regarding proprietary estoppel, it appears that different types of relationship will feature different rights, interests and expectations which will require protection and enforcement. As such, context is of paramount importance. Fiduciary duties will be imposed where it is appropriate, and necessary to do so.

3.6.3 Conclusion

What can be concluded based on this brief discussion on equitable devices is that like in contract, there exists a distinction between commercial and non-commercial relationships.²⁵⁷ This supports the assertion that the type of interest which is being pursued or protected will influence the court’s judgment. In cases concerning proprietary estoppel, it is made clear that parties entering into typical arms’ length commercial dealings are considered to be capable of protecting themselves, as well as to understand any risks which they face.²⁵⁸ Context is a key consideration for the court. For example, commercial relationships have consistently been distinguished from those of a familial nature such as that which exists between married couples.²⁵⁹ It can be inferred that the court’s reasoning is informed type of interest which is being pursued or protected. The division concerns rights of a personal nature, versus attempts to make a profit or commercial gain.²⁶⁰ The clearest example of this can be seen in the contrasting decisions of *Cobbe v Yeoman’s Row Management Ltd*²⁶¹ and *Thorner v Major*.²⁶² *Cobbe v Yeoman’s Row Management Ltd* makes it clear that the general approach of the court in respect of commercial cases will be to avoid the type of uncertainty which promissory estoppel is capable of introducing.²⁶³ In this case, the claimant was considered to have taken a commercial risk, and based on his pre-existing industry experience it was reasonable for him to bear

²⁵⁶ Arvind (n 246) 169.

²⁵⁷ See *Royal Bank of Scotland Plc v Etridge* (n 187); See also *Stack v Dowden* (n 190).

²⁵⁸ *ibid*, [88] (Nicholls LJ).

²⁵⁹ See *Stack v Dowden* (n 190); *Pettitt v Pettitt* (n 192); *Gissing v Gissing* (n 193).

²⁶⁰ See *Cobbe v Yeoman’s Row Management Ltd* (n 201) [91]; *Thorner v Major* (n 196).

²⁶¹ *ibid*.

²⁶² *Thorner v Major* (n 196).

²⁶³ *Cobbe v Yeoman’s Row Management Ltd* (n 201) [81]; See also *Motivate Publishing FZ LLC v Hello Ltd* (n 209) [74].

the costs.²⁶⁴ Promissory estoppel was allowed in *Thorner v Major* based on the circumstances and context of the relationship between the parties. In this case it was a family relationship. It is possible that promissory estoppel could be raised in a commercial setting. However, based on the approach which can be seen in the cases noted above, the fact that a relationship is commercial in nature will make this less likely. It is harder to trigger because any non-contractual assurances which may be provided by one party to another would be assessed in part based on the context in which they are made. As we have seen, relying on such an assurance is generally considered to be a business risk which should be shouldered by the party who takes it.

The general position is that fiduciary duties will not apply in commercial relationships except for those which specifically require them. Examples of such commercial relationships may include trusts, agency relationships, partnerships and joint ventures.²⁶⁵ These relationships will feature varying rights, interests and expectations that will require protection and enforcement. As such, context is of paramount importance. It will not be the norm for equity to intervene and impose fiduciary duties in typical commercial relationships. The courts will only impose fiduciary duties where it is appropriate and necessary to do so. We can see that the court will look to utilise equitable mechanisms based on the reasoning behind a claim being brought. Context is a contributing factor in the court's decision-making process and, as such, whether the claim which is being made in a commercial or non-commercial context is a relevant consideration. This is not an absolute bar to their use, but it is quite clear that convincing the courts to trigger them will be more difficult.

3.7 Overall Conclusion

Based on this analysis, there are a number of conclusions which have been outlined. Discussion began by considering literature on the process of judicial decision-making. Next was the work of the American Legal Realists who were focused on context and the potential for the incorporation of non-legal factors such as commercial norms into judicial decision-making. This highlighted the potential that non-legal norms could be a factor in judicial decision-making in commercial cases. However, it is important to bear in mind that in a common law legal system like that of the UK, the importance of precedent cannot be discounted. This is because judges are bound by precedent and are required to follow the rulings of previous courts. They must also adhere to the reasoning which is within those rulings. With this in mind, that reasoning was extracted. It is the wording used in the rulings of the

²⁶⁴ *ibid* [91].

²⁶⁵ See *Boardman v Phipps* (n 251); See also *Re Goldcorp Exchange* (n 247); *Aluminium Industrie Vaassen BV v Romalpa Aluminium* (n 255); Mason (n 242) 245; Steven White 'Commercial Relationships and the Burgeoning Fiduciary Principle' (2000) 9 Griffith Law Review 98, 99.

courts in both commercial and non-commercial cases which has led to the overall conclusions in this chapter. They have allowed the reasoning behind treating commercial contracts as a distinct category to be inferred on the face of that wording.

With these decisions in mind, it appears that on a fundamental level contract law will remain the same whether or not a dispute concerns a commercial contract. What can be inferred from the approaches adopted by the courts is that despite being a part of the same legal construct, it is necessary to interpret commercial contracts differently to those which are not.²⁶⁶ This is required in order to ensure that certainty and predictability in commercial dealing can be guaranteed. This predictability is based on what can be described as commercial norms and practices which are at all times influenced by context. The rationale behind adopting such an approach is based on the type of right which a party is attempting to protect or enforce. When this is done for commercial purposes with the overriding intention of creating profit, the courts will take into account certain factors. These could include commercial reasonableness, as well as industry customs and practices and will influence their interpretation.²⁶⁷

In cases of a non-commercial nature, where a right is being enforced or protected for purely personal ends such as pleasure or enjoyment, the courts will take account of that.²⁶⁸ They will consider personal preferences ahead of what would generally be considered to make commercial sense. Such factors are not considered by the courts in purely commercial cases.²⁶⁹ There is a need for the courts to find balance between these approaches. The reasoning applied in *Ruxley Electronics & Constructions Ltd v Forsyth*²⁷⁰ demonstrates this. There was an acceptance that damages should be paid for loss of amenity, but a refusal to extend this to what would amount to reinstatement or specific performance based on unreasonable cost. Such a cost would have severely impaired the commercial party going forward. With this in mind, there is a claim that ‘in refusing reinstatement on the basis of reasonableness, and in making an award on the basis of a subjective loss of amenity, the judgments are consonant with precedent. In trammelling the extent of the award by reference to an objective standard, the judgments are consonant with principle’.²⁷¹ The objective standard which is being referred to is, of course, reasonableness, while the subjective element concerns the award for loss of amenity. The application of this type of reasoning regarding commercial value and cost of

²⁶⁶ See the awards for loss of amenity in *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129) as well as the “Holiday” cases including *Diesen v Samson* (n 122); *Jarvis v Swans Tours Ltd* (n 111); *Watts v Morrow* (n 116); *Farley v Skinner* (n 118); *Milner v Carnival Plc* (n 106): These can be compared with the approaches in specifically commercial cases such as *The Rozel* (n 54); *The Maersk Colombo* (n 58).

²⁶⁷ On rational commercial purpose see *Fiona Trust & Holding Corp v Privalov* (n 61) [5]-[7]; One ‘business common sense’ see *Antaios Compania Naviera SA v Salen Rederierna AB* (n 63) 201.

²⁶⁸ See *Jarvis v Swans Tours Ltd* [1973] QB 233; *Watts v Morrow* [1991] 1 WLR 1421; *Farley v Skinner* [2001] UKHL 49; *Diesen v Samson* (1971) SLT 49.

²⁶⁹ *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518 [70] (Millet LJ).

²⁷⁰ *Ruxley Electronics & Constructions Ltd v Forsyth* (n 129).

²⁷¹ Rosalind MM McInnes ‘The yellow brick road: Ruxley revisited: Case Comment’ (1998) 14 Construction Law Journal 33, 43.

reinstatement that would be more common within commercial contracting demonstrates a level of discretion which judges utilise in their decision-making.

One could make the claim that assessing damage awards in a commercial context is a simpler process. Commercial settlements consider commercial value, whether this is the reduction in value, the market cost of a replacement or the relevant resale value for example.²⁷² In contrast, non-commercial disputes consider other, often intangible losses. These may include injury to feelings as a result of loss of enjoyment, distress or disappointment.²⁷³ Calculating an award for loss of amenity or for a lost consumer surplus is a difficult task. Despite this, it is something that should be compensated where required. There is a suggestion that there is nothing special about commercial contracts and that they 'are construed in the same way as any other contracts'.²⁷⁴ Staughton suggests four principal tools which the courts will adopt in interpreting contracts. These include, first, the wording of the contract. Second, any surrounding circumstances to which both parties were aware. Third, in the event that absurdity could arise based on the ordinary meaning of wording used, what they could reasonably be likely to mean may be considered. Fourth is the reality and customs of the market.²⁷⁵ That these tools can be adopted is not in dispute. In fact, they are a logical set to utilise. However, if it is accepted that the commercial setting is different, it follows that elements such as the surrounding circumstances, as well as the reality of the market will have an impact on the way that a contract is interpreted. Based on the discussion of case law which considers measures for commercial value,²⁷⁶ commercial reasonableness,²⁷⁷ time for delivery,²⁷⁸ and restraint of trade,²⁷⁹ it is clear that this is the case. When this, as well as the decision in *Ruxley Electronics & Constructions Ltd v Forsyth* is considered, it appears that while it may well be true that there is nothing special about commercial contracts, there is at the very least, something different about them.

Finally, the interest-based approach can also be seen in equity, specifically in the case of proprietary estoppel, as well as in the application of fiduciary duties. Again, there exists a clear distinction between the way a court will treat disputes arising from commercial and non-commercial relationships.²⁸⁰ It is evident that a party who enters into typical commercial dealings are considered

²⁷² *The Rozel* (n 54); *The Maersk Colombo* (n 58); *The Alecos M* (n 59).

²⁷³ See *Beal* (n 104) Para 26-144; *Jarvis v Swans Tours Ltd* (n 111); *Watts v Morrow* (n 116); *Farley v Skinner* (n 118); *Diesen v Samson* (n 122). Other cases include *Jackson v Horizon Holidays Ltd* (n 115); *Jackson v Chrysler Acceptances Ltd* [1978] RTR 474; *Kemp v Intasun Holidays Ltd* [1987] 2 FTLR 234.

²⁷⁴ Sir Christopher Staughton, 'How do the Courts Interpret Commercial Contracts' (1999) 58 Cambridge Law Journal 303.

²⁷⁵ *ibid*, 313.

²⁷⁶ *The Rozel* (n 54); *The Maersk Colombo* (n 58); *The Alecos M* (n 59).

²⁷⁷ See *Antaios Compania Naviera SA v Salen Rederierna AB* (n 63); *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* (n 65); *Society of Lloyd's v Robinson* (n 69); *Rainy Sky SA and others v Kookmin Bank* (n 74).

²⁷⁸ See *The Naxos* (n 79); *Thunderbird Industries Llc v Simoco Digital UK Limited* (n 83).

²⁷⁹ See *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* (n 89).

²⁸⁰ See *Royal Bank of Scotland Plc v Etridge* (n 187); See also *Stack v Dowden* (n 190).

able to protect themselves and to understand any risks which they face.²⁸¹ Contrast this with relationships of a familial nature like those between married couples.²⁸² It can be inferred that the court's reasoning is informed type of interest which is being pursued or protected. The division concerns rights of a personal nature and attempts to make a profit or commercial gain.²⁸³ The clearest example of this can be seen in the contrasting decisions of *Cobbe v Yeoman's Row Management Ltd*²⁸⁴ and *Thorner v Major*.²⁸⁵ *Cobbe v Yeoman's Row Management Ltd* makes it clear that the general approach of the courts in respect of commercial cases will be to avoid the uncertainty which promissory estoppel may introduce.²⁸⁶ In contrast, promissory estoppel was allowed in *Thorner v Major* based on the circumstances and context of the relationship between the parties.²⁸⁷ It is possible that promissory estoppel could be raised in a commercial setting. However, this will be less likely. This is because relying on non-contractual assurances in a commercial setting is considered to be a risk which should be shouldered by the party who chooses to rely on them.²⁸⁸ Note also that fiduciary duties will only be applied by the courts in commercial relationships which specifically require them. Such relationships may include trusts, agency relationships, partnerships and joint ventures for example.²⁸⁹ These types of relationship will feature varying rights, interests and expectations that will require protection and enforcement. As such, whether a claim is being made in a commercial or non-commercial context is of paramount importance and contributes to a court's decision-making process.

With respect to the overarching intention of this thesis, the conclusions reached within this chapter are relevant on the basis that they elucidate the context based approach which is being applied by the court in contract cases. This is in the sense that the interests of the parties involved influence the commercial distinction. This is based on whether they are profit driven, or, of a more personal nature. This distinction, which has been shown to exist, and be routinely applied will be carried forward within the remainder of this thesis. It will be set out that the efficient breach of commercial contracts is legitimate based on the underlying profit generation intent that underpins commercial contracts.

²⁸¹ *ibid* [88] (Nicholls LJ).

²⁸² See *Stack v Dowden* (n 190); *Pettitt v Pettitt* (n 192); *Gissing v Gissing* (n 193).

²⁸³ See *Cobbe v Yeoman's Row Management Ltd* (n 201) [91] (Walker LJ); *Thorner v Major* (n 196).

²⁸⁴ *ibid*.

²⁸⁵ *Thorner v Major* (n 196).

²⁸⁶ *Cobbe v Yeoman's Row Management Ltd* (n 201) [81] (Walker LJ); See also *Motivate Publishing FZ LLC v Hello Ltd* (n 209) [74].

²⁸⁷ *Thorner v Major* (n 196).

²⁸⁸ See *Cobbe v Yeoman's Row Management Ltd* (n 201) [81] (Walker LJ).

²⁸⁹ See *Boardman v Phipps* (n 251); *Re Goldcorp Exchange Ltd* (n 247); *Aluminium Industrie Vaassen BV v Romalpa Aluminium* (n 255); See also Mason (n 242) 245: See also Steven White 'Commercial Relationships and the Burgeoning Fiduciary Principle' (2000) 9 Griffith Law Review 98, 99.

Chapter 4

An Argument against Promise as the Basis of English Contract Law: Allaying Concerns Regarding Efficient Breach in the Commercial Contracting Context

4.1 Introduction

The purpose of this chapter is to demonstrate that broadly deontological concerns regarding efficient breach are not relevant in the commercial setting. Originality stems from the approach that is adopted in order to deal with some of the perceived moral issues surrounding efficient breach of contract. This will involve outlining that the perception that breach of contract is akin to breaking a promise, and thus, morally impermissible, is incorrect. This is on the basis that promising does not form the basis of English contract law and thus, any moral requirements that may be attached to promise making, and breaking, are not applicable. The technicalities or characteristics of an efficient breach will not be discussed in depth here. The intention is to provide a grounding upon which the theory may be applied.

Much of the existing literature that disputes the legitimacy of efficient breach takes the position that it is wrong because it is synonymous with promise breaking. By considering commercial contracting in light of the purpose for which it operates, the moral issues regarding promise breaking will be shown to be inapplicable. This will demonstrate that contracting is treated differently in the commercial sphere, allowing the approach of the courts in commercial disputes to be better understood.

Grounding the claims which this thesis makes regarding the theory of efficient breach by setting out that classically promise based concerns are irrelevant in the commercial context, will allow the legitimacy, as well as the technicalities of the theory's application to be discussed later. This is important because it will aid in demonstrating that contracting is treated differently in the commercial sphere.¹ Further, a grasp of this principle allows the approach of the courts to commercial disputes, and the subsequent remedies to be better understood. The case will be made for the legitimacy of an act consequentialist attitude to breach of contract in the commercial context.² A breach would be

¹ See generally Chapter 2; See also Chapter 3.

² Act consequentialism is concerned with the direct consequences of a particular action. An action will be considered morally right if it creates the maximum level of utility compared to other available options.

efficient (and desirable) where the position of the breaching party after the payment of expectation damages would be preferable to that which would have followed performance.³

It will be set out that a promise and a contract are fundamentally different concepts based on the domain in which they operate. They serve different purposes specific to where they are utilised. As such, it would be inappropriate to consider them as synonymous. This separation is particularly resonant in the case of commercial contracts. The suggestion is that commercial contracts sit separately to non-commercial contracts based on the profit generation focus which underpins them.⁴ As a result, attempts to discount the legitimacy of the theory of efficient breach, as well as its consequentialism-based ideology on the basis that contractual enforceability is built on the promise principle would be flawed. A further issue is when, where, and how the state should intervene through the use of the courts. It will be set out that the state does not seek to enforce contracts in order to uphold private morality. Rather, their intention is to protect reliance on reciprocal exchanges.

Whether the promise principle forms the basis of English contract law on a practical level will then be considered. This involves investigating the development of contract law in a historical sense. This will provide an outline of contract law's development that will then be utilised in order to demonstrate that promise is not in fact a foundational element within English contract law. The key consideration will be the development of English contract law which grew from tortious roots through trespass, debt, covenant and *assumpsit*.⁵ This displays a genesis which does not include the practice of promising. Also, that the additional formalities which are required in order to make a contract enforceable highlight the difference between contract and promise.⁶ It will be set out that in English law, contracting is based on reciprocal exchange rather than the moral power of a promise. It does not protect promises; rather it protects reliance and exchange. This is more in line with harm based torts and compensating for this harm (or loss). With this in mind, it has been outlined that 'an Englishman is liable not because he has made a promise, but because he has made a bargain'.⁷

³ See generally Oliver Wendell Holmes Jr, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995; See also RL Birmingham, 'Breach of Contract, Damage Measures, and Economic Efficiency' (1970) 24 Rutgers Law Review 273; John H Barton, 'The Economic Basis of Damages for Breach of Contract' (1972) 1 The Journal of Legal Studies 277, 300; RA Posner, *Economic Analysis of Law* (1st edn, Little, Brown and Company 1972) 57.

⁴ See 2.8 Overall Conclusion.

⁵ See Ranulf de Glanville, *The treatise on the laws and customs of the realm of England commonly called Glanvill* (GDG Hall ed and tr, New Edited edn, OUP, 2002); See also Sir Frederick Pollock & Frederic William Maitland, *The History of English Law before the time of Edward I* (2nd edn, CUP 1898) 136; SFC Milsom, *The Historical Foundations of the Common Law* (Butterworths 1969); Sir John Baker, *The Oxford History of the Laws of England* (OUP 2003); JH Baker, *An Introduction to English Legal History* (4th edn, OUP 2011); David Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2006).

⁶ See for example AWB Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (OUP 1987).

⁷ MP Furmston, *Cheshire, Fifoot and Furmston's Law of Contract* (16th edn OUP 2012) 41.

To provide some additional context, the development of contract law elsewhere will be considered. This will include Roman law, the development of medieval European contract law, and the canon law. The relevance of this is highlighting that English contract law developed differently to that of continental Europe, which is more in line with holding promise to be a foundational principle. Also, it will be highlighted that claims which suggest that in the 19th century the laws of Europe were imported into English law are unlikely to be correct.⁸ This is due to the process of English legal education at that time. The education of legal practitioners was undertaken within the Inns of Court, a practical setting, rather than in Universities. While Roman law was taught in English universities by the late 19th century, it was not applied to practice.⁹ There will also be a note on the contrast between contract and equity in respect of the formalities which, while they are a pre-requisite in contract, are not in equity. The differing approach to providing remedies for breach of trust will also be highlighted.¹⁰ This will aid in demonstrating that in English law, contract and promise are distinct entities and should be viewed as such.

It will be outlined that English contract law is consequentialist in a positive sense. Following this, it will be necessary to deal with the normative issue at hand and analyse whether this should be case. The contrasting positions of the consequentialist, and deontological outlooks on promise breaking will be set out. Consequentialist ideology aligns with utilitarianism (act utilitarianism) and considers that promises should be kept when doing so will achieve the highest overall level of good.¹¹ This means that the reasoning behind keeping a promise will be based on achieving the best possible consequences.¹² The Deontological view is that keeping a promise is the only acceptable course of action. It is focused on the need to keep an individual promise rather than encouraging ‘the intrinsically good state of affairs of people keeping their promises’.¹³ There will also be a note on aretaic concerns which are based on virtue ethics.

⁸ See for example James Gordley, *Foundations of Private Law* (OUP 2006).

⁹ See JH Baker, *An Introduction to English Legal History* (4th edn, OUP 2011) 161-162; See also Geoffrey Samuel, *A Short Introduction to the Common Law* (Edward Elgar 2013) 74; MH Hoeflich, ‘The Americanization of British legal education in the nineteenth century’ (1987) 8 *The Journal of Legal History* 244, 246; Roy Stuckey, ‘The Evolution of Legal Education in the United States and the United Kingdom: How one system became more faculty oriented while the other became more consumer oriented’ (2004) 6 *Journal of Clinical Legal Education* 101, 108; Andrew Boon and Julian Webb, ‘Legal Education and Training in England and Wales: Back to the Future?’ (2008) 58 *Journal of Legal Education* 79, 82.

¹⁰ See generally John McGhee (ed), *Snell’s Equity* (33rd edn, Sweet & Maxwell 2014); See also Jamie Glistler and James Lee (eds), *Hanbury & Martin: Modern Equity* (20th edn, Sweet & Maxwell 2015).

¹¹ See John Rawls, ‘Two Concepts of Rules’ (1955) 64 *The Philosophical Review* 3, 13.

¹² *ibid*; See also David Ross and Phillip Stratton-Lake, *The Right and the Good* (OUP 2002) 38: ‘Utilitarians say that when a promise ought to be kept it is because the total good to be produced by keeping it is greater than the total good to be produced by breaking it, the former including as its main element the maintenance and strengthening of general mutual confidence, and the latter being greatly diminished by a weakening of this confidence’.

¹³ Stephen Darwall, ‘Agent-Centered Restrictions From the Inside Out’ in Stephen Darwall (ed) *Deontology* (Blackwell 2003) 114.

It will be clear that promissory theories of contracting align with the deontological approach, but that there is a flaw within deontological ideology. This is on the basis that it is at best difficult, and at worst, impossible to judge whether or not an action is good without taking into account its consequences. Also, claims regarding the wrong which exists within promise breaking are based predominantly on their virtuous nature. While these virtues may seem intuitive, it is peculiar that they should form the basis of contractual liability, without the reasoning behind them being articulated. These virtues, as well as the reasoning behind them, should be evidenced, rather than be based on an assertion that they are valid. Framing the discussion of efficient breach that is to follow based on this foundation is an original approach that has not been attempted elsewhere.

It will be concluded that it is incorrect to suggest that the promise principle forms the basis of contractual enforceability in English law. This is based on the domain in which contracting operates. Also, that the application of the theory of efficient breach in any given context requires that the consequentialist approach is adopted. With that in mind, it is essential that consequentialism and an approach focused on wealth maximisation are justified. Ultimately, the consequences which will flow from entering into a contractual agreement provide the reason for doing so. As such, a consequentialism based attitude to contracting is legitimised. This leads to the assertion that an efficient breach in the context of commercial contracting cannot be discounted based on issues of morality which arise from promise breaking.

4.2 What is a Promise and what is a Contract?

There are two predominant approaches which are adopted in terms of defining a contract. They are described as either a promise which is enforced by law, or as an agreement which gives rise to legally enforceable obligations.¹⁴ Before discussing the relationship which exists between a promise and a contract, it is important to outline working definitions for the two. This is on the basis that the argument that will be advanced within this chapter is that the two are distinct entities.

¹⁴ See generally Hugh G Beale (ed), *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 1-014; See also Edwin Peel, *Treitel on The Law of Contract* (14th edn, Sweet & Maxwell 2015) 1-001.

4.2.1 On Promise

Hogg notes that much of the literature which discusses promise and contract does not attempt to provide a definition for “promise”,¹⁵ and that it ‘is a statement by which one person commits to some future beneficial performance or the beneficial withholding of a performance, in favour of another person’.¹⁶ Other definitions include a promise as ‘a commitment or assurance that something will (or will not) be done in future’,¹⁷ or as representing ‘the promisor’s commitment to carry out the initial decision by doing what is promised at some future time despite a subsequent change of mind’.¹⁸ The common theme is that it is an undertaking to carry out future action for another’s benefit.

A promise will normally require an existing relationship between promisor and promisee, meaning that they may trust another.¹⁹ Trust is said to explain why breaking a promise is wrong, as the parties’ commitment to one another is influenced by their relationship.²⁰ It is outlined that ‘promissory relations are open and flexible, providing greater room for moral development’.²¹ Penner sets out that promises are a type of voluntary obligation that ‘enable people to make arrangements and carry on relationships they could not do otherwise, thus allowing people to establish special bonds’.²² Like Raz, Penner also notes that these bonds characterise ‘our relationships with others that we consider valuable’.²³ Scanlon suggests that the obligations which arise from a promise are based on the social practice. Further, that there is a moral judgment placed on breaking, or violating certain norms.²⁴ It is highlighted that Hume considered that such moral judgments are ‘a reaction of impartial disapproval toward acts of promise-breaking, a reaction that reflects our recognition that the institution of promising is in everyone’s interests’.²⁵ Also, that the motivation to keep a promise could be influenced by a variety of factors which include cost, commitment and conditions.²⁶

There is a suggestion that promises play a role in producing trust, which serves to facilitate social coordination and cooperation. However, it seems that without the existence of trust, the moral force

¹⁵ Martin Hogg, *Promises and Contract Law* (CUP 2011) 4; Hogg cites three examples including PS Atiyah, *Promise, Morals, and Law* (OUP 1983) 8; Charles Fried, *Contract as Promise* (Harvard University Press 1981) 9; Dori Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (Hart 2003).

¹⁶ *ibid*, 6.

¹⁷ Henry Mather, *Contract Law and Morality* (Greenwood Press 1999) 1.

¹⁸ E Allan Farnsworth, *Changing Your Mind: The Law of Regretted Decisions* (Yale University Press 1998) 29.

¹⁹ Dori Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (Hart 2003) 11.

²⁰ *ibid*, 20.

²¹ Prince Saprai, ‘Balfour V Balfour and the separation of contract and promise’ (2017) *Legal Studies* 1, 24.

²² JE Penner, ‘Voluntary Obligations and the Scope of the Law of Contract’ (1996) 2 *Legal Theory*, 325, 326.

²³ *ibid*, 325, 326; See also Joseph Raz, ‘Is There a Reason to Keep a Promise’ in Gregory Klass, George Letsas and Prince Saprai (eds) *Philosophical Foundations of Contract Law* (OUP 2014) 64.

²⁴ TM Scanlon, *What We Owe to Each Other* (Harvard University Press 2000) 295-296.

²⁵ *ibid*, 296; See also David Hume, *A Treatise of Human Nature Book III, Part II Section V ‘Of the Obligation of Promise’* (1739).

²⁶ Richard B Brandt, *Facts, Values, and Morality* (CUP 1996) 148.

of promising is diminished. Any requirement to keep a promise is informed by an individual's internal moral conscience. This will mean that any requirement to keep a promise is effectively self-imposed.²⁷ As Hume observed:

Since every new promise imposes a new obligation of morality on the person who promises, and since this new obligation arises from his will; it is one of the most mysterious and incomprehensible operations that can possibly be imagined, and may even be compared to transubstantiation or holy orders, where a certain form of words, along with a certain intention, changes entirely the nature of an external object, and even of a human creature.²⁸

That an obligation arises from the will of promisors may lead to problems regarding enforceability where the promisor finds promise breaking advantageous. There is also a suggestion that 'if promises are ever binding that is because of the value of people having the power to determine (up to a point) the strength of the promised act relative to other interests'.²⁹ Further, that an individual has 'the power intentionally to shape the form of his moral world, to obligate himself to follow certain goals, or to create bonds and alliances with certain people and not others'.³⁰

The key points are that a promise can be defined as an undertaking regarding a future course of action for the benefit of another. They will usually take place within an existing relationship of trust and confidence between promisor and promisee. Finally, whether a promise will be kept is very much contingent on the relationship between the people who are a party to it. With this in mind, it is now necessary to move on to outline the characteristics of a contract. This is to allow the two to be compared.

4.2.2 On Contract

Contracting signals intentions and shared understandings as well as providing the enforceability which promises lack. It requires committing to legal responsibility in the event of non-performance.³¹ They have been described as 'closed and relatively rigid'.³² Enforceability comes from the consent

²⁷ See Steven Shavell, 'Law versus Morality as Regulators of Conduct' (2002) 4 *American Law and Economics Review* 227, 236.

²⁸ David Hume, *A Treatise of Human Nature Book III*, Part II Section V 'Of the Obligation of Promise' (1739).

²⁹ Joseph Raz, 'Is There a Reason to Keep a Promise' in Gregory Klass, George Letsas and Prince Saprai (eds) *Philosophical Foundations of Contract Law* (OUP 2014) 64.

³⁰ Joseph Raz, 'Promises and Obligations' in PMS Hacker and J Raz (eds) *Law, Morality, and Society* (OUP 1977) 228.

³¹ Randy E Barnett, 'Contract is Not Promise; Contract is Consent' in Gregory Klass, George Letsas and Prince Saprai (eds) *Philosophical Foundations of Contract Law* (OUP 2014) 48.

³² Saprai (n 21) 24.

to be legally bound.³³ Consent provides an additional commitment to go alongside any moral requirements.³⁴ This is on the basis that ‘contractual promisors intend to give their promisees not just moral authority but also the legal capacity to compel them to pursue the ends that the contract specifies’.³⁵ As such, contract law can be seen ‘as a mechanism for enforcing an obligation that is morally complete without it’.³⁶ Raz set out that communicating an intention to undertake an obligation ‘does not “produce” an obligation by any form of magic which can then be “intuited”’. Indeed, some such communications do not create any obligation’.³⁷ The claim is that a conception of contracts based on an obligation relies on the perception that actions will only be obligatory if a mandatory rule requires it.³⁸

The obvious question is whether enforceable agreements change the dynamic with regard to promising? Rawls noted that ‘the rules defining promising are not codified, and ... one’s moral thinking of what they are necessarily depends on one’s moral training’.³⁹ Shavell sets out that the threat of a loss of wealth or a custodial sentence outweighs guilt or the disapproval of others.⁴⁰ Also, that there is dilution of the impact of moral sanctions regarding commercial firms.⁴¹ Further, because undesirable conduct (promise breaking) often leads to large private gains, legal sanctions will be required.⁴² A practice’s moral standing may generate the obligation to keep agreements but this is not binding unconditionally or absolutely.⁴³ This suggests that any binding nature of a promise will be based on the relationship between the parties rather than any overarching moral force. Contract could be said to transform a ‘promisor’s choice to perform the promised act into an external object that juridically belongs to the promisee’.⁴⁴ Prior to the contract’s formation, ‘the choice to act in a specific way is a function of the actor’s self-determining agency’.⁴⁵ A contract’s key characteristics are reciprocity, and enforceability.

³³ See for example Randy E Barnett, ‘A Consent Theory of Contract’ (1986) 86 *Columbia Law Review* 269.

³⁴ Barnett (n 31) 48; See also Randy E Barnett, ‘Some Problems with Contract as Promise’ (1992) 77 *Cornell Law Review* 1022.

³⁵ Daniel Markovits, ‘Contract and Collaboration’ (2004) 113 *The Yale Law Journal* 1417, 1449.

³⁶ Ernest J Weinrib, *The Idea of Private Law* (OUP 2012) 52.

³⁷ Raz (n 30) 218.

³⁸ *ibid*, 223.

³⁹ Rawls (n 11) 31.

⁴⁰ Shavell (n 27) 236.

⁴¹ *ibid*, 242.

⁴² *ibid*, 252.

⁴³ Scanlon (n 24) 309-314.

⁴⁴ Weinrib (n 36) 139.

⁴⁵ *ibid*.

4.2.3 Conclusion

Like promises, contracts concern obligations which are undertaken voluntarily, but which are bilateral or multilateral joint ventures requiring collaboration.⁴⁶ This squares with the view that contracts are based on protecting reliance on reciprocal exchange. English contract law developed with this in mind.⁴⁷ As well as signalling intent and highlighting shared understandings, a contract's function is to provide a method to seek a remedy following breach. Enforceability can be seen as additional to any moral commitment which may exist in promising by invoking the legal system through court action. The final contrast between a promise and a contract is that despite both being voluntary, a contract will be reciprocal in nature. These conclusions illustrate a fundamental difference between a promise, and a contract.

4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised

Having outlined the basic difference between a promise, and a contract, the intention here is to analyse the details of their application. It is important to consider the context within which a promise, or a contract is being employed in order to fully understand its normative force. The normative power of a contract will, in a general sense, be different to the normative power of a promise made between friends or relatives for example. As such, any moral force which is embodied within a promise will not necessarily be equivalent to that which exists in contracting. Also, that commercial contracting sits separately to non-commercial contracting.⁴⁸ This is important because where the intention behind a commercial contract will be the generation of profit, a non-commercial contract may have broader intentions such as facilitating pleasure or enjoyment.⁴⁹ The domain within which contracting sits is separate from promises. Contract functions not to ensure the fulfilment of promises, but to protect a party's reliance and expectation.⁵⁰ With this in mind, it has been suggested that 'moral generalities, to the extent that they exist, are at best domain-specific'.⁵¹ This means that moral obligations are not ubiquitous and therefore, must be considered in light of the context in which they are being discussed.

⁴⁶ See James Penner, 'Promises, Agreements, and Contracts' in Gregory Klass; George Letsas; Prince Saprai (eds) *Philosophical Foundations of Contract Law* (OUP 2014) 117-118.

⁴⁷ See Glanville (n 5); See also SFC Milsom, *The Historical Foundations of the Common Law* (Butterworths 1969); Sir John Baker, *The Oxford History of the Laws of England* (OUP 2003); Baker (n 9); David Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2006); Simpson (n 6); Furmston (n 7) 41.

⁴⁸ See Chapters 2 & 3.

⁴⁹ See for example the holiday cases: *Diesen v Samson* (1971) SLT 49; *Jarvis v Swans Tours Ltd* [1973] QB 233; *Watts v Morrow* [1991] 1 WLR 1421; *Farley v Skinner* [2001] UKHL 49; *Milner v Carnival Plc* [2010] EWCA Civ 389; [2010] 3 All ER 701.

⁵⁰ See for example Nathan B Oman, *The Dignity of Commerce* (The University of Chicago Press 2016) 67.

⁵¹ Johan Brannmark, 'Moral Disunitarianism' (2016) 66 *The Philosophical Quarterly* 481, 482.

This is not to suggest that no moral requirement to keep a promise exists. However, there is an obvious problem because despite evidence of distaste for promise breaking, there is difficulty preventing it. Parties look to protect themselves against non-performance, particularly in commercial relationships. This is because:

[A]s commerce (that is, trade, and interaction generally) expands a need arises for a method by which strangers, lacking regular and intimate contact which breeds trust, can bind themselves to actions at a distance ... Making a promise, on Hume's account, is a special, relatively formal, method of undertaking obligations to others, one in which the use of language and formalized devices plays a crucial role.⁵²

As such, it seems reasonable to assert that the prominence of the reciprocal contract results from the problems in enforcing promises.

4.3.1 Understanding Contract Law

It is useful to consider the ultimate aims which contracting seeks to fulfil within the domains in which they exist. An effective way to understand contract law is to consider which system of rules will contribute to the best consequences within a particular setting. Goodin suggests that utilising utilitarian ideology in a decision making capacity is potentially legitimate when we consider who is tasked with utilising that approach to reach a decision, the context and circumstances in which that decision is being made, as well as the purpose and aims of the decision.⁵³ By applying this methodology to commercial contracting we can see where a utilitarian (or consequentialist) approach could be utilised legitimately. Due to the overriding profit generation intention which underpins commercial contracting, a broadly act utilitarian (or act consequentialist) approach will be justifiable. This feeds naturally into the overarching claim which this thesis seeks to advance regarding the legitimacy of the efficient breach of commercial contracts.

4.3.2 The Role of the State

Questions could also be asked regarding when, and where the state should be expected to intervene through the use of the courts. It is clear that the keeping of promises between private individuals is

⁵² See Gerald J Postema, *Bentham and the Common Law Tradition* (OUP 1986) 85; See also Hume (Treatise 515-20 and Treatise 519-20).

⁵³ Robert E Goodin, *Utilitarianism as a Public Philosophy* (CUP 1995) 61.

not an issue which the state will be required to intervene on. Mill set out that ‘the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others’.⁵⁴ It is not for the state to uphold a particular standard of private morality. Contractual actions in court are intended only to ensure that interests in reciprocal exchanges which have been contracted for are protected.

4.3.3 Conclusion

It is the case that the domain within which contracting sits is separate to that of promises. Contracting functions to invoke reliance where there is not necessarily a pre-existing relationship of trust and confidence between parties. This is particularly salient in commercial contracting. As Atiyah suggested, ‘philosophers who still write about the duty to keep promises with the high moral tone that one often finds (for example in Ross, Hare, Hart, Warnock, or Rawls) appear to be reflecting the moral attitudes of the last century rather than those of the present day’.⁵⁵

4.4 The Historical Development of English Contract Law

Having set out that promise and contract are distinct on a modern sense, it is now necessary to assess whether there is any legitimacy to claims that the English law of contract grew from promising. To achieve this, the development of English contract law in a historical sense will be discussed. There is a suggestion that legal principles which originated elsewhere and which featured promise as a key feature were imported into the English law of contract.⁵⁶ However, it will be outlined that English contract law is rooted in tort, more specifically in trespass.⁵⁷ As such, compensation is awarded to reflect harm (or loss) suffered with the intention of placing the injured party, so far as is possible, in the position that they would have been in had the contract been performed.⁵⁸ Also that it developed with a focus on reciprocity.⁵⁹ This will aid in demonstrating further that the perceived likeness

⁵⁴ See John Gray and GW Smith, *JS Mill's On Liberty in Focus* (Routledge 1991) 30.

⁵⁵ PS Atiyah, *Promises, Morals, and Law* (OUP 1983) 139.

⁵⁶ See James Gordley, *The Philosophical Origins of Modern Contract Doctrine* (Clarendon 1991) 161.

⁵⁷ David Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2006) 130: See generally Sir Frederick Pollock & Frederic William Maitland, *The History of English Law before the time of Edward I* (2nd edn, CUP 1898) 184.

⁵⁸ See Beale (n 14) 26-001; See also *Robinson v Harman* (1848) 1 Ex. 850, 855; *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Blackburn LJ).

⁵⁹ See generally Glanville (n 5); See also SFC Milsom, *The Historical Foundations of the Common Law* (Butterworths, London, 1969); Sir John Baker, *The Oxford History of the Laws of England* (OUP, 2003); Baker (n 9); Ibbetson (n 57); Simpson (n 6); Furmston (n 7) 41.

between promise, and contract is unfounded, and thus, that moral impermissibility arguments raised to counter the theory of efficient breach based on that likeness cannot be applied, at least in the commercial context.

4.4.1 English Contract Law's Tortious Roots

Baker notes that because the common law was based on precedent from the very beginning, the first book (or treatise) written on the subject written between 1187 and 1189 was 'a compilation of writs with an account of the procedures which they initiated'.⁶⁰ Based on this it seems that the logical starting point is the law surrounding debt. A writ of debt was employable in contractual contexts and allowed that a contractor had the potential to receive compensation for the defendant's wrong.⁶¹ Glanville noted that 'the cause of the debt may be loan for consumption, or sale, or loan for use, or letting, or deposit or any other just cause of indebtedness'.⁶² It is suggested that 'Glanville's writ of debt was sufficiently flexible to encompass claims to specific chattels as well as goods and money'.⁶³ It is the case that 'in its earliest form, the action of trespass had the capacity to deal with breaches of contract'.⁶⁴ This is based on harm committed by one party against another.

4.4.2 The Action of Covenant

The next phase of development took place in the thirteenth century which saw the emergence of the action of covenant.⁶⁵ These were much like in modern day contractual disputes.⁶⁶ They have been said to occupy a 'niche between the entitlement-based action of debt and the loss-based action of trespass'.⁶⁷ By the fourteenth century, a deed under seal was required to bring an action of covenant in the King's courts, meaning that an action of covenant was barred in cases of informal contracts.⁶⁸ In the case of informal contracts, another form of action was required, namely an action in debt which

⁶⁰ Baker (n 9) 175; Glanville (n 5).

⁶¹ Ibbetson (n 57) 33.

⁶² Glanville (n 5)117; See generally Sir Frederick Pollock & Frederic William Maitland, *The History of English Law before the time of Edward I* (2nd edn, CUP 1898) 136.

⁶³ Ibbetson (n 57) 20; See also Baker (n 9); 321; See also Warren Swain, 'Contract as Promise: The Role of Promising in the Law of Contract. An Historical Account' (2013) 17 *Edinburgh Law Review* 1, 8.

⁶⁴ *ibid*, 21.

⁶⁵ *ibid*; See also Baker (n 9) 318; Warren Swain, 'Contract as Promise: The Role of Promising in the Law of Contract. An Historical Account' (2013) 17 *Edinburgh Law Review* 1, 8.

⁶⁶ SFC Milsom, *The Historical Foundations of the Common Law* (Butterworths 1969) 213.

⁶⁷ Ibbetson (n 57) 22.

⁶⁸ Milsom (n 66) 214; See also *De Wetenhale v Arden* (1346) YB Edw III (RS Part II) 148 in AKR Kiralfy, *A Source Book of English Law* (Sweet & Maxwell 1957) 181–183.

did not require the support of a document under seal.⁶⁹ This change has been said to have led to the action of covenant falling into disuse by the close of the fourteenth century.⁷⁰ This is clear evidence of a growing need to ensure that an action could successfully be brought.

4.4.3 The Action in Assumpsit

Following the action of covenant was the action in assumpsit. This could be brought in order to recover damages following a breach of an assumpsit (or contract) where a plaintiff could demonstrate that they had entered into an agreement with the defendant. It is outlined that assumpsit was ‘not treated as basing the action upon contract, but as one of the elements leading up to damage to the plaintiff’s person or property’.⁷¹ This meant that ‘the defendant undertook to do something, and did it so badly that the plaintiff, who had relied upon the undertaking, suffered damage at the hands of the defendant’.⁷² Furthermore, assumpsit ‘was primarily meant to fix a tortious liability on the defendant’.⁷³ Importantly, simply promising to do something did not render the defendant liable.⁷⁴ There are two key points to note here. First, that entering into an agreement had to be evidenced, meaning that where ‘there was written evidence of a contract, in the form of a document under seal, there were few theoretical obstacles to liability’.⁷⁵ Second, the law was only concerned with reciprocal relationships.⁷⁶ Baker set out that an action of assumpsit would be ‘founded on mutual promises, and therefore places the emergence of a consensual view of contract quite close to the first establishment of assumpsit for nonfeasance’.⁷⁷ This further illustrates the growing need to utilise formal measures in order to show that the agreement was enforceable. Focus was placed on reciprocal, rather than gratuitous or unilateral agreements.

By the middle of the sixteenth century the promise was formally separated from the contract as ‘the King’s Bench held that this subsequent promise might be an empty fiction, and that the plaintiff was entitled to judgment if the jury was satisfied that a contract had been made’.⁷⁸ Following *Slade’s*

⁶⁹ *ibid*, 215

⁷⁰ Ibbetson (n 57) 28.

⁷¹ Theodore FT Plucknett, *A Concise History of the Law* (5th edn, Little, Brown and Company 1956) 638.

⁷² *ibid*.

⁷³ *ibid*, 639; See also Simpson (n 6) 199; James Oldham, *English Common Law in the Age of Mansfield* (University of North Carolina Press 2004) 80; Beale (n 14) 1-146.

⁷⁴ Warren Swain, ‘Contract as promise: the role of promising in the law of contract. An historical account’ (2013) 17 *Edinburgh Law Review* 1, 11.

⁷⁵ Sir John Baker, *The Oxford History of the Laws of England* (OUP 2003) 814.

⁷⁶ Ibbetson (n 57) 71.

⁷⁷ Baker (n 75) 846; See also Baker (n 9) 333-337; Plucknett (n 71) 643; Swain (n 74) 11.

⁷⁸ Ibbetson (n 57) 138.

case,⁷⁹ the action of assumpsit was based on promise but ‘only in the weakest sense of the word’.⁸⁰ “Promise” simply denoted that it was a voluntary undertaking. The result was that ‘by separating the promise from the underlying obligation it was possible to meet the objection that debt, which was referable only to the underlying contract, was the appropriate form of action’.⁸¹ As such, assumpsit which began its life as an action in trespass moved towards consensual contract.⁸² This is important as it demonstrates that in reality, the role of promise within English contract law is a minor one.

4.4.4 The Role of Consideration

Contract’s reciprocal nature is evidenced by the growing importance of consideration.⁸³ This is the next key stage of English contract law’s development which must be considered. Ibbetson highlights that informal contracts were only enforceable in medieval law when they were reciprocal in nature. This was ‘the very essence of the idea of contract’.⁸⁴ In the sixteenth and seventeenth century there existed a different common law of contract in respect of the requirement for consideration to that which can be seen today.⁸⁵ Simpson highlighted that there was at this time ‘a firm association between the action of assumpsit and the need to aver consideration in the pleadings’.⁸⁶ Blackstone noted that some sort of consideration was ‘absolutely necessary to the forming of a contract, that a nudum pactum or agreement to do or pay anything on one side, without any compensation on the other, is totally void in law’.⁸⁷ A promise would not be binding, thus creating no obligation without proper reason or motive.⁸⁸ Examples of consideration could include land, chattels, and services.⁸⁹

Atiyah suggested that consideration was pivotal in creating an obligation, while promise was less of a concern.⁹⁰ Two sided agreements would be enforced by the common law.⁹¹ Farnsworth sets out that contract law would generally only acknowledge two legal bases for enforcement. These included the formality of the seal, and the doctrine of consideration. The two were intended to distinguish

⁷⁹ *Slade’s case* 1602 4 Co Rep 9a.

⁸⁰ Ibbetson (n 57) 138; See also *Slade’s case* 1602 4 Co Rep 9a.

⁸¹ Swain (n 74) 10.

⁸² Milsom (n 66) 279.

⁸³ Hogg (n 15) 120; See also Ibbetson (n 57) 142; K Zweigert and H Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn OUP 1998) 373.

⁸⁴ See Ibbetson (n 57) 141.

⁸⁵ See PS Atiyah, *The Rise and Fall of Freedom of Contract* (Reprint edn, OUP 2003) 140; See also Baker (n 9) 339.

⁸⁶ Simpson (n 6) 406.

⁸⁷ Sir William Blackstone, *Commentaries on the Laws of England* (Clarendon Press 1769) 445.

⁸⁸ Atiyah (n 85) 140; See also *Golding’s Case* (1586) 2 Leon 72.

⁸⁹ AWB Simpson, *Assumpsit and the Doctrine of Consideration* (Clarendon 1987) 416; See also Simpson (n 6) 412.

⁹⁰ Atiyah (n 85) 140.

⁹¹ Simpson (n 6) 416.

effective transactions from those which are not.⁹² Fuller noted that the use of formalities such as consideration had three key functions. An evidentiary function, a cautionary function (effectively a check against inconsiderate action), and a channelling function (such as using a seal to formalise a promise).⁹³ The seal insured ‘a satisfactory memorial of the promise and induces deliberation in the making of it. It serves also to mark or signalize the enforceable promise; it furnishes a simple and external test of enforceability’.⁹⁴ This extended to the commercial sphere as a business person who wished to make a promise binding could utilise the seal.⁹⁵ This demonstrates the importance of ensuring that commercial transactions were enforceable, a theme that continues today.

Based on its historical development, it is clear is that reciprocal exchange, rather than promise forms the basis of English contract law. This is demonstrated by way which formal measures, particularly the doctrine of consideration function.⁹⁶ With the development of English contract law outlined, the next issue for discussion is its contrast with civil law systems. This is done order to outline that English contract law is fundamentally distinct in terms of its characteristics regarding compensation, namely its focus on damage that is caused.

4.4.5 A Contrast between Common Law and Civil Law Systems

There is a contrast between contract law in the English common law and contract law in civil legal systems.⁹⁷ English law is based on precedent, while civil law systems utilise a codified framework.⁹⁸ This is borne out when claims breach of contract are considered in respect of the type of interest which is protected. The issue is whether it is the damage that is suffered, or the interest in performance which is compensated. It is set out that ‘in both German and French law ... a contractor is in principle entitled to demand that his contract be performed in specie’.⁹⁹ In German law, a creditor may ‘bring a claim for performance of a contract and to obtain a judgment ordering the debtor to

⁹² Farnsworth (n 18) 44-45.

⁹³ LL Fuller, ‘Consideration and Form’ (1941) 41 Columbia Law Review 799, 800; See also K Zweigert and H Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn OUP 1998) 367.

⁹⁴ *ibid*, 800-801.

⁹⁵ *ibid*.

⁹⁶ Anne De Moor, ‘Are Contracts Promises’ in John Eekelaar and John Bell (eds) *Oxford Essays in Jurisprudence* (OUP 1987) 123; cf Henry Winthrop Ballantine, ‘Is the Doctrine of Consideration Senseless and Illogical?’ (1913) 11 Michigan Law Review 423; Lord Wright, ‘Ought the Doctrine of Consideration to Be Abolished from the Common Law?’ (1936) 49 Harvard Law Review 1225; Andrew Burrows, *Understanding the Law of Obligations* (Hart 1998) 197.

⁹⁷ See generally RC Van Caenegem, *Judges, Legislators and Professors: Chapters in European Legal History* (CUP 1987) 113; See also Manlio Bellomo, *The Common Legal Past of Europe: 1000-1800* (The Catholic University of America Press 1995) 223; JH Gebhardt ‘Pacta Sunt Servanda’ (1947) 10 MLR 159.

⁹⁸ For a general outline on how these systems operate see H Patrick Glenn, *Legal Traditions of the World* (OUP 2004).

⁹⁹ K Zweigert and H Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn OUP 1998) 479; See also Section 241 of the German Civil Code and Article 1184 of the French Civil Code.

fulfil it',¹⁰⁰ though this can only be ordered where performance is still possible. The French civil code outlines that 'a party to a synallagmatic contract who has not received what he was promised is entitled to demand resolution of the contract and damages or "to require the other to perform the agreement in so far as that is still possible"'.¹⁰¹

There has been a recent reform of French civil code relating to contract.¹⁰² It is suggested that this was done due to a lack of clarity within the code, as well as because French law was viewed as commercially unattractive.¹⁰³ The reforms are said to affirm the centrality of specific performance as a remedy within the French system. Note though that this had 'been construed by the courts restrictively as only applying to obligations which were personal in character'.¹⁰⁴ Specific performance will now not be available if there is a 'disproportion between its cost to the promisor and the benefit to the promisee'.¹⁰⁵ Previously a contract breaker could not avoid performance based 'on grounds of proportionality or reasonableness'.¹⁰⁶ This is said to bring about some level of alignment with the English system 'where specific performance is granted only exceptionally, the remedy will be refused if it would cause undue hardship to the defaulting promisor'.¹⁰⁷

In English law 'the innocent party's only right, in general, is to bring a claim for breach of contract, a claim which is historically derived from the tort remedy of trespass and which always leads to monetary compensation or damages'.¹⁰⁸ An award will customarily reflect any disparity between the contract price and market value.¹⁰⁹ There is also a suggestion that in English law there is no legal, or moral reason to perform a contract, only that there may be a duty to provide compensation in the event of breach.¹¹⁰ There are limitations placed on damage awards based on reasonableness, mitigation, and rules limiting the compensation of non-pecuniary losses. Contrast this with French law where 'there is no such requirement of reasonableness, non-pecuniary loss is widely compensated, and there is no doctrine of mitigation'.¹¹¹ The suggestion is that the reasons for this difference in approach in French law include 'the binding force of contract, incentivizing performance, the desire for transactional security, and the principle of full compensation'.¹¹² Also,

¹⁰⁰ *ibid*, 472.

¹⁰¹ *ibid*, 475.

¹⁰² Solène Rowan, 'The New French Law of Contract' (2017) 66 ICLQ 805; See also John Cartwright, *The Code Napoléon Rewritten: French Contract Law after the 2016 Reforms* (Hart 2017).

¹⁰³ *ibid*, 807-809.

¹⁰⁴ *ibid*, 821; See also Articles 1217 and 1221 of the French Civil Code.

¹⁰⁵ Article 1221 of the French Civil Code.

¹⁰⁶ Rowan (n 102) 821-822; See also Solène Rowan, *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance* (OUP 2012) 37-52.

¹⁰⁷ *ibid*, 822.

¹⁰⁸ Zweigert and Kötz (n 99) 479.

¹⁰⁹ JH Gebhardt 'Pacta Sunt Servanda' (1947) 10 MLR 159, 162.

¹¹⁰ *ibid*, 167-168.

¹¹¹ Solène Rowan, *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance* (OUP 2012) 166.

¹¹² *ibid*, 240.

that breach is considered to be reprehensible and that ‘French law is morality-orientated’.¹¹³ It is noted that because ‘English contract law has historically developed in a very commercial context, it is the product of commercial consciousness and pragmatism’.¹¹⁴ Further, that this may explain the reasoning behind the limitations placed on damage awards.¹¹⁵ These include the requirement to mitigate, meaning that ‘a claimant cannot recover for losses which he could have avoided by taking reasonable steps’.¹¹⁶ Also, the rule on remoteness means that only losses which arise in the usual course of dealing or which were contemplatable by the parties at the time will be recoverable.¹¹⁷ Finally, after the ruling in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)*¹¹⁸ a claimant will be unable to claim for losses for which the defendant could not reasonably be assumed to have taken responsibility for.

4.4.6 Conclusion

English contract law’s development started in tort where compensation is awarded in respect of harm (or loss) suffered, rather than in respect of the performance that should have been rendered. It has developed with reciprocity in mind.¹¹⁹ Based on the roots which are tort based, English contract law is detached from promise. This is unlike the contract law of other jurisdictions which feature promise as a foundational principle. The result is that English contract law features a consequentialist nature in a positive sense. This is visible with respect to assessing damages for breach of contract. Awards of damages are intended to provide compensation for any damage, loss, or injury suffered as a result of a breach. The intention is to place an injured party in the position which they would have been in had the contract been performed, in so far as far as is possible.¹²⁰

¹¹³ *ibid.*

¹¹⁴ *ibid.*

¹¹⁵ See Beale (n 14) 26-002.

¹¹⁶ *ibid.*, 26-079.

¹¹⁷ *ibid.*, 26-107; See also *Hadley v Baxendale* (1854) 9 Ex 341.

¹¹⁸ [2009] 1 AC 61.

¹¹⁹ See Glanville (n 5); See also Milsom (n 66); Baker (n 75); Baker (n 9); Ibbetson (n 57); Simpson (n 6); Furmston (n 7) 41.

¹²⁰ See Beale (n 14) 26-001; See also *Robinson v Harman* (1848) 1 Ex. 850, 855; *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Blackburn LJ).

4.5 The Historical Development of Contract Law Elsewhere

The next step will be to look at the development of contract law elsewhere. This is because contract law in other jurisdictions developed differently to English contract law. References are made to promising as well as the requirement that something was added to it to allow enforceability. This has relevance as it has been argued that English contract law has been influenced by the development of contract in Roman law, continental Europe, and the canon law.¹²¹ Also, based on the legal training process which was employed at this time, it is unlikely that English contract law was influenced by outside sources. The relevance of this discussion comes in reaffirming that English contract law developed in a way which did not feature promise as a foundational influence.

4.5.1 Roman Law

In Roman law, promise is said to have formed the basis of the *stipulatio*.¹²² It required a request for a promise to act in a particular way, followed by providing further consent in a formal manner.¹²³ This could include ‘writing down an agreement, signing that agreement, shaking hands, registration in some central archive, or even using the word “contract”’.¹²⁴ It is notable that this ‘insistence on question and answer with the characteristic repetition of at least a key word (the verb) also make it abundantly clear when a contract had in actual fact been concluded’.¹²⁵ The formality served an important purpose, ensuring that the party who was to incur the obligation was aware of what was going to happen and allowing for it to be seriously considered.¹²⁶ Also, an agreement in writing would provide clarity, as well providing a source of evidence.¹²⁷

¹²¹ See Reinhard Zimmerman, ‘Roman Law and European Culture’ (2007) *New Zealand Law Review* 341, 369-370: Citing Baker (n 9) 29.

¹²² Hogg (n 15) 115; See generally WF Harvey, *A brief digest of the Roman law of contracts* (Oxford J Thornton 1878); Gordley (n 56); Andrew M Riggsby, *Roman Law and the legal world of the Romans* (CUP 2010); James Gordley, ‘The Method of the Roman Jurists’ (2013) 87 *Tulane Law Review* 933; Swain (n 74) 5-6.

¹²³ See Gordley (n 56) 31; See also James Gordley, *Foundations of Private Law* (OUP 2006) 290; Andrew M Riggsby, *Roman Law and the legal world of the Romans* (CUP 2010) 122; Reinhard Zimmerman, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (OUP 1996) 68; Peter Birks and Eric Descheemaeker, *The Roman Law of Obligations* (OUP 2014) 53.

¹²⁴ Andrew M Riggsby, *Roman Law and the legal world of the Romans* (CUP 2010) 122.

¹²⁵ Reinhard Zimmerman, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (OUP 1996) 69.

¹²⁶ Peter Birks and Eric Descheemaeker, *The Roman Law of Obligations* (OUP 2014) 35.

¹²⁷ *ibid.*

4.5.2 European Contract Law

The next area of interest is its development in continental Europe.¹²⁸ Here relevant jurists and philosophers drew on the work of Aristotle who had characterised such transactions as sales and leases ‘as acts of “voluntary commutative justice”. The transaction was just when the value of what each party gave equalled that of what he received’.¹²⁹ In contrast, acts of liberality concerned ‘giving resources to enrich another person’.¹³⁰ Aristotle set out that a system of distributive justice would secure a fair share of resources amongst citizens. It followed then that commutative or corrective justice would serve to protect that share.¹³¹ Further, that ‘if one person takes or destroys what belongs to another, commutative justice requires that an equivalent amount be paid as compensation’.¹³² A number of medieval jurists and philosophers are considered to have drawn on this approach in formulating their ideas of contract law. These include Thomas Aquinas in the thirteenth century, as well as the late scholastics (or Spanish natural law school) who, during the sixteenth century are said to have ‘rebuilt the Roman law in force in their day on Aristotelian principles’.¹³³ In addition, Tomasso di Vio (or Cajetan) claimed that an individual who was promised a gift could not demand that the promise was kept because making a gift was a matter of liberality.

The Aristotelian distinction is important because in the case of commutative justice the object is to protect an individual party’s share of a particular resource. In the case of a gift, a ‘refusal to perform leaves the disappointed party no worse off than if the promise had never been made’.¹³⁴ It is suggested that much like the late scholastics, Molina was of the view that contract rules in the Roman tradition were matters of positive law which required formality on occasion; however, it was possible, in principle to ‘transfer a right to another by indicating one’s intention to do so’.¹³⁵ They distinguished contracts of reciprocal interest from liberalities in the same way as Roman law.¹³⁶ Pufendorf is said to have believed that a binding promise required acceptance, as well as a visible sign on consent.¹³⁷ However, it was noted that written evidence was a ‘much stronger security, both against

¹²⁸ See generally Swain (n 74).

¹²⁹ Gordley (n 8) 292: Citing Aristotle’s *Nicomachean Ethics* V.iv 1130.

¹³⁰ *ibid.*

¹³¹ James Gordley, ‘Enforcing Promises’ (1995) 83 *California Law Review* 547, 549: Citing Aristotle’s *Nicomachean Ethics* V.ii 1131-1132.

¹³² *ibid.*

¹³³ *ibid.*, 551; See also JB Moyle, *The Institutes of Justinian Translated into English* (5th edn, Clarendon 1913); St. Thomas Aquinas, *The Collected Works of St. Thomas Aquinas* (FR Larcher tr, IntelLex Corporation 1993); Bernard McGinn, *Thomas Aquinas’s Summa theologiae: A Biography* (Princeton University Press 2014).

¹³⁴ Gordley (n 8) 293.

¹³⁵ Gordley (n 131) 557.

¹³⁶ *ibid.*, 557.

¹³⁷ Swain (n 74) 13.

forgetfulness, and against unfaithfulness'.¹³⁸ Grotius made a distinction between a contract and a promise in setting out that 'contract is something more than promise. Promise has indeed the consequence that it is improper not to perform what is promised, but does not give another party any right to accept the same'.¹³⁹ French jurists Domat and Pothier also utilised this distinction setting out that it 'meant more than the tautology that a party either does or does not receive back something in return for what he gives'.¹⁴⁰ They viewed a gratuitous contract as one whereby a 'donor must actually intend to benefit the other party, and if he does not, the contract is not a gratuitous contract whatever the documents to which the parties subscribed may say'.¹⁴¹ They believed that any rules which purport to govern the obligations of parties to an agreement should be dependent on the type of agreement which they entered into. Rules governing an exchange would be intended to ensure that 'each party receives an equivalent, and in the case of a gratuitous contract, that the donor behaves sensibly'.¹⁴²

The legal scholars of continental Europe carried through the distinction which Aristotle applied to different types of transaction. Where acts of commutative justice included bargains or exchanges, acts of liberality concerned gifts. The development of this area of law came about differently to that which took place in England. While there is a distinction between enforceable and unenforceable agreements, it seems more likely that, like in Roman law, the contract law of continental Europe could have grown out of promise. This was not the case in English contract law.

4.5.3 The Canon Law

The next consideration is the canon law, which featured a focus on promises.¹⁴³ The canon law has also influenced English equity with a focus being placed on fairness and morality.¹⁴⁴ In Canon law courts common law practitioners had no right of audience.¹⁴⁵ The practitioners who operated within

¹³⁸ Samuel Von Pufendorf, *Of the Law of Nature and Nations*: Book III, VI, 26 (B Kennet tr, 4th edn 1729); See also Swain (n 74) 13.

¹³⁹ H Grotius, *The Jurisprudence of Holland* (RW Lee tr, 1926) Book III, I, 10; See also Swain (n 74) 13.

¹⁴⁰ James Gordley and Arthur Taylor Von Mahren, *An Introduction to the Comparative Study of Private Law* (CUP 2006) 416.

¹⁴¹ *ibid.*

¹⁴² *ibid.*

¹⁴³ See Charles P Sherman, 'A Brief History of Medieval Roman Canon Law in England' *University of Pennsylvania Law Review* 233, 246. It is set out that they heard cases concerning 'matters of ecclesiastical economy; church property; ecclesiastical dues and tithes; marriage; divorce; legitimation; testate and intestate successions of personal property; contracts involving pledge of faith or oath; various crimes and torts'.

¹⁴⁴ See Richard Hedlund, 'The Theological Foundations of Equity's Conscience' (2015) 4 *Oxford Journal of Law and Religion* 119, 123; See also Timothy Haskett, 'The Medieval English Court of Chancery' (1996) 14 *Law and History Review* 245, 247; Jack Moser, 'The Secularization of Equity' (1997) 26 *Capital University Law Review* 483, 92.

¹⁴⁵ See Peter Stein, *Roman Law in European History* (CUP 1999) 88.

these courts did so within the Doctors' Commons, which was the equivalent of the Inns of Court.¹⁴⁶ Medieval canon lawyers viewed breaking a promise as a wrong and as such, an action could be brought before a canon law court.¹⁴⁷ When an oath was added to a promise, "spiritual jurisdiction" could be utilised in order to enforce it leading to a situation where 'the courts of the English church came to exercise a very considerable jurisdiction over promises coupled with an oath'.¹⁴⁸ This addition served to make a promise enforceable. In terms of a remedy, the courts would make order to "unbreach" that faith which was achieved not through specific performance, but through the payment of a sum of money.¹⁴⁹ Note that as time moved on, the jurisdiction which the church held over promises disappeared. This began in the late fifteenth century and was effectively complete by the 1530s.¹⁵⁰ This demonstrates a clear role for promise within canon law. However, it is again clear that a promise alone was not enough to attract the involvement of a canon law court. In this case, an "oath" was added in order that the promise in question would become enforceable.

4.5.4 Conclusion

The importance of discussing elements of Roman law, European contract law and the canon law is based on the suggestion that they have influenced English contract law.¹⁵¹ It is true that Roman law was taught at the Universities of Oxford and Cambridge.¹⁵² However, it is important to keep in mind that in England, legal practitioners were not educated in a university setting as is the case today. The 'English professional structure was wholly independent of the university law faculties, where only canon law and Roman Civil law were taught, and this ... ensured the autonomous character of English law and its isolation from the influence of Continental jurisprudence'.¹⁵³ Rather, these legal practitioners were trained at the Inns of Court.¹⁵⁴ This approach to legal education did not begin to

¹⁴⁶ *ibid*; See also GD Squibb, *Doctor's Commons: A History of the College of Advocates and Doctors of Law* (Clarendon 1877); William Senior, *Doctors' Commons and the Old Court of Admiralty* (Longmans, Green and Co 1922).

¹⁴⁷ Gordley (n 8) 291.

¹⁴⁸ RH Helmholz and JH Baker, *The Oxford History of the Laws of England: The Canon law and Ecclesiastical Jurisdiction from 597 to the 1640s Volume I* (OUP 2004) 359-362; See also Charles P Sherman, 'A Brief History of Medieval Roman Canon Law in England' (1920) 68 *University of Pennsylvania Law Review* 233, 253; Ibbetson (n 57) 136.

¹⁴⁹ *ibid*, 365.

¹⁵⁰ *ibid*, 368.

¹⁵¹ See Zimmerman (n 121) 369-370: Citing Baker (n 9) 29.

¹⁵² See Baker (n 9) 170-172.

¹⁵³ *ibid*, 154.

¹⁵⁴ *ibid*, 161-162; See Geoffrey Samuel, *A Short Introduction to the Common Law* (Edward Elgar 2013) 74; Peter Stein, *Roman Law in European History* (CUP 199) 87; MH Hoeflich, 'The Americanization of British legal education in the nineteenth century' (1987) 8 *The Journal of Legal History* 244, 246; Roy Stuckey, 'The Evolution of Legal Education in the United States and the United Kingdom: How one system became more faculty oriented while the other became more consumer oriented' (2004) 6 *Journal of Clinical Legal*

change until the second half of the 19th century.¹⁵⁵ Roman law was ‘a subject of no interest to those practising the common law’.¹⁵⁶ As such, it seems clear that Roman law was not in fact “received” by the English law as it was in continental Europe.¹⁵⁷ There is a suggestion that Roman law has influenced English law in some ways. For example, Glanville is said to have drawn on this “foreign law” in discussing agreements and contracts and that Roman law’s influence can be seen in a variety of English law’s basic principles.¹⁵⁸ Also, there is a claim that a ‘knowledge of Roman law is often a prerequisite to a basic understanding of the legal norms in force. An understanding of Roman law is also important for the critical evaluation of present or proposed legislation’.¹⁵⁹

There is a suggestion that European principles have been imported into English contract in their entirety. For example, Gordley's claim is that contract law has experienced major doctrinal change, but that it continues to exhibit the structure built by the late scholastics which drew on the work of Aristotle and Thomas Aquinas but has become detached from the philosophical basis of that structure.¹⁶⁰ The claim is that during the nineteenth century Anglo-American (as well as French and German) jurists and treatise writers ‘purged the doctrines of the natural lawyers of Aristotelian concepts and principles that seemed wrong or unintelligible to them. They bent and stretched the ideas they retained to make them do the work of those they had abandoned’.¹⁶¹ However, it seems unlikely that the English law of contract which developed from tortious roots has had European influences in an all-encompassing sense. To recall the discussion of the Lex Mercatoria, in particular, the work Lord Mansfield which took place in chapter 2, there is evidence of certain practices being imported.¹⁶² Mansfield’s aim is said to have been the incorporation of European commercial law principles into the common law.¹⁶³ This is evidenced by what effectively amounts to implying consideration regarding letters of credit and bills of exchange.¹⁶⁴ However, this was done in a very specific way. It was intended to encourage practicality within the commercial sphere. It did not

Education 101, 108; Andrew Boon and Julian Webb, ‘Legal Education and Training in England and Wales: Back to the Future?’ (2008) 58 *Journal of Legal Education* 79, 82.

¹⁵⁵ Geoffrey Samuel, *A Short Introduction to the Common Law* (Edward Elgar 2013) 75.

¹⁵⁶ *ibid.*, 74; See also GD Squibb, *Doctor’s Commons: A History of the College of Advocates and Doctors of Law* (Clarendon 1877) 1.

¹⁵⁷ Edward D Re, ‘The Roman Contribution to the Common Law’ (1961) 29 *Fordham Law Review* 447, 448.

¹⁵⁸ Charles P Sherman, ‘Romanization of English Law’ (1914) *Yale Law Journal* 318, 325-329.

¹⁵⁹ Franz Wieacker, ‘The Importance of Roman Law for Western Civilization and Western Legal Thought’ (1981) 4 *Boston College International and Comparative Law Review* 257, 279.

¹⁶⁰ Geoffrey Samuel, ‘Book Review - The Philosophical Origins of Modern Contract Doctrine’ (1992) 12 *Legal Studies* 246, 268.

¹⁶¹ Gordley (n 56) 161.

¹⁶² See Baker (n 9) 351; See also JH Baker and SFC Milsom, *Sources of English Legal History: Private Law to 1750* (2 edn, OUP 2010): Includes: *Woodford v Wyatt* (1626) HLS MS 106, fo 263 (Exchequer Chamber); *Browne v London* (1671) KB 27/1919, m. 523; *Sarsfield v Witherley* (1689) KB 27/2056, mm. 645–646; *Clerke v Martin* (1702) 2 Ld Raym. 757; *Martin v Sitwell* (1691) 1 Show KB 156, Holt KB 25.

¹⁶³ Baker (n 9) 351; See also S Todd Lowry, ‘Lord Mansfield and the Law Merchant: Law and Economics in the Eighteenth Century’ (1973) 7 *Journal of Economic Issues* 605, 609.

¹⁶⁴ See *Pillans and Rose v Van Mierop and Hopkins* (1765) 3 Burrow 1663, 1666; See also *Woodward v Rowe* (1666) 2 Keb 105.

fundamentally alter English contract law doctrine in a wider sense; rather it added a useful element to it.¹⁶⁵ This type approach has been described as ‘a cautious sampling of the new ideas (from the continent) while adapting them to the necessities of legal, political and social life’.¹⁶⁶ Keeping this, and the approach to English legal education in mind, it appears that while promise may have been a foundational principle of contract elsewhere, this is unlikely to be the case in English contract law. This is an important factor with respect to the overarching claim of this thesis. This is because it negates claims regarding the moral impermissibility of the efficient breach of contract based on a perceived likeness with promise breaking. This is on the basis that promise has not played a part in the development of English contract law.

4.6 A Contrast between Contract and Equity

To further illustrate that English contract law is based on reciprocal exchange rather than promise, some elements of English equity will be discussed. It will be set out that a contrast can be drawn between contract law and equity in requiring formalities. In addition, the way in which equity approaches the provision of remedies for breach of trust will be noted. The intention is to highlight that English contract law has specific characteristics, particularly with respect to commercial contracts, and that these characteristics differ from other areas of English law.

4.6.1 On Formalities and Moral Conscience

Generally speaking, equity sits separately from other areas of English law. Newman noted that ‘administration of equity in a separate court has placed a seemingly indelible stamp on Anglo-American law ... the impression remains that the principles of equity are less appropriate in actions for damages than in suits for specific relief’.¹⁶⁷ English equity grew from the canon law, which is influenced by Christian morality and Roman law, as well as the Lord Chancellor’s authority to hear cases where the common law failed to provide solutions.¹⁶⁸ Lord Chancellors, unlike common law

¹⁶⁵ See Stein (n 145) 106.

¹⁶⁶ Glenn (n 98) 223.

¹⁶⁷ Ralph Newman, ‘Equity in Comparative Law’ (1968) 17 *International and Comparative Law Quarterly* 807, 809.

¹⁶⁸ See Richard Hedlund, *Conscience and Unconscionability in English Equity* (PhD Thesis, The University of York 2016) 54; See also Newman (n 167) 808; Eric Kemp, ‘The Spirit of the Canon Law and its Application in England’ (2012) 14 *Ecclesiastical Law Journal* 5, 7; K Kahana Kagan, *Three Great Systems of Jurisprudence* (Stevens & Sons 1955).

judges were usually clerics trained in the canon law.¹⁶⁹ Chancellors are perceived to have played a dual role as judge and jury. Their reasoning was informed by conscience.¹⁷⁰ On the case law concerning conscience in medieval equity, it is outlined that the petitions in question alleged that the defendant had fallen below a standard required by morality.¹⁷¹

4.6.2 On Awards of Damages

A moral standard is demonstrated within remedies for breach of trust. In trust law:

[T]he conscience of the trustee is bound to give effect to the entitlements of the beneficiary or to carry out the purposes for which the property was vested in him ... the trust is imposed upon the trustee to prevent him from benefiting unconscionably from his ownership of the property.¹⁷²

The suggestion is that equity is better known for non-monetary remedies including rescission, rectification, specific performance, or an injunction. However, situations may arise where the court will order a monetary payment in respect of a personal claim.¹⁷³ Trustees could be liable for personal remedies which would require them to take account of their stewardship of the trust's assets, and for proprietary remedies. This would allow a beneficiary to seek to recover trust assets or their traceable proceeds. This will also apply where assets have been transferred to a third party by the trust, assuming that the beneficiary's equitable interest in that property has not been extinguished.¹⁷⁴

Traditionally equity has utilised taking account of the trust.¹⁷⁵ A trustee will be 'liable to pay a sum of money that will restore the trust to the position it would have been in if the breach had not occurred'.¹⁷⁶ This may be described as providing equitable compensation, intended to be

¹⁶⁹ See Hedlund (n 144) 123; Timothy Haskett, 'The Medieval English Court of Chancery' (1996) 14 *Law and History Review* 245, 247; Jack Moser, 'The Secularization of Equity' (1997) 26 *Capital University Law Review* 483, 92; Jamie Glister and James Lee (eds), *Hanbury & Martin: Modern Equity* (20th edn, Sweet & Maxwell 2015) 143–145; See generally RC Van Caenegem, *Judges, Legislators and Professors: Chapters in European Legal History* (CUP 1987) 120.

¹⁷⁰ Baker (n 9) 106.

¹⁷¹ Hedlund (n 168) 82.

¹⁷² McGhee (n 10) 21-001; See also *Westdeutsche v Islington LBC* [1996] AC 669 at 705, 709.

¹⁷³ *ibid.*, 20-001.

¹⁷⁴ *ibid.*, 30-002.

¹⁷⁵ M Conaglen, 'Equitable Compensation for Breach of Trust: Off Target' (2016) 40 *Melbourne University Law Review* 126, 128; See also *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) [1513] (Lewison J).

¹⁷⁶ McGhee (n 10) 30-002; See also Jamie Glister and James Lee (eds), *Hanbury & Martin: Modern Equity* (20th edn, Sweet & Maxwell 2015) 675; *Libertarian Investments Ltd v Hall* [2014] 1 HKC 368; [2013] HKCFA 93 [168].

restitutionary or restorative rather than providing compensation for a loss.¹⁷⁷ An award seeks to provide compensation in respect of the performance interest, rather than to repair harm. *Target Holdings Ltd v Redfern*¹⁷⁸ set out that the intention is ‘to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach’.¹⁷⁹ In *AIB Group (UK) plc v Mark Redler & Co Solicitors*¹⁸⁰ it was noted that ‘where there has been a breach of that duty, the basic purpose of any remedy will be either to put the beneficiary in the same position as if the breach had not occurred or to vest in the beneficiary any profit which the trustee may have made by reason of the breach’.¹⁸¹

Damage may include a loss of profit, which is different to loss of profit within contract law. The expectation measure of damages in contract will compensate lost profits, but will not necessarily mean that an order for account will be made, as would be the case following breaches of trust. This is because profit made stemming from a breach of trust may be attributed to the trust. The approach is restitutionary, or gains-based. This contrasts with the loss-based approach in compensatory contractual awards. It is noted that:

[T]he concepts of restitution and compensation are not the same though they will on occasions fulfil the same need. Restitution is analogous to property: it concerns wealth or advantage which ought to be returned or transferred by the defendant to the plaintiff. It is a form of specific implement.¹⁸²

Restitutionary awards may be available for breach of contract in exceptional cases.¹⁸³ Here it was noted that a court may use discretion and make an order for the account of any profits which they deem to have been unjustly received. This is on the basis that ‘the plaintiff’s interest in performance may make it just and equitable that the defendant should retain no benefit from his breach of contract’.¹⁸⁴ The suggestion is that in assessing whether such an approach would be legitimate ‘a useful general guide, although not exhaustive, is whether the plaintiff had a legitimate interest in preventing the defendant’s profit-making activity and, hence, in depriving him of his profit’.¹⁸⁵ It was set out that it would be wrong to consider restitution for breach of contract without considering the fact that it is intended to provide a substitute for a performance interest.¹⁸⁶ However, there would be

¹⁷⁷ See Jamie Glister and James Lee (eds), *Hanbury & Martin: Modern Equity* (20th edn, Sweet & Maxwell 2015) 674.

¹⁷⁸ [1996] AC 421.

¹⁷⁹ *ibid*, 439 (Browne-Wilkinson LJ).

¹⁸⁰ [2014] UKSC 58.

¹⁸¹ *ibid* [64] (Toulson LJ).

¹⁸² *Attorney General v Blake* [2001] 1 AC 268, 296 (Hobhouse LJ).

¹⁸³ *ibid*.

¹⁸⁴ *ibid*, 285 (Nicholls LJ).

¹⁸⁵ *ibid*.

¹⁸⁶ See Richard Nolan, ‘Remedies for Breach of Contract: Specific Enforcement and Restitution’ in Francis Rose (ed), *Failure of Contracts: Contractual, Restitutionary and Proprietary Consequences* (Hart 1997) 38.

difficulty in awarding restitutionary damages for breach of contract in all cases. Issues may include that a defendant's gains may not correlate with a claimant's interest, as well as a lack of guidance which exists regarding the type of occasion where a defendant should be stripped of their gain.¹⁸⁷ Also, it may 'undermine the existing contractual compensatory regime and the particular balancing of relevant values (such as the avoidance of waste, overcompensation and harshness to the defendant) which that regime represents'.¹⁸⁸

4.6.3 Conclusion

The intention of this discussion was to highlight that English contract law developed into a system based on reciprocal exchange, while, in contrast, equity focused on creating a method for redressing wrongs which were unfair or morally impermissible. Equity's grounding within England's church courts appears to be the reason for this distinction. Those who passed judgment believed it to be their duty to enforce morality and private conscience. It is set out that:

[T]he inherent jurisdiction of the Court of Chancery, and all its successor courts in common law jurisdictions across the world, to supervise and if necessary intervene in the administration of trusts is an ancient and well-established jurisdiction of such courts. It is a jurisdiction that marks a radical distinction between the law of trusts and the wider law of obligations.¹⁸⁹

Had contract grown out of the moral requirement to keep promises, it would likely be more in line with equity in terms of its operation. The most probable consequence would be a preference for remedies which are restitutionary. These would be gains-based, rather than loss-based following a breach of contract and may include specific performance or an order for account of profits (or disgorgement damages). The key point is that unlike in equity, English contract law has distinct characteristics which lend themselves to the application of efficient breach of commercial contracts.

¹⁸⁷ See Mindy Chen-Wishart, 'Restitutionary Damages for Breach of Contract' (1998) 114 LQR 363, 368.

¹⁸⁸ *ibid.*

¹⁸⁹ Richard C Nolan, 'The execution of a trust shall be under the control of the court: A Maxim in Modern Times' (2016) 2 Canadian Journal of Comparative and Contemporary Law 469, 471.

4.7 The Deontological, and the Consequentialist approaches to Promising

The next issue for discussion are the contrasts between the deontological and consequentialist views of promising. Broadly speaking, the deontological approach is one that conflicts with efficient breach, while the consequentialist approach is one which endorses it. The two approaches will be outlined before moving on to set out that consequentialism is synonymous with act utilitarianism. Aretaic concerns, which are based on virtue ethics will also be noted. This will serve to set up the discussion of promissory theories of contract that will follow. These theories align with the deontological approach.

4.7.1 The Deontological Approach

In characterising the deontological approach, Kaplow and Shavell cite Kant, Ross, and Searle.¹⁹⁰ They set out that ‘the broadly held intuition that promises should be kept, even when breaking them would advance the greater good’.¹⁹¹ Also, that a promise is ‘something that prima facie ought to be kept, and it does not, on reflection, seem self-evident that production of maximum good is the only thing that makes an act obligatory’.¹⁹² Further, that once a promise is made, whether or not it has been relied upon or either party has benefitted from it, a duty to keep it arises, even where there will be no reliance, or benefit in future.¹⁹³ Deontology attaches weight to values such as ‘autonomy, human dignity, basic liberties, truth telling, fidelity, fair play, and keeping one’s promises over the promotion of good outcomes’.¹⁹⁴ However, it is notable that deontological disdain towards acts such as promise breaking, lying or withholding information, is perceived to be weaker than “more serious” infringements on the liberty of others.¹⁹⁵

¹⁹⁰ See Immanuel Kant, *Groundwork of the Metaphysics of Morals* (Mary Gregor and Jens Timmerman eds, Cambridge University Press 2011); See also WD Ross, ‘The Ethics of Punishment’ (1929) 4 *Journal of Philosophical Studies* 205; JR Searle, ‘How to Derive “ought” from “is”’ (1964) 73 *Philosophical Review* 43.

¹⁹¹ Louis Kaplow and Steven Shavell, *Fairness vs Welfare* (Harvard University Press 2009) 157: See specifically footnotes 6-8.

¹⁹² WD Ross, ‘From the Right and the Good’ in in Stephen Darwall (ed) *Deontology* (Blackwell 2003) 74.

¹⁹³ Eyal Zamir and Barak Medina, *Law, Economics, and Morality* (OUP 2010) 298.

¹⁹⁴ *ibid*, 41; See also Michael B Dorff, ‘Why Welfare Depends on Fairness: A Reply to Kaplow and Shavell’ (2002) 75 *Southern California Law Review* 847, 851: It was set out that consequentialists focus on outcomes while deontologists ‘use their principles to make the point that some actions are simply wrong, regardless of their consequences, and are therefore forbidden’. On Deontological works generally see: Immanuel Kant, *Foundations of the Metaphysics of Morals* (Lewis White Beck tr, 1969); John Rawls, *A Theory of Justice* (Reprint edn, Belknap Press 2005); David Ross, *The Right and the Good* (OUP 2002); Nathan B Oman, *The Dignity of Commerce* (The University of Chicago Press 2016) 85.

¹⁹⁵ Zamir and Medina (n 193) 262.

4.7.2 The Consequentialist Approach

Consequentialism views that all that determines whether an act is moral are its consequences. As such, ‘the way to tell whether a particular choice is the right choice for an agent to have made is to look at the relevant consequences of the decision’.¹⁹⁶ The consequentialist attitude to promising is that keeping it, or breaking it, should be informed by the consequences that would follow.¹⁹⁷ Rawls characterised the approach to mean that ‘when a person makes a promise the only ground upon which he should keep it, if he should keep it, is that by keeping it he will realize the most good on the whole’.¹⁹⁸ A consequentialist will see breaking a promise as an acceptable course of action if it lead to what they perceive to be a greater good. This reflects classic economic theory on welfare maximisation, where parties are rational actors whose actions intend to serve their own interests. It has been set out that in a scenario concerning a potentially efficient breach, ‘the promisor is obligated to perform the promise only if an independent assessment of the consequences recommends performance’.¹⁹⁹

Some view the consequentialist (or utilitarian) view as incompatible with the perceived moral requirements of promising.²⁰⁰ Rawls suggested that a promisor should consider both the specific impact of breaking a promise, and the effect that breaking that promise will have on the practice of promising generally.²⁰¹ The argument is that because ‘the practice is of great utilitarian value, and since breaking one’s promise always seriously damages it, one will seldom be justified in breaking one’s promise’.²⁰² Also, that ‘if we view our individual promises in the wider context of the practice of promising itself, we can account for the strictness of the obligation to keep promises’.²⁰³ Other criticism includes the suggestion ‘that failing to follow through on a contractual relationship is not conducive to virtuous character or to the maintenance of a flourishing community’.²⁰⁴ Additionally, that resistance to the concept of efficient breach can be attributed to aretaic concerns that are based on virtue ethics, and thus, from his perspective nothing short of actual performance is acceptable.²⁰⁵ With this in mind, it is set out that a reinterpretation which aligns monetary damages does nothing to dispel the moral impermissibility of breach.²⁰⁶

¹⁹⁶ Phillip Pettit, *Consequentialism* (Dartmouth 1993) xiii.

¹⁹⁷ See Frank Menetrez, ‘Consequentialism, Promissory Obligation, and the Theory of Efficient Breach’ (2000) 47 *UCLA Law Review* 859, 874; See also Stephen Darwall, *Consequentialism* (Blackwell 2003) 1.

¹⁹⁸ Rawls (n 11) 13.

¹⁹⁹ Menetrez (n 197) 874.

²⁰⁰ See for example Seanna Shiffrin, ‘Must I Mean What You Think I should Have Said’ (2012) 98 *Virginia Law Review* 159.

²⁰¹ Rawls (n 11) 14.

²⁰² *ibid.*

²⁰³ *ibid.*

²⁰⁴ Avery Katz, ‘Virtue Ethics and Efficient Breach’ (2012) 45 *Suffolk University Law Review* 777, 779.

²⁰⁵ *ibid.*

²⁰⁶ *ibid.*

The flaw in the arguments against consequentialism is that it is difficult to judge an action's impact without taking account of its consequences. This is particularly relevant in contracting because the consequences stemming from the agreement provide the reason for entering into them. In commercial contracting, the primary inspiration will be the financial consequences which follow. It has been set out that:

[T]he argument suggests is that the very best arguments for nonconsequentialism will all turn out, on closer inspection, to be arguments for consequentialism, albeit versions of consequentialism that are grounded in relative values that had hitherto escaped our attention.²⁰⁷

Arguments which encourage the adoption of an approach based on virtues rely not on evidence of those virtues and their effects, but on a somewhat nebulous conception that they are valid. Further, it has been suggested that 'ethical common sense not bolstered by consequentialism leaves us merely with our inhibitions and our prejudices'.²⁰⁸

4.7.3 Act and Rule Utilitarianism

Act utilitarianism concerns the consequences of an action. It is considered morally right if it creates the greatest level of utility. Rule utilitarianism views 'that the right action is that which is in accord with that set of rules which, if generally or universally accepted, would maximize utility'.²⁰⁹ It considers that a rule which requires that a promise be kept will produce the best consequences overall. Rule utilitarianism focuses on actions but 'rightness and wrongness depends on rules'.²¹⁰ It is argued that rules should be selected based on which one will provide the greatest expected value.²¹¹ The claim is that an act will be 'morally permissible if it is allowed by the rules whose widespread internalization (including the costs of getting them internalized) has the greatest expected value'.²¹² Atiyah set out that a rule utilitarian will accept that it is not possible 'to weigh up the probable consequences of every single act which we are called upon to perform'.²¹³ The suggestion is that general rules, or conduct that is of utilitarian character, should be adopted on the basis that adherence would lead to a greater good than an alternative rule. This relieves the responsibility of making a

²⁰⁷ Michael Smith, 'The Value of Making and Keeping Promises' in Hanoch Sheinman (ed) *Promises and Agreements: Philosophical Essays* (OUP 2011) 215.

²⁰⁸ Joel J Kupperman, 'A Case for Consequentialism' (1981) 18 *American Philosophical Quarterly* 305, 312.

²⁰⁹ See JS Mill, *Utilitarianism* (Roger Crisp ed, OUP 1998) 16.

²¹⁰ *ibid.*

²¹¹ Brad Hooker, 'Promises and Rule-Consequentialism' in Hanoch Sheinman (ed), *Promises and Agreements: Philosophical Essays* (OUP 2011) 244.

²¹² *ibid.*, 245.

²¹³ Atiyah (n 55) 80.

decision based on the best outcomes, requiring only that a relevant rule be followed. It would be unnecessary for a promisor to concern themselves with the consequences attached to performance, or breaking a promise. They should ensure that their promise would fall under the general rule that promises should be kept, subject to potential exceptions. In short, ‘the rule itself must be adopted on utilitarian grounds; but the individual act need not be’.²¹⁴

4.7.4 On Aretaic Concerns

Katz notes that beyond deontological and consequentialist approaches are aretaic concerns based on virtue ethics.²¹⁵ These are said to be “prior” or more important than those concerning rightness or wrongness.²¹⁶ It is set out that the debate over efficient breach has ‘focused on deontological concerns (specifically, whether contract breach is equivalent to promise-breaking, and whether promise-breaking in the contractual context is necessarily wrong)’.²¹⁷ It is also noted that Shiffrin combined deontological and aretaic issues and that ‘the intuitive resistance that many people experience to the concept of efficient breach may be better explained by aretaic concerns-that is, by virtue ethics’.²¹⁸ However, it does not appear that the gulf between deontological and aretaic concerns is as great as Katz suggests. Deontological issues in this context can be distilled down to a requirement that a promise is kept because keeping that promise is valuable in itself, while aretaic issues require that a promise is kept because that is what a person of virtuous character should do and that this is valuable to the “community” as a whole. In reality, the two are similar in that the reasoning behind keeping a promise is based on the moral requirements of promise making.

4.7.5 Conclusion

The intention of this discussion was to outline that consequentialist (or act utilitarian) approaches will align with the classical conception of the theory of efficient breach which is concerned only with the consequences of a breach. The key point is that it would be difficult, if not impossible to assess whether an action has a positive or a negative impact without taking account of the consequences. This is of great importance within contracting as those consequences provide a reason for entering

²¹⁴ *ibid.*

²¹⁵ See Roger Crisp and Michael Slote, *Virtue Ethics* (OUP 1997); See also Daniel Statman, *Virtue Ethics: A Critical Reader* (Edinburgh University Press 1997); Stephen Darwall, *Virtue Ethics* (Blackwell 2003);

²¹⁶ Daniel Statman, *Virtue Ethics: A Critical Reader* (Edinburgh University Press 1997) 7-8; See also Crisp and Slote (n 215).

²¹⁷ Katz (n 204) 779.

²¹⁸ *ibid.*

into them. This is of note with regard to commercial contracting as the overriding intention of the contracting parties will be the production of profit. As such, any arguments that encourage the adoption of an approach based on virtues alone rely not on evidence of those virtues and their effects, but on a broad assumption that they are valid.

4.8 Promissory Theories of Contract

Promissory theories of contract broadly align with the deontological (or aretaic) approach. They seek to explain contract law using promise as a guiding principle. They view a contractual obligation as self-imposed as it is created through the communication of an intention to perform a promise.²¹⁹ Obligations are perceived to arise because of a promisor's voluntary act, rather than any outside influence.

Fried suggested that contract features the promise principle as its central moral theme.²²⁰ Kimel notes that in Fried's view 'the requirement to keep a promise as arising primarily out of the very act of promise-making, rather than from the consequences that breaking or keeping a promise may entail'.²²¹ The claim is that promises should be kept because that is the course of action which is morally right. More recently Fried outlined that his intention in *Contract as Promise* was to provide a 'structure by which actors could determine for themselves the terms of their interaction and cooperation—whether in commercial or personal relations'.²²² It has been suggested that by placing focus on individual rights, with an aversion to both collective interest, and to economic analysis, Fried aligns himself with Kant,²²³ who, in *Metaphysics of Morals* set out that rather than a particular good or service, a promisee acquires the right to make a claim against the promisor in respect of that right.²²⁴ This could be interpreted in one of two ways, either that the promisee has a right to claim performance specifically, or that they may claim for damages in respect of that.

Fried is criticised for appearing to depart from the moral requirements of promising.²²⁵ The issue is the acceptance of damages as an appropriate remedy. The obvious issue concerns how a connection between the promise principle and expectation damages be nuanced in the way that Fried suggests. This is problematic because if a promise should always be performed, then remedies of a

²¹⁹ Stephen Smith, *Contract Theory* (OUP 2004) 44; See also Oman (n 50) 76.

²²⁰ Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (OUP 2015).

²²¹ Kimel (n 19) 8.

²²² Fried (n 220) 137.

²²³ Weinrib (n 36) 51.

²²⁴ Immanuel Kant, *The Metaphysics of Morals* (Mary Gregor ed and tr, CUP 1996) Para 6:274.

²²⁵ Seanna V Shiffrin, 'The Divergence of Contract and Promise' (2007) 120 *Harvard Law Review* 708; See also Kaplow and Shavell (n 191) 160.

restitutionary nature, or potentially specific performance would be appropriate.²²⁶ This is the view which Fried's critics, most notably Shiffrin, adopt.²²⁷

The need to go beyond moral sanctions is a consistent problem. Benson notes that a moral obligation 'does not go so far as to explain a duty that is owed to another as a matter of justice, in contrast to a duty of fidelity or of self-consistency that, though it may relate to another, is required only as a part of virtue'.²²⁸ The claim is that the morality of promising does not create a basis for contract law because in a contractual context an obligation is based upon a relation. This is in the sense that 'not only must the contractually bound defendant perform the promised act, but that performance is owed to a particular plaintiff'.²²⁹ Any moral obligation will be relevant to the promisor alone. Therefore, the promisee would possess no right to insist that performance takes place.

4.9 Overall Conclusion

The primary intention of this chapter was to provide a platform to go on to analyse efficient breach in the context of commercial contracts. This was original based on the approach that has been adopted in order to deal with some of the perceived moral issues surrounding an efficient breach of contract. It has been demonstrated that broadly deontological concerns regarding efficient breach are irrelevant within commercial contracting by dealing with the moral issues surrounding efficient breach. These take the position that breach of contract is wrong because it is synonymous with breaking a promise.

In English law promise is not, and moreover, should not be considered to form the basis of contracting. Promises require an existing relationship of trust and confidence between promisor and promisee. This relationship will contribute to the moral force which influences whether a promise will be kept. In contrast, contracts seek to invoke reliance without the necessity for a pre-existing relationship of trust and confidence between those involved. They are bilateral, or multilateral in their nature. As such they require collaboration between the parties involved and are focused on protecting reliance.²³⁰ A primary function of contract is to provide a method for one party to seek an enforceable remedy against another following breach, a feature which promises lack. It was set out that contracting's domain differs from that of promising. This is reflected by the state's role in

²²⁶ An example which illustrates the type of situation where it would legitimately be appropriate to break a promise relates to meeting a friend. On the way to that meeting one party discovers an individual who is severely injured. By taking that injured party to hospital the promise made to a friend is broken, and legitimately so.

²²⁷ See Shiffrin (n 225) 722.

²²⁸ Peter Benson, 'Abstract Right and the Possibility of a Nondistributive Conception of Contract: Hegel and Contemporary Contract Theory' (1989) 10 *Cardozo Law Review* 1077, 1116.

²²⁹ Weinrib (n 36) 52.

²³⁰ See Penner (n 46) 117-118.

enforcing them. This is not enforcing a standard morality between individuals, but protecting reciprocal exchanges. This is particularly resonant in the context of commercial contracting.

It was set out that English contract law has developed with reciprocity in mind.²³¹ Also, based on its tortious roots, it is practically detached from promises. This is unlike the contract law of other jurisdictions which appear to have featured it as a foundational principle. As a result, it has developed a consequentialist nature. This is most apparent with regard to the approach to assessing damages for breach of contract, which are intended to provide compensation for any damage, loss, or injury which is suffered as a result of a breach, placing an injured party, as far as is possible, in the position that they would have been in, had the contract been performed.²³² This method for assessing damages is naturally consequentialist in seeking to provide compensation based on the actual loss suffered.

After outlining the characteristics of deontological, consequentialist, and aretaic approaches, it was set out that the application of the theory of efficient breach in any given context requires that the consequentialist approach is adopted. In any context, it is the consequences of entering into a contract which provide the reason for doing so. More specifically, in commercial settings, contracts are entered into with the intention of generating a profit. With this in mind, an act consequentialist approach to contracting is legitimate as it offers the potential to maximise the levels of profit, or equally minimise losses. It was also made clear that deontological (or aretaic) approaches adopted in promissory theories of contract are problematic because promise breaking carries only moral sanctions which are relevant to the promisor alone. The promisee has no mechanism to enforce performance.

Within commercial contracting, which is geared towards profit generation, it is reasonable to assert that a different standard should be applied to assessing any requirements which parties are held to. As such, an efficient breach in the context of commercial contracting cannot be discounted based on issues of morality that arise from promise breaking. Moving on to build a defence of efficient breach of contract in the commercial context on this foundation will be the focus of the remaining chapters of this thesis.

²³¹ See Glanville (n 5); See also Milsom (n 66); Baker (n 75); Baker (n 9); Ibbetson (n 57); Simpson (n 6); Furmston (n 7) 41.

²³² See Beale (n 14) 26-001; See also *Robinson v Harman* (1848) 1 Ex. 850, 855; *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Blackburn LJ).

Chapter 5

The Economic Analysis of Law and the Theory of Efficient Breach

5.1 Introduction

The intention of this chapter is to set up the original analysis which will follow. This includes the criticisms of efficient breach in chapter 6 and the case that will be made for the functionality of efficient breach of commercial contracts in chapter 7. Setting out the foundation upon which chapters 6 and 7 are built is essential because to demonstrate how and why the efficient breach of commercial contracts is legitimate, an understanding of the theory is required.

First of all, the economic analysis of law will be introduced. This is done in order to ground the theory of efficient breach. Some of the criticisms directed at the economic approach will also be set out, though these are not problematic as the claims which this thesis makes relate only to the breach of commercial contracts. This is important because chapter 7 asserts that within this context, adopting an approach in line with pursuing economic efficiency regarding breach of contract is legitimate. The theory of efficient breach will then be outlined because in order to analyse its application to commercial contracts in chapter 6, the theory must be understood. This will include outlining some relevant English case law examples, as well as some from the United States.

Next, the idea of efficiency will be discussed. This includes introducing a number of measures which are utilised within economics, as well as economic analysis of law. This is essential because it may vary in different settings. It is necessary to understand the differing approaches which may be adopted, as well as to justify which ones should be utilised within commercial contracting. This will be followed by a discussion of the role which efficiency may play within decision making. It will be set out that elements of economic efficiency, in this case wealth maximisation and the Kaldor-Hicks criterion,¹ may legitimately inform decisions relating to the breach of commercial contracts. This is due to the profit producing intent which underpins them.² Issues stemming from a pursuit of efficiency will then be highlighted. This includes noting that the legal process has a value beyond solely efficiency. Examples of this include the criminal law as well as the process of judicial decision making. There will also be a note on the problematic nature of interpersonal utility comparisons in

¹ See 5.4.3 Welfare Maximisation and Utilitarianism; See also 5.4.2 The Kaldor-Hicks Criterion

² See 2.8 Overall Conclusion; See also 3.7 Overall Conclusion.

assessing efficiency. However, it will be outlined that efficiency can be of use in appropriate settings of which commercial contracting is an example.

It will be set out that economic theories of contract primarily seek to answer two questions. First, which contracts should be enforceable? Second, which remedies should be available following breach?³ Also, that these theories tend to adopt an approach which seeks to promote economic efficiency by promoting the movement of resources into the possession of those who value them most.⁴ Economic theories of contract have been criticised due to a perceived failure to provide a fully explanatory theory of contract.⁵ There is also criticism of the court's role in terms of the application and enforcement of contract law.⁶ In addition, it is essential to discuss the methods by which damage awards for breach of contract are assessed with a focus on the expectation measure. This seeks to put a claimant in the position that they would have been in had performance taken place, in so far as this can be achieved through a monetary award.⁷

Ultimately it will be made clear that it is most appropriate to utilise economic principles only in suitable settings within contract law. The assertion made is that commercial contracting is such a setting. It will be concluded that within the commercial contract context, efficiency may legitimately be judged based on wealth maximisation, as well as the Kaldor-Hicks criterion featuring the caveat that compensation must be paid. Additionally, it will be set out that a simple approach to characterising an efficient breach will be adopted. This will involve characterising it as a breach of contractual terms on the basis that it is more cost effective to do so. This will take into account the cost of performance compared with the cost breach and the payment of compensatory damages. Such an approach may be adopted to either reduce losses, or to maximise total gains.

5.2 The Economic Analysis of Law

The theory of efficient breach is a product of the economic analysis of law which has both positive and normative elements. It is positive in the sense that it can be perceived to explain the structure of the law, suggesting that it has evolved in pursuit of efficiency. In a normative sense, economic analysis is said to be useful in suggesting how the law may be improved.⁸ The approaches to the

³ See Thomas J Miceli, *Economics of the Law* (2nd edn, Stanford University Press 2009) 88; See also Robert Cooter and Thomas Ulen, *Law and Economics* (6th edn, Pearson 2013) 299; Lewis A Kornhauser 'An introduction to the economic analysis of contract remedies' (1986) 57 *University of Colorado Law Review* 683, 685.

⁴ See 5.4.4 Economic Efficiency.

⁵ See 5.7 Economic Theories of Contract.

⁶ See 6.2.1.3 The Role of the Court.

⁷ See 5.8.2 The Expectation Interest.

⁸ Miceli (n 3) 2.

economic analysis of law can be split between three schools; the Chicago (or positive) school, the Yale (or normative) school and the functional school.⁹ The positive school is concerned with the incentives which the legal system produces based on the natural evolution of legal rules.¹⁰ For example, it is noted that Posner has used efficiency in a positive or descriptive way.¹¹ The approach of the positive school is restricted ‘to the descriptive study of the incentives produced by the legal system largely because its adherents believe that efficient legal rules evolve naturally’.¹² It is primarily concerned with the market system and its influence on an economy which is focused on property and contract as well as the allocation of resources.¹³ However, there is a suggestion that scholars within this school have ‘acknowledged from the outset that the economist’s competence in the evaluation of legal issues is limited’.¹⁴ This is on the basis that:

While the economist’s perspective can prove crucial for the positive analysis of the efficiency of alternative legal rules and the study of the effects of alternative rules on the distribution of wealth and income, Chicago style economists generally recognized the limits of their role in providing normative prescriptions for social change or legal reform.¹⁵

Next, the normative school views the law as a facility to remedy perceived failure within the market.¹⁶ The belief is that ‘there is a larger need for legal intervention in order to correct for pervasive forms of market failure’.¹⁷ Further, that this school is ‘often presented as more value-tainted and more prone to policy intervention than the Chicago law and economics school’.¹⁸ Unlike the positive school, it seeks to inform, or influence the market system, rather than be informed or influenced by it directly.

Finally, the functional school focuses on the preferences of individuals which are informed by their circumstances.¹⁹ It is set out that:

⁹ See generally Francesco Parisi, ‘Positive, Normative and Functional Schools in Law and Economics’ (2004) 18 *European Journal of Law and Economics* 259; See also Jonathan Klick and Francesco Parisi, ‘Wealth, Utility, and the Human Dimension’ (2005) 1 *New York Journal of Law and Liberty* 590.

¹⁰ Jonathan Klick and Francesco Parisi, ‘Wealth, Utility, and the Human Dimension’ (2005) 1 *New York Journal of Law and Liberty* 590, 591.

¹¹ David Partlett ‘Economic Analysis of Law – Book Review’ (1980) 11 *Federal Law Review* 238, 243; See also RA Posner, ‘The Economic Approach to Law’ (1975) 53 *Texas Law Review* 757; RA Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014).

¹² Francesco Parisi and Jonathan Klick, ‘Functional Law and Economics: The Search for Value-Neutral Principles of Lawmaking’ (2004) 79 *Chicago-Kent Law Review* 431; See also Charles K Rowley, ‘Social Sciences and Law: The Relevance of Economic Theories’ (1981) 1 *OJLS* 391.

¹³ Francis E Holahan and Edward Sussna, ‘Economic Analysis of Law – Book Review’ (1977) 28 *Journal of Legal Education* 234, 237; See also Lawrence Lessig, ‘The New Chicago School’ (1998) 27 *The Journal of Legal Studies* 661; Robert C Ellickson, ‘Law and Economics Discovers Social Norms’ (1998) 27 *Journal of Legal Studies* 537, 550.

¹⁴ Parisi and Klick (n 12) 434.

¹⁵ *ibid.*

¹⁶ Klick and Parisi (n 10) 591; See also Parisi and Klick (n 12) 431; Jules L Coleman, ‘The Normative Basis of the Economic Analysis of Law’ (1982) 34 *Stanford Law Review* 1105, 1131.

¹⁷ Parisi and Klick (n 12) 435.

¹⁸ *ibid.*, 434-435.

¹⁹ Parisi (n 9) 266; See also Gordon Tullock, *The Logic of the Law* (Basic Books 1971).

[T]he functional school allows for the possibility of using insights from public choice economics to remedy faulty legal rules at a meta-level. However, unlike the normative school, the functional school also recognizes that there are failures in the political market that make it unlikely that changes will be made on a principled basis. Also, because it is difficult to identify all of the ultimate consequences of corrective legal rules, the functional school focuses on using economic theory to design legal meta-rules that lead to efficiency *ex ante*. Achieving this *ex ante* efficiency requires the design of legal institutions that induce individuals to internalize the effects of their private activities, as well as to reveal their true preferences in situations where collective decisions must be made.²⁰

The claim is that it ‘focuses on mechanism design issues to explain the origins of law, capturing both the efficiency and non-efficiency perspectives of the other two schools’.²¹ It is therefore more able to acknowledge the impact of preferences which are not necessarily efficiency focused.

With all of this in mind, the approach which will be advanced by this thesis is broadly normative. It will suggest an approach that should be explicitly adopted with regard to the efficient breach of commercial contracts. That being said, it will be set out that the approach has effectively already been applied.²² It is not intended to attempt to predict the behaviour of contracting parties. There is also a functional element as the preferences of the breaching party will be considered.²³ The suggestion is not that an efficient breach should, or will take place, only that a party to a commercial contract will be justified should they choose to pursue it. Again, it must be made clear that this justification applies to the relevant party’s choice to breach efficiently, as well as to the law’s approach in limiting the available remedy to expectation damages. The use of this remedy in commercial contract disputes effectively condones the breach.

The approach is justifiable based on the context within which it is to be utilised. As Coleman outlined, the Kaldor-Hicks (or wealth maximisation) approach is generally ‘not a defensible conception of justice’.²⁴ However, it is the case that ‘whether or not a Kaldor-Hicks efficient change in policy is warranted or an institution designed to maximize wealth is justified depends on a much richer conception of moral agency, the good, justice, institutional competence, and the nature of the state’.²⁵ Therefore, the validity of the application of this kind of approach is contextual.

²⁰ Parisi and Klick (n 12) 431-432.

²¹ *ibid*, 450.

²² See 5.3.3 Examples of Efficient Breach in English Case Law.

²³ See 5.5 Efficiency Based Decision Making.

²⁴ Jules L Coleman, ‘The Normative Basis of the Economic Analysis of Law’ (1982) 34 *Stanford Law Review* 1105, 1131.

²⁵ *ibid*.

5.2.1 The Genesis of the Economic Analysis of Law

Marrying the law with economics is not a new approach.²⁶ In its current form, economic analysis of the law dates back to the early 1960s, specifically the works of Ronald Coase and Guido Calabresi.²⁷ Calabresi suggested that economic reasoning could be applied to tort law to ascertain who bears the cost of an accident.²⁸ The field was advanced by Posner's *Economic Analysis of Law* in 1973.²⁹ Posner focuses on wealth maximisation which concerns allocating resources to those who value them most.³⁰ Maximising wealth and efficiency is placed at the forefront of legal analysis.³¹ Becker applied economic analysis to human behaviour.³² On the criminal law, Becker noted that optimal enforcement will depend on factors including the costs attached to catching and convicting offenders, whether punishments are fines or prison terms and how offenders respond to changes in enforcement methods.³³ In this case, focus will be placed on attempting to maximise the wealth which stems from contractual dealing.

5.2.2 Rationality and the Preferences of Decision Makers

Within the economic analysis of law, assumptions are made regarding the rationality, and the individual preferences of decision makers.³⁴ This is said to explain the way which parties respond to

²⁶ See for example Cesare Bonesana di Beccaria, *An Essay on Crimes and Punishments* (Stephen Gould 1809); See also Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation* (IntelLex Corporation 1995); JR Commons, *Legal Foundations of Capitalism* (University of Wisconsin Press 1957); Karl Marx, *Capital: A Critical Analysis of Capitalist Production* (Allen & Unwin 1938); Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Liberty Classics 1981).

²⁷ See RH Coase, 'The Problem of Social Cost' (1960) 3 *The Journal of Law and Economics* 1; See also Guido Calabresi, 'Some Thoughts on Risk Distribution and the Law of Torts' (1961) 70 *Yale Law Journal* 499; For a brief overview of the economic analysis of the law prior to 1960 see Wolfgang Weigel, *Economics of the Law: A Primer* (Routledge 2008) 12-13.

²⁸ Guido Calabresi, 'Some Thoughts on Risk Distribution and the Law of Torts' (1961) 70 *Yale Law Journal* 499.

²⁹ RA Posner, *Economic Analysis of Law* (1st edn, Little Brown and Company, 1973); See also Francesco Parisi, 'Positive, Normative and Functional Schools in Law and Economics' (2004) 18 *European Journal of Law and Economics* 259, 260.

³⁰ See RA Posner, 'Utilitarianism, Economics, and Legal Theory' (1979) 8 *Journal of Legal Studies* 103.

³¹ Robert D Cooter, 'Law and the Imperialism of Economics: An Introduction to the Economic Analysis of Law and a Review of the Major Books' (1981) 29 *UCLA Law Review* 1260, 1265.

³² Gary S Becker, *The Economic Approach to Human Behavior* (The University of Chicago Press 1976).

³³ Gary S Becker, 'Crime and Punishment: An Economic Approach' in Gary Becker and William M Landes (eds), *Essays in the Economics of Crime and Punishment* (National Bureau of Economic Research 1974) 2; See also RA Posner, 'Gary Becker's Contributions to Law and Economics' (1993) 22 *The Journal of Legal Studies* 211.

³⁴ See Gary S Becker, *Economic Theory* (Alfred A Knopf 1971) 25; See also Lewis A Kornhauser 'An introduction to the economic analysis of contract remedies' (1986) 57 *University of Colorado Law Review* 683, 687; See also Francesco Parisi, 'Positive, Normative and Functional Schools in Law and Economics' (2004) 18 *European Journal of Law and Economics* 259, 262.

legal rules in that they will account for the legal consequences of their decisions.³⁵ Posner set out that law and economics assumes that individuals will act rationally to maximise their own satisfactions.³⁶ Further, that the task which faces economics is to analyse the implications of acting in this way.³⁷ The rational person (or Homo-Economicus) is a creation of economics used to analyse group behaviour. It is a weighted average of the behaviour of a number of individuals. The suggestion is that overall a group will act as if its members are rational.³⁸ Rational decision making involves comparing costs with benefits and choosing an option which best suits the decision maker.³⁹ Becker noted that “each consumer has an ordered set of preferences, and he chooses the most preferred position available to him”.⁴⁰ Also, that there is a consensus that rational behaviour will imply “consistent maximisation of a well-ordered function, such as a utility or profit function”.⁴¹

There is a suggestion that the rational person will seek to maximise their self-interest and in doing so, only limited concern will be demonstrated for the well-being of others.⁴² To clarify, economists do not necessarily believe that all individuals act this way.⁴³ It is set out that human behaviour should not be compartmentalised. At this point it is worth noting that issues relating to behavioural economics will be dealt with later.⁴⁴ On occasion it may be based on maximisation, on others it may

³⁵ Lewis A Kornhauser ‘An Introduction to the Economic Analysis of Contract Remedies’ (1986) 57 University of Colorado Law Review 683, 690.

³⁶ RA Posner, ‘The Economic Approach to Law’ (1975) 53 Texas Law Review 757, 761.

³⁷ RA Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) 3.

³⁸ This approach has been analysed from a variety of perspectives. See for example Amartya K Sen, ‘A Critique of the Behavioural Foundations of Economic Theory’ (1977) 6 Philosophy and Public Affairs 317; See also Girardeau A Spann, ‘A Critical Legal Studies Perspective on Contract Law and Practice’ (1988) Annual Survey of American Law 223; Elizabeth Anderson, ‘Should Feminists Reject Rational Choice Theory’ in Louise M Anthony and Charlotte E Witt (eds) *A Mind of One’s Own: Feminist Essays on Reason and Objectivity* (2nd edn, Westview Press 2002); 374-375; Neil H Buchanan, ‘Playing with Fire: Feminist Legal Theorists and the Tools of Economics’ in Martha Albertson Fineman and Terence Dougherty (eds) *Feminism Confronts Homo Economicus: Gender, Law, and Society* (Cornell University Press 2005); Euclid Tsakalotos, ‘Homo Economicus and the Reconstruction of Political Economy: Six Theses of the Role of Values in Economics’ (2005) 29 Cambridge Journal of Economics; Carlos Bastien and Jose Luis Cardoso, ‘From Homo Economicus to Homo Corporativus: A Neglected Critique of Neoclassical Economics’ (2007) 36 The Journal of Socio-Economics 118; Irene CL Ng and Lu-Ming Tseng, ‘Learning to Be Sociable The Evolution of Homo Economicus’ (2008) 67 The American Journal of Economics and Sociology 265; Jonathan Aldred, *The Skeptical Economist: Revealing the Ethics Inside Economics* (Earthscan 2009) 231; Chritoph Hanisch, ‘Negative Goals and Identity: Revisiting Sen’s Critique of Homo Economicus’ (2013) 4 Rationality, Markets and Morals 157; Khandakar Elahi, ‘Behavioural Controversy Concerning Homo Economicus: A Humean Perspective’ (2014) 7 The Journal of Philosophical Economics 2; Klaus Mathis and Ariel David Steffen, ‘From Rational Choice to Behavioural Economics: Theoretical Foundations, Empirical Findings and Legal Implications’ in Klaus Mathis (ed) *European Perspectives on Behavioural Law and Economics* (Springer 2015).

³⁹ See for example John Sloman and Dean Garratt, *Essentials of Economics* (7th edn, Pearson 2016) 8; See also John Sloman, Jon Guest and Dean Garratt, *Economics* (10th edn, Pearson 2018) 12; Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 10.

⁴⁰ Becker (n 34) 26.

⁴¹ Becker (n 32) 153.

⁴² Werner Z Hirsch, *Law and Economics: An Introductory Analysis* (3rd edn, Academic Press 1999) 12.

⁴³ See Becker (n 32) 153; See also Paul Burrows and Cento G Veljanovski, *The Economic Approach to Law* (Butterworths 1981) 3.

⁴⁴ See 5.5.3 Behavioural Economics.

not. The claim is that human behaviour ‘can be viewed as involving participants who maximize their utility from a stable set of preferences and accumulate an optimal amount of information and other inputs in a variety of markets’.⁴⁵ Note also that an economist will often refer to utility, rather than self-interest.⁴⁶

5.2.3 Criticisms of the Economic Analysis of Law

Economic analysis of the law could potentially be dismissed on the basis that the rational approach has been said to conflict with the interests of society as pursuing individual profit can be ‘inconsistent with attainment of societal net benefit objectives’.⁴⁷ Next, because it fails to ‘account for the special nature of legal obligation and law’s relationship with morality’.⁴⁸ Also, the suggestion that it should not extend into the law ‘because economics is about money and the goods and services it can (or should be made able to) buy’.⁴⁹ An obvious issue is ‘the difficulty of assigning weights to the values which are to be incorporated in a decision’.⁵⁰ Whilst this could be problematic for attempts to apply economic analysis to every area of the law, it does not present issues in terms of the claims which this thesis makes which are limited to the efficient breach of commercial contracts.⁵¹

5.2.4 Conclusion

This thesis is not attempting to model or predict the behaviour of a particular group. To do this would be economic analysis in a positive sense. As Friedman set out, the task for positive economics ‘is to provide a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances’.⁵² The focus here is normative as it concerns ‘propositions that derive ultimately from the ethics of society’.⁵³ The intention is to set out how particular areas should function based on economic reasoning. It is also functional in that it will take account of the individual preferences of contracting parties.⁵⁴ This thesis will demonstrate the functionality of efficient breach, a product of the economic analysis of law solely within the context

⁴⁵ Becker (n 32) 14.

⁴⁶ Posner (n 37) 3.

⁴⁷ Hirsch (n 42) 12.

⁴⁸ Jonathan Morgan, *Contract Law Minimalism* (CUP 2013) 43.

⁴⁹ Holahan and Sussna (n 13) 236.

⁵⁰ *ibid*, 238.

⁵¹ See Chapter 7.

⁵² Milton Friedman, *Essays in Positive Economics* (University of Chicago Press 1953) 4.

⁵³ EJ Mishan, *Introduction to Normative Economics* (OUP 1981) 2.

⁵⁴ See 5.5 Efficiency Based Decision Making.

of commercial contracting.⁵⁵ Nothing will be said regarding how a party will, or should act when faced with the opportunity to breach efficiently. The only claim is that they would be justified in choosing to do so. With this in mind, it is now appropriate to move on to outline the theory of efficient breach.

5.3 The Theory of Efficient Breach

The focus of this thesis is to advance the claim that the efficient breach of commercial contracts is legitimate. Any discussion of efficient breach must take account of Oliver Wendell Holmes' suggestion that 'the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else'.⁵⁶ This appears to cast aside any contractual requirement other than the need to pay damages in the event of breach.⁵⁷ Buckland suggested that Holmes' position regarding contractual liability is analogous to tort based on the liability to pay damages. Also, that there is no need to consider promising as an issue.⁵⁸ As was noted previously, the formulation of efficient breach which this thesis advances differs to the Holmes inspired iteration in the sense that it is solely limited to commercial contracts.

5.3.1 The Rationale for Efficient Breach

The theory is based on the idea that breach will be justified where it results in a more economically efficient outcome. This will mean that the position of the breaching party, after the payment of expectation damages, would be preferable to that which would have come about through performance. It has been set out that 'economic efficiency ... encourages optimal reallocation of factors of production and goods without causing material instability of expectations'.⁵⁹ Further, that

⁵⁵ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised

⁵⁶ Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995.

⁵⁷ See for example Posner (n 37); See also Gregory Klass, 'Efficient Breach' in Gregory Klass, George Letsas and Prince Sapra (eds) *The Philosophical Foundations of Contract Law* (OUP 2014) 362; Richard RW Brooks, 'The Efficient Performance Hypothesis' (2006) 116 The Yale Law Journal 568, 571; Melvin A Eisenberg, 'Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law' (2005) 93 California Law Review 975, 1018; Charles J Goetz and Robert E Scott, 'Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach' (1977) 77 Columbia Law Review 554, 558; Neil Andrews, Malcolm Clark, Andrew Tettenborn and Graham Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (2nd edn, Sweet & Maxwell 2017) 397.

⁵⁸ WW Buckland, 'The Nature of Contractual Obligation' (1944) 8 Cambridge Law Journal 247.

⁵⁹ RL Birmingham, 'Breach of Contract, Damage Measures, and Economic Efficiency' (1970) 24 Rutgers Law Review 273, 292.

‘adherence to this standard would promote proper functioning of the market mechanism’.⁶⁰ In the first edition of *Economic Analysis of Law* Posner set out that:

In some cases a party to a contract would be tempted to breach the contract simply because his profit from breach would exceed his expected profit from completion of the contract. If his profit from breach would also exceed the expected profit to the other party from completion of the contract, and if damages are limited to loss of expected profit, there will be an incentive to commit a breach.⁶¹

The focus here is an opportunity to increase profit. It is also important to note that the same reasoning is applicable where a breaching party is seeking to decrease potential losses. In this way, it ‘considers two types of changes: good news and bad news’.⁶²

5.3.2 Illustrations of Efficient Breach

Efficient breach has been illustrated through the use of paradigm hypothetical scenarios concerning business transactions. These illustrations are of use in an explanatory sense. However, it is important to keep in mind that their purpose is simply that. Posner’s position is as follows:

Suppose I sign a contract to deliver 100,000 custom-ground widgets at 10c apiece to A for use in his boiler factory. After I have delivered 10,000, B comes to me, explains that he desperately needs 25,000 custom-ground widgets at once since otherwise he will be forced to close his pianola factory at great cost, and offers me 15c apiece for 25,000 widgets. I sell him the widgets and as a result do not complete timely delivery to A, causing him to lose \$1,000 in profits. Having obtained an additional profit of \$1,250 on the sale to B, I am better off even after reimbursing A for his loss and B is also better off. The breach is therefore Pareto superior.⁶³

A similar approach is adopted by Klass:

Suppose on April 1, Third Party contacts Seller and offers to purchase 100 units for \$1,300, or \$13 per unit. Third Party is a competitor of Buyer and is willing to pay more for the goods because it has a new, less expensive production method. Whereas Buyer’s production costs are \$6 per unit, Third Party’s costs are \$3. Seller does not have the capacity to produce more

⁶⁰ *ibid.*

⁶¹ Posner (n 29) 57.

⁶² Gregory Klass ‘Efficient Breach’ in Gregory Klass, George Letsas and Prince Saprai (eds), *Philosophical Foundations of Contract Law* (OUP 2014) 364.

⁶³ *ibid.*, 131.

than 100 units and so can sell to Third Party only if it breaches with Buyer. To keep things simple, suppose on April 1, Buyer has not yet invested any resources in the transaction and if Seller breaches, Buyer will not be able to get replacement goods elsewhere. Sale to Third Party is more efficient than sale to Buyer. The transaction between Seller and Buyer creates \$4 of value for each unit sold (\$18 market price - \$8 Seller costs - \$6 Buyer costs). Sale to Third Party, on the contrary, will produce \$7 per unit (\$18 market price - \$8 Seller costs - \$3 Third Party costs). If we want to maximize social welfare (as measured in dollars), we want Seller to breach the contract with Buyer and sell to Third Party.⁶⁴

More generally, Eisenberg notes that the over-bidder paradigm concerns ‘a seller who has contracted to sell a commodity to a buyer breaches the contract in order to resell the commodity’.⁶⁵ The loss paradigm is said to concern ‘a seller who has contracted to render a performance to a buyer breaches the contract because she determines that her cost of producing the performance would exceed the value that the buyer places on the performance’.⁶⁶ Finally, the mitigation paradigm requires that ‘a buyer who has contracted to purchase a commodity that takes time to produce countermands performance by the seller because he determines that the value of the performance to him, if completed, will be less than the contract price’.⁶⁷

For theoretical purposes, Goetz and Scott characterise efficient breach effectively. They note that an award of compensation will align with the theory on the basis that it will provide ‘incentives for the promisor to breach a contract which has become inefficient ex post, compensate the promisee for his expected gain, and reallocate his resources to more highly valued uses’.⁶⁸ Value will be maximised as no party is adversely affected. This requires that an award of damages in line with a legitimate expectation interest is paid. This is the approach to efficient breach that this thesis will adopt going forward.

5.3.3 Examples of Efficient Breach in English Case Law

Crucially, there is evidence of English commercial contract case law which exhibits the characteristics of an efficient breach. This is on the basis that a party saw breaching and paying damages as a more attractive option than performing the contract. However, it is notable that whether

⁶⁴ Klass (n 62) 364.

⁶⁵ Melvin A Eisenberg, ‘Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law’ (2005) 93 California Law Review 975, 998.

⁶⁶ *ibid*, 1014.

⁶⁷ *ibid*, 1016.

⁶⁸ Charles J Goetz and Robert E Scott, ‘Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach’ (1977) 77 Columbia Law Review 554, 558.

the case is one of efficient breach is not expressly set out. As such, it is necessary to infer this based on the available facts contained within the judgments which are provided. This discussion is not intended to provide a comprehensive treatment of all the cases of this type. It simply seeks to highlight that what could be categorised as efficient breaches, can, and do take place within English commercial contract law. In the following cases there is evidence regarding the factors which influenced the decision of the breaching parties. This is information points to an efficient breach of contract which has been allowed to stand by the court.

First, *Morris-Garner v One Step (Support) Ltd*⁶⁹ concerned whether or not compensation for breach of contract could be valued based on what were defined as “negotiating damages”. These consist of the fee that would hypothetically have been charged to release a party from their existing contractual obligations.⁷⁰ The case concerned the purchase of a business which provided ‘rented accommodation and support services to enable vulnerable individuals referred by local authorities ... to live as independent lives as possible in the community’.⁷¹ The agreement in question contained non-compete, as well as non-solicit covenants. This required that the defendant would ‘keep information concerning its business transactions confidential’.⁷² They would also be prohibited ‘from engaging in a business that was in competition with it or soliciting its clients, without its consent’.⁷³ A second defendant also agreed to be bound by a similar form of covenants after having terminated their employment with the claimant.⁷⁴

In the Supreme Court, the defendant sought to avoid liability for damages stemming from the principles established in *Wrotham Park Estate Co v Parkside Homes Ltd*.⁷⁵ Lord Reed outlined that the claimant:

‘[I]n respect of the breach of the non-compete and non-solicit covenants ... sought an account of profits, or alternatively what were described as restitutionary damages, in such sum as it might reasonably have demanded as a quid pro quo for releasing the defendants from those covenants, or, in a further alternative, what were described as compensatory damages for the loss it had suffered by reason of the defendants' breach of those covenants. In respect of the breach of confidence, it sought an account of profits, or alternatively damages’.⁷⁶

⁶⁹ [2018] UKSC 20; [2018] 2 WLR 1353.

⁷⁰ *ibid* [48] Note that “Negotiating Damages” was preferred to “Wrotham Park Damages” which stemmed from the decision in *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798; [1973] 10 WLUK 84. 6.2.1.6 Restitutionary Remedies.

⁷¹ *ibid* [7] (Lord Reed)

⁷² *ibid* [9] (Lord Reed)

⁷³ *ibid*.

⁷⁴ *ibid*.

⁷⁵ [1974] 1 WLR 798; [1973] 10 WLUK 84.

⁷⁶ *Morris-Garner v One Step (Support) Ltd* (n 69) [11].

Importantly, the defendant did not seek to suggest that they had not breached the terms of the agreement. Only the quantification of damages was in contention. This suggests that they knowingly acted in breach with the intention of benefitting themselves financially. This is in line with the characteristics of an efficient breach.⁷⁷

Lord Reed set out that:

[T]his is a case brought by a commercial entity whose only interest in the defendants' performance of their obligations under the covenants was commercial. Indeed, a restrictive covenant which went beyond what was necessary for the reasonable protection of the claimant's commercial interests would have been unenforceable. The substance of the claimant's case is that it suffered financial loss as a result of the defendants' breach of contract. The effect of the breach of contract was to expose the claimant's business to competition which would otherwise have been avoided. The natural result of that competition was a loss of profits and possibly of goodwill. The loss is difficult to quantify, and some elements of it may be inherently incapable of precise measurement. Nevertheless, it is a familiar type of loss, for which damages are frequently awarded.⁷⁸

Further, that this case was 'not one where the breach of contract has resulted in the loss of a valuable asset created or protected by the right which was infringed'.⁷⁹ This is particularly resonant with respect to the claims which this thesis advances with respect to the legitimacy of the efficient breach of commercial contracts. The Supreme Court were unwilling to depart from the usual approach with respect to quantifying compensatory awards of damages. Most notably, they did not seek to punish the party who sought to improve their position through breach by awarding damages for account of profit. This suggests that the court are not averse to allowing behaviour which features the characteristics of an efficient breach to take place. Here this is displayed by their unwillingness to award "negotiating damages" where they may ostensibly have been required. This is because 'common law damages for breach of contract are not a matter of discretion. They are claimed as of right, and they are awarded or refused on the basis of legal principle'.⁸⁰

Next, in *Vitol SA v Beta Renewable Group SA*,⁸¹ a contract for the provision of biofuel was breached. Importantly, the defendant ultimately accepted that they had breached the contract.⁸² There was substantial discussion which concerned whether or not the defendant's obligations had been removed following their communication of their intention to breach. This resulted from the claimant's failure

⁷⁷ See 5.3.2 Illustrations of Efficient Breach.

⁷⁸ *Morris-Garner v One Step (Support) Ltd* (n 69) [98] (Lord Reed); The point regarding a particular asset is notable; See also 6.2.1.6 Restitutory Remedies.

⁷⁹ *ibid* [99] (Lord Reed).

⁸⁰ *ibid* [95].

⁸¹ [2017] EWHC 1734 (Comm).

⁸² *ibid* [3].

to nominate a vessel as per the agreement. The issue that was being considered was whether this amounted to a clear and unequivocal acceptance of the breach.⁸³ This was effectively an attempt by the defendant to cleverly avoid any liability by contending ‘that its obligation to deliver the biofuel was conditional upon nomination by Vitol of the time(s) for loading and the performing vessel(s)’.⁸⁴ Importantly though, this did not negate the existence of a breach of contract based on the defendant’s ‘openly declared inability to perform in advance of the deadline for nomination’.⁸⁵ As a result, the claimant was entitled to damages.⁸⁶

Despite the approach adopted in terms of the defence that was raised, it is important to consider the actions of the defendant prior to this. It is evident that their approach aligns with the characteristics of an efficient breach. The defendant made a decision to breach contract and communicated that intention to the claimant. The very fact that this took place highlights that at the time of that communication being made, the defendant preferred to breach and pay damages, rather than perform the contract. The rationale behind the decision to breach was covered within correspondence between the two parties. It was outlined that they were unable to produce the required biodiesel and did not expect to be able to do so in the short to medium term. Also, that they hoped to enter that market again in future.⁸⁷ This suggests that the defendant was taking precautions in to protect their ability to function effectively going forward. Therefore, it seems intuitive that the defendant was of the view that at that time, the costs of performing the contract outweighed the benefits.⁸⁸ There were attempts on the part of the claimant to negotiate potential alternatives to allow some form of performance to take place.⁸⁹ This was unsuccessful leading the defendant to again outline that they were unable to perform.⁹⁰ They then went on to acknowledge the claimant’s rights under the agreement, which amounted to an ability to claim damages.⁹¹

The claimant sought to claim damages based on two approaches.⁹² Their primary claim accounted for lost profit from a hypothetical sub-sale, as well as the use of hedging instruments.⁹³ The court viewed that this did not represent ‘a fair or proper basis of compensation’⁹⁴ and thus, the claim was rejected. The court outlined that ‘it is common ground that, if liability is established, Vitol is entitled to damages on a market value basis’.⁹⁵ As a result, damages were awarded to reflect this convention.

⁸³ *ibid* [44]–[46].

⁸⁴ *ibid* [32] (Carr J).

⁸⁵ *ibid* [55] (Carr J).

⁸⁶ *ibid* [59].

⁸⁷ *ibid* [15].

⁸⁸ See 5.3.2 Illustrations of Efficient Breach.

⁸⁹ *Vitol SA v Beta Renewable Group SA* (n 81) [17]–[18].

⁹⁰ *ibid* [21].

⁹¹ *ibid* [25].

⁹² *ibid* [60].

⁹³ *ibid* [69].

⁹⁴ *ibid* [72] (Carr J).

⁹⁵ *ibid* [73] (Carr J).

This amounted to the difference between the original contract price, and the higher price which the claimant was required to pay for a replacement.⁹⁶ On a potential sub-sale, it was set out that there was no evidence of an agreement at the suggested price. Also, that ‘the factors that might justify an award of loss of profit on a sub-sale ... are not obvious on the facts’.⁹⁷ This suggests that had the claimant been able to prove that their opportunity to complete a sub-sale at a specific price had existed, they would have been able to claim compensation for that loss. This would align with the expectation measure of damages, which includes lost profit and is a feature of an efficient breach.⁹⁸

Next, in *Societe des Industries Metallurgiques SA v The Bronx Engineering Co Ltd*,⁹⁹ a seller was unable to complete delivery of machinery by a specified date. Delivery would have only been possible at a later date, by which time ‘the plaintiffs’ import licence from the Tunisian Government had expired and their request for an extension thereof was still being dealt with’.¹⁰⁰ On the 11th of December 1973, the seller outlined that unless arrangements were made to allow them to complete delivery by the 25th of December 1973 they would treat the contract as repudiated. On the 20th of December, they communicated the fact that they were treating the contract as repudiated to the buyer.¹⁰¹ It is important to note that by that time, the seller had found an alternate buyer for the machinery who agreed to pay a ‘substantially enhanced price’.¹⁰² The defendant sought to complete the sale to this new purchaser. This feature of the case is particularly resonant when this case is considered alongside the principles of an efficient breach noted above.¹⁰³

The claimant sought an injunction to prevent the sale to the new buyer in order for it to ‘be possible for the Court at the trial to decree specific performance if that be deemed to be an appropriate form of remedy’.¹⁰⁴ The core of their claim was that ‘were they ... obliged to go to another manufacturer they would probably have to wait another 9-12 months before they could get delivery of such new machinery and that, by reason of that delay and other factors, they would stand to lose a substantial sum’.¹⁰⁵ The primary issue considered by the court was whether specific performance, which the claimant coveted, would be available. This would prevent the defendant from completing the sale of the machinery to the new buyer, and force them to perform as per the terms of the contract.

While there was some sympathy with the claimant’s position, the view of the court was that there was ‘nothing which removes this case from the ordinary run of cases arising out of commercial

⁹⁶ *ibid* [75].

⁹⁷ *ibid* [70] (Carr J).

⁹⁸ See 5.8.2 The Expectation Interest.

⁹⁹ [1975] 1 Lloyd’s Rep 465.

¹⁰⁰ *ibid*, 467 (Edmund David LJ).

¹⁰¹ *Societe des Industries Metallurgiques SA v The Bronx Engineering Co Ltd* (n 99).

¹⁰² *ibid*, 467 (Edmund David LJ).

¹⁰³ See 5.3.2 Illustrations of Efficient Breach.

¹⁰⁴ *Societe des Industries Metallurgiques SA v The Bronx Engineering Co Ltd* (n 99) 469 (Buckley LJ).

¹⁰⁵ *ibid*, 468 (Edmund David LJ).

contracts where damages are claimed'.¹⁰⁶ The position was that they would 'not decree specific performance where the commodity is one which can be ordinarily obtained in the market, because in such a case damages are a sufficient remedy'.¹⁰⁷ In this case it was 'true that you cannot walk into a store or warehouse or a shop and buy this type of machinery from stock'.¹⁰⁸ However, it was thought to be 'a type of machinery which is obtainable in the market in the ordinary course upon placing an order'.¹⁰⁹ As a result, the court chose to enforce a payment of damages. This was said to be appropriate despite potential difficulty in quantification as the view was 'that the damages would eventually be satisfactorily quantified'.¹¹⁰ The financial position of the defendant was also considered. It was outlined that there was 'no suggestion of financial inability in the defendants to satisfy such a money judgment (whatever its dimensions) as might be awarded against them to cover all such items of damages as the plaintiffs could legitimately rely upon'.¹¹¹ The reasoning in *Re Wait*,¹¹² where Lord Atkin set out 'that in contracts for the sale of goods the only remedy by way of specific performance is the statutory remedy, and it follows that as the goods were neither specific nor ascertained the remedy of specific performance was not open to the creditors'¹¹³ was considered here.

In terms of analysing this case with efficient breach in mind, the approaches adopted by the defendant, as well as the court must be considered. The defendant's approach suggests that in their view, choosing to breach and pay damages was the more cost-effective option in the relevant circumstances. While their rationale is not expressly set out, the fact they sought to avoid being forced to perform in specie, in favour of paying damages suggests that they believed that the benefit derived from selling the machinery to the new buyer outweighed the cost of paying those damages. This is in line with the characteristics an efficient breach.¹¹⁴ In addition, the court's response to the actions of the defendant demonstrates acquiescence to the approach advanced by the theory of efficient breach. This is on the basis that they refused to enforce specific performance, favouring an award of damages. This is important for two reasons. First, they took the view that monetary damages would adequately compensate the claimant's losses. Second, they did not seek to punish the defendant for breaching contract by restricting their ability benefit by selling the machinery to an alternate buyer at a higher price.

The next case of note is *Cooperative Insurance Society Ltd v Argyll Stores (Holdings) Ltd*¹¹⁵ which

¹⁰⁶ *ibid.*

¹⁰⁷ [1975] 1 Lloyd's Rep 465, 469 (Buckley LJ).

¹⁰⁸ *ibid.*

¹⁰⁹ *ibid.*

¹¹⁰ *ibid.*, 470 (Buckley LJ).

¹¹¹ *ibid.*, 468 (Edmund David LJ).

¹¹² [1927] 1 Ch 606.

¹¹³ *ibid.*, 630 (Atkin LJ).

¹¹⁴ See 5.3.2 Illustrations of Efficient Breach.

¹¹⁵ [1998] AC 1; [1997] 2 WLR 898.

concerned a tenant of a retail unit within a shopping centre breaching a keep open covenant. This was done because the supermarket which they were operating was making a substantial loss.¹¹⁶ As a result, the decision to breach the covenant and pay damages, rather than continue trading was made. Again, this is important when considered alongside the characteristics of an efficient breach noted previously.¹¹⁷ The claimant's response was to attempt to ensure that the tenant continued trading, at least until an alternate tenant could be found by enforcing the covenant, as well as offering to negotiate a temporary rent concession. This was done on the basis that believed that the supermarket's closure would have a detrimental effect on the shopping centre and the other tenants who operated within it.¹¹⁸ Legal proceedings were brought 'claiming specific performance of the covenant to keep open and damages'.¹¹⁹

Ultimately, specific performance was refused by the court. The reasoning for this is of note. First, it was set out that:

To compel the operation for an indefinite period of a business by a person who is unwilling to operate it and has formed a commercial judgment that it is not viable is a serious restriction on the operation of the market and commercial flexibility. In the present case, the reopening of the store temporarily pending an assignment would have been extremely wasteful.¹²⁰

Also, that 'it cannot be in the public interest for the courts to require someone to carry on business at a loss if there is any plausible alternative by which the other party can be given compensation'.¹²¹ This highlights that the courts are averse to enforcing performance where the decision not to perform has been made for commercial reasons. It was outlined that 'the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance'.¹²² Further, that damages would end the legal relationship between the parties meaning that 'the forensic link between them is severed, they go their separate ways and the wounds of conflict can heal'.¹²³

Again, to analyse this case with efficient breach in mind, the approach adopted by the defendant, and the response of the court must be considered. First, the defendant made the decision to breach for financial reasons, namely to reduce inevitable losses. By doing this they were accepting that they would become liable to pay damages. This aligns with the characteristics of an efficient breach.¹²⁴ In response, the court were of the view that it would be wrong to force the defendant to carry on a loss making business activity. As such, they chose to award damages in preference to specific

¹¹⁶ *ibid*, 10.

¹¹⁷ See 5.3.2 Illustrations of Efficient Breach.

¹¹⁸ *Cooperative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* (n 115) 10.

¹¹⁹ *ibid*, 10 (Lord Hoffmann).

¹²⁰ *ibid*, 6 (Lord Hoffmann).

¹²¹ *ibid*, 15 (Lord Hoffmann).

¹²² *ibid*.

¹²³ *ibid*, 16 (Lord Hoffmann).

¹²⁴ See 5.3.2 Illustrations of Efficient Breach.

performance.

In addition to cases such as those noted above, there are also situations where the reasons behind a party's decision to breach are not evident within the judgments. This is potentially problematic in terms of analysing whether or not such cases are examples of an efficient breach of contract. However, there are occasions where in the event of a repudiatory breach of a commercial contract, the case could be made that the reasoning for doing so relates to the financial consequences that follow. This is on the basis that if the assumption that commercial parties are primarily interested in profit generation and maximising their own wealth is accepted, then a decision to repudiate is likely to be informed by the pursuit of that interest. This approach would be akin to that of an efficient breach on the basis that a party viewed breaching and paying damages as a more attractive option.

In *Hinde v Liddel*¹²⁵ a defendant was unable to supply grey shirtings by a specified date. They informed the claimant that they would be unable to perform five days prior to the agreed date of delivery.¹²⁶ This amounted to repudiatory breach of contract. Whilst it is unclear why the defendant was unable to provide the product as per the agreement, it seems reasonable to assert that this would be due to the cost of sourcing it by the required date. This inference is made on the basis that the claimant was able to mitigate their loss by finding a suitable (but not exact) replacement by the date that was specified, though this was at a higher cost due to their superior quality.¹²⁷ Following this, the defendant admitted that the claimant had made every possible effort to acquire an appropriate replacement and that it was the nearest match in terms of quality and price which could be delivered by the required date.¹²⁸ It is this feature of the case that is particularly interesting. This is because the obvious question that could be raised concerns why the defendant chose not to attempt to source this replacement themselves. Based on the information that is available it seems legitimate to infer that in the circumstances, the defendant viewed that the costs attached to sourcing this replacement outweighed the benefit that they would derive by performing the contract as had been agreed.

It was outlined that 'the general measure of damages in such a case would be the value of the thing on the day when the contract ought to have been fulfilled, and in general the market price gives this value'.¹²⁹ However, because of the lack of a market for a direct replacement, the view was that 'the value of the goods contracted to be supplied by the defendants at the time of their breach of contract was the price the plaintiff had to give for the substituted article'.¹³⁰ As a result, the claimant was entitled to the difference in price between what had been contracted for originally, and the price which they paid for the more expensive replacement. This was because 'the only reasonable thing

¹²⁵ (1875) LR 10 QB 265.

¹²⁶ *ibid.*

¹²⁷ *ibid.*, 266.

¹²⁸ *ibid.*, 266-267.

¹²⁹ *ibid.*, 269 (Blackburn J).

¹³⁰ *ibid.*, 270 (Blackburn J).

the plaintiff could do was to put himself in the same position as if the defendants had fulfilled their contract by obtaining a somewhat dearer article'.¹³¹ It therefore appears that a requirement to pay that difference in price rather than endeavour to perform was deemed to be preferable by the defendant. This would align their approach with an efficient breach of contract.¹³²

*The Golden Victory*¹³³ primarily concerned the date from which damages should be assessed due to the existence of a clause which provided the right to cancel the contract should war or hostilities commence between specified countries.¹³⁴ However, prior to this taking place the contract was repudiated. This led to a legitimate claim for damages.¹³⁵ Most of the discussion concerned whether or not the inevitable award of damages should reflect the fact that had the contract not been breached, it would have been cancelled under the relevant clause when the Second Gulf War began in March of 2003. However, for the purposes of this analysis the focus is the repudiatory breach itself. It was set out that:

The Charterers in breach of contract repudiated the charter on 14 December 2001 when the charter had nearly four years still to run (but subject, of course, to the clause 33 possibilities of cancellation). The Owners accepted the repudiation on 17 December 2001 and claimed damages for the Charterers' breach of contract.¹³⁶

Whilst the information that is available is admittedly limited, specifically the fact that the reasoning for repudiation is not expressly set out, it seems intuitive that the defendant saw breaching and paying any subsequent damages as a cost effective course of action. This is on the basis that by they were accepting a liability to pay damages by repudiating the agreement almost four years early. This suggests that in their view, the benefits that would flow from breaching and paying damages would outweigh the costs attached to performance. If this were the case, this approach is clearly in line with the ideology of an efficient breach of contract.¹³⁷ The fact that the agreement included a clause allowing it to be cancelled should war break out, which was then considered to limit the value of damages that could be awarded to the claimant simply adds to the benefit which the defendant ultimately derived through choosing to breach.

¹³¹ *ibid.*

¹³² See 5.3.2 Illustrations of Efficient Breach.

¹³³ *Golden Strait Corporation v Nippon Yusen Kubishka Kaisha (The Golden Victory)* [2007] UKHL 12; [2007] 2 AC 353.

¹³⁴ *ibid* [2] (Bingham LJ).

¹³⁵ *ibid* [8] (Bingham LJ).

¹³⁶ *ibid* [27] (Scott LJ).

¹³⁷ See 5.3.2 Illustrations of Efficient Breach.

5.3.4 Additional Examples in US Case Law

For illustrative purposes a small number of US cases will now be noted. In *Peevyhouse v Garland Coal & Mining Company*,¹³⁸ a breach of contract related to a failure to perform reparative work to land which had been impacted upon by one party's mining activity. Because the cost of the work far exceeded the impact it would have had on the value of the land in question, increasing it by only \$300, whilst costing \$29,000 to carry out, the court chose to award a far smaller sum in damages.

Next, in *Patton v Mid-Continent Systems Inc.*,¹³⁹ a breach took place in relation to a franchise agreement regarding the operation of truck-stops. This concerned only franchising truck-stops operated by the claimant with respect to the ability to accept the defendant's credit card. The defendant committed a breach by franchising other truck-stops within a specified excluded area. The breach was not in question. Initially the claimant was awarded \$2,250,000 in punitive damages. However, this was subsequently reduced to \$100,000; a far lower amount. It was Posner, in his role as a judge, who set out that:

Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to breach his promise, provided he makes good the promisee's actual losses.¹⁴⁰

Furthermore, punitive damages were said to inappropriate on this occasion as they would lead to an inefficient result.¹⁴¹ Interestingly, Tawil has set out that whilst Posner noted the theory of efficient breach, in this case, the result did not flow from it. It is suggested that had this been the case, 'he would have undoubtedly formed a general proposition which resists the idea that punitive damages should be awarded in breach of contract cases'.¹⁴² Further, that ultimately the decision 'was that the breach, regardless of its efficiency or otherwise, did not justify punitive damages because it was not wrongful according to the necessary legal definition'.¹⁴³

Finally, a particularly interesting case is *Walgreen Co v Sara Creek Property Co*¹⁴⁴ where Posner awarded an injunction rather than damages in respect of a breach of contract regarding restrictions on the letting of retail space to a competing pharmacy within a shopping mall. The defendant raised the argument that the breach was efficient and thus, that damages should be awarded in preference

¹³⁸ 22 Ill.382 P.2d 109 (Okla. 1962).

¹³⁹ 841 F.2d 742 (7th Cir. 1988).

¹⁴⁰ *ibid.*, 750.

¹⁴¹ *ibid.*

¹⁴² Tareq Al-Tawil, 'English Contract Law and the Efficient Breach Theory: Can They Co-Exist?' (2015) *Maastricht Journal of European and Comparative Law* 396, 416.

¹⁴³ *ibid.*

¹⁴⁴ 966 F.2d 273 (7th Cir. 1992).

to an injunction. It was set out that there were obvious advantages to awarding an injunction in this case. First, that the approach ‘shifts the burden of determining the cost of the defendant’s conduct from the court to the parties’.¹⁴⁵ This was on the basis that if it was the case ‘that Walgreen’s damages are smaller than the gain to Sara Creek from allowing a second pharmacy into the shopping mall, then there must be a price for dissolving the injunction that will make both parties better off’.¹⁴⁶ The rationale was that ‘a battle of experts is a less reliable method of determining the actual cost to Walgreen of facing new competition than negotiations between Walgreen and Sara Creek over the price at which Walgreen would feel adequately compensated for having to face that competition’.¹⁴⁷ Whilst this may appear to be supportive of a claim against efficient breach, it is the case that Posner’s focus on the pursuit of efficiency remained. An interesting question surrounds the approach which would have been adopted had it been clear based on the facts that an award of damages would have been efficient in this case

This small group of US cases set out that an efficiency based rationale is utilised in reaching judgments regarding breach of contract. However, much like in English case law, there is resistance in terms of articulating that the theory of efficient breach is being applied. Even Posner is unwilling to go this far as is clear in *Patton v Mid-Continent Systems Inc.*¹⁴⁸ However, it is notable that the result in *Peevyhouse v Garland Coal & Mining Company*¹⁴⁹ demonstrates the characteristics of an efficient breach quite obviously.

5.3.5 Conclusion

The theory of efficient breach functions based on the rationale that it will be justified where it results in a more economically efficient outcome. Breach will be considered to be desirable if the position of the breaching party is preferable to that which would have come about through contractual performance after the payment of expectation damages. There is evidence of attempts to make claims regarding the functionality of efficient breach through the use of hypothetical paradigm scenarios which tend to concern business transactions. This can be a useful tool in terms of explaining the theory. However, it is important to note that the efficiency of a breach may only be assessed based on empirical evidence. The use of hypotheticals simply provides examples of efficient or inefficient breaches. They prove nothing in terms of the validity of the theory itself.

¹⁴⁵ *ibid* 275-276.

¹⁴⁶ *ibid*.

¹⁴⁷ *ibid*.

¹⁴⁸ *Patton v Mid-Continent Systems Inc* (n 139).

¹⁴⁹ *Peevyhouse v Garland Coal & Mining Company* (n 138).

Most crucially, there is evidence within English case law that breach has taken place based on financially minded reasoning.¹⁵⁰ However, it must be noted that the reasoning behind these decisions is not made explicitly clear within the judgments. As such, it must be inferred. This is also the case within some US case law as the unwillingness to articulate that the theory is being applied is clear.¹⁵¹

5.4 Measures of Efficiency

Having briefly outlined the economic approach to law, as well as the basic features of an efficient breach, it is now necessary to deal with the technical elements of what efficiency means. It is the case that pursuing efficiency is a key element of the economic analysis of law as it informs much of the reasoning which takes place. With that in mind, it is essential to set out what efficiency means in this context. This is less straightforward than may be expected due to a lack of clarity resulting from economists' use multiple forms of efficiency. The differences between these forms can prove difficult for non-economists.¹⁵² It will be set out that an approach in line with wealth maximisation and the Kaldor-Hicks criterion (featuring the caveat that compensation is paid) is legitimate when the efficient breach of commercial contracts is being considered. This is due to the underlying profit driven motivation that underpins them.

5.4.1 Pareto Optimality

Pareto Optimality is the measure of efficient allocation of resources most frequently referenced by economists.¹⁵³ It is also often noted within law and economics.¹⁵⁴ It functions on the basis 'that one allocation of resources is superior to another if at least one person is better off under the first than under the second and no one is worse off'.¹⁵⁵ An outcome will be Pareto optimal when the well-being

¹⁵⁰ See 5.3.3 Examples of Efficient Breach in English Case Law.

¹⁵¹ See 5.3.4 Additional Examples in US Case Law.

¹⁵² Cooter (n 31) 1263: These different forms of efficiency are said to include efficient production, efficient exchange, Pareto efficiency, national income maximisation, wealth maximisation, and utilitarian efficiency.

¹⁵³ See Vilfredo Pareto, *Manuel D'economie Politique* (1927 edn) translated in Terence Wilmot Hutchison, *A Review of Economic Doctrines 1970-1929* (Clarendon 1953); See also EJ Mishan, *Elements of cost-benefit analysis* (2nd edn, George Allen and Unwin 1976) 14; John Black, Nigar Hashimzade, and Gareth Myles, *A Dictionary of Economics* (OUP 2012); John Sloman, Jon Guest and Dean Garratt, *Economics* (10th edn, Pearson 2018) 348.

¹⁵⁴ See Posner (n 37) 14; See also Frank H Stephen, *The Economics of the Law* (Harvester Wheatsheaf 1988) 41; Wolfgang Weigel, *Economics of the Law: A Primer* (Routledge 2008) 16; Jules L Coleman, 'Efficiency, Utility and Wealth Maximisation' (1980) 8 Hofstra Law Review 509, 512; Nathan B Oman, *The Dignity of Commerce* (The University of Chicago Press 2016) 68.

¹⁵⁵ RA Posner, *The Economics of Justice* (Reprint edn, Harvard University Press 1981) 88.

of one party cannot be improved without causing detriment to another party. An outcome will be Pareto superior when an action would improve the position of one party without diminishing that of another. Issues arise when an action would improve the position of one party whilst simultaneously diminishing that of others. This is because such situations would no longer be advantageous to a community as a whole.¹⁵⁶

On a theoretical level, the Pareto measure demonstrates what will be efficient (or optimal) in a particular setting. It is set out that ‘a Pareto improvement which positively requires that when some are made better off, no one is actually made worse off, is assured of fairly wide acceptance’.¹⁵⁷ However, there are claims that Pareto optimal could describe any status quo and that Pareto superior scenarios are, in fact, unlikely to exist. It has been suggested that ‘in real life ... there are few changes that hurt no one; thus the Pareto criterion effectively becomes a recipe to stick to the status quo and let things be’.¹⁵⁸ Lawson notes that ‘if Pareto superior moves are a virtual impossibility ... then any given state of affairs will be Pareto optimal’.¹⁵⁹ Also, Mokal, writing in a corporate insolvency law context, highlights that because ‘few Pareto superior transactions can be made, it follows that almost any state of affairs is Pareto optimal’.¹⁶⁰ It is suggested that ‘not much guidance can be gained about the real world from a set of criteria which outlaws virtually every transaction, and which validates almost any distribution of resources’.¹⁶¹ Posner notes that because ‘the conditions for Pareto superiority are rarely satisfied in the real world, yet economists talk quite a bit about efficiency ... the operating definition of efficiency in economics cannot be Pareto superiority’.¹⁶² Also, that when an economist notes efficiency, ‘nine times out of ten he means Kaldor-Hicks efficient’.¹⁶³

¹⁵⁶ Pareto (n 153) 225.

¹⁵⁷ EJ Mishan, *Elements of Cost Benefit Analysis* (2nd edn, George Allen and Unwin 1976) 15; See also Guido Calabresi, ‘The Pointlessness of Pareto: Carrying Coase Further’ (1991) 100 *The Yale Law Journal* 1211, 1216.

¹⁵⁸ Ha-Joon Chang, *Economics: The User’s Guide* (Pelican Books 2014) 122; See also Joseph V Femia, *Pareto and Political Theory* (Routledge 2006) 51; See also Nicola Acocella, *The Foundations of Economic Policy: Values and Techniques* (Brendan Jones tr, CUP 1998) 32.

¹⁵⁹ Gary Lawson, ‘Efficiency and Individualism’ (1992) 42 *Duke Law Journal* 87.

¹⁶⁰ RJ Mokal, *Corporate Insolvency Law: Theory and Application* (OUP 2005) 22.

¹⁶¹ *ibid*; See also Guido Calabresi, ‘The Pointlessness of Pareto: Carrying Coase Further’ (1991) 100 *The Yale Law Journal* 1211, 1216.

¹⁶² Posner (n 37) 15.

¹⁶³ *ibid*.

5.4.2 The Kaldor-Hicks Criterion

The Kaldor-Hicks criterion represents a development on the Pareto measure.¹⁶⁴ It assumes that monetary compensation can effectively repair any damage caused when one party's position is improved whilst another's is simultaneously diminished.¹⁶⁵ To be clear, here compensation is being considered in a broad theoretical sense. The rules which apply to damage awards for breach of contract such as remoteness and mitigation will not be considered at this point. They will, of course, be discussed later. The case made for the Kaldor-Hicks criterion is as follows:

It is possible to make everybody better off than before, or at any rate to make some people better off without making anybody worse off ... if all those who suffer as a result are fully compensated for their loss, the rest of the community will still be better off than before.¹⁶⁶

Coase suggested that most economists would agree that problems will be solved satisfactorily when the damage causing party is required to pay for any damage that is caused. The provision of suitable compensation will mean that the outcome will be Kaldor-Hicks efficient.¹⁶⁷

It is the Kaldor-Hicks approach to wealth maximisation which dominates the application of economic analysis to contract law. However, there are potential problems; the most obvious is that it functions based on the assumption that monetary compensation can adequately remedy any damage that is caused. The suggestion is that all that is required for it to fail is the involvement of one individual 'who sincerely cannot be bought'¹⁶⁸ by any level of after-the-fact compensation. However, in this case the suggestion is that monetary awards will be legitimised as it will allow the profit orientated interests of the contracting parties to be effectively compensated. An additional issue stems from Kaldor's apparent suggestion that the payment of compensation is not actually required. Following the example provided it was noted that whether or not a party 'should in fact be given compensation or not, is a political question on which the economist, qua economist, could hardly pronounce an opinion'.¹⁶⁹ This view separates the production of wealth from its distribution. Here, focus is solely on increasing total value. However, in the context of an efficient breach of contract, the payment of compensation will clearly be required.

¹⁶⁴ *ibid.*, 14; See also Wolfgang Weigel, *Economics of the Law: A Primer* (Routledge 2008) 15; Jules L Coleman, 'Efficiency, Utility and Wealth Maximisation' (1980) 8 Hofstra Law Review 509, 513; Nathan B Oman, *The Dignity of Commerce* (The University of Chicago Press 2016) 69.

¹⁶⁵ See John Black, Nigar Hashimzade, and Gareth Myles, *A Dictionary of Economics* (OUP 2012).

¹⁶⁶ N Kaldor, 'Welfare Propositions of Economics and Interpersonal Comparisons of Utility' (1939) 49 *The Economic Journal* 549, 550.

¹⁶⁷ See Coase (n 27) 2.

¹⁶⁸ Lawson (n 159) 91.

¹⁶⁹ N Kaldor, 'Welfare Propositions of Economics and Interpersonal Comparisons of Utility' (1939) 49 *The Economic Journal* 549, 550.

5.4.3 Welfare Maximisation and Utilitarianism

It is suggested that efficiency will be achieved through moving to maximise overall total welfare, often characterised as maximising social welfare. The claim is that law and economics scholars will deem ‘actions or institutions “efficient” to the extent that they increase or improve ‘social welfare’.¹⁷⁰ This is in line with principles of utilitarianism.¹⁷¹ There are different forms of utilitarianism which could be considered.¹⁷² However, for current purposes it is only necessary to discuss it in a broad sense. Bentham set out that ‘it is the greatest happiness of the greatest number that is the measure of right and wrong’.¹⁷³ Also, that ‘the obligation to minister to general happiness, was an obligation paramount to and inclusive of every other’.¹⁷⁴ According to Mill, utilitarianism ‘holds that actions are right in proportion as they tend to promote happiness, wrong as they tend to produce the reverse of happiness’.¹⁷⁵ Happiness is characterised as ‘intended pleasure, and the absence of pain’ and unhappiness as ‘pain, and the privation of pleasure’.¹⁷⁶ There is a suggestion that utilitarianism will be faced with issues in ‘explaining to someone who loses in a Benthamite calculation why it is fair to make him suffer simply so that others may prosper’.¹⁷⁷ More recently utilitarianism has been said to view that the legitimacy of an action will be tied to whether its outcome will increase the total level of well-being when compared with an alternative. It is focused on acts and will determine whether they are right based on their outcomes.¹⁷⁸

Utilitarianism assumes that happiness is a good in itself. It is irrelevant whose happiness is being considered:

The only thing that matters for a utilitarian is how much happiness there is, and if he takes distributional considerations into account it is only because these have some bearing on the total amount of happiness in the world. From a utilitarian point of view, there is only one

¹⁷⁰ *ibid*, 78.

¹⁷¹ See Generally DE Moore, *Ethics* (OUP 1966) Chapter 1; See also Henry Sidgwick, *The Methods of Ethics* (InteLex Corporation 1995) Chapter 4. For a historical account of Utilitarianism see Ben Eggleston and Dale Miller, *The Cambridge Companion to Utilitarianism* (CUP 2014).

¹⁷² For a discussion of utilitarianism in a legal (specifically tort focused) context see Craig Purshouse, ‘Utilitarianism as Tort Theory: Countering the Caricature’ (2018) 38 *Legal Studies* 24.

¹⁷³ Jeremy Bentham, *A Fragment on Government* (Clarendon 1891) 93.

¹⁷⁴ *ibid*; See also Henry R West, ‘Mill and Utilitarianism in the Mid-Nineteenth Century’ in Ben Eggleston and Dale Miller, *The Cambridge Companion to Utilitarianism* (CUP 2014) 61.

¹⁷⁵ John Stuart Mill, *Utilitarianism* (Roger Crisp ed, OUP 1998) 55.

¹⁷⁶ *ibid*.

¹⁷⁷ Ronald Dworkin, ‘Why Efficiency? - A Response to Professors Calabresi and Posner’ (1980) 8 *Hofstra Law Review* 563, 583.

¹⁷⁸ Krister Bykvist, *Utilitarianism: A Guide for the Perplexed* (Continuum 2010) 18-19.

relevant yardstick by which to assess the morality of actions and institutions: their tendency to increase or decrease overall happiness.¹⁷⁹

It concerns ‘pleasures, satisfactions, or preferences of the actor’,¹⁸⁰ and ‘requires the aggregation of all of the subjective goods of individuals and it considers as best the outcome in which the total of individual satisfactions is maximized’.¹⁸¹

Utilitarianism has been criticised on various occasions from a number of perspectives.¹⁸² A key issue is the subjective nature of pleasures, satisfactions and preferences which are generally intangible. What this means is that they are at best difficult, and at worst impossible to measure effectively. This issue relating to quantification naturally leads us on to economic efficiency in search of an effective measure.

5.4.4 Economic Efficiency

Economists have described efficiency as a ‘making the maximum use of available resources’.¹⁸³ Also, that it concerns the value of output compared with the level of input.¹⁸⁴ It has been likened to Kaldor-Hicks efficiency where ‘a change is efficient when the winners from the change could, in principle, compensate the losers’.¹⁸⁵ Again, it was noted within the prior discussion of the Kaldor-Hicks criterion, that within the context of the discussion of an efficient breach of contract, it is not enough that compensation could be paid. Actual payment of that compensation it is a requirement. The suggestion is that economic efficiency will be achieved when the benefits which flow from resources are maximised.¹⁸⁶ In a market setting, it concerns attempts to maximise the total welfare of buyers and sellers.¹⁸⁷ However, assessing welfare in this way is limited.¹⁸⁸ Attempting to prove a claim that

¹⁷⁹ See Anthony T Kronman, ‘Wealth Maximization as a Normative Principle’ (1980) 9 *Legal Studies* 227, 232; See also Dworkin (n 165) 571.

¹⁸⁰ Ernest J Weinrib, ‘Utilitarianism, Economics and Legal Theory’ (1980) 30 *University of Toronto Law Journal* 307, 309.

¹⁸¹ *ibid.*

¹⁸² See for example JJC Smart and Bernard Williams, *Utilitarianism: For and Against* (CUP 1973); See also Michael Slote, ‘Utilitarianism, Moral Dilemmas, and Moral Cost’ (1985) 22 *American Philosophical Quarterly* 161; Jonathan Glover (ed), *Utilitarianism and its Critics* (Macmillan 1990); Purshouse (n 127).

¹⁸³ Black, Hashimzade and Myles (n 165).

¹⁸⁴ Paul Heyne, *The Economic Way of Thinking* (9th edn, Prentice Hall 2000) 131.

¹⁸⁵ Richard O Zerbe Jr, ‘An Integration of Equity and Efficiency’ (1998) 73 *Washington Law Review* 349, 353

¹⁸⁶ John Sloman, Jon Guest and Dean Garratt, *Economics* (10th edn, Pearson 2018) 12; See also Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 199.

¹⁸⁷ Richard Craswell, ‘Passing On the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships’ (1991) 43 *Stanford Law Review* 361; See also Lawson (n 159) 79-80.

¹⁸⁸ Lawson (n 159) 82: This is because any calculation of total social welfare will encounter the problem of interpersonal comparability. There is ‘no way to add, subtract, compare, or contrast the economic welfare, understood as the satisfaction, of A and B’.

efficiency will be achieved through an increase in total social welfare is difficult because there is no standard measure that every member of society will accept in terms of valuing their own personal preferences or satisfactions.¹⁸⁹ Without such a measure, an increase cannot be proven. With this in mind, it has been noted that ‘while happiness is a philosophical concept that cannot be easily measured, wealth is more practical and measurable’.¹⁹⁰

5.4.5 Wealth Maximisation

Dworkin highlighted a distinction between the economists’ attitude towards efficiency and that which is utilised in the economic analysis of law. The suggestion is that an economist will interpret efficiency to be based on the Pareto measure while those who deal in law and economics will interpret it to mean wealth maximisation.¹⁹¹ Under wealth maximisation, resources will be allocated efficiently when no further reallocation would increase the overall wealth of society.¹⁹² An action will be efficient to the extent that it increases wealth, rather than welfare or utility.¹⁹³ This is an important distinction because unlike welfare, or utility, “wealth” is being used to denote a specific, measurable approach to assessing an increase in value. It relates to ‘the sum of all tangible and intangible goods and services’.¹⁹⁴ This is assessed based on the monetary value attached to those goods and services.

Maximising value is seen as socialistic because if those who improve their position gain more than those who lose, total value can be said to have increased. This is despite the individualistic nature of any valuation.¹⁹⁵ Value is assessed ‘based on what people are willing to pay for something rather than on the happiness they would derive from having it’.¹⁹⁶ Dworkin set out that maximum wealth is achieved ‘when goods and other resources are in the hands of those who value them most, and someone values a good more if and only if he is both willing and able to pay more in money (or in the equivalent of money) to have it’.¹⁹⁷ It concerns only the ‘private wants and preferences of affected individuals, weighted by disposable income’.¹⁹⁸ Claims based on desire alone are excluded. An

¹⁸⁹ *ibid*, 80.

¹⁹⁰ Klick and Parisi (n 10) 602.

¹⁹¹ RM Dworkin, ‘Is Wealth a Value’ (1980) 9 *The Journal of Legal Studies* 191, 194.

¹⁹² RA Posner, ‘The Value of Wealth: A Comment on Dworkin and Kronman’ (1980) 9 *Journal of Legal Studies* 243.

¹⁹³ Lawson (n 159) 92.

¹⁹⁴ RA Posner, *The Problems of Jurisprudence* (1993 edn Harvard University Press) 356.

¹⁹⁵ Frank I Michelman, ‘Norms and Normativity in the Economic Theory of Law’ (1978) 62 *Minnesota Law Review* 1015, 1020.

¹⁹⁶ RA Posner, *The Economics of Justice* (Harvard University Press 1983) 60.

¹⁹⁷ Dworkin (n 179) 191; See also See Anthony T Kronman and RA Posner, *The Economics of Contract Law* (Little, Brown and Company 1979) 1; See also David Campbell, ‘On What is Valuable in Law and Economics’ (1996) 8 *Otago Law Review* 489.

¹⁹⁸ Michelman (n 195) 1032.

inability to pay more for a particular resource than its current owner, or those competing for it will mean that a claim to that resource cannot be established. This is irrespective of the level of desire which is harboured for that resource.¹⁹⁹

Posner disputes claims that wealth maximisation and utilitarianism are synonymous.²⁰⁰ This is due to utilitarianism's focus on happiness rather than wealth.²⁰¹ Wealth maximisation is focused on preferences, which are based on a monetary value within a market.²⁰² Adam Smith set out that the market value of a resource is intrinsically linked to the available quantity and the existing demand.²⁰³ When demand exceeds the available quantity, the value market value will rise. When the available quantity exceeds demand, the market value will be reduced. Finally, where the available quantity is equal to the existing demand, the market value will reflect (or very closely reflect) the natural price.²⁰⁴

The aim of wealth maximisation is to reallocate resources to their most valued use through market transactions. It is claimed that most economists would agree that free markets do, in fact, maximise society's wealth.²⁰⁵ This is based on an implicit acceptance that when resources go through market exchanges they will find their way into the hands of those who value them the most.²⁰⁶ Posner set out that wealth maximisation:

[E]ncourages and rewards the traditional virtues ... and capacities associated with economic progress. The capacities (such as intelligence) promote the efficiency with which resources can be employed; the virtues (such as honesty, and altruism in its proper place), by reducing market transaction costs, do the same.²⁰⁷

Coleman has been critical of Posner's use of wealth maximisation as an alternative to the Pareto criterion as a moral basis for economic analysis.²⁰⁸ It is suggested that wealth maximisation is not an efficiency criterion but 'an alternative to the utilitarian basis for justifying the pursuit of efficiency- in this case, Kaldor-Hicks efficiency'.²⁰⁹ The dispute concerns whether increased wealth is synonymous with increased utility. Concern is also raised regarding the claim that wealth maximisation is capable of providing a moral defence for the pursuit of a Kaldor-Hicks

¹⁹⁹ Posner (n 192).

²⁰⁰ Posner (n 30).

²⁰¹ See Klick and Parisi (n 10) 602.

²⁰² Posner (n 30) 119.

²⁰³ This approach is referred to as 'The Invisible Hand' where competitive markets facilitate the movement of resources to where they are valued most.

²⁰⁴ See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Liberty Classics 1981).

²⁰⁵ RA Posner, *The Economics of Justice* (Harvard University Press 1983) 67.

²⁰⁶ See Sloman and Garratt (n 39) 21; also Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 110-111; Anthony T Kronman and RA Posner, *The Economics of Contract Law* (Little, Brown and Company 1979) 1; David Campbell, 'On What is Valuable in Law and Economics' (1996) 8 Otago Law Review 489.

²⁰⁷ Posner (n 30) 124.

²⁰⁸ Coleman (n 24) 1114.

²⁰⁹ *ibid*, 1115.

improvement.²¹⁰ The suggestion is that maximising wealth is objectionable because it is defined by an individual's willingness to pay. This is problematic because it favours parties who possess greater levels of money or necessary resources.²¹¹ It is also set out that Posner's approach, where 'monetary value is not an instrument of measuring the maximand; it is the maximand'²¹² is implausible because money is not a moral good. Further, that 'a rich person is not ipso facto morally superior to a poor one'.²¹³ With this in mind, the claim is that the way in which Posner's wealth maximisation principle is different to utilitarianism is that it demands that ethical issues are monetised.²¹⁴

It is legitimate to utilise wealth maximisation, where efficiency is assessed using monetary value as a measure when discussing the efficient breach of commercial contracts. This is on the basis that the primary reason for their existence is the production of profit. It is acknowledged that assessing wealth (or welfare, or utility) in this way may not be appropriate in other settings. However, there are no issues regarding the use of this approach for the purposes of this specific analysis.

5.4.6 Conclusion

Ultimately, it is the case that in assessing efficiency, it is important to keep in mind the context in which it is being done. It has been set out that there is a variety of approaches which may be adopted and that it is important to consider wealth maximisation because efficient breach is built on the idea that it is a legitimate goal. While there are potential moral issues with this approach based on the use of money, or monetary value to measure utility, it will be outlined that this is not the case within the context of commercial contracting. This is due to the underlying profit driven motivation behind it. With this in mind, this analysis will proceed on the basis that an approach which is in line with the Kaldor-Hicks criterion (featuring the actual payment of damages) and wealth maximisation, is legitimate when the efficient breach of commercial contracts is being considered.

5.5 Efficiency Based Decision Making

A key claim which this thesis makes is that when an opportunity to breach efficiently arises, it does not necessarily have to be acted upon. However, should a party choose to pursue it, that course of

²¹⁰ *ibid.*

²¹¹ See Kronman (n 179) 240.

²¹² Weinrib (n 180) 311.

²¹³ *ibid.*

²¹⁴ *ibid.*, 315.

action will be justified. What they have available is efficient optionality. It is the case that when an opportunity to breach efficiently arises, a contracting party will have a decision to make. This will involve carrying out a cost-benefit analysis. In this case, it will be a subjective measure based on the individual preferences of the party involved. There are some natural limitations placed on this however. These are based on bounded rationality.

5.5.1 Cost-Benefit Analysis

Making a decision regarding an efficient breach would likely involve the application of a cost-benefit analysis which is based on following a particular course of action ‘only if the sum of the measures of its costs and benefits is positive’.²¹⁵ Its requirements are said to be synonymous with those of a potential Pareto improvement. This is otherwise known as an outcome that will be Kaldor-Hicks efficient.²¹⁶ There is also an implicit assumption that it will be measurable by units of currency.²¹⁷ As a result, there are difficulties in terms of integrating elements which concern a social welfare function. This leads to the suggestion that it should be confined to estimating only monetary gain and loss.²¹⁸

The relevance of a cost-benefit analysis is informing decisions based on the balance of probability, as well as the preferences of the decision maker. It has been set out that any information ‘when reduced to a single point of time by acceptable methods, are to be interpreted as contributions, positive or negative, to the magnitude of some resulting Pareto improvement’.²¹⁹ It is intuitive that some type of cost-benefit analysis will play a role where parties are considering an efficient breach. They may simply consider the total value of performance vs the total value of breach in a specific transaction. However, they may opt to take into account other factors beyond costs and benefits in a monetary sense. These could include the potential impact on their relationship with the other party, or the potential damage which may be caused to their reputation within a particular industry, for example. The next point for discussion are the limits which bounded rationality will place on a cost-benefit analysis.

²¹⁵ D Copp ‘The Justice and Rationale of Cost-Benefit Analysis’ (1987) 23 *Theory and Decision* 65, 68.

²¹⁶ Mishan (n 157) 14; See also 5.4.2 The Kaldor-Hicks Criterion.

²¹⁷ Wolfgang Weigel, *Economics of the Law: A Primer* (Routledge 2008) 15; See also Cento Veljanovski, *The Economics of Law: An Introductory Text* (Institute of Economic Affairs 1990) 41.

²¹⁸ See EJ Mishan, *Economic Efficiency and Social Welfare (Routledge Revivals): Selected Essays on Fundamental Aspects of the Economic Theory of Social Welfare* (Reprint edn, Routledge, 2012) 165.

²¹⁹ Mishan (n 157) 15.

5.5.2 Bounded Rationality

There is inherent uncertainty when utilising a cost-benefit analysis due to bounded rationality.²²⁰ This concerns the limitations which exist in relation to the information-processing capacity of an individual.²²¹ It exists because ‘people are not omniscient; their information is imperfect and improvable only at a cost’.²²² Limits on a party’s rationality include a lack of perfect knowledge, incomplete information regarding potential alternatives, and an inability to calculate the best course of action based on complexity in assessing cost as well as other environmental constraints.²²³ However, this does not negate the process. Parties will be able to make decisions based on the information which they possess, as well as informed predictions.

5.5.3 Behavioural Economics

There is a view that people ‘are not entirely rational in any strict sense of the term’.²²⁴ This refers to rationality in an individual utility maximising sense. The role of behavioural economics is to test whether or not people operate in a way which is representative of the homo-economicus model upon which economic analysis of the law has relied.²²⁵ The suggestion is that while useful, predictions based on the model are limited based on the impact of bounded rationality, biases, heuristics, willpower and the limits to which people are truly self-interested.²²⁶ This is on the basis that ‘human beings make mistakes in their judgment and decision-making. These mistakes are predictable, pervasive, and difficult to correct’.²²⁷ This could have an impact on the decisions which individuals

²²⁰ See 6.5.2 Bounded Rationality, Transaction Costs and Pre-Breach Predictions.

²²¹ HA Simon, ‘Theories of Bounded Rationality’ in CB McGuire and Roy Radner (eds), *Decision and Organization: A Volume in Honor of Jacob Marschak* (North-Holland Publishing Co 1972) 162; Richard H Thaler, *Quasi Rational Economics* (Russell Sage Foundation 1994); John Conlisk, ‘Why Bounded Rationality?’ (1996) 34 *Journal of Economic Literature* 669.

²²² VP Goldberg ‘Relational Exchange’ (1980) 23 *American Behavioural Scientist* 337, 339.

²²³ Simon (n 209) 163-164.

²²⁴ Jonathan Baron, ‘Heuristics and Biases’ in Eyal Zamir and Doran Teichman (eds), *Oxford Handbook of Behavioral Economics and the Law* (OUP 2014) 31.

²²⁵ Christine Jolls, Cass R Sunstein and Richard Thaler, ‘A Behavioral Approach to Law and Economics’ (1998) 50 *Stanford Law Review* 1471, 1476.

²²⁶ *ibid*; See also Amos Tversky and Daniel Kahneman, ‘Judgment under Uncertainty: Heuristics and Biases’ (1974) 185 *Science* 1124; Oren Bar-Gill, *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets* (OUP 2012) 9: The focus here is consumer contracts though the points regarding imperfect rationality are equally relevant.

²²⁷ Thomas S Ulen, ‘The Importance of Behavioral Law’ in Eyal Zamir and Doran Teichman (eds), *Oxford Handbook of Behavioral Economics and the Law* (OUP 2014) 91.

make. They could be based on preferences which are not driven by rationality in a wealth maximising sense. They could also be influenced by other social preferences,²²⁸ or by happiness and utility.²²⁹

Sunstein notes that a gap in relation to the application of the behavioural approach ‘is especially important for economic analysis of law’²³⁰ on the basis that it is concerned with non-market behaviour to a large degree. Further, that it is within non-market transactions ‘that from the conventional model are - it is generally conceded-most likely to occur’.²³¹ Additionally, it is notable that ‘the principal general difficulty of modern economic theory is surely the difficulty of assigning weights to the values which are to be incorporated in a decision’.²³² However, it is within the context of commercial contracting, where acting rationally in terms of seeking to maximise wealth seems intuitive. This, by its very nature allows weight to be assigned to values in a monetary sense. Again, this is not to say that parties to commercial contracts must act in this way as it is important to make clear that this is not prescriptive approach. This means that other relevant preferences may play a roll. As such, the only claim is that a party will be justified in breaching efficiently should they choose to.²³³ This justification applies to the party’s choice to breach efficiently, and also, to the law’s approach in limiting the available remedy to expectation damages.

5.5.4 Conclusion

In relation to the overarching intention of this thesis, the key point here is that in the case of an efficient breach, a breaching party will make a decision which is informed by efficiency. However, there are other factors which may contribute to it. The total value of performance vs the total value of breach may simply be considered. Additionally, factors beyond costs and benefits in a monetary sense (such as impact on a contracting relationship or industry reputation) may also be taken into account. There is, of course an inherent level of uncertainty when utilising a cost-benefit analysis due to bounded rationality. However, this does not negate the legitimacy of the claim. This is because contracting parties will be capable of making decisions based on the information which they possess alongside informed predictions. The homo-economicus model has limitations. However, within the context of commercial contracting, acting in line with this approach seems intuitive based on the profit generation focus of commercial agreements. Most importantly, this is not intended to suggest that parties will act in this way. The only claim is that they will be justified in doing so should they

²²⁸ Edward Cartwright, *Behavioral Economics* (2nd edn, Routledge 2014) 320.

²²⁹ *ibid*, 465.

²³⁰ Cass R Sunstein, ‘Behavioral Analysis of Law’ (1997) 64 *The University of Chicago Law Review* 1175, 1176.

²³¹ *ibid*.

²³² Holahan and Sussna (n 13) 238.

²³³ See 5.5 Efficiency Based Decision Making.

choose to. Once again, this applies to the breaching party's choice, as well as to the law's approach in limiting the available remedy to the expectation measure of damages. The use of this remedy in commercial contract disputes effectively condones the breach.

5.6 Issues with Pursuing Economic Efficiency

The pursuit of economic efficiency is, in a general sense, contentious. This is because economic efficiency will, by design, be less concerned with whether a process by which an outcome is achieved is fair, just or moral. Focus is on whether that outcome is economically efficient however that outcome is achieved.²³⁴ It is important to deal with these issues effectively because the theory of efficient breach with regard to commercial contracts relies on the pursuit of economic efficiency in a specific, and legitimate setting.

There is a view that issues such as justice and equity should not be judged based on efficiency.²³⁵ Further, that a legislator can legitimately adopt policies that are not necessarily efficient based on moral reasoning.²³⁶ Posner has been criticised for 'not sufficiently reminding his readers, that the inefficient result may be socially desirable, either because it is more just or fair or is designed for some other legitimate social purpose'.²³⁷ There is also a claim that simply pursuing efficiency 'says nothing about what the decision maker is or ought to be trying to do'.²³⁸ It will be set out that whilst economic efficiency is not a justifiable goal in many legal settings, it can be legitimised with respect to the efficient breach of commercial contracts. Again, this is due to the underlying profit production intent which underpins those contracts, and the parties' reasons for entering them.

5.6.1 Application to the Criminal Law and Judicial Decision Making

Issues may arise relating to the potential application of economic analysis to the criminal law, as well as to judiciary's decision making. In criminal law there is potential for a clash between punishing criminal acts and the forward looking nature of economics in terms of deterrence. It is suggested that 'punishment is justified if and to the extent that it produces a desired state of affairs; if the optimal

²³⁴ Paul Burrows and Cento G Veljanovski, *The Economic Approach to Law* (Butterworths 1981) 17.

²³⁵ See Tomasz Machelski 'A Critique of Law & Economics – An Austrian School Perspective' (2012) 31 *Studies in Logic, Grammar and Rhetoric* 207, 217; See also Eyal Zamir and Barak Medina, *Law, Economics, and Morality* (OUP 2010) 1.

²³⁶ See Russell Hardin, 'The Morality of Law and Economics' (1992) 11 *Law and Philosophy* 331, 333.

²³⁷ Partlett (n 11) 243.

²³⁸ Holahan and Sussna (n 13) 235.

degree of punishment so derived is out sync with intuitions about the reprehensibility of a particular crime, so much the worse for those intuitions'.²³⁹ This means that whilst it may not be cost-effective to punish certain criminal acts, other factors may require that it takes place.

On judicial decision making it is suggested that 'the economic analysis of law provides an inadequate account of judicial behaviour because economic models are incompatible with a jurisprudence that recognizes basic rule-of-law values'.²⁴⁰ Additionally the judicial process is said to be 'ill equipped to register and consider all the costs and benefits that might flow from a particular decision ... it is impossible for a passive judiciary to identify all the external effects of its actions'.²⁴¹ Also that one may question 'whether judges have the authority to seize upon a private dispute framed by and in terms of the respective litigant's interest as an opportunity to promote desirable social policies, for example, efficiency and distributional justice'.²⁴² Ultimately these are criticisms of the way in which the consideration of moral principles may be limited within the economic analysis of law.²⁴³

5.6.2 Could Economic Efficiency Lead to Efficient Crime or Efficient Tort?

One may also look to the suggestion that the economic approach, more specifically wealth maximisation, could lead to issues such as efficient crime or efficient tort. This issue will be dealt with in more detail in chapter 6.²⁴⁴ For now it is emphasised that an approach in line with wealth maximisation is only being suggested in the context of the breach of commercial contracts. This will mean that because loss or damage may be adequately compensated through an award of damages, it will satisfy the Kaldor-Hicks criterion. This would not necessarily be the case in other areas of the law because unlike parties to commercial contracts, affected parties cannot be presumed to act with the underlying intention of generating a profit.

²³⁹ Dan M Kahan, 'The Theory of Value Dilemma: A Critique of the Economic Analysis of Criminal Law' (2002) John M Olin Center for Studies in Law, Economics, and Public Policy Working Papers, Paper 280, 1.

²⁴⁰ Neil S Siegel, 'Sen and the Hart of Jurisprudence: A Critique of the Economic Analysis of Judicial Behavior' (1999) 87 California Law Review 1581, 1582.

²⁴¹ Malcolm Feeley, 'Economic Analysis of Law – Book Review' (1977) 71 The American Political Science Review 422.

²⁴² Jules Coleman, 'Efficiency, Utility, and Wealth Maximization' (1980) 8 Hofstra Law Review 509, 550.

²⁴³ See Hardin (n 236) 381.

²⁴⁴ See 6.2.3.2 Efficient Crimes and Efficient Torts relating to Property.

5.6.3 The Issue of Interpersonal Comparisons

It is clear that the pursuit efficiency has issues because ‘unless one is willing to make interpersonal comparisons ... it simply cannot be said that such an uncompensated Kaldor-Hicks move is an improvement’.²⁴⁵ This means that attempts to utilise efficiency outside the realm of market transactions is problematic.²⁴⁶ Coleman notes that interpersonal utility comparisons must be made in order to establish whether the efficiency test has been satisfied. This requires that a net gain in utility is created as it is necessary to know whether the winners in a given scenario have won more than the losers have lost.²⁴⁷ Katz sets out that economic efficiency does not illustrate whether goals like material gain, private profit, protection of the environment, or social justice are legitimate. Rather, its function is to demonstrate how best these goals could be pursued.²⁴⁸

Pursuing economic efficiency is legitimised based on the belief that total wealth will be promoted. This will take place when rational self-interested individuals engage in the process of free exchange and the belief that Pareto improvements will ultimately increase utility. Calabresi noted that the approach ‘only necessarily serves “utility” on the most peculiar, not to say absurd, assumption about the relationship between wealth and utility, namely, that \$1 is as likely to be worth as much to the rich person as to the poor person’.²⁴⁹ Also that an efficiency move based on maximising wealth is ‘merely instrumental and needs to be attached to some account of what it is instrumental toward before it can be evaluated’.²⁵⁰

5.6.4 Conclusion

Any case which is made for efficient breach in a particular context must accept that the pursuit of efficiency (or wealth maximisation), where monetary value is the measure is a legitimate and justifiable goal. This is a key requirement within this thesis because ultimately, the intention is to justify the efficient breach of commercial contracts. There is a suggestion that law and economics differs from neoclassical economic theory where efficiency yields predictions of the behaviour of a

²⁴⁵ Guido Calabresi, ‘The Pointlessness of Pareto: Carrying Coase Further’ (1991) 100 *The Yale Law Journal* 1211, 1223.

²⁴⁶ Hardin (n 236) 339.

²⁴⁷ Coleman (n 242) 519.

²⁴⁸ Avery Katz, ‘Economic Foundations in Contract Law’ in Gregory Klass, George Letsas and Prince Saprai (eds), *Philosophical Foundations of Contract Law* (OUP 2014) 174.

²⁴⁹ Guido Calabresi, ‘About Law and Economics: A Letter to Ronald Dworkin’ (1980) 8 *Hofstra Law Review* 553, 556.

²⁵⁰ *ibid.*

party based on promoting their own interests.²⁵¹ This is because economic efficiency has a clear role and a direct influence within economics, but the same cannot be said of the law. While some areas of the law can potentially be illuminated by economic reasoning, there are others that cannot.²⁵² This issue will be touched upon in discussing the legitimacy of economic theories of contract. The suggestion will be made that economic reasoning, more specifically the pursuit of efficiency, will be appropriate in certain settings and that commercial contracting is such a setting. This is because commercial contracts exist primarily to facilitate the generation of profit for the parties involved, therefore it follows that pursuing wealth maximisation will be legitimised.

5.7 Economic Theories of Contract

Economic theories of contract seek to interpret or explain contract law using economic analysis. Contract law is considered by many to be the natural environment for the application of economic analysis,²⁵³ and that there is an economic basis of contract law.²⁵⁴ A recurring theme regarding the intention of contract law is that it seeks to outline which contracts should be enforceable, as well as which remedies should be available following breach.²⁵⁵ From the perspective of an economic theory, contract law aims to facilitate, as well as to promote efficient exchanges. This means that they will help a good or service find its way into the possession of the party who values it most. It is set out that ‘contract law has developed over the centuries as a means of facilitating economic exchanges’.²⁵⁶ Also, that ‘contract law enables people to make credible commitments to cooperate with each other. They maximise the gain from cooperation when law creates efficient incentives for performance and reliance’.²⁵⁷ Accordingly, the economic view regarding the intention behind contractual remedies will first be introduced. This will be followed by highlighting some of the criticism which has been directed at the economic analysis of contract law before outlining the role which the court plays in the application and enforcement of contract law. It will be set out that the most appropriate way to

²⁵¹ See Hardin (n 236) 342.

²⁵² Cooter (n 31) 1266.

²⁵³ See for example Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 150.

²⁵⁴ See Anthony T Kronman and RA Posner, *The Economics of Contract Law* (Little, Brown and Company 1979) 10; Cites Thomas Hobbes, *Leviathan* (Blackwell) 192-196; John Umbeck, ‘A Theory of Contract Choice and the California Gold Rush’ (1978) 20 *Journal of Law and Economics* 421; Robert L Birmingham, ‘Legal and Moral Duty in Game Theory: Common Law Contract and Chinese Analogies’ (1969) 18 *Buffalo Law Review* 99, 103 - 110; Gordon Tullock, *The Logic of the Law* (Basic Books Inc 1971) 35-47; Charles O Hardy, *Risk and Risk-Bearing* (University of Chicago Press 1923) 1-5 and 60-61; Oliver Wendell Holmes, *The Common Law* (1881) 298-305; Ronald H Coase, ‘The Nature of The Firm’ (1937) 4 *Economics* 386, 390-392.

²⁵⁵ Miceli (n 3) 88; See also Robert Cooter and Thomas Ulen, *Law and Economics* (6th edn, Pearson 2013) 299; Lewis A Kornhauser ‘An introduction to the economic analysis of contract remedies’ (1986) 57 *University of Colorado Law Review* 683, 685.

²⁵⁶ Hirsch (n 42) 105.

²⁵⁷ Robert Cooter and Thomas Ulen, *Law and Economics* (6th edn, Pearson 2013) 297.

use economic theories of contract, or to apply economic principles to contract law is to do so only where it is appropriate. Once again, the claim is that commercial contracting is an appropriate setting based on the underlying profit driven motives which underpin such contracts.

5.7.1 The Intention of Contractual Remedies

The suggestion within economic theories of contract is that remedies are intended to induce efficient actions and that individuals seek to enter into contracts featuring terms that will maximise their own profits.²⁵⁸ For example, it is set out that that damage awards ‘should induce the seller to perform when the parties would have so agreed, and in other cases to provide the appropriate alternative performance in damages’.²⁵⁹ In addition, it is suggested that the courts should look to enhance the efficiency of contracting by providing missing terms should contracts be incomplete, as well as to maximise the gains which flow from trade.²⁶⁰ This reference to trade suggests a focus on commercial transactions within a market. However, while inducing efficient actions may be the intention of standard compensatory damage awards, it must be noted that this will not necessarily be the case for other remedies which can occasionally be awarded for breach of contract.

Specific performance is a discretionary remedy for breach of contract which is not utilised on a regular basis. Importantly, it will not be awarded where an award of damages is deemed to be adequate.²⁶¹ It requires that a contract is performed in specie.²⁶² Importantly, specific performance will only be enforced when it is deemed appropriate to do so.²⁶³ It is intended to provide exactly what the contract specified rather than its monetary equivalent. This is an issue which will be discussed at greater length later.²⁶⁴ For now it is sufficient to note that specific performance exists as a contractual remedy which, on occasion, can be utilised for a purpose which does not induce an efficient action. Next, disgorgement (or account of profit) requires that a defendant must turn over any profit which they accrue as a result of the breach.²⁶⁵ This may take place without causing any loss to a claimant in terms of a reduction on wealth, but could deprive them of ‘the opportunity to charge the defendant for permission to carry on the activity which has led to the defendant's enrichment’.²⁶⁶ It is intended

²⁵⁸ Kornhauser (n 35) 692.

²⁵⁹ *ibid*, 698.

²⁶⁰ See Miceli (n 3) 89-90.

²⁶¹ Hugh G Beale, *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 26-042.

²⁶² *ibid* 27-003–27-004.

²⁶³ See *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1.

²⁶⁴ See 6.2.1.7 Specific Performance.

²⁶⁵ Beale (n 261) 29-159; See also The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 15-001; *Attorney General v Blake* [2001] 1 AC 268; *Experience Hendrix v PPX Enterprises Inc* [2003] 1 All ER (Comm) 830 CA.

²⁶⁶ *ibid*, 29-145.

to punish what is perceived to be wrongful conduct on the part of the defendant. Again, this remedy for breach of contract will be discussed in more depth in chapter 6.²⁶⁷

The important point is that whilst these remedies exist, they will not be problematic with regard to the efficient breach of commercial contracts. This is on the basis that the types of behaviour which would trigger their use will not necessarily be evident.²⁶⁸ In this specific sense then, the idea that remedies in the form of compensatory damages for the breach of commercial contracts can be said to seek to induce efficient actions.

5.7.2 Criticism of the Economic Analysis of Contract Law

There has been some criticism of the application of economic analysis to contract law. This is based on a perceived failure to fully explain it using economic principles. There are three parts to this criticism. First, it is suggested that economics ‘does not explain why expectation damages are the standard remedy ... or why liquidated damages are not always enforced’.²⁶⁹ Second, that ‘it does not explain the function of the consideration doctrine or promissory estoppel’.²⁷⁰ Third, that ‘it does not explain why the law sometimes encourages people to disclose information and at other times does not’.²⁷¹ In response, Craswell suggests that the most important goal of economic analysis has been misidentified, outlining that the normative goal which economists pursue ‘does not demand a fully worked out theory with complete and close-ended answers’.²⁷² Rather, its goal is simply to shed more light on contract rules.²⁷³

With this in mind, the suggestion is that the economic approach should be utilised where it is most appropriate to do so. This is in place of attempting to use it to explain contract law in its entirety. In this case, the context of commercial contracting provides what can be described as a natural environment for economic principles to be utilised.²⁷⁴ This is based on the intention to generate profit which underpins commercial contracts.²⁷⁵ This is an intention which aligns with wealth

²⁶⁷ See 6.2.1.5 Punitive Damages and Disgorgement.

²⁶⁸ See 6.2.1.8 Conclusion.

²⁶⁹ EA Posner, ‘Economic Analysis of Contract Law after Three Decades: Success or Failure?’ (2003) 112 Yale Law Journal 829, 880.

²⁷⁰ *ibid.*

²⁷¹ *ibid.*

²⁷² Richard Craswell, ‘In That Case, What Is the Question? Economics and the Demands of Contract Theory’ (2003) 112 Yale Law Journal 903, 923-924.

²⁷³ *ibid.*, 924.

²⁷⁴ See Mitchell (n 253) 150.

²⁷⁵ See 2.8 Overall Conclusion.

maximisation. Because of this, the economic approach can be utilised effectively. In other areas of contract law, or the law more generally, this would not be the case.

5.7.3 Conclusion

The most suitable way to utilise economic theories of contract, or equally to use economic principles to interpret or analyse contract law is to do so only where it is appropriate. This is far more functional than attempting to explain the entirety of contract law.²⁷⁶ The claim which this thesis makes is that the setting of commercial contracting is an appropriate area of contract law in which certain economic principles (such as a preference for wealth maximisation) may be applied. This is based on the underlying profit driven motives of the parties to a commercial contract.

5.8 Measures of Damages

Within any discussion of efficient breach, it is vital that the issue of compensatory damages is dealt with. This is because their legitimacy is a foundational feature in terms of justifying any version of the theory. Birmingham set out that ‘efficiency requires a measure of damages for breach of contract which places the innocent party in as good a position as he would have been in if default had not occurred rests largely in the presumed relevance of the competitive model to the modern market system’.²⁷⁷ There exists a preference for monetary damages where it is adequate.²⁷⁸ Damages seek to provide compensation for any damage, loss or injury suffered as a result of that breach intended to place the injured party on the position they would have found themselves had the contract been performed to the extent that money can achieve it.²⁷⁹ Eisenberg highlights the indifference principle which requires that ‘contract remedies should be designed to make a promisee indifferent between performance by the promisor and legal relief for breach’.²⁸⁰ There are three primary methods of measuring damage awards which are generally acknowledged by law and economists. These are the

²⁷⁶ See Craswell (n 272) 924.

²⁷⁷ Birmingham (n 59) 285-286.

²⁷⁸ See *Co-Operative Insurance v Argyll Stores* (n 218); See also Beale (n 261) 27-005.

²⁷⁹ Beale (n 261) 26-001; See also Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (2nd edn, CUP 2006) 74; Neil Andrews, Malcolm Clark, Andrew Tettenborn and Graham Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (2nd edn, Sweet & Maxwell 2017) 405; Hirsch (n 42) 116; *Robinson v Harman* (1848) 1 Ex. 850, 855; *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Blackburn LJ).

²⁸⁰ Eisenberg (n 65) 1049.

restitution interest, the reliance interest, and the expectation interest. There is also a suggestion that there could be scope to protect a fourth interest based on the cost of a lost opportunity.

5.8.1 Restitution, Reliance and Loss of Opportunity

The restitution interest concerns recovery of a benefit where one party has paid money, or alternatively conferred some other type of benefit on another. It seeks to restore any payments which are made prior to a breach.²⁸¹ The intention is to restore the performance interest, rather than providing compensation for harm or loss.²⁸² This gains-based recovery system is more commonly seen following breach of trust, however, in exceptional cases it may be extended to breach of contract.²⁸³

The reliance interest concerns losses or expenses which a victim of breach has incurred. It seeks to place the wronged party in the position which they would have been in had the contract never been made.²⁸⁴ It is said to warrant protection because it is based on the amount by which a victim of breach has lost.²⁸⁵ A claimant is only able to claim for the value for any wasted expenses incurred in anticipation of contractual performance.²⁸⁶ This is limited to expenses which are incurred after the contract has been made.²⁸⁷ Claimants will be required to choose to claim for wasted expenditure or to claim for lost profits.²⁸⁸ The suggestion is that a claimant will be likely to seek damages based on the reliance interest should they lack adequate proof to demonstrate their loss based on the expectation interest, or where a contract has become unprofitable, meaning that a net loss could not

²⁸¹ Miceli (n 3) 74; Nicholas Mercuro and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2nd edn, Princeton University Press 2006) 142.

²⁸² See *Target Holdings Ltd v Redfern* [1996] AC 421, 439 (Browne-Wilkinson LJ); See also *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58.

²⁸³ See *Attorney General v Blake* [2001] 1 AC 268, 285 (Nicholls LJ); Neil Andrews, Malcolm Clark, Andrew Tettenborn and Graham Virgo, *Contractual Duties: Performance, Breach, Termination and Remedies* (2nd edn, Sweet & Maxwell 2017) 562; TT Arvind, *Contract Law* (OUP 2017) 519.

²⁸⁴ See *Omak Maritime Ltd v Mamola Challenger Shipping Co Ltd* [2010] EWHC 2026 (Comm) [38] (Teare J); See also *Lloyd v Stanbury* [1971] 1 WLR 535, 544 (Brightman J); Nicholas Mercuro and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2nd edn, Princeton University Press 2006) 142; Cooter and Ulen (n 257) 303.

²⁸⁵ Beale (n 261) 26-019; See also The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 4-036; Andrew Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP 2004) 64.

²⁸⁶ Beale (n 261) 26-021; See also *Saint Line Ltd v Richardsons, Westgarth & Co Ltd* [1940] 2 KB 99, 105.

²⁸⁷ See *Anglia TV v Reed* [1972] 1 WB 60; [1971] 3 WLR 528.

²⁸⁸ *ibid* 528; See also *CCC Films (London) v Impact Quadrant Films* [1985] QB 16; *Filobake Ltd v Rondo Ltd* [2005] EWCA Civ 563 [64]-[65]; The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 4-028.

be proven.²⁸⁹ Reliance will likely be simple to measure as any claim will reflect expenditure which has already taken place.

Cooter and Ulen suggest the Opportunity Cost measure.²⁹⁰ This is very much like the English concept of loss of chance.²⁹¹ This is subject to the limits imposed by remoteness and causation.²⁹² It is set out that:

[I]n some cases the amount of the claimant's loss cannot be precisely ascertained because it is not known what would have happened had the defendant not broken the contract, as, for example, where whether the claimant would have made a profit or gained some advantage depends on a contingency, does not deprive the claimant of a remedy.²⁹³

The suggestion is that entering into a contract may lead to the potential loss of an opportunity to negotiate an alternate contract elsewhere. This measure of damages would be calculated based on the value of the lost opportunity.²⁹⁴ However, it would potentially be harder to measure than the expectation interest as it would require information regarding potential alternate contracts. Also, problems may arise because the courts are wary of awarding hard to measure damages.²⁹⁵

5.8.2 The Expectation Interest

The expectation interest concerns any benefit which the victim legitimately expected to receive following a contract's completion. It will take into account loss of profit which stems from breach.²⁹⁶ Its aim is to place the wronged party in the equivalent position to that which they would have found themselves in had the contract been performed.²⁹⁷ The claim is that an award which reflects the

²⁸⁹ Beale (n 261) 26-024.

²⁹⁰ Cooter and Ulen (n 257) 304.

²⁹¹ See Beale (n 261) 26-016; See also The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 10-040; *Chaplin v Hicks* [1911] 2 KB 786; *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602, 1623; *Kitchen v Royal Air Force Association* [1958] 1 WLR 563.

²⁹² *ibid*, 26-058.

²⁹³ *ibid*, 26-016.

²⁹⁴ Cooter and Ulen (n 257) 303.

²⁹⁵ See Steven Shavell, 'Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts' (2009) 107 *Michigan Law Review* 1569, 1575.

²⁹⁶ See for example *MMP GmbH v Antal International Network Ltd* [2011] EWHC 1120 (Comm); See also *J P Morgan Chase Bank v Springwell Navigation Corp* [2006] EWCA Civ 161; *Jackson v Royal Bank of Scotland plc* [2005] UKHL 3; [2005] 1 WLR 377; *Cottrill v Steyning and Littlehampton Building Society* [1966] 1 WLR 753; TT Arvind, *Contract Law* (OUP 2017) 476.

²⁹⁷ See *Flame SA v Glory Wealth Shipping PTE Ltd* [2013] EWHC 3153 (Comm) [18]; See also Beale (n 261) 26-021; The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 4-007; TT Arvind, *Contract Law* (OUP 2017) 474. Nicholas Mercurio and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2nd edn, Princeton University Press 2006) 141; Cooter and Ulen (n 257) 301.

expectation interest will lead to indifference between contractual performance and breach.²⁹⁸ There is a claim that expectation damages is the only measure which promotes efficiency whilst discouraging inefficiency.²⁹⁹ With this in mind, it is set out that the expectation measure ‘is the primary measure for damages for breach of contract’.³⁰⁰ There is a suggestion that this interest is ‘perhaps the weakest claim to protection, since it represents something that the victim did not have before the contract was made’.³⁰¹ However, it is clear that the legitimacy of any defence of efficient breach rests on the functionality of the expectation measure. The need to adequately compensate the legitimate expectations of a party who suffers a breach cannot be underestimated. The most obvious point to note regarding the expectation measure is that if a payment of damages is less than the legitimate expectation, the breach which has occurred is by default inefficient and thus illegitimate.³⁰² This is because the key justification for the measure is protecting the expectation of the party who suffers the effects of a breach. The discussion of the efficient breach of commercial contracts within the remainder of this thesis will proceed on the basis that the expectation measure will fulfil the necessary compensatory requirements which arise.

5.8.3 Conclusion

The expectation measure is the foundational principle upon which the theory of efficient breach is built. Early on, it was acknowledged that the principle of compensation will be consistent with the theory of efficient breach on the basis that it will lead to resources being allocated to higher value uses after the payment of compensation.³⁰³ If the damages in question were less than the expectation, this would not be achieved. As Shavell notes, issues would arise where damages are less than the amount required to meet the victim’s expectation. Further, that because breach is more likely to take place where the cost of performance exceeds the cost of paying damages, there would be a moral hazard should the measure of damages fall short of a claimant’s legitimate expectation.³⁰⁴

²⁹⁸ Cooter and Ulen (n 257) 301.

²⁹⁹ Nicholas Mercuro and Steven G Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2nd edn, Princeton University Press 2006) 141.

³⁰⁰ Beale (n 261) 26-021; See also The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 4-036; Andrew Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP 2004) 34-38; Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (2nd edn, CUP 2006) 75.

³⁰¹ Beale (n 261) 26-019; See also The Hon Mr Justice James Edelman, Dr Jason Varuhas, Simon Colton (eds), *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 4-036.

³⁰² Steven Shavell, ‘Is Breach of Contract Immoral?’ (2007) 56 *Emory Law Journal* 439, 441.

³⁰³ Goetz and Scott (n 68) 558.

³⁰⁴ Shavell (n 302) 450.

5.9 Overall Conclusion

This chapter sought to provide detail on some of the key elements relating to efficient breach. The economic analysis of law was introduced before setting out some of the criticisms which have been directed at it. The criticisms were not problematic on the basis that the claims which are made relate to the breach of commercial contracts. The theory of efficient breach was then outlined to ensure that it was fully understood. This was followed by a discussion of efficiency because it was necessary to understand the differing approaches which may be adopted. It was also important to justify which ones should be utilised within commercial contracting. The role which efficiency may play within decision making was also discussed. The potential issues which may stem from the law's pursuit of efficiency were highlighted. This included the idea that the legal process has a value which extends beyond efficiency. It was noted that efficiency can be of use in appropriate settings. Further, that the efficient breach of commercial contracts is such a setting. It was set out that economic theories of contract seek to assess which contracts should be enforceable, and which remedies should be available following breach. Also, that they tend to adopt an approach geared towards promoting economic efficiency. This involves encouraging the movement of resources into the possession of those who value them most.

The main takeaway points for this chapter are that in the context of commercial contracting it is legitimate to judge efficiency based on the principle of wealth maximisation as well as to utilise the Kaldor-Hicks criterion (where payment of compensation is required). Again, it is important to keep in mind that this claim is limited to commercial contracts only. Also, that a simple approach to defining an efficient breach will be adopted going forward. It will be characterised as involving the breach of a contract's terms where it is more cost effective to do so; taking into account the total cost of performance vs breach and the payment of compensatory damages. This may be done either to reduce loss, or to maximise total gain.³⁰⁵ These key points will be applied throughout the remaining chapters of this thesis. The next step will be to deal with existing criticisms of the theory effectively.

³⁰⁵ See for example Eisenberg (n 65) 997: 'The theory of efficient breach holds that breach of contract is efficient, and therefore desirable, if the promisor's gain from breach, after payment of expectation damages, will exceed the promisee's loss from breach'.

Chapter 6

Criticisms of the Theory of Efficient Breach

6.1 Introduction

This chapter's original contribution comes in setting out why a variety of criticisms which have been directed at the theory of efficient breach do not derail its application to commercial contracts. Dealing with this variety of criticisms with this commercial contract based application in mind is yet to be attempted elsewhere. Providing a systematic treatment of each of these criticisms will allow the application of the theory of efficient breach to be discussed in chapter 7.

Efficient breach has been discussed for many years.¹ Based on the conclusions reached in chapter 5, the approach regarding efficiency that will be utilised is based on wealth maximisation and the Kaldor-Hicks criterion (featuring the actual payment of compensation).² When assessing efficiency it is important to consider the context in which it is being done. The suggestion is that this approach is legitimate when considering breach of commercial contracts. This is justified by adequately compensating parties who suffer a breach through a monetary award. This is efficient on the basis that one party is afforded the opportunity to improve their position and the other is compensated and will be no worse off.

The approach that will be adopted here is thematic. The criticisms of efficient breach which will be considered are grouped into four categories. The first category concerns the potential clashes and contrasts with existing legal doctrines. These include issues relating to awards of damages, namely whether the difficulties inherent in calculating damages are problematic, whether damage awards are naturally under-compensatory, the role of the court, and the potential relevance of awards of nominal and punitive damages as well as the relevance of restitutionary remedies and specific performance. Next is a perceived likeness with a variety of torts including tortious interference with contract, economic duress as well as the tort of intimidation. This will be followed by considering whether efficient breach potentially infringes on property rights. This includes the potential extension of the approach to efficient crimes and efficient torts relating to property. It will then be set out that the duty of good faith in commercial contracting does not inhibit the legitimacy of the efficient breach of commercial contracts. This is because where there is no evidence of improper conduct the duty

¹ See 5.3 The Theory of Efficient Breach.

² See 5.4.3 Welfare Maximisation and Utilitarianism; See also 5.4.2 The Kaldor-Hicks Criterion.

will not be infringed. Finally, a contrast with trust law in terms of execution and remedies will be discussed.

The second category concerns issues relating to the application of an instrumentalist approach to the law. The first consideration is the moral impermissibility of breach of contract.³ This is the most common method by which efficient breach is refuted on the basis that it conflicts with a moral requirement that promises should not be broken. It will be made clear that this is inapplicable to commercial contracts. Next is the potential that moral practices could be corroded. This is in both a business focused and a wider sense and includes the discussion of evidence of a distaste for promise breaking and “opportunistic” breach, the need to cultivate good habits, and the potential impact on business ethics.

The third category concerns commercial practices. These include commercial reality, and the impact of relational contracting. The suggestion that efficient breach would negatively impact the commercial system will then be discounted. This is on the basis that it is the existence of a contract which allows parties to operate knowing that they will be able to pursue a remedy following a breach. Also, that the nature of commercial agreements limits the potential for moral considerations to be drawn upon. Finally, it will be highlighted that the opportunity to breach efficiently does not dictate that an efficient breach will take place, only that it could.

The fourth category concerns potential clashes relating to applying the theory of efficient breach. This will include a discussion of whether an efficient breach is possible in a practical sense, the flaws in some of the current analysis of efficient breach, as well as bounded rationality, transaction costs and pre-risk predictions. It will be set out that there is the potential for, as well as evidence of efficient breach in English contract law. This draws on the discussion of the relevant case law in chapter 5.⁴ Ultimately, it will be concluded that none of these criticisms successfully derail the theory of efficient breach with respect to commercial contracts. It will then be possible to shift focus to making the case for the efficient breach of commercial chapter in chapter 7.

6.2 Potential Clashes and Contrasts with Existing English Legal Doctrines

The first group of criticisms are based on the extent to which the theory of efficient breach clashes with existing English legal doctrines. Grouping these criticisms in this way is a novel approach to take. The issues to be analysed include clashes relating to calculating, as well as awarding damages, a perceived likeness with a variety of torts, as well as a potential infringement on property rights.

³ See Chapter 4.

⁴ See 5.3.3 Examples of Efficient Breach in English Case Law.

Whether any issues stem from the good faith requirement in contracting will also be considered. Regarding commercial contracting, it will be concluded that none of these potential clashes negate the legitimacy of the theory of efficient breach. The final consideration will be the clear contrast that exists with trust law with respect to execution and remedies. It is important to establish that efficient breach is able to fit amongst established legal doctrines in order to make the case for its legitimacy with respect to commercial contracts within English law.

6.2.1 On Damages

The first area of interest concerns the way in which a theory of efficient breach interfaces with damage awards. This includes considering the process by which awards are calculated, as well the problems which exist within it. The suggestion that awards are inevitably under compensatory will then be considered. The role of the court with regard to calculating as well as enforcing awards of damages will also be discussed. Finally, the potential relevance of nominal, as well as punitive damages will be assessed.

It will be set out that in any area of the law, difficulty may arise whenever awards of damages are to be calculated. However, in commercial contracting the process is simplified because loss can be quantified based on market value. It will be noted that it would be bold to attempt to discount the damage calculation process based on inherent difficulties in quantification. Also, that issues would not be raised by an award of nominal damages because the practical implications of an efficient breach would effectively be accepted should such an award be made. The same can be said for punitive damages because an efficient breach of a commercial contract would not exhibit the type of behaviour that would trigger this type of award.

6.2.1.1 Are Inherent Difficulties in Calculating Damages Problematic?

There are issues surrounding whether or not an award of damages to reflect the expectation interest of a contracting party can truly compensate their loss. Eisenberg highlights three problems with this approach. First are the costs attached to dispute settlement on the basis that they would not be incurred following performance.⁵ However, it is obvious that costs are attached to any litigation. Also, it is important to keep in mind that in England, the loser in a contract dispute will, in principle,

⁵ Melvin A Eisenberg, 'Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law' (2005) 93 California Law Review 975, 995.

be responsible for the winner's costs. The court will assess costs based on the relevant civil procedure rules.⁶ Accordingly, it is wrong to discount the legitimacy of efficient breach based on the cost of legal proceedings, especially where the breaching party is responsible for costs. Second are the losses accrued between breach and the payment of damages. The suggestion is that this may be measured by compound interest to reflect the rate attached to borrowing funds during that period.⁷ This is not a novel approach. For example, the late payments of commercial debts are regulated due to the costs which are caused by delays.⁸ Third, that performance will not carry the risk of the breaching party going into insolvency between a breach taking place, and damages being paid.⁹ Whilst this is a risk, at any time there is the potential that a party could become insolvent. It would of course be unfortunate if this took place in the period. However, this is not a strong enough reason to discount efficient breach entirely.

It seems illogical to suggest that damages are inappropriate because they are difficult to calculate. For example, in *Societe des Industries Metallurgiques SA v The Bronx Engineering Co Ltd*,¹⁰ despite difficulty, damages remained the remedy.¹¹ This was because the machinery in question was available from a different supplier.¹² Furthermore, it would be bold to discount the entire damage calculation process based on inherent difficulties in quantification. It is also notable that calculating awards is simplified in commercial settings on the basis that losses will be assessed based on commercial (or market) value. This is particularly straightforward in areas such as commodities and sale of goods. In addition, non-pecuniary losses would not be considered, simplifying the process further.¹³

6.2.1.2 Are Awards of Damages Under Compensatory?

Efficient breach is also criticised based on the damage calculation process. Eisenberg's position is that conventional approaches to damage awards do not fulfil the indifference requirement. This is due to 'the way in which market-price damages are measured, the way in which the uncertainty rule is administered in contract law, and the principle of *Hadley v Baxendale*'.¹⁴ *The Achilles*¹⁵ sets out that it is not enough that possible loss could be foreseen. Responsibility must be assumed for that

⁶ CPR 44.3.

⁷ Eisenberg (n 5) 995.

⁸ Late Payment of Commercial Debts (Interest) Act 1998, s 1.

⁹ Eisenberg (n 5) 996.

¹⁰ [1975] 1 Lloyd's Rep 465.

¹¹ *ibid*, 470 (Buckley LJ).

¹² *ibid*, 469 (Buckley LJ).

¹³ See 3.5.2 Loss of Amenity and the Consumer Surplus.

¹⁴ Eisenberg (n 5) 1049; *Hadley v Baxendale* (1854) 156 ER 145; (1854) 9 Ex 341.

¹⁵ *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] UKHL 48; [2009] 1 AC 61.

loss. With this in mind, it has been noted that *Hadley v Baxendale*¹⁶ has ‘been effectively ousted by the market convention’.¹⁷ Further, that “Lord Hoffmann ... regarded this convention as independently reflecting the expectations of a reasonable or prudent commercial contractor’.¹⁸ The argument is that specific performance will better satisfy the principle of indifference. There is a suggestion that this would place pressure on promisors to terminate a contract through mutual negotiation rather than unilateral breach.¹⁹ The contention is that normal methods for quantifying damages will fail to provide full compensation which would result in inefficient breach.²⁰

In analysing examples discussed by Macaulay as well as by Macneil, Campbell outlined that it would be wrong to allow breach where the claimant would not be compensated as efficiency requires.²¹ It is suggested that a cooperative attitude to potential breach will result in either allowing it, or anticipating it.²² The conclusion is that when properly applied, efficient breach ‘articulates a contractual norm of cooperation’ and that this will allay any concerns raised by relational contract theorists.²³ Efficiency will be achievable because breach will incorporate ‘flexibility into the system of exchanges, allowing parties’ relief from unanticipated expensive obligations when further performance would merely be wasteful as the plaintiff can be compensated in damages’.²⁴ Campbell asserts that a key function of contract law is to allow breach where it is properly regulated and involves adequate compensation so as to be a ‘normative contractual action’.²⁵

It is impossible to draft a contract which accounts for all future contingencies as a consequence of bounded rationality. Should they arise, there is a need to adapt. Where an agreement has become inefficient, it could be renegotiated. It could also be terminated by mutual consent. Both options assume that common ground can be found, and also that the relationship between the parties remains functional. However, it could be the case that parties may be unwilling to renegotiate. The possibility of a breach provides leverage to trigger renegotiation, encouraging an unwilling party to reconsider their position. If this was impossible then breach provides a final option. In this way breach plays a key role in the way which Campbell suggests.

¹⁶ (1854) 9 Ex 341; 156 ER 145.

¹⁷ Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 77.

¹⁸ *ibid.*

¹⁹ Eisenberg (n 5) 1049.

²⁰ David Campbell, ‘Breach and Penalty as Contractual Norm and Contractual Anomie’ (2001) *Wisconsin Law Review* 681, 688.

²¹ *ibid.*, 690; See also Ian R Macneil, ‘Contract Remedies: A Need for Better Efficiency Analysis’ (1988) 144 *Journal of Institutional and Theoretical Economics* 6, 15; Stewart Macaulay, ‘The Reliance Interest and the World Outside the Law Schools’ Doors’ (1991) *Wisconsin Law Review* 247, 249.

²² *ibid.*

²³ *ibid.*

²⁴ *ibid.*

²⁵ *ibid.*

6.2.1.3 The Role of the Court

Issues also exist regarding the court's role in calculating and enforcing awards of damages following a breach. Shavell highlights the reluctance to compensate "hard-to-measure" elements including lost profits or idiosyncratic losses.²⁶ However, if a party can demonstrate the value of any lost profit, they would be compensated for it. There is inherent difficulty whenever non-pecuniary losses are factored into contractual damage awards as demonstrated in *Ruxley v Forsyth*.²⁷ However, damages in commercial cases do not account for non-pecuniary losses. Market value is the measure, meaning that subjective valuation is not an issue.²⁸ Therefore, limiting focus to commercial contracting negates the relevance of idiosyncratic losses.²⁹

The next issue is that the courts limit damages to losses which were reasonably foreseeable when the contract was made.³⁰ Limitations include the rules relating to mitigation and remoteness.³¹ These are foundational rules. To suggest that they are flawed raises issues greater than simply the functionality of efficient breach, extending to the calculation process more generally. As such, whenever compensatory damages are to be quantified, issues exist regarding accuracy.

6.2.1.4 Nominal Damages

Questions may be raised regarding the intent behind awarding nominal damages for breach of contract.³² Nominal damages are used 'to establish the infringement of the claimant's legal right',³³ but lack a vindicatory element as an 'award of a pound or two is unlikely ... to provide adequate

²⁶ Steven Shavell, 'Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts' (2009) 107 Michigan Law Review 1569, 1575.

²⁷ [1996] AC 344.

²⁸ See Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (2nd edn, CUP 2006) 171; See also *Channel Island Ferries Ltd v Cenargo Navigation Ltd (The Rozel)* [1994] CLC 168; *Southampton Container Terminals Ltd v Hansa Schiffahrts GmbH (The Maersk Colombo)* [2001] EWCA Civ 717; *Sealace Shipping Co Ltd v Oceanvoice Ltd (The Alecos M)* [1991] 1 Lloyd's Rep 120.

²⁹ *ibid*, 173; See also Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 5-015.

³⁰ See *Victoria Laundry v Newman Industries* [1949] 2 KB 528, 539; See also Steven Shavell, 'Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts' (2009) 107 Michigan Law Review, 1569, 1575.

³¹ See Generally Hugh G Beale, *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 26-002: The mitigation requirement 'mitigation' for losses for which the defendant could not reasonably be assumed to have taken responsibility for; See also Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 2-002; Adam Kramer, *The Law of Contract Damages* (2nd edn, Hart 2017) 300.

³² *ibid*, 26-009; See also Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 12-001.

³³ *ibid*; See also David Pearce and Roger Halson, 'Damages for Breach of Contract: Compensation, Restitution and Vindication' (2008) 28 OJLS 73, 76.

satisfaction for the fact that a wrong has been committed'.³⁴ They may 'indicate a lack of any substantive merit in the claimant's case'.³⁵ A claimant who recovers nominal damages 'has in reality lost and in reality the defendant has established a complete defence'.³⁶ In *Mappouras v Waldrons Solicitors*,³⁷ no loss was caused by a breach. The court awarded 'a small sum, not intended to compensate for anything at all, in order to mark the fact that there has been a breach of contract, but not in any way to compensate the appellant'.³⁸ In *The Mediana*,³⁹ it demonstrated 'an infraction of a legal right'.⁴⁰ The sum 'has no existence in point of quantity'.⁴¹ However, it is suggested that 'nominal damages are an ineffective means of vindicating the performance right'.⁴²

Unlike contractual claims, not all common law claims can be made where no damage exists. Negligence requires damage in order to be compensated. The availability of nominal damages in contract suggests that despite evidence of a "wrong" per se, the nature of that wrong does not require punishment. It should be noted that nominal damages are a technical win for the party receiving them. This may be important regarding costs.⁴³ Here the question is how the award of nominal damages would impact a case concerning the efficient breach of a commercial contract. An award would mean that the court acknowledges that a wrong has been committed, but would also make clear that there is no ascertainable damage to the claimant. It would be symbolic in three senses. First, there is a wrong which must be acknowledged. Second, no ascertainable damage has been caused. Third, any wrong does not require substantial punishment. As such, the impact of an efficient breach would effectively be accepted should an award of nominal damages be made.

6.2.1.5 Punitive Damages and Disgorgement

Punitive damages may occasionally be awarded following a breach of contract.⁴⁴ This is possible where 'the defendant's conduct is sufficiently outrageous to merit punishment, as where it discloses malice, fraud, cruelty, insolence or the like, or as where, should the defendant be a government

³⁴ David Pearce and Roger Halson, 'Damages for Breach of Contract: Compensation, Restitution and Vindication' (2008) 28 OJLS 73, 76.

³⁵ *ibid*, 77.

³⁶ *Hyde Park Residence Ltd v Yelland* [1999] RPC 655, 670 (Jacob J).

³⁷ [2002] EWCA Civ 842.

³⁸ *ibid* [15] (Kay LJ).

³⁹ [1900] AC 113.

⁴⁰ *ibid*, 116 (Earl of Halsbury LC).

⁴¹ *Beaumont v Greathead* (1846) 2 CB 494, 499.

⁴² Pearce and Halson (n 34) 74.

⁴³ This is because the loser will be responsible for those costs which will be assessed based on part 44 of the Civil Procedure Rules.

⁴⁴ See Beale (n 31) 1-151 and 26-044.

servant, it is oppressive, arbitrary or unconstitutional'.⁴⁵ Disgorgement (or account of profit) concerns forcing a defendant to turnover profits accrued resulting from breach.⁴⁶ They 'are not based upon loss to the claimant. They are based upon a benefit received by the defendant which was obtained at the expense of the claimant'.⁴⁷ They are different to restitutionary damages on the basis that they do not replace something which the claimant had previously possessed.

*Attorney General v Blake*⁴⁸ concerned an action against a former member of the British Security Services. Standard contractual remedies were unsuitable, meaning that an order for account of profit was made.⁴⁹ This will not be available simply for breach of contract.⁵⁰ It was set out that it is useful to consider 'whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit'.⁵¹ *Rookes v Barnard*⁵² outlines that this could include 'oppressive, arbitrary or unconstitutional action by the servants of the government',⁵³ and also where 'the defendant's conduct has been calculated by him to make a profit for himself which may exceed the compensation payable to the plaintiff'.⁵⁴ The second category stemmed from the view that 'one man should not be allowed to sell another man's reputation for profit'.⁵⁵ Note that the case concerned an employment contract and the tort of intimidation, an issue which will be discussed in more depth shortly.⁵⁶ It was set out that this approach may be utilised 'whenever it is necessary to teach a wrongdoer that tort does not pay'.⁵⁷ It is also notable that employment contracts are not considered to be ordinary commercial contracts.⁵⁸

There are calls for wider use of punitive damages within contract law.⁵⁹ Rowan suggests that they should feature regulatory rules and 'could be tailored to certain types of contract which potentially give rise to exploitation and specific concerns about industry practices'.⁶⁰ This 'would avoid the potentially far-reaching and, in some respects, negative consequences of introducing punitive damages in commercial law'.⁶¹ Because the focus here is efficient breach in commercial contracting,

⁴⁵ Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 13-001.

⁴⁶ See Beale (n 31) 26-046.

⁴⁷ McGregor (n 45) 15-001.

⁴⁸ [2001] 1 AC 268, [2000] 3 WLR 625.

⁴⁹ Beale (n 31) 26-045.

⁵⁰ *ibid* 26-044; See also *Crawfordsburn Inn Limited v Neill Graham* [2013] NIQB 79 [18] (Weatherup J).

⁵¹ *AG v Blake* (n 48) 285 (Lord Nicholls).

⁵² [1964] AC 1129.

⁵³ *ibid*, 1226 (Lord Devlin); See also Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 13-017.

⁵⁴ *ibid*; See also Harvey McGregor, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017) 13-021.

⁵⁵ *ibid*, 1227 (Lord Devlin).

⁵⁶ See 6.2.2.3 The Tort of Intimidation.

⁵⁷ *Rookes v Barnard* (n 52) 1227 (Lord Devlin).

⁵⁸ See 2.6.2.1 Contracts of Employment.

⁵⁹ See for example Curtis Bridgeman, 'Corrective Justice in Contract Law: Is There a Case for Punitive Damages?' (2003) 56 *Vanderbilt Law Review* 237.

⁶⁰ Solène Rowan, 'Reflections on the Introduction of Punitive Damages for Breach of Contract' (2010) 30 *OJLS* 495, 517.

⁶¹ *ibid*.

the suggestion is that there is no role for punitive damages on the basis that the justification for breach is efficiency. The party who suffers the breach will be compensated in line with the expectation measure. Therefore, the breach does not exhibit the behaviour which could lead to punitive damages.

6.2.1.6 Restitutionary Remedies

Restitutionary remedies will generally not be available for breach of contract. There is an exception relating to cases concerning the sale of unique goods, often land.⁶² It is the case that a court:

[W]ill have regard to all the circumstances, including the subject matter of the contract, the purpose of the contractual provision which has been breached, the circumstances in which the breach occurred, the consequences of the breach and the circumstances in which relief is being sought.⁶³

In *Teacher v Calder*,⁶⁴ it was held that a breach of contract allowing a defendant to enter a more profitable contract with a third party would not lead to a departure from the usual approach to calculating damages.⁶⁵ It is noted that:

[E]xceptional cases such as *Blake* do not lend themselves easily to an economic analysis, when dealing with commercial cases such as *Teacher* ... the theory of efficient breach would tend to suggest that upholding the rule found in *Teacher* would be to the benefit of both immediate and potential commercial contracting parties.⁶⁶

This is due to a preference for certainty and providing ‘commercial parties with the opportunity to engage with the realities of commerce’.⁶⁷ As was set out in *Tito v Waddell (No 2)*,⁶⁸ the intention is ‘not one of making the defendant disgorge what he has saved by committing the wrong, but one of compensating the plaintiff’.⁶⁹

*Wrotham Park Estate Co Ltd v Parkside Homes Ltd*⁷⁰ concerned an infringed restrictive covenant. A restitutionary award was made as no devaluation to the land in question had taken place. As such, there was no damage to compensate. The result was an award that reflected what the claimant would

⁶² Hanoch Dagan, ‘Restitutionary Damages for Breach of Contract: An Exercise in Private Law Theory’ (2000) 1 *Theoretical Enquiries in Law* 115, 139.

⁶³ *AG v Blake* (n 48) 285 (Lord Nicholls).

⁶⁴ [1899] AC 451.

⁶⁵ *ibid*, 467-468 (Lord Davey).

⁶⁶ Andrew Gray, ‘Disgorgement Damages’ (2013) 7 *Journal of Business Law* 657, 677; See also David Campbell, ‘The Treatment of *Teacher v Calder* in *AG v Blake*’ (2002) *MLR* 256.

⁶⁷ *ibid*.

⁶⁸ [1977] Ch 106.

⁶⁹ *ibid*, 332 (Megarry VC).

⁷⁰ [1974] 1 *WLR* 798.

have charged to relax the covenant.⁷¹ This approach was considered in *Morris-Garner v One Step (Support) Ltd*⁷² where the term “negotiating damages” was used. Note that this case was also discussed in chapter 5. Key is that this claim stemmed from a contractual right concerning land. Jackman noted a dichotomy ‘whereby restitutionary remedies are directed against institutional harm, whereas compensatory remedies operate to redress personal harm’.⁷³ Also, that the English common law ‘does not take a censorious attitude to breach of contract, consistently with the view that a party to a contract, unlike a fiduciary, operates at arm's length and holds his powers for his own benefit’.⁷⁴ This allows a party to change their mind regarding performance because ‘in the absence of specific performance or an injunction ... on payment of compensation for the other party's reliance or lost expectations, he may deploy his resources more profitably elsewhere’.⁷⁵

6.2.1.7 Specific Performance

The obvious distinction regarding specific performance relates to contracts which concern the sale of land, and those which do not.⁷⁶ Writing with the acquisition of businesses in mind, Eisenberg and Miller noted the need for an asset to be unique in order for specific performance to be awarded.⁷⁷ Where a suitable replacement is available, specific performance is unlikely. *Lumley v Wagner*⁷⁸ featured an injunction to prevent the defendant from singing at an alternate venue to that which she was contractually obliged to. The court would not enforce specific performance. Lord St Leonards LC set out that whilst it was impossible to force the defendant to perform, they would have ‘no cause of complaint if I compel her to abstain from the commission of an act which she has bound herself not to do, and thus possibly cause her to fulfil her engagement’.⁷⁹ In *Warner Brothers Pictures, Incorporated v Nelson*,⁸⁰ where services were ‘of a special, unique, extraordinary and intellectual character’,⁸¹ they had a value which could not be ‘reasonably or adequately compensated in damages’.⁸² Like *Lumley v Wagner*,⁸³ an injunction was granted to prevent the defendant working

⁷¹ *ibid*, 815.

⁷² [2018] UKSC 20; [2018] 2 WLR 1353 [48] (Lord Reed).

⁷³ IM Jackman, ‘Restitution for Wrongs’ (1989) 48 Cambridge Law Journal 302, 320.

⁷⁴ *ibid*.

⁷⁵ *ibid*.

⁷⁶ See for example Theodore Eisenberg and Geoffrey P Miller, ‘Damages Versus Specific Performance: Lessons from Commercial Contracts’ (2015) 12 Journal of Empirical Legal Studies 29, 69.

⁷⁷ *ibid*.

⁷⁸ (1852) 42 ER 687; (1852) 1 De Gex Macnaghten & Gordon 604.

⁷⁹ *ibid*, 619.

⁸⁰ [1937] 1 KB 209.

⁸¹ *ibid*, 220 (Branson J).

⁸² *ibid*.

⁸³ *Lumley v Wagner* (n 78)

for anyone other than the claimant for a period of time. *Grimston v Cunningham*⁸⁴ concerned an agreement between an actor and a theatrical manager. Here, because ‘the injury suffered in consequence of the breach of the agreement would be out of all proportion to any pecuniary damages which could be proved or assessed by a jury’,⁸⁵ an injunction was granted. These cases highlight that even where a contract is for the provision of a specific service, the court may be unwilling to enforce specific performance. There is an aversion to forcing a party to act against their will, even where they had agreed to act in a certain way. Specific performance may be available with respect to contracts for the sale of land.⁸⁶ It may be available because an award of damages is inadequate as ‘each piece of land is unique in character, and a disappointed purchaser cannot take any damages and buy another identical property’.⁸⁷

6.2.1.8 Conclusion

Whenever damage awards are quantified, there is potential difficulty. However, in commercial contracting, where losses can be quantified based on market value without the need to account for non-pecuniary losses, the process is simplified. Issues arising as a result of the court’s role with respect to calculating damages following an efficient breach are not problematic as this applies whenever compensation is quantified. As a result, it would be a bold claim to discount the entire damages calculation process based on potential difficulties which are inherent in quantification. Similarly, issues are not raised by the potential of an award of nominal damages on the basis that the practical impacts of an efficient breach would effectively be accepted. The same can be said for punitive damages because the efficient breach of a commercial contract would not exhibit the type of behaviour that would trigger such an award. This is on the basis that the breach will be justified by efficiency, and also because the party who suffers the breach will be compensated in line with the expectation measure. The same applies to restitutionary awards. Ultimately, the suggestion that an efficient breach is impossible because normal methods for quantifying damages will fail to provide full compensation, is flawed.

⁸⁴ [1894] 1 QB 125; See also *Warner Brothers Pictures, Incorporated v Nelson* (n 80) 221.

⁸⁵ *ibid*, 130 (Wills J).

⁸⁶ See for example Barbara Bogusz and Roger Sexton, *Complete Land Law: Text, Cases, and Materials* (5th edn, OUP 2017) 52; See also Ben McFarlane, Nicholas Hopkins, and Sarah Nield, *Land Law: Text, Cases, and Materials* (3rd edn, OUP 2015) 299.

⁸⁷ Judith-Anne MacKenzie, *Textbook on Land Law* (16th edn, OUP 2016) 66.

6.2.2 A Likeness with Various Torts

The next area of interest is the extent to which an efficient breach could exhibit the characteristics of various torts. These include tortious interference in the form of inducing breach of contract, economic duress, and the tort of intimidation. The existence of a tort that may have a likeness to efficient breach could shed light on any potential issues with the theory's application.

6.2.2.1 Tortious Interference with Contract

It is suggested that where a third party encourages breach, it amounts to tortious interference with contract in the form of inducement.⁸⁸ The claim is that 'tortious interference, not "efficient" breach, actually is efficient—or at least should be presumed so in the absence of empirical evidence to the contrary'.⁸⁹ A clash exists between subscribers to a Holmes inspired ideology of contractual rights and liability,⁹⁰ and those who see 'contractual rights as a species of property which deserve special protection'.⁹¹ Additionally, the existence of the tort suggests that wrongdoing may have taken place.

Inducing breach of contract is an economic tort.⁹² Its genesis is *Lumley v Gye*⁹³ which concerned an action against the inducer in *Lumley v Wagner*.⁹⁴ A party 'who procures the damage maliciously might justly be made responsible beyond the liability of the contractor'.⁹⁵ Further, that 'a person who wrongfully and maliciously ... with notice, interrupts the relation subsisting between master and servant by procuring the servant to depart from the master's service ... commits a wrongful act for

⁸⁸ See generally Hazel Carty, *An Analysis of the Economic Torts* (OUP 2010); See also Tony Weir, *Economic Torts* (Clarendon 1997) 30; Hazel Carty, 'The Economic Torts in the 21st Century' (2008) 124 LQR 641; Hazel Carty, 'The Modern Functions of the Economic Torts: Reviewing the English, Canadian, Australian, and New Zealand Positions' (2015) 74 Cambridge Law Journal 261; Fred S McChesney, 'Tortious Interference Versus "Efficient" Breach: Theory and Empirical Evidence' (1999) 28 Journal of Legal Studies 131, 185.

⁸⁹ Fred S McChesney, 'Tortious Interference Versus "Efficient" Breach: Theory and Empirical Evidence' (1999) 28 Journal of Legal Studies 131, 185.

⁹⁰ See Oliver Wendell Holmes Jr, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995: This is characterised by the ruling in the US case of *Sorenson v Chevrolet Motor Co* 214 NW 754; 171 Minn 260 (Minn 1927). At 265 it was set out that 'the defendant corporation has a legal right to breach its contract with the plaintiff and pay the resulting damages'.

⁹¹ *OBG Ltd v Allan* [2007] UKHL 21; [2008] 1 AC 1.

⁹² See generally Carty (n 88); See also Tony Weir, *Economic Torts* (Clarendon 1997) 30; Hazel Carty, 'The Economic Torts in the 21st Century' (2008) 124 LQR 641; Hazel Carty, 'The Modern Functions of the Economic Torts: Reviewing the English, Canadian, Australian, and New Zealand Positions' (2015) 74 Cambridge Law Journal 261;

⁹³ (1853) 118 ER 749; See also *Allen v Flood* [1898] AC 1; See also McGregor (n 45) 48-004.

⁹⁴ (1852) 42 ER 687; (1852) 1 De Gex Macnaghten & Gordon 604.

⁹⁵ *Lumley v Gye* (n 93) 234 (Erle J).

which he is responsible at law'.⁹⁶ It is a product of competition law.⁹⁷ Also, a defendant does not necessarily have to intend to cause harm, but must have intended to cause a party to act inconsistently with their existing obligations by breaching the contract.⁹⁸ In *Douglas v Hello*⁹⁹ it was set out that:

The essence of the tort is that the conduct is done with the object or purpose (but not necessarily the predominant object or purpose) of injuring the claimant or, which seems to us to be the same thing, that the conduct is in some sense aimed or directed at the claimant.¹⁰⁰

In *OBG v Allan*,¹⁰¹ Lord Nicholls noted that a defendant will be liable 'if he intended to persuade the contracting party to breach the contract'.¹⁰² Lord Hoffmann set out that 'if the breach of contract is neither an end in itself nor a means to an end, but merely a foreseeable consequence, then ... it cannot for this purpose be said to have been intended'.¹⁰³ The tort is significant regarding trade unions calling on their members to strike in contravention of their employment contracts. As a result, there are limits on actions of this type against trade unions.¹⁰⁴

This tort could cast doubt over the Holmes inspired view because it suggests that a wrong is committed by the party who encourages breach. However, punitive damages (such as an account of profit) will not generally be available for infringements of purely contractual rights,¹⁰⁵ or where the agreement concerns commodities which are available within the market.¹⁰⁶ It is only available in rare circumstances.¹⁰⁷ Also, it is notable that the tort simply shifts the requirement to pay damages to the third party. The result is the same as in an action for breach of contract, but the route to achieve it is altered. Partlett suggested that inducing breach is intended to "alleviate long-term relational problems due to changing circumstances or opportunistic behaviour and therefore of encouraging cooperation between parties with its attendant social benefits".¹⁰⁸ Carty notes that these contracts could concern 'employment, leases, professional and long-term business relationships'.¹⁰⁹ There is also a suggestion

⁹⁶ *ibid*, 752-753 (Crompton J).

⁹⁷ Tony Weir, *An Introduction to Tort Law* (2nd edn, OUP 2006) 198.

⁹⁸ *ibid*, 199-200; See also Simon Deakin, Angus Johnston, Sir Basil Markesinis, *Markesinis and Deakin's Tort Law* (7th edn, OUP 2012) 475; Christian Witting, *Street on Torts* (14th edn, OUP 2014) 385.

⁹⁹ [2005] EWCA Civ 595.

¹⁰⁰ *ibid* [224] (Phillips MR).

¹⁰¹ *OBG Ltd v Allan* (n 91).

¹⁰² *ibid* [192] (Nicholls LJ).

¹⁰³ *ibid* [43] (Hoffmann LJ); See also *Millar v Bassey* [1994] EMLR 44; See also Christian Witting, *Street on Torts* (14th edn, OUP 2014) 389.

¹⁰⁴ See for example Trade Disputes Act 1906 s 4(1); See also Christian Witting, *Street on Torts* (14th edn, OUP 2014) 406.

¹⁰⁵ See *Surrey County Council v Bredero Homes Ltd* [1993] 1 WLR 1361, 1365; See also Lionel D Smith, 'Disgorgement of the profits of Breach of Contract: Property, Contract and "Efficient Breach"' (1995) 24 *Canadian Business Law Journal* 121, 130.

¹⁰⁶ See *AB Corporation v CD Company (The Sine Nomine)* [2002] 1 Lloyd's Rep 805, 807.

¹⁰⁷ See *AG v Blake* (n 48).

¹⁰⁸ David F Partlett, 'From Victorian Opera to Rock and Rap: Inducement to Breach of Contract in the Music Industry' (1992) 66 *Tulane Law Review* 771, 798; See also Carty (n 88) 57.

¹⁰⁹ Carty (n 88) 57.

that sanctioning the inducer will provide ‘an incentive to go to the promisee and bargain with him rather than seducing or browbeating the promisor’.¹¹⁰

Importantly, assuming that a third party must be involved in line with the classic over-bidder paradigm is incorrect. This requires that a party is induced to breach a contract in favour of a preferable offer from a third party. However, other scenarios may arise where breach is efficient. For example, there could be a situation where losses could be reduced, or where a shift in the market value of a resource means performance would not be cost-effective. Simester and Chan note that ‘efficient breaches do not imply third parties at all, let alone third parties who initiate breaches’.¹¹¹ However, if we assume that such a situation may arise, an obvious issue is that any action will not be brought not against a contracting party, but against a third party. This is problematic as the suggestion is that contract law protects ‘expectations of performance by the other contracting party, not performance by the whole universe’.¹¹² A remedy is available against the breaching party. It is unclear why an alternate course of action should be available. This could be perceived as insulting the autonomy of the contract breaker.¹¹³ Also, that ‘damages for persuasion to breach are measured by contractual damages; hence, the operation of any efficient breach doctrine would, as it should, feed indirectly to the tort by means of the contract’.¹¹⁴

Inducing breach can lead to liability for damage caused.¹¹⁵ This may include a profit which a claimant would have received, or a profit which they were subsequently unable to acquire from other contracts.¹¹⁶ However, in *Surrey County Council v Bredero Homes Ltd*,¹¹⁷ it was ruled that infringements of contractual rights would not lead to disgorgement.¹¹⁸ This was based on previous case law.¹¹⁹ In *University of Nottingham v Fishel*,¹²⁰ the view was that an account of profit for breach of contract should not be available.¹²¹ This was also said to apply to employment contracts.¹²² Also, note the suggestion that an award for an account of profit should not be available where a commodity is replaceable within the market.¹²³ This is important as efficient breach of commercial contracts is

¹¹⁰ Tony Weir, *Economic Torts* (Clarendon 1997) 5.

¹¹¹ AP Simester and Winnie Chan, ‘Inducing Breach of Contract: One Tort or Two?’ (2004) 63 *The Cambridge Law Journal* 132, 145.

¹¹² David Howarth, ‘Against *Lumley v Gye*’ (2005) 68 *MLR* 195, 209.

¹¹³ *ibid*, 206.

¹¹⁴ Simester and Chan (n 111)145.

¹¹⁵ See *Lumley v Gye* (n 93); See also Beale (n 31) 1-202.

¹¹⁶ Harvey McGregor, *McGregor on Damages* (19th edn, Sweet & Maxwell 2014) 48-006.

¹¹⁷ [1993] 1 *WLR* 1361.

¹¹⁸ *ibid*, 1365; See also Lionel D Smith, ‘Disgorgement of the profits of Breach of Contract: Property, Contract and “Efficient Breach”’ (1995) 24 *Canadian Business Law Journal* 121, 130.

¹¹⁹ See for example *Whitwham v Westminster Brymbo Coal and Coke Co* [1896] 2 *Ch* 538; *Watson, Laidlaw & Co Ltd v Pott, Cassels and Williamson* (1914) 31 *RPC* 104; *Strand Electric and Engineering Co Ltd v Brisford Entertainments Ltd* [1952] 2 *QB* 246.

¹²⁰ [2000] *ICR* 1462.

¹²¹ *ibid*, 1487 (Elias J).

¹²² *ibid*, 1488 (Elias J).

¹²³ See *The Sine Nomine* (n 106) 807.

being considered. It is also suggested that ‘the commercial law of this country should not make moral judgments, or seek to punish contract-breakers’.¹²⁴

An obvious question here is why a party to contract would seek to recover a remedy from a third party? There are two likely reasons. The first is that the prospects for recovering damages from the breaching party are small. For example, they may be facing insolvency or other financial difficulties. Second, there is a chance that there exists a desire to “punish” the inducer. However, as is set out above, infringements of purely contractual rights will generally not lead to disgorgement. Additionally, it will not be available where replacements may be sourced. As such, all that will be recovered is the value that has been lost. Any profit above that level is not accessible.

The key point is that any likeness between efficient breach and tortious interference assumes third party involvement in line with the over-bidder paradigm. This will not necessarily be the case. Also, it was set out in *The Sine Nominee*¹²⁵ that ‘international commerce on a large scale is red in tooth and claw ... there should not be an award of wrongful profits where both parties are dealing with a marketable commodity ... for which a substitute can be found in the market place’.¹²⁶ The claims which this thesis advances are specific to commercial contracts which will customarily take place within a market place where replacements are likely to be available.¹²⁷ As such, suggesting that efficient breach of commercial contracts will be impermissible because tortious interference illustrates that there may be something objectionable about inducing a breach is incorrect. It is also important to note the suggestion that an order for an account of profit is not available for infringements of purely contractual rights,¹²⁸ or where the dealing concerns a commodity which is replaceable in the market.¹²⁹ As such, profit made following a breach would not be accessible.

6.2.2.2 Economic Duress

Threatening to breach contract based on efficiency could be seen to exhibit the characteristics of economic duress.¹³⁰ This could mean ‘that certain threats or forms of pressure, not associated with

¹²⁴ *ibid.*

¹²⁵ *ibid.*

¹²⁶ *ibid.*, 806.

¹²⁷ Though it is accepted that this will not always be the case.

¹²⁸ See *Surrey County Council v Bredero Homes Ltd* (n 105) 1365; See also Lionel D Smith, ‘Disgorgement of the profits of Breach of Contract: Property, Contract and “Efficient Breach”’ (1995) 24 *Canadian Business Law Journal* 121, 130.

¹²⁹ See *The Sine Nomine* (n 106) 807.

¹³⁰ See Generally *Occidental Worldwide Investment Corp v Skibs A/S Avanti* [1976] 1 *Lloyd’s Rep* 293; See also *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd* [1979] *QB* 705, 719 (Mocatta J); MH Ogilvie, ‘Economic Duress: An Elegant and Practical Solution’ (2011) 3 *Journal of Business Law* 229; TT Arvind, *Contract Law* (OUP 2017) 348.

threats to the person, nor limited to the seizure or withholding of goods, may give grounds for relief to a party who enters into a contract as a result of the threats or the pressure'.¹³¹ *Pao On v Lau Yiu Long*¹³² outlined that such a claim may function in principle but must be made out on the facts. *DSND Subsea Ltd v Petroleum Geo Services ASA*¹³³ set out the necessary requirements, including pressure '(a) whose practical effect is that there is compulsion on, or a lack of practical choice for, the victim, (b) which is illegitimate, and (c) which is a significant cause inducing the claimant to enter into the contract'.¹³⁴ In deciding whether pressure was illegitimate, the court will consider evidence of an actual or threatened breach, whether this was in good faith, whether there was any practical option aside from submission to any pressure, whether there was a protest at the time, and where affirmation and subsequent reliance took place.¹³⁵ It must be distinguishable 'from the rough and tumble of the pressures of normal commercial bargaining'.¹³⁶ This is important because acting in self-interest or utilising practices such as hard-bargaining will be distinguishable.

It is suggested that 'a party who has agreed to a contractual variation cannot always avoid the variation simply because the other party had threatened to break the contract if it was not varied and this threat had some influence on the party seeking relief. Something more must be shown'.¹³⁷ It is argued that 'for a contract to be voidable for economic duress, the threat must not only have been wrongful but illegitimate in the sense of being without any commercial or similar justification'.¹³⁸ Akman notes that "'Economic duress" refers to one party's using his superior economic power in an illegitimate manner in order to compel the other party to agree to enter into a contract or to enter it on particular terms'.¹³⁹ Further, that commonly it is 'a threat by one party to break an existing contract unless the other party agrees to its variation'.¹⁴⁰ This is unclear because as was noted previously, the potential for breach may encourage renegotiation.

In this situation the defence of justification may be raised.¹⁴¹ *Glamorgan Coal Co v South Wales Miners' Federation*¹⁴² set out a number of considerations to be taken into account. These include 'the nature of the contract broken; the position of the parties to the contract; the grounds for the breach; the means employed to procure the breach; the relation of the person procuring the breach to the

¹³¹ Beale (n 31) 8-015.

¹³² [1980] AC 614; See also Beale (n 31) 8-015.

¹³³ [2000] BLR 530.

¹³⁴ *ibid* [131] (Mr Justice Dyson).

¹³⁵ *ibid*.

¹³⁶ *ibid*.

¹³⁷ Beale (n 31) 8-022; See also *Occidental Worldwide Investment Corp v Skibs A/S Avanti* (n 130); *Pao On v Lau Yiu Long* (n 132).

¹³⁸ *ibid*, 8-024.

¹³⁹ Punar Akman, 'The Relationship Between Economic Duress and Abuse of a Dominant Position' (2014) 1 LMCLQ 99, 100.

¹⁴⁰ *ibid*.

¹⁴¹ See Carty (n 88) 63.

¹⁴² [1903] 2 KB 545.

person who breaks the contract; ... the object of the person in procuring the breach'.¹⁴³ In the case of an efficient breach of a commercial contract, there will be a clear commercial justification. This is because it will be done to maximise profit, or minimise loss. It is suggested that on occasion it may be commercially reasonable 'to claim extra remuneration or some other extra-contractual concession'¹⁴⁴ in order to continue performance. In such cases the threat of breach can be considered to be an example of reasonable commercial pressure.¹⁴⁵

6.2.2.3 The Tort of Intimidation

A threat to breach could be perceived to exhibit the characteristics of the tort of intimidation.¹⁴⁶ This tort was initially intended to be triggered by threats of violence, though this limitation has disappeared.¹⁴⁷ It requires that a victim is targeted.¹⁴⁸ Also, 'there is a chasm between doing what you have a legal right to do and doing what you have no legal right to do, and there seems ... to be the same chasm between threatening to do what you have a legal right to do and threatening to do what you have no legal right to do'.¹⁴⁹ In *Morgan v Fry*,¹⁵⁰ Lord Denning outlined that any threat of violence, tort or breach of contract would meet the requirements for the tort of intimidation because the defendant's conduct would be unlawful.¹⁵¹

It is outlined that 'threatening a breach of contract may be a much more coercive weapon than threatening a tort, particularly when the threat is directed against a company or corporation'.¹⁵² This is noteworthy as the focus here is commercial contracting. The suggestion is that a threat to breach 'should only be treated as unlawful means for the purposes of three-party intimidation, that is to say the position in *Rookes v Barnard* and in most labour dispute cases, and that for two-party intimidation the claimant should have to show a physical threat of some kind'.¹⁵³ With this in mind, it has been noted that 'because the tort of intimidation has been developed to include a threatened breach of contract ... intimidation—like inducing breach of contract—should benefit from a justification

¹⁴³ *ibid*, 574 (Romer LJ).

¹⁴⁴ Beale (n 31) 8-040.

¹⁴⁵ *ibid*; See also *Pao On v Lau Yiu Long* (n 132).

¹⁴⁶ See Generally Christian Witting, *Street on Torts* (14th edn, OUP 2015) 403; See also Simon Deakin, Angus Johnston, and Basil Markesinis, *Markesinis and Deakin's Tort Law* (7th edn, OUP 2012) 489.

¹⁴⁷ *ibid*.

¹⁴⁸ Weir (n 97) 199.

¹⁴⁹ *Rookes v Barnard* (n 52) 1168-9 (Lord Reid).

¹⁵⁰ [1968] 2 QB 710.

¹⁵¹ *ibid*, 724.

¹⁵² *Rookes v Barnard* (n 52) 1169 (Lord Reid).

¹⁵³ Simon Deakin, Angus Johnston, and Basil Markesinis, *Markesinis and Deakin's Tort Law* (7th edn, OUP 2012) 489.

defence'.¹⁵⁴ Much like claims regarding economic duress, here there will be a clear commercial justification meaning that a threat of breach would not be illegitimate.

6.2.2.4 Conclusion

First, where a likeness is drawn between efficient breach and tortious interference, there is a natural assumption that there will be third party involvement. This will not necessarily be the case. Next, the existence of tortious interference could be seen to demonstrate that there is something objectionable about inducing a breach. This is potentially problematic. It is notable, however, that an order for an account of profit is not available for infringements on purely contractual rights,¹⁵⁵ or where commodities may be replaced within a market.¹⁵⁶ This means that profit made via breach is not accessible. Also, that due to the existence of a commercial justification, the efficient breach of a commercial contract will not be synonymous with the torts of economic duress or intimidation.

6.2.3 Potential infringement on Property Rights

Having discussed the potential clashes which efficient breach may have with the English approach to contract damages, as well as its issues relating to tort, the next issue concerns its potential infringement on property rights. Friedmann suggested that efficient breach 'is in principle, equally applicable to property rights, where it leads to the adoption of a theory of "efficient theft" or "efficient conversion"'.¹⁵⁷ This could extend to tort generally. The suggestion is that the law will not allow parties to 'keep ill-gotten gains, efficient or not'.¹⁵⁸ This raises questions as it is at odds with the fact that property 'is not to be taken and given to another without the owner's consent'.¹⁵⁹ The claim is that 'proprietary rights must be purchased, and it is not clear why contractual rights should be different'.¹⁶⁰ It is important to consider the resource here. Dagan notes that individuals may value a resource to a level where being deprived of it leads to 'a sense of violation and of a diminishing of

¹⁵⁴ Jenny Steele, *Tort Law: Text, Cases, and Materials* (4th edn, OUP 2017) 101.

¹⁵⁵ See *Surrey County Council v Bredero Homes Ltd* (n 105) 1365; See also Lionel D Smith, 'Disgorgement of the profits of Breach of Contract: Property, Contract and "Efficient Breach"' (1995) 24 *Canadian Business Law Journal* 121, 130.

¹⁵⁶ See *The Sine Nomine* (n 106) 807.

¹⁵⁷ Daniel Friedmann, 'The Efficient Breach Fallacy' (1989) 18 *The Journal of Legal Studies* 1, 4; See also Lionel D Smith, 'Disgorgement of the profits of Breach of Contract: Property, Contract and "Efficient Breach"' (1995) 24 *Canadian Business Law Journal* 121, 135.

¹⁵⁸ Lionel D Smith, 'Disgorgement of the profits of Breach of Contract: Property, Contract and "Efficient Breach"' (1995) 24 *Canadian Business Law Journal* 121, 135.

¹⁵⁹ Friedmann (n 157) 13-14.

¹⁶⁰ Smith (n 158) 135.

the self'.¹⁶¹ It is also noted that attempts to draw an analogy between contractual and property rights is difficult because, despite being valuable, contracts are considered to be a characterless good.¹⁶² Further, where 'a resource is viewed as a merely fungible ... asset with no direct bearing on the identity of its holder, the more likely the holder will be willing (or less reluctant) to share it with others ... as long as his well-being is preserved (through compensation)'.¹⁶³ The difference is clear regarding claims for specific performance of contracts concerning land.¹⁶⁴

6.2.3.1 Contractual Rights vs Property Rights

There are distinctions between property rights and contractual rights in line with the differences between rights in rem and rights in personam.¹⁶⁵ Hohfeld defined a right in rem (or multital right) as one which resides 'in a single person (or single group of persons) but availing respectively against persons constituting a very large and indefinite class of people'.¹⁶⁶ A right in personam (or paucital right) was said to reside 'in a person (or group of persons) and availing against a single person (or single group of persons); or else it is one of the few fundamentally similar, yet separate, rights availing respectively against a few definite persons'.¹⁶⁷ A right in rem will apply against tangible property including land or a chattel and will be enforceable against the world entirely.¹⁶⁸ They are genuine ownership rights. In contrast, a right in personam will apply only against certain categories of person.¹⁶⁹ It is suggested that 'the notion that the concept of a legal "right" (in the sense of a right-claim) has as its necessary correlative the existence of a legal "duty" in someone else, is for Hohfeld one key to understanding the different nature of in rem and in personam rights'.¹⁷⁰

¹⁶¹ Dagan (n 62) 134; See also Karl Olivecrona, 'Locke's Theory of Appropriation' (1974) 24 *The Philosophical Quarterly* 220, 224: 'The idea of the extension of the personality to objects is also natural to us. We can have a feeling of things being so intimately connected with ourselves that they are part of our very selves. Being deprived of such objects represents something more than an economic loss. It is experienced as an attack on the personality itself. The feeling of unification with a physical thing varies according to circumstances. It is strongest with regard to things in daily use or dear to us for sentimental reasons'.

¹⁶² Dagan (n 62) 139.

¹⁶³ *ibid.*, 137.

¹⁶⁴ See Bogusz and Sexton (n 86) 52; See also Ben McFarlane, Nicholas Hopkins, and Sarah Nield, *Land Law: Text, Cases, and Materials* (3rd edn, OUP 2015) 299; MacKenzie (n 87) 66.

¹⁶⁵ See for example Wesley Newcomb Hohfeld, 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1917) 26 *The Yale Law Journal* 710; See also Thomas W Merrill and Henry E Smith, 'The Property/Contract Interface' (2001) 101 *Columbia Law Review* 773, 851.

¹⁶⁶ *ibid.*, 718.

¹⁶⁷ *ibid.*

¹⁶⁸ JE Penner and E Melissaris, *McCoubrey & White's Textbook on Jurisprudence* (5th edn, OUP 2012) 109; See also MacKenzie (n 87) 24.

¹⁶⁹ MacKenzie (n 87) 24.

¹⁷⁰ Thomas W Merrill and Henry E Smith, 'The Property/Contract Interface' (2001) 101 *Columbia Law Review* 773, 781; See also Hohfeld (n 165) 712.

Under the common law, contractual rights and proprietary rights are perceived to be ‘diametrically opposed’.¹⁷¹ Contractual rights are an example of rights in personam.¹⁷² They are said to be transient and able to pass into rights in rem at their conclusion. Therefore, the claim is that rights in rem are genuine ownership rights.¹⁷³ It is also worth noting that, unlike tangible property, contractual rights cannot be converted.¹⁷⁴ Hansmann and Kraakman outline that ‘the attribute that distinguishes a property right from a contract right is that a property right is enforceable, not just against the original grantor of the right, but also against other persons to whom possession of the asset, or other rights in the asset, are subsequently transferred’.¹⁷⁵ Penner sets out that ‘the right to property is a right to exclude others from things which is grounded by the interest we have in the use of things’¹⁷⁶ while contracts concern a ‘voluntary relationship by which people can, for consideration, act co-operatively and consensually exploit each other’s advantages of whatever kind’.¹⁷⁷ Lee suggests that ‘for Penner, property and contract are intrinsically dissimilar because they protect different interests. The interest that underpins property is the interest we have in using or dealing with things’.¹⁷⁸ Penner’s focus with regard to property rights is the thing itself.

A lack of clarity between proprietary and contractual rights exists ‘due to the difficulty of distinguishing breach and infringement’.¹⁷⁹ Also, that the law suggests that a contract should be seen as a mode of acquisition but that it is still a right of ownership on the basis that it enables an exclusive right of possession for the thing that is contracted for.¹⁸⁰ Additionally, the rationale behind compensatory damages is said to be in line with the idea that something is acquired through the formation of the contract.¹⁸¹ Whilst it is clear that a contract provides something, this seems to fall short of the type of complete (and exclusionary) rights which would be vested in property ownership. The boundary is evident with regard to attempts to extend conversion to contractual rights. *OBG v Allan*¹⁸² offered an avenue to achieve this by setting out that *Lumley v Gye*¹⁸³ ‘treats contractual rights as a species of property which deserve special protection, not only by giving a right of action against

¹⁷¹ Pey-Woan Lee, ‘Inducing Breach of Contract, Conversion and Contract as Property’ (2009) 29 OJLS 511, 513; See also Hohfeld (n 165) 712.

¹⁷² Penner and Melissaris (n 168) 110.

¹⁷³ Peter Benson, ‘Philosophy of Property Law’ in Jules L Coleman, Kenneth Einer Himma, and Scott J Shapiro (eds), *The Oxford Handbook of Jurisprudence and Philosophy of Law* (OUP 2004) 778.

¹⁷⁴ See *Kuwait Airways Corporation v Iraqi Airways Company* [2002] UKHL 19; [2002] 2 AC 883; See also Sarah Green, *The Tort of Conversion* (Hart 2009); Simon Douglas, ‘The Scope of Conversion: Property and Contract’ (2011) 74 MLR 329.

¹⁷⁵ Henry Hansmann and Reinier Kraakman, ‘Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights’ (2002) 31 *The Journal of Legal Studies* 373, 378.

¹⁷⁶ James Penner, *The Idea of Property in Law* (OUP 2000) 68.

¹⁷⁷ *ibid.*, 92.

¹⁷⁸ Lee (n 171) 515.

¹⁷⁹ Omri Ben-Shahar, ‘Contract versus Property Damages’ (2012) 12 *Academia Sinica Law Journal* 1, 20.

¹⁸⁰ Benson (n 173) 782.

¹⁸¹ *ibid.*

¹⁸² *OBG Ltd v Allan* (n 91).

¹⁸³ *Lumley v Gye* (n 93).

the party who breaks his contract but by imposing secondary liability on a person who procures him to do so'.¹⁸⁴ Treating contractual rights as property suggests that it may be possible to convert them. However, Lee suggests that 'the expansion of conversion is not possible because a claimant does not have a right, exigible against the world, to the financial value of his contractual right'.¹⁸⁵ This will mean 'that when a defendant deprives a claimant of the financial value of his contractual right, the defendant does not breach a legal duty'.¹⁸⁶

6.2.3.2 Efficient Crimes and Efficient Torts relating to Property

The rationale behind efficient breach could be dismissed on the basis that it could be applied to actions such as theft or tort. This tangential issue is to be dealt with briefly on the basis that applying the reasoning behind efficient breach to commercial contracting does not encourage its use in other spheres. On efficient crime, it is sufficient to outline that the rules relating to contract law are inapplicable.¹⁸⁷ The same can be said with respect to efficient tort. Both claims appear to rely on an overly utilitarian approach to efficiency, considering only increases in total utility, welfare, or wealth, but not its distribution.¹⁸⁸ Within commercial contracting, efficient breach would utilise the wealth maximisation approach but considers distribution though the Kaldor-Hicks criterion featuring the caveat that compensation must be paid.¹⁸⁹ Where compensation is paid in line with the expectation measure, it is legitimate to claim that efficiency has been achieved as only compensatable detriment has been caused. Also, interests stemming from commercial contracts can generally be adequately compensated by an award of damages. In criminal law and the law of tort, this would not necessarily be the case.

6.2.3.3 Conclusion

The intention of this section was to set out that suggesting that the theoretical approach utilised in efficient breach will be equally applicable to crimes or torts relating to property is wide of the mark.¹⁹⁰

¹⁸⁴ *OBG Ltd v Allan* (n 91) [32].

¹⁸⁵ Simon Douglas, 'The Scope of Conversion: Property and Contract' (2011) 74 MLR 329, 349.

¹⁸⁶ *ibid.*

¹⁸⁷ See the Theft Act 1968, s 1.

¹⁸⁸ See John Stuart Mill, *Utilitarianism* (Roger Crisp ed, OUP 1998) 55; See also Anthony T Kronman, 'Wealth Maximization as a Normative Principle' (1980) 9 Legal Studies 227, 232; Ernest J Weinrib, 'Utilitarianism, Economics and Legal Theory' (1980) 30 University of Toronto Law Journal 307, 309.

¹⁸⁹ See 5.4.2 The Kaldor-Hicks Criterion.

¹⁹⁰ See Friedmann (n 157) 4; See also Smith (n 158) 135.

This is because such claims rely on overly utilitarian approaches to efficiency, where wealth or welfare distribution is not considered.¹⁹¹ Efficient breach of commercial contracts legitimately utilises wealth maximisation as well as the Kaldor-Hicks criterion, requiring that any detriment caused is compensated in line with the expectation measure. This is based on the profit generation intention behind commercial contracting. Finally, restitutionary remedies or specific performance will only be available for breaches of a contract which relates to cases concerning the sale of unique goods such as land.¹⁹²

6.2.4 Good Faith in Commercial Contracts

Having dealt with issues relating to damage calculation, a potential likeness with tort, and also issue relating to infringement on property rights, the next issue for discussion is whether good faith requirements in commercial contracting provides a stumbling block to the application of efficient breach in that context. Good faith is said to be ‘most aptly conveyed by such metaphorical colloquialisms as “playing fair”, “coming clean” or “putting one's cards face upwards on the table”’.¹⁹³ It concerns ‘fair and open dealing’,¹⁹⁴ including ‘information sharing, co-operation and even loyalty between contracting parties, depending on the kind of parties involved and the nature of the agreement’.¹⁹⁵ Breaching a contract with the intention of pursuing self-interest could conflict with such requirements. It is also noted that ‘the enforceability of a good faith obligation voluntarily assumed by the parties should depend on the agreement itself or on reasonable inferences drawn from the practices or usages of the parties, not from vague moral standards of decency or fair play’.¹⁹⁶

6.2.4.1 Where Will a Requirement of Good Faith Apply?

Any requirement to negotiate in good faith is irrelevant because efficient breach is concerned with performance only. It was suggested in *Walford v Miles*¹⁹⁷ that it would be ‘unworkable in practice as

¹⁹¹ Mill (n 188) 55; See also Anthony T Kronman, ‘Wealth Maximization as a Normative Principle’ (1980) 9 Legal Studies 227, 232; Ernest J Weinrib, ‘Utilitarianism, Economics and Legal Theory’ (1980) 30 University of Toronto Law Journal 307, 309.

¹⁹² Dagan (n 62) 139.

¹⁹³ *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1988] 2 WLR 615; [1989] QB 433, 439 (Bingham LJ).

¹⁹⁴ *ibid.*

¹⁹⁵ Mitchell (n 17) 130.

¹⁹⁶ Leon E Trakman and Kunal Sharma, ‘The Binding Force of Agreements to Negotiate in Good Faith’ (2014) 73 Cambridge Law Journal 598, 628.

¹⁹⁷ [1992] 2 AC 128.

it is inherently inconsistent with the position of a negotiating party'.¹⁹⁸ It is noted that Lord Ackner viewed 'that an undertaking to negotiate intrudes on the freedom of parties to make negotiating concessions, to withdraw from negotiations, or to negotiate with third parties during the course of negotiations'.¹⁹⁹

*Yam Seng Pte Limited v International Trade Corporation Limited*²⁰⁰ outlined that a duty to perform in good faith should apply to existing contractual relationships.²⁰¹ This duty is intended to 'ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into'.²⁰² It will be contingent on the context of individual cases.²⁰³ Good faith requirements within private relationships will not extend where no contractual relationship exists between the parties.²⁰⁴ *Monde Petroleum SA v Westernzagros Limited*²⁰⁵ set out that 'there is no general doctrine of "good faith" in English contract law'²⁰⁶ and that any such duty will be 'implied by law as an incident of certain categories of contract (for example, contracts of employment and contracts between partners or others whose relationship is characterised as a fiduciary one)'.²⁰⁷ Also, that 'that the mere fact that a contract is a long-term or relational one is not, of itself, sufficient to justify such an implication'.²⁰⁸

6.2.4.2 The Impact on Efficient Breach

It is the case that 'in any situation it is dishonest to deceive another person by making a statement of fact intending that other person to rely on it while knowing the statement to be untrue'.²⁰⁹ Assuming that one party does not mislead the other, efficient breach will not be dishonest. Assessing whether conduct is improper is objective, depending 'not on either party's perception of whether particular conduct is improper but on whether in the particular context the conduct would be regarded as commercially unacceptable by reasonable and honest people'.²¹⁰ Assuming that damages are in line with the expectation interest this would be commercially reasonable. It is important to note that

¹⁹⁸ *ibid*, 138 (Ackner LJ).

¹⁹⁹ *Trakman and Sharma* (n 196) 602.

²⁰⁰ [2013] EWHC 111.

²⁰¹ *ibid* [26]-[27].

²⁰² *ibid* [126] (Leggatt J).

²⁰³ *ibid* [141].

²⁰⁴ *Trakman and Sharma* (n 196) 601.

²⁰⁵ [2016] EWHC 1472 (Comm).

²⁰⁶ *ibid* [249] (Salter QC); See also *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200 [82] (Jackson LJ).

²⁰⁷ *ibid*.

²⁰⁸ *ibid* [250] (Salter QC); See also *Inc v TRW Lucas Varity Electric Steering Ltd* [2016] EWCA Civ 396 at [68].

²⁰⁹ *Yam Seng Pte Limited v International Trade Corporation Limited* (n 200) [141] (Leggatt J).

²¹⁰ *ibid* [144] (Leggatt J).

central to good faith is ‘the presumed intention of the parties and meaning of their contract, its recognition is not an illegitimate restriction on the freedom of the parties to pursue their own interests’.²¹¹ At the core of efficient breach is a party’s right to pursue their own interests. The interests of other parties are accounted for through the expectation measure of damages. As such, it is difficult to see how any good faith requirement would conflict with a breach of a commercial contract that is efficient.

It is interesting to briefly consider how jurisdictions which focus more on good faith would react to an efficient breach. Note the suggestion that ‘breach, consideration of the theory of efficient breach in the context of the civil law reveals an atmosphere that is not preclusive of the idea of efficient breach but which is certainly less friendly than American common law’.²¹² A useful example is French law.²¹³ The French civil code requires that contracts are ‘negotiated, formed and performed in good faith’.²¹⁴ However, it is highlighted that the new French civil code does not define good faith. This is problematic because it ‘is perceived by some commercial parties as vague, allowing the court too much discretion, and as inimical to contractual certainty’.²¹⁵ Based on case law inferences, good faith includes ethical conduct, loyalty, cooperation and coherence.²¹⁶ The fact that in French law, specific performance is available in principle for breach of contract was discussed previously.²¹⁷ It is important to keep in mind that recent reforms to the code were made in part due to the perception that French contract law was commercially unattractive.²¹⁸ Specific performance is now unavailable where there is a disproportionate difference between the cost to the promisor and benefit to the promisee, or where undue hardship would be caused to the promisor.²¹⁹ This suggests that where a commercial justification can be provided for breach of contract, damages, rather than specific performance will be the remedy. Again, where the breach takes place based on a commercial justification, and not in bad faith, there is no reason to suggest that it would be illegitimate.

²¹¹ *ibid* [148] (Leggatt J).

²¹² Ronald K Scalise Jr, ‘Why No “Efficient Breach” in the Civil Law?: A Comparative Assessment of the Doctrine of Efficient Breach of Contract’ (2007) 55 *The American Journal of Comparative Law* 721, 763.

²¹³ See Solène Rowan, ‘The New French Law of Contract’ (2017) 66 *ICLQ* 805, 813; See also Article 1104 of the French Civil Code.

²¹⁴ See Article 1104 of the French Civil Code.

²¹⁵ Rowan (n 213) 814.

²¹⁶ *ibid*.

²¹⁷ See 4.4.5 A Contrast between Common Law and Civil Law Systems.

²¹⁸ *ibid*; See also Rowan (n 213) 807-809.

²¹⁹ *ibid*; See also Article 1221; Rowan (n 213) 821-822.

6.2.4.2 Conclusion

The duty of good faith in commercial contracting does not inhibit the functionality of efficient breach. It focuses on factors such as fairness and honesty. Where there is no evidence of improper conduct, issues of good faith will be irrelevant. Efficient breach does not necessitate such conduct. In fact, it does the opposite as the expectation measure of damages takes account of the interests of the party who suffers the breach. As such, the good faith requirement does not impinge upon the application of efficient breach to commercial contracts.

6.2.5 A Contrast with Trust Law

The final point of interest regarding potential clashes with existing legal doctrines is a contrast that exists between contract, and trust law. This concerns execution and remedies.²²⁰ Trust law gives rise to obligations where performance may be enforced. Property law is another example of this.²²¹ This is unlike contract law where any interests in performance are generally remedied through damages. The intention is to further highlight that a commercial contract is a category of obligation that is legitimately treated differently to instruments that emerge elsewhere.

There is no case to be made for efficient breach of trust. This is based on the underlying principles regarding the execution of trusts. The most obvious difference is that a beneficiary has the right 'to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law'.²²² This is a clear right to performance which is evidenced by the remedies which are available. In the case of a breach of duty by a trustee:

[T]he basic purpose of any remedy will be either to put the beneficiary in the same position as if the breach had not occurred or to vest in the beneficiary any profit which the trustee may have made by reason of the breach (and which ought therefore properly to be held on behalf of the beneficiary).²²³

Resultantly, the law and economics inspired approach which is adopted with respect to the efficient breach of contract cannot be applied to trust law.

²²⁰ See 4.6.2 On Awards of Damages.

²²¹ See 6.2.3 Potential infringement on Property Rights.

²²² *Target Holdings v Redferns* [1996] AC 421, 434 (Browne-Wilkinson LJ); See also *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58; [2015] AC 1503 [28] (Toulson LJ).

²²³ *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58; [2015] AC 1503 [64] (Toulson LJ).

Should it be required, the execution of a trust will fall under the jurisdiction of the court.²²⁴ This is unlike contract where the court simply enforces remedies. The court may answer questions regarding execution.²²⁵ They may also remove and appoint trustees.²²⁶ This highlights the importance of the performance interest of beneficiaries in trust law. Providing remedies through substitute performance is unlike the approach in contract. Of course, a claimant in a contract dispute could (and likely will) use that compensation to access substitute performance. However, in trust law that substitute performance will be facilitated by the court itself. Further, in more serious situations the court will ensure that a trust is performed. This is clear evidence that the execution of trusts is fundamentally different to the performance of a contract.

These contrasts further illustrate the fact that commercial contracts sit apart, not only from other forms of contract, but from other legal doctrines. Accordingly, it would be flawed to suggest that approaches which would be illegitimate in other areas cannot be applied to commercial contracts. As such, applying economic reasoning in the form of efficient breach to commercial contracting should not be discounted.

6.2.6 Conclusions Regarding Potential Clashes and Contrasts with Legal Doctrines

The intention here was to outline that the application of efficient breach to English contract law is not impinged upon by these potential clashes with existing English legal doctrines. It has been outlined that potential clashes between the efficient breach of commercial contracts and existing legal doctrines do not negate the theory's legitimacy. On damages, it was noted that quantification is potentially problematic in any area of the law, but that the process is simplified in the case of commercial contracts. Further, it would be bold to claim that the entire damage calculation process should be discounted based on inherent difficulties in quantification. In addition, no issues are raised by the potential of an award of nominal damages on the basis that the practical impact of a breach would effectively be accepted. The same can also be said for punitive damages as an efficient breach of a commercial contract would not trigger an award. Finally, the claim that an efficient breach will be impossible because normal methods for quantifying damages will fail to provide full compensation is flawed. On a potential likeness with a number of torts, it was pointed out that the legitimacy of an efficient breach of a commercial contract would not be negated. In tortious interference there is a natural assumption that there will be third party involvement in line with the over-bidder paradigm.

²²⁴ See *Morice v Bishop of Durham* (1805) 32 ER 947, 954 (Lord Eldon); See also *McPhail v Doulton* [1971] AC 424, 440 (Hodson LJ); *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26; [2003] 2 AC 709 [36] (Walker LJ).

²²⁵ CPR 64.2 (a) (ii); See also 64BPD.1.

²²⁶ See the Trustee Act 1924, s 41(1).

This will not necessarily be the case. Also, as a result of a commercial justification, the efficient breach of a commercial contract will not be synonymous with the torts of either economic duress or intimidation. On clashes with property rights, the suggestion that the theoretical approach utilised in efficient breach will be applicable to crimes or torts relating to property is incorrect.²²⁷ This is because commercial contracting provides a setting where a wealth maximisation, in line with the Kaldor-Hicks criterion (featuring the actual payment of compensation) may legitimately be applied. In cases concerning crime or tort this would be inappropriate. Furthermore, restitutionary remedies or specific performance will be available for breach of a contract concerning the sale of unique goods such as land.²²⁸ Efficient breach is also not inhibited by the existence of the duty of good faith because where there is no evidence of improper conduct, issues regarding infringements on good faith will not be a concern. An efficient breach does not necessitate that such conduct will be evident. Finally, there are clear contrasts between the function of contract, particularly commercial contracting, and trust law in terms of execution and remedies. This was discussed in order to highlight that the ideology which can give rise to the efficient breach of commercial contracts should not be considered to extend to other areas of contract law or to the law more generally. The next step is to move on to discuss other categories of criticism which may be directed at the application of efficient breach to commercial contracting.

6.3 Clashes with the Application of an Instrumentalist Approach

Instrumentalist theories aim to encourage actions based on a particular objective. In the case of efficient breach that objective is economic efficiency.²²⁹ However, these approaches have been criticised. For example, it has been suggested that ‘a purely instrumental view deprives law of any internal moral integrity: law becomes an empty vessel that can be used to do anything, no matter how reprehensible’.²³⁰ They contrast with approaches which focus on corrective justice.²³¹ It is noteworthy that Weinrib set out that expectation damages are a form of compensation for breach of contract which is in line with corrective justice. This is on the basis that they represent the value of performance.²³² Further, that if the law must be coherent a combination of corrective, and distributive

²²⁷ See Friedmann (n 157) 4; See also Smith (n 158) 135.

²²⁸ Dagan (n 62) 139.

²²⁹ See 5.4.4 Economic Efficiency.

²³⁰ Brian Z Tamanaha, ‘How an Instrumental View of Law Corrodes the Rule of Law’ (2007) 56 De Paul Law Review 469, 505.

²³¹ See Ernest J Weinrib, *Corrective Justice* (OUP 2012) 72-75; See also Ernest J Weinrib, *The Idea of Private Law* (OUP 2012) 56; Ernest J Weinrib, ‘Correlativity, Personality, and the Emerging Consensus on Corrective Justice’ (2001) 2 *Theoretical Inquiries in Law*, 107, 108; Ernest J Weinrib, ‘Corrective Justice’ (1992) 77 *Iowa Law Review* 403, 410; Ernest J Weinrib, *The Idea of Private Law* (OUP 2012) 56; Ernest J Weinrib, ‘The Gains and Losses of Corrective Justice’ (1995) 44 *Duke Law Journal* 277.

²³² *ibid*, 183.

justice cannot be utilised.²³³ The claim is that because ‘private law relationships are characteristically bipolar, their coherence is a matter of corrective justice’.²³⁴ The issues which will now be considered include the suggested moral impermissibility of breach of contract, and the corrosion of other moral practices in both a wide and business centric sense. However, it will be concluded that none of these issues negate the legitimacy of the efficient breach of a commercial contract.

6.3.1 The Moral Impermissibility of Breach of Contract

The most common basis upon which the theory of efficient breach is refuted is that it is at odds with the moral requirements of promising.²³⁵ This will now be recapped briefly, before moving on to outline why such criticism is not applicable to commercial contracting. The reasons why efficient breach will not affect other moral practices will also be set out.

Chapter 4 outlined that deontological concerns regarding efficient breach are irrelevant within commercial contracting by dealing directly with potential moral issues. In English law, promise is not, and moreover, should not be considered as the basis of contract as it developed with reciprocity in mind. It features tortious roots and is thus detached from promise.²³⁶ Whilst both contracts and promises concern voluntary obligations, the promises which are being considered here require an existing relationship of trust and confidence between promisor and promisee. This contributes to any moral force impacting whether it will be kept.²³⁷ Contracts may invoke reliance without this pre-existing relationship and intend to protect reliance.²³⁸ They provide a method to seek an enforceable remedy following breach. Because commercial contracts are geared towards profit generation, it is reasonable to assert that their nature is different to those which are non-commercial. This distinction is based on the mutual profit generating focus of the parties.²³⁹ The institution of commercial contracting is different from non-commercial contracting. Because of this, a different standard will apply to the parties involved.²⁴⁰ As such, efficient breach in the context of commercial contracting cannot be discounted based on issues of morality arising from promise breaking.

²³³ Ernest J Weinrib, *The Idea of Private Law* (OUP 2012) 73.

²³⁴ *ibid*, 74.

²³⁵ See Chapter 4.

²³⁶ See 4.4 The Historical Development of English Contract Law.

²³⁷ Promises such as those which may be made by a person or group of people to the entire world are not being considered here.

²³⁸ See James Penner, ‘Promises, Agreements, And Contracts Mind’ in Gregory Klass; George Letsas; Prince Saprai (eds) *Philosophical Foundations of Contract Law* (OUP 2014) 117-118.

²³⁹ See Chapter 2 and Chapter 3.

²⁴⁰ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

Shiffrin argues that people enter contracts seeking ‘the specific good or service, not a voucher that will allow one to contract to obtain the good or service at a later date (even at a discount)’.²⁴¹ This view makes some assumptions. First, that contract exists to secure performance. However, chapter 4 set out that it is intended to protect against non-performance by providing a mechanism to claim compensatory damages following breach. Second, that contracting parties do not accept that compensatory damages should be the default remedy for breach of contract. This appears to cast aside years of contract law history and convention based on the mistaken perception that the English law of contract grew from promise. Shiffrin’s claim is that performance rather than the payment of damages should be the default remedy.²⁴² Also, that ‘self-interest and that roughly consequentialist approach to fidelity are incompatible with the morality of promising’.²⁴³

Consequentialist approaches are criticised on the basis that they ‘are incapable of capturing that moral content’.²⁴⁴ Further, that because ‘efficient breach is a direct application of consequentialist reasoning, efficient breach ... contravenes the moral requirements of the contract promise’.²⁴⁵ Rigoni suggests that Shavell’s position regarding efficient breach can be characterised as follows:

One is only morally obligated to perform a promise in circumstances such that a homo economicus promisor and a homo economicus promisee would agree to performance in that circumstance. Therefore, efficient breach is always morally permitted.²⁴⁶

Whilst this sounds pejorative, it is technically correct. The homo-economicus (or rational person) paradigm involves comparing costs with benefits and choosing an option which best suits the economic preferences of the decision maker.²⁴⁷ This paradigm has been analysed from a variety of perspectives.²⁴⁸ However, the claim of this thesis is that by mutually entering into a contractual

²⁴¹ Seana V Shiffrin, ‘Could Breach of Contract be Immoral?’ (2009) 107 Michigan Law Review 1551, 1565.

²⁴² *ibid.*, 1567.

²⁴³ Seana V Shiffrin, ‘Must I Mean What You Think I Should Have Said?’ (2012) 98 Virginia Law Review 159, 161; See also Dawinder S Sidhu, ‘A Crisis of Confidence and Legal Theory: Why the Economic Downturn Should Help Signal the End of the Doctrine of Efficient Breach’ (2011) Georgetown Journal of Legal Ethics 357, 361.

²⁴⁴ Frank Menetrez, ‘Consequentialism, Promissory Obligation, and the Theory of Efficient Breach’ (2000) 47 UCLA Law Review 859, 883.

²⁴⁵ *ibid.*

²⁴⁶ Adam Rigoni, ‘The Moral Impermissibility of Efficient Breach’ (2016) 17

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800446> accessed 24 September 2018; See also Steven Shavell, ‘Is Breach of Contract Immoral?’ (2006) 56 Emory Law Journal 439.

²⁴⁷ See 5.2.2 Rationality and the Preferences of Decision Makers.

²⁴⁸ See Amartya K Sen, ‘A Critique of the Behavioural Foundations of Economic Theory’ (1977) 6 Philosophy and Public Affairs 317; See also Girardeau A Spann, ‘A Critical Legal Studies Perspective on Contract Law and Practice’ (1988) Annual Survey of American Law 223; Elizabeth Anderson, ‘Should Feminists Reject Rational Choice Theory’ in Louise M Anthony and Charlotte E Witt (eds) *A Mind of One’s Own: Feminist Essays on Reason and Objectivity* (2nd edn, Westview Press 2002); 374-375; Neil H Buchanan, ‘Playing with Fire: Feminist Legal Theorists and the Tools of Economics’ in Martha Albertson Fineman and Terence Dougherty (eds) *Feminism Confronts Homo Economicus: Gender, Law, and Society* (Cornell University Press 2005); Euclid Tsakalotos, ‘Homo Economicus and the Reconstruction of Political Economy: Six Theses of the Role of Values in Economics’ (2005) 29 Cambridge Journal of Economics;

relationship intending to generate profit and by proxy, maximising wealth, and means that the homo-economicus model may legitimately be applied. All parties must have a profit generation objective.²⁴⁹ This is unlike a consumer contract, for example, where one party will seek a profit from the transaction, but this will not necessarily be the case for the other.

6.3.2 The Corrosion of Moral Practices

Having dealt with the suggested moral impermissibility of breach of contract, the next area of interest is the suggestion that accepting efficient breach could have a detrimental effect on moral practices. This includes a general distaste for promise breaking and what has been described as “opportunistic” breach. Also, claims that moral practice in a wider sense could be corroded, as well as a suggestion that it could have a negative impact on business ethics and business culture. This considers the potential impact which routine promise breaking may have on conduct. The suggestion is that perceived negative conduct displayed by efficient breach will influence decisions because individuals will not necessarily be capable of compartmentalising behaviour to specific settings.²⁵⁰ Also, that ‘the law plays (or is meant to play) a leadership role in shaping social practice’.²⁵¹ On this point, Herman notes that “‘politics of the right sort’ can frame obligations that individuals are able to satisfy, and even carry some of the burden of moral responsibility’²⁵² and that this can make individuals ‘better moral agents’.²⁵³

Carlos Bastien and Jose Luis Cardoso, ‘From Homo Economicus to Homo Corporativus: A Neglected Critique of Neoclassical Economics’ (2007) 36 *The Journal of Socio-Economics* 118; Irene CL Ng and Lu-Ming Tseng, ‘Learning to Be Sociable The Evolution of Homo Economicus’ (2008) 67 *The American Journal of Economics and Sociology* 265; Jonathan Aldred, *The Skeptical Economist: Revealing the Ethics Inside Economics* (Earthscan 2009) 231; Christoph Hanisch, ‘Negative Goals and Identity: Revisiting Sen’s Critique of Homo Economicus’ (2013) 4 *Rationality, Markets and Morals* 157; Khandakar Elahi, ‘Behavioural Controversy Concerning Homo Economicus: A Humean Perspective’ (2014) 7 *The Journal of Philosophical Economics*; Klaus Mathis and Ariel David Steffen, ‘From Rational Choice to Behavioural Economics: Theoretical Foundations, Empirical Findings and Legal Implications’ in Klaus Mathis (ed) *European Perspectives on Behavioural Law and Economics* (Springer 2015).

²⁴⁹ This is not to suggest that the only focus should be the production of profit, only that it will be particularly important to commercial parties. Other social or community minded concerns may be considered. See for example Andreas Rühmkorf, *Corporate Social Responsibility, Private Law and Global Supply Chains* (Edward Elgar 2015) 29; Christian R Thauer, *The Managerial Sources of Corporate Social Responsibility* (CUP 2014) 12; Jeffrey Smith, ‘Corporate Social Purpose and the Task of Management’ in Greg Urban (ed), *Corporations and Citizenship* (University of Pennsylvania Press 2014) 57.

²⁵⁰ Seana V Shiffrin, ‘The Divergence of Contract and Promise’ (2007) 120 *Harvard Law Review* 708, 741.
²⁵¹ *ibid.*

²⁵² Barbara Herman, ‘Morality and Everyday Life’ (2000) 74 *Proceedings and Addresses of the American Philosophical Association* 29, 36.

²⁵³ *ibid.*

6.3.2.1 A Distaste for Promise Breaking and “Opportunistic” Breach

There is some empirical evidence of distaste for promise breaking.²⁵⁴ Within this study, subjects considered that those who caused harm through breach of contract were ‘more immoral and should feel more guilt than a person who caused harm via negligence’.²⁵⁵ There was a prevailing view that a promisor should at all times perform the contract as expected, ahead of breaching and paying damages, even where it would be profitable to do so.²⁵⁶ Further, in cases of intentional breach there was a call for punitive damages.²⁵⁷ Lewinsohn-Zamir suggests that generally there is “a clear preference for in-kind remedies and entitlements”.²⁵⁸ It is asserted that, generally speaking, people will prefer to receive what was promised, rather than its value, no matter how accurate the valuation may be.²⁵⁹ The claim is also made that in-kind remedies are preferred by both laypersons and business people.²⁶⁰

There was a perception that a decision to breach should be viewed differently should it take place in “fortunate” rather than “unfortunate” circumstances.²⁶¹ Usual economic analysis treats the two as the same and will not ‘distinguish between a case where performance becomes overly difficult for the promisor and one in which breach is due to the availability of a more lucrative contract’.²⁶² With this in mind, any loss suffered in either case is considered identical.²⁶³ Perillo sets out that the classic efficient breach is intentional, rather than unfortunate, and that a lack of deterrence for intentional breaches should not be read as encouraging them.²⁶⁴ These intentional breaches have been described as “opportunistic”. However, it has also been suggested that whilst most breaches are intentional,

²⁵⁴ See Tess Wilkinson-Ryan and Jonathan Baron ‘Moral Judgment and Moral Heuristics in Breach of Contract’ (2009) 6 *Journal of Empirical Legal Studies* 405

²⁵⁵ *ibid*, 419.

²⁵⁶ *ibid*, 420.

²⁵⁷ *ibid*, 422.

²⁵⁸ Daphna Lewinsohn-Zamir, ‘The Questionable Efficiency of the Efficient-Breach Doctrine’ (2012) 168 *Journal of Institutional Theoretical Economics* 5, 16; See also Daphna Lewinsohn-Zamir, ‘Can’t Buy Me Love: Monetary Versus In-Kind Remedies’ (2013) *University of Illinois Law Review* 151, 162; Seanna Shiffrin, ‘Could Breach of Contract be Immoral’ (2009) 107 *Michigan Law Review* 1551, 1565: Shiffrin argues that in entering into a contract one does so seeking ‘the specific good or service, not a voucher that will allow one to contract to obtain the good or service at a later date (even at a discount)’.

²⁵⁹ Daphna Lewinsohn-Zamir, ‘Can’t Buy Me Love: Monetary Versus In-Kind Remedies’ (2013) *University of Illinois Law Review* 151, 180-181.

²⁶⁰ *ibid*, 193-194.

²⁶¹ See Daniel Friedmann, ‘The Efficient Breach Fallacy’ (1989) 18 *The Journal of Legal Studies* 1, 2-3; See also Joseph M Perillo, ‘Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference’ (2000) 68 *Fordham Law Review* 1085, 1095; Oren Bar-Gill and Omri Ben-Shahar, ‘An Information Theory of Willful Breach’ (2009) 107 *Michigan Law Review* 1479, 1499.

²⁶² Lewinsohn-Zamir (n 244) 9.

²⁶³ *ibid*.

²⁶⁴ Joseph M Perillo, ‘Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference’ (2000) 68 *Fordham Law Review* 1085, 1095.

they are not necessarily predatory or opportunistic.²⁶⁵ Further, Posner suggests that, in fact, most breaches are not opportunistic, that many are involuntary based on cost, and that some are voluntary and efficient.²⁶⁶ However, this seems problematic because in any potential efficient breach scenario, the opportunity for a party to improve their position would be presented.

There is evidence of negative feeling towards “opportunistic” breaches. This appears to stem from the feeling that this type of behaviour will reveal negative character traits which should be discouraged.²⁶⁷ For example, even Posner has suggested that breach in order to take advantage of another party’s vulnerability would be inappropriate.²⁶⁸ The implication is that opportunism has negative connotations.²⁶⁹ It seems then that such a breach would necessarily feature some form of unjust or unfair behaviour, which could be seen to mistreat another party, or take advantage of their vulnerability.²⁷⁰ Posner provides an example which concerns the misuse of money provided in advance of the delivery of specified goods. The money is subsequently used to build a swimming pool for personal use. Here the wrong is clear. With this in mind, it is unclear why a contract law remedy should be sought. Granted, it would appear that a breach of contract has taken place, however, it seems that other areas of the law would suffice in terms of providing a remedy, based on the facts available. For example, it seems that an action for fraud or theft could be utilised effectively. Further, the punitive remedy that Posner suggests (account of profit) would simply not suffice. This is because there is no profit to be claimed.

As was noted above, the evident issue is that all potential efficient breaches necessitate a level of opportunism on the part of the breaching party. However, in case of a commercial contract the decision to breach is not unfair or unjust by default. This is because while the opportunity exists for the breaching party to improve their position, this does not mean that they will be unfairly taking advantage of the other party. As has been set out, the use of the expectation measure of damages negates this issue as the party who suffers the breach will be effectively compensated using the expectation measure. This is on the basis that the overriding intention behind commercial contracting is to generate profit and thus, monetary damages will suffice. Because of this, it would be inappropriate to judge them based on a same moral standard that could potentially be attributed to

²⁶⁵ Oren Bar-Gill and Omri Ben-Shahar, ‘An Information Theory of Willful Breach’ (2009) 107 Michigan Law Review 1479, 1499.

²⁶⁶ See RA Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) 129.

²⁶⁷ *ibid.*

²⁶⁸ *ibid.*

²⁶⁹ *ibid.*

²⁷⁰ See Timothy G Hawkins, C Michael Wittmann and Michael M Beyerlein, ‘Antecedents and Consequences of Opportunism in Buyer-Supplier Relations: Research Synthesis and New Frontiers’ (2008) *Industrial Marketing Management* 895: Opportunism is said to feature ‘self-interest seeking with guile’ and ‘aggressive selfishness’. Also that it ‘disregards the impact of a firm’s actions on others’. The claim is that actions such as ‘stealing, cheating, breach of contract, dishonestly, distorting data, obfuscating issues, confusing transactions, false threats and promises, cutting corners, cover ups, disguising attributes or preferences, withholding information, deception, and misrepresentation’ fall within these boundaries.

promises. In addition, we have seen that it not for the courts to enforce such a standard. Rather, their focus is to provide adequate remedies based on the consequences of a breach of contract.

6.3.2.2 Cultivating Habits

The cultivation of behavioural habits has been a subject of interest for philosophers such as Aristotle and Kant.²⁷¹ Cureton sets out that Kant's view is that people must 'work to cultivate a good character, in part by repeatedly practicing virtuous acts over time; but no matter what we do we can never reach moral perfection'.²⁷² Influences on individual behaviour can be considered from a number of perspectives. For example, it has previously been set out that behavioural economics scholars accept there are idiosyncrasies within the decision making of individuals. This will mean that they will not necessarily act in line with the homo-economicus paradigms.²⁷³ They may be influenced by factors such as bounded rationality, biases, heuristics, willpower and limits on their self-interest.²⁷⁴ Decisions could be made based on influences such as social preferences,²⁷⁵ or happiness and utility.²⁷⁶ The claim is that individuals will draw on previous decisions which become part of their reactions when faced with moral decisions.²⁷⁷ Cooter's view is that the law influences the values to which people subscribe by impacting on an existing equilibrium. The suggestion is that 'changing the equilibrium can create or destroy a social norm without changing individual values. Creating focal points is the first expressive use of law'.²⁷⁸ Also, that the law has the ability to alter the values of rational people because the 'law induces rational people to change their preferences'.²⁷⁹ Further, it is suggested that if the need for state coercion is reduced a more liberal approach to government is made possible.²⁸⁰ Finally, nudge theory can be considered here.²⁸¹ Sunstein sets out that a nudge will alter a person's behaviour in a predictable way. However, this will not be achieved 'without

²⁷¹ See Aristotle, *Nicomachean Ethics* (Book 2 on Moral Virtue); See also Immanuel Kant, *The Metaphysics of Morals* (Mary Gregor (ed and tr) CUP 1996) Para 6:387.

²⁷² Adam Cureton, 'Kant on Cultivating a Good and Stable Will' in Iskra Fileva, *Questions of Character* (OUP 2016) 64.

²⁷³ See 5.2.2 Rationality and the Preferences of Decision Makers.

²⁷⁴ See Christine Jolls, Cass R Sunstein and Richard Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 *Stanford Law Review* 1471, 1545.

²⁷⁵ Edward Cartwright, *Behavioral Economics* (2nd edn, Routledge 2014) 320.

²⁷⁶ *ibid*, 465.

²⁷⁷ Shiffrin (n 250) 741.

²⁷⁸ Robert Cooter, 'Expressive Law and Economics' (1998) 27 *The Journal of Legal Studies* 585, 586.

²⁷⁹ *ibid*.

²⁸⁰ *ibid*, 608.

²⁸¹ See Generally Richard H Thaler and Cass R Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Yale University Press 2008); See also Cass R Sunstein, *Why Nudge? : The Politics of Libertarian Paternalism* (Yale University Press 2014); Cass R Sunstein, 'Nudging: A Very Short Guide' (2014) 37 *The Journal of Consumer Policy* 583.

forbidding any options or significantly changing their economic incentives'.²⁸² Importantly it is outlined that in order for an intervention to be considered a nudge it 'must be easy and cheap to avoid. Nudges are not mandates'.²⁸³

Shiffrin suggests that morally virtuous behaviour will be guided by the cultivation of good habits and that 'morally good agents do not and cannot consciously redeliberate about all the relevant considerations bearing on a decision on every occasion'.²⁸⁴ Because of the perceived similarity between contract and promise, and the fact that contracts are entered into as a part of day to day life, the claim is that individuals could be tempted to shift 'back and forth from one set of norms to the other'.²⁸⁵ There are two issues to consider here. The first is whether or not breach of contract is a negative act. Chapter 4 highlighted that within commercial contracting, breaching in pursuit of efficiency gains may be perceived as positive in a consequentialist sense. Commercial contracting is geared towards profit generation. As such, it seems reasonable to assert that the parties should be held to a different standard.²⁸⁶ Also, viewing breach as wrong based on a perceived synonymy with promise breaking is based on an intangible standard of ethics or virtues. While these may seem intuitive, they, and the reasoning behind them should be evidenced rather than being based on assertions of validity. The conclusion was that efficient breach in the context of commercial contracting cannot be discounted based on perceived issues of immorality arising from promise breaking. Simply because breach of contract is perceived to be wrong by some, it is not necessarily the case in an all-encompassing sense. The second issue is whether contract law should concern itself with potential impact within other settings. A consequentialist approach is not appropriate in many contexts. This is why claims regarding efficient crime or efficient torts are indefensible. However, the reasons why a breach of a specifically commercial contract (which is adequately compensated) could lead to other actions which are perceived to be negative, is unclear. It is not the role of contract law to regulate this type of activity.

The point could also be made that a person entering into contracts in a professional capacity may be more able to compartmentalise their approach. This could apply to those who act on behalf of companies, or individual business people such as sole traders. This approach has faced criticism in the form of what Solomon describes as an Aristotelean approach to business ethics. It is outlined that:

[W]hile business life has its specific goals and distinctive practices and people in business have their particular concerns, loyalties, roles and responsibilities, there is no 'business

²⁸² *ibid*, 6.

²⁸³ *ibid*.

²⁸⁴ Shiffrin (n 250) 741.

²⁸⁵ *ibid*, 742.

²⁸⁶ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

world' apart from the people who work in business and the integrity of those people determines the integrity of the organization as well as vice versa.²⁸⁷

That being said, there is no conclusive proof that people will or will not be capable of compartmentalising their behaviours. With that in mind, it would be inappropriate to disallow an efficient breach of a commercial contract on the basis that it may influence behaviour in other sectors.

6.3.2.3 Potential Impact on Business Ethics

Business ethics are said to support contract law 'by providing additional reasons for performance'²⁸⁸ and that ultimately business activity is built 'upon trust in its relationships with suppliers, consumers and employees'.²⁸⁹ It is suggested that it 'is primarily concerned with those issues not covered by the law, or where there is no definite consensus on whether something is right or wrong'.²⁹⁰ However, it has faced criticism based on its limitations.²⁹¹ For example, there is a suggestion that its aims are rarely ambitious.²⁹² Contractual relationships exist between employees, creditors, suppliers, customers and advisors, but the suggestion is that contract law in isolation will not ensure that performance takes place. Factors such as honesty and trust are said to encourage it.²⁹³ There is also a claim that if management had no faith in the honesty of other parties, contracts would not be formed due to commercial risk.²⁹⁴

There is a view that because commercial law focuses on intangible legal rights it is difficult to reach a consensus on how they should be acquired or exercised. This is due to the different circumstances in which they operate.²⁹⁵ Robin notes that 'asking businesses to go beyond their good citizen role in a competitive environment, where there are no natural capitalistic motivations, is unrealistic'.²⁹⁶ However, the influence which businesses may on society should not be completely

²⁸⁷ Robert C Solomon, 'Corporate Roles, Personal Virtues: An Aristotelean Approach to Business Ethics' (1992) 2 *Business Ethics Quarterly* 317, 338.

²⁸⁸ Barbara Mescher, 'Business Ethics and The Law of Contract' (2009) 8 *Journal of Law and Financial Management* 8, 10.

²⁸⁹ *ibid.*, 11.

²⁹⁰ Andrew Crane and Dirk Matten, *Business Ethics: Managing Corporate Citizenship and Sustainability in the Age of Globalization* (4th edn, OUP 2016) 6.

²⁹¹ Campbell Jones, Martin Parker and René Ten Bos, *For Business Ethics* (Routledge 2005).

²⁹² *ibid.*, 19.

²⁹³ Mescher (n 288) 11; See also George G Brenkert and Tom L Beauchamp, 'Introduction' in George G Brenkert (ed), *The Oxford Handbook of Business Ethics* (OUP 2010) 4.

²⁹⁴ *ibid.*

²⁹⁵ Gerard Brennan, 'Commercial Law and Morality' (1989) 17 *Melbourne Law Review* 100, 103; Crane and Matten (n 290) 7: 'It is often not just a matter of deciding between right and wrong, but between courses of action that different actors, for different reasons, both believe are right – or both believe are wrong'.

²⁹⁶ D Robin, 'Toward an Applied Meaning for Ethics in Business' (2009) 89 *Journal of Business Ethics* 139, 148.

discounted.²⁹⁷ The suggestion is that government should direct business conduct in the way it desires through legislation.²⁹⁸ This may concern the environment, future generations, stakeholders and unethical business practices for example.²⁹⁹ However, while these issues are legitimate concerns, it is clear that they are not, and should not be governed by contract law.

That business ethics based concerns, such as industry reputation will play into whether a party chooses to breach a contract in pursuit of efficiency gains, is not disputed. As will be discussed in greater depth later, claims about the legitimacy of an efficient breach does not direct that it should take place, only that it could. A breaching party will likely make a decision with this in mind. They may perform, attempt to renegotiate, or breach a contract based on multiple factors which may influence their preferences. For example, if an individual contracting relationship or a reputation within an industry is deemed to be of great importance, the decision to forgo the opportunity to breach efficiently may be made.

6.3.3 Conclusion

The intention here was to set out that it is legitimate to adopt an instrumentalist approach (namely wealth maximisation) with regard to the application of the theory of efficient breach to commercial contracts. This is because their overriding intention is profit generation, and at least on some level, wealth maximisation.³⁰⁰ This is also supported by the discussion of appropriate domains in which a utilitarian approach may be adopted which was carried out earlier.³⁰¹ On the moral impermissibility of breach of contract, the claim made in chapter 4 that efficient breach in the context of commercial contracting cannot be discounted due to issues of morality which arise from promise breaking, was reiterated. This is because parties enter into commercial contracts mutually, with the intention to generate profit. They will seek to maximise wealth, and thus, the homo-economicus model may legitimately be applied. With respect to evidence of a general distaste for promise breaking, or “opportunistic” breach, it was outlined that the efficient breach of a commercial contract will not feature the type of unjust, or unfair behaviour that would feature in an “opportunistic” breach. On the law’s need to cultivate good habits, it was set out that there is no proof that individuals will be unable to compartmentalise their behaviours. As a result, it would be inappropriate to discount the efficient breach of a commercial contract purely because it may influence behaviour in other sectors. Finally, on business ethics it was set out that whilst relevant, it is not the role of contract law to

²⁹⁷ See Crane and Matten (n 290) 12.

²⁹⁸ Robin (n 296) 148.

²⁹⁹ *ibid.*

³⁰⁰ See 2.8 Overall Conclusion.

³⁰¹ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

govern conduct based on business ethics. It is notable that concerns based in that realm such as industry reputation or accepted conduct, will be likely to influence whether a party chooses to breach a contract in pursuit of efficiency gains. Claims about the legitimacy of choosing to breach efficiently do not direct that this should take place, but only claim that it could.

6.4 Clashes Based on Commercial Practices

The next area of interest are the ways the theory of efficient breach may potentially clash with current practices within the commercial sector. The reality of commercial dealing will be considered first. This will be followed by a discussion of the issues raised by relational contracting before concluding that the legitimacy of an efficient breach of a commercial contract cannot be discounted based on these perceived clashes.

6.4.1 Commercial Reality

It is arguable that commerce is reliant on trust and the performance of promises, and that if parties failed to perform, the commercial system could be negatively impacted. It is suggested that within commercial relationships ‘norms of trust and co-operation are enforced by the mutual self-interest of the parties in maintaining a good relationship, backed up by reputational damage to businesses that act in opportunistic ways’.³⁰² Morgan’s position is that a minimalistic contract law would best suit parties’ needs. This means that a limited number of rules would be imposed allowing the parties to dictate the nature of their agreement. It is suggested that ‘parties that wish for rules enforcing co-operation, or deterring opportunism, may easily stipulate for this. A limited contract law maximizes freedom of contract’.³⁰³ Contract law would be facilitative rather than prescriptive. It seems intuitive that the norms which Morgan highlights, including trust and cooperation, as well as reputational damage would have a non-legal impact on contracting parties. However, the key role of contract law seems to be to function after the fact.

The growth of the commercial system (namely trade) required formal methods to guard against non-performance.³⁰⁴ A contract provides this, allowing remedies to be pursued post breach. The decision

³⁰² Jonathan Morgan, ‘In defence of Baird Textiles: A Sceptical View of Relational Contract Law’ in David Campbell, Linda Mulachy and Sally Wheeler (eds) *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan 2016) 187.

³⁰³ *ibid.*

³⁰⁴ See Gerald J Postema, *Bentham and the Common Law Tradition* (OUP 1986) 85; See also Hume (Treatise 515-20 and Treatise 519-20).

to breach has already been reached. It may have taken into account factors such as reputational damages based on the preferences of the breaching party. Breach will not necessarily be the primary option, nor should it be perceived to occur regularly. However, where a party deems it efficient, believing that it better suits their preferences, it will be justifiable.

Shiffrin suggests that ‘breach against a business may not sting as harshly as when it is suffered by a person’.³⁰⁵ Also, that:

[T]he more permissive intuition with respect to breach between organizations may not be a response to the general rule or practice but rather may encapsulate more particularized ethical assessments of singular cases of business-to-business breach within closely competitive contexts’.³⁰⁶

However, it is noted that ‘contract norms that authorize or encourage intentional breach of promise for gain among organizational actors should still give us some pause’.³⁰⁷ The suggestion is that accepting efficient breach could negatively impact the commercial system because parties will feel less able to trust, as well as enter into transactions with others. However, it is contract law that provides protection in the event of a breach, allowing parties to operate on the understanding that they may pursue a remedy. It is also noted that commercial law, specifically that which relates to corporate forms, cannot draw on moral considerations which impact on other areas of the law.³⁰⁸ This is because there is no moral consensus regarding the acquisition of intangible legal rights. Further, that moral considerations regarding commerce are more complicated than those which concern personal conduct.³⁰⁹

6.4.2 Efficient Breach and Relational Contracting

The next issue to consider is relational contracting.³¹⁰ Relational contracts are longer term in nature, where the ‘paper deal’ does not reflect the agreement entirely.³¹¹ They rely on the extended

³⁰⁵ Shiffrin (n 250) 746.

³⁰⁶ *ibid.*

³⁰⁷ *ibid.*, 747.

³⁰⁸ Brennan (n 295) 103.

³⁰⁹ *ibid.*

³¹⁰ See generally Ian R Macneil, *The Relational Theory of Contract: Selected Works of Ian Macneil* (David Campbell ed, Sweet & Maxwell 2001); See also Harris, Campbell and Halson (n 28) 31-33; Hugh Collins, *Regulating Contracts* (OUP 2002); Nick Van der Beek, ‘Long-term Contracts and Relational Contracts’ in Gerrit De Geest (ed) *Contract Law and Economics* (Edward Elgar 2011) 299; TT Arvind, *Contract Law* (OUP 2017) 11.

³¹¹ Mitchell (n 17) 186; See also Ian R Macneil, ‘Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law’ (1978) 72 *Northwestern University Law Review* 854; Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ (2003) 66 *MLR* 44.

functionality of the relationship and thus, may require a level of trust. It is suggested that a number, if not all contracts, will be relational in some way when the social context in which they exist is properly understood.³¹² Macneil noted that a relational approach will take account of the relationship and its development. This may include contributions from the original agreement, though the extent to which they would be relevant will vary.³¹³ Further, that due to increased complexity and an extended duration, relational contracts could become problematic should they be too rigid in their terms. The potential for flexibility would be essential.³¹⁴

6.4.2.1 The Features of a Relational Contract

The suggestion is that a relational law of contract would feature two key elements. First, that the written part of the contract (or “paper deal”) does not reflect the agreement entirely.³¹⁵ Second, factors such as ‘commercial practices, expectations and implicit dimensions’³¹⁶ will outline the weight which should be attached to the document. Also, such factors should have the potential to give rise to legally enforceable obligations.³¹⁷ Contractual interpretation with commercial concerns in mind is well established.³¹⁸ Andrews highlights that we have seen reference to ‘commercial good sense’,³¹⁹ a ‘reasonable commercial person’,³²⁰ ‘business common sense’,³²¹ and ‘commercial common sense’.³²² Commercial background and the factual matrix have also been acknowledged.³²³ As Mitchell sets out, a truly relational approach requires that ‘the object of the interpretation exercise should not be the contractual documents, but the entire business relationship’.³²⁴

³¹² Jonathan Morgan, *Contract Law Minimalism* (CUP 2013) 66; See also Harris, Campbell and Halson (n 28) 32; Ian R Macneil, ‘The Many Futures of Contracts’ (1974) 47 *Southern California Law Review* 691, 710–712.

³¹³ Ian R Macneil, ‘Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law’ (1978) 72 *Northwestern University Law Review* 854, 890; See also David Campbell, *The Relational Theory of Contract: Selected Works of Ian Macneil* (Sweet & Maxwell 2001); Mitchell (n 17) 171.

³¹⁴ *ibid*, 900.

³¹⁵ Mitchell (n 17) 186; See also Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ (2003) 66 *MLR* 44.

³¹⁶ *ibid*.

³¹⁷ *ibid*.

³¹⁸ See Neil Andrews, ‘Interpretation of Contracts and “Commercial Common Sense”’: Do Not Overplay this Useful Criterion’ (2017) 76 *Cambridge Law Journal* 36. See chapter 2.

³¹⁹ *Prenn v Simmonds* [1971] 1 *WLR* 1381, 1389 (Wilberforce LJ).

³²⁰ *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] *AC* 749, 771 (Steyn LJ).

³²¹ *Rainy Sky SA v Kookmin Bank* [2011] 1 *WLR* 2900 [21] (Clarke LJ).

³²² *Arnold v Britton* [2015] *AC* 1619 [17]-[19] (Neuberger LJ).

³²³ *ibid* [81] (Neuberger LJ); *Ravennavi SpA* [2007] *EWCA Civ* 58 [12] (Moor-Bick LJ) See Sir Robert Goff, ‘Commercial Contracts and the Commercial Court’ [1984] *LMCLQ* 382, 388; See also Catherine Mitchell, ‘Obligations in Commercial Contracts: A Matter of Law or Interpretation?’ (2012) *Current Legal Problems* 1, 17; *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* (n 321) 779.

³²⁴ Mitchell (n 17) 239.

There is a claim that placing sole focus on the written document forces the courts to ‘close their eyes to real expectations resting in the implicit dimensions of contract and significant reliance on them’.³²⁵ Issues are said to exist around the interpretation of words which do not have a fixed meaning, as well as an inability to predict future contingencies leading to gaps in written contracts.³²⁶ Campbell noted that the key point of relational contract theory is that all contracts are relational, rather than there being separate classes of discrete and relational contracts.³²⁷ This is on the basis that all contractual relationships may feature some relational elements, though this will vary from case to case, and be dependent on context.

6.4.2.2 Inherent Problems in Relational Contracting

Campbell and Harris highlight that contract law faces issues regarding longer term agreements as parties may not be intending to maximise their utility purely through contractual performance. The suggestion is that utility may be maximised through fostering long-term cooperation, based on trust rather than contractual obligation.³²⁸ Further, contract law does not provide adequate mechanisms to deal with longer term contracts.³²⁹ Also, there is a claim that long-term cooperation does not square with the concept of individual utility maximisation.³³⁰ This is potentially problematic for the theory of efficient breach because maximising individual utility (in this case wealth) is its foundation. When value is placed on long term collaboration, it seems that acting in pursuit of individual self-interest could be incompatible. There is a suggestion that the relational model has been devalued due to the ‘ease and simplicity of the classic economic model’,³³¹ but that some traditional economic assumptions have been relaxed. These include views on human behaviour and bounded rationality, which now better align with the relational model.³³² It has been set out that despite difficulty, values

³²⁵ Stewart Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ (2003) 66 MLR 44, 45.

³²⁶ *ibid.*, 45-46.

³²⁷ David Campbell, ‘Arcos v Ronaasen as a Relational Contract’ in David Campbell, Linda Mulachy and Sally Wheeler (eds) *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan 2016) 163.

³²⁸ See David Campbell and Donald Harris, ‘Flexibility in Long-term Contractual Relationships: The Role of Co-operation’ (1993) 20 *Journal of Law and Society* 166, 167.

³²⁹ Harris, Campbell and Halson (n 28) 32.

³³⁰ Campbell and Harris (n 328) 173.

³³¹ Chapin F Cimino, ‘The Relational Economics of Commercial Contract’ (2015) 3 *Texas A&M Law Review* 91, 93. Citing Kenneth G Dau-Schmidt, ‘Economics and Sociology: The Prospects for an Interdisciplinary Discourse on Law’ (1997) *Wisconsin Law Review* 389; Eirik G Furbotn and Rudolph Richter, *Institutions and Economic Theory: The Contribution of the New Institutional and Economic Theory* (2nd edn, University of Michigan Press 2005); Oliver E Williamson, ‘The Economics of Organization: The Transaction Cost Approach’ (1981) 87 *American Journal of Sociology* 548.

³³² *ibid.*, 93-94.

beyond solely wealth maximisation may be utilised.³³³ Commitment to wealth maximisation may lead to the assumption that the opportunity to breach efficiently requires that it takes place. However, chapter 7 will outline that such an opportunity will not mean that an efficient breach must take place, only that it could. Other options such as performing as specified or renegotiation could be utilised but this will be based on the potential breaching party's individual preferences.

6.4.2.3 The Reality of Relational Contracting

Macaulay claimed that contractual disputes are likely to be settled without needing to refer to the contractual document or to litigate.³³⁴ Beale and Dugdale noted that contractual remedies will be avoided because they are inflexible and held a view that lawyers do not necessarily understand the needs of commerce.³³⁵ Also, that even where a written document contains terms outlining the process which should be adopted, the preference is to avoid referring to it to find a resolution.³³⁶ It was later noted that where contractual obligations take place over an extended period, cooperation will be required because contingencies may arise and circumstances may change. This could mean that the language contained within the document could be an inadequate guide. Rather than engaging in renegotiation, the suggestion is that adjustments will be made when required.³³⁷ This supports the suggestion that 'dispute resolution outside the courts is invariably contextual and relational'.³³⁸ It is also claimed that where relational issues are not evident, larger corporate parties will not breach efficiently. Rather, they will breach the contract and avoid paying compensation which accurately reflects the expectation interest, for example by offering 'an insulting token settlement, and practice scorched earth litigation tactics'.³³⁹ Whilst this is unfortunate, it does not devalue efficient breach from a theoretical standpoint. To breach and delay the payment of damages to the point where the other party is adversely affected will detract from the efficiency of the breach. This is because

³³³ *ibid*, 128. Citing Matthew Rabin, 'An Approach to Incorporating psychology into Economics' (2013) 103 *American Economic Review* 617; Matthew Rabin, 'Incorporating Limited Rationality into Economics' (2013) 51 *Journal of Economic Literature* 528; Robert E Scott, 'A Theory of Self-Enforcing Indefinite Agreements' (2003) 103 *Columbia Law Review* 1641.

³³⁴ Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55.

³³⁵ Hugh Beale and Tony Dugdale, 'Contracts between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law and Society* 45, 59.

³³⁶ Macaulay (n 335) 61; See also Harris, Campbell and Halson (n 28) 28; Beale and Dugdale (n 336) 59.

³³⁷ Stewart Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 *MLR* 44, 47; See also Mireia Artigot I Golobardes and Fernando Gomez Pomar, 'Long-term Contracts in the Law and Economics Literature' in Gerrit De Geest (ed) *Contract Law and Economics* (Edward Elgar 2011) 334.

³³⁸ Morgan (n 312) 197.

³³⁹ Stewart Macaulay, 'Relational Contracts Floating on a Sea of Custom? Thoughts about the ideas of Ian Macneil and Lisa Bernstein' (2000) 94 *Northwestern Law Review* 775, 782.

expectation damages are essential. Thus, should such an approach be adopted, it would not be an efficient breach.

6.4.2.4 Conclusion

The intention here was to set out that the suggestion that efficient breach would negatively impact the commercial system is incorrect. The idea that parties would feel less able to trust others and enter into transactions with them is flawed because it is contract law which provides protection by allowing parties to operate knowing that they will be able to pursue a remedy in the event of a breach. Also, the complex nature of commercial agreements limits the potential for moral considerations to be drawn on.³⁴⁰ It is important to note that any decision to breach will be made based on the preferences of the breaching party. This may be influenced by factors such as reputational damage. On this point, relational contracts do not pose an insurmountable problem for the theory of efficient breach. The misconception is that the wealth maximisation approach will require that an efficient breach takes place when available. This is not the case because the opportunity does not dictate that an efficient breach will take place, only that it could.³⁴¹

6.4.3 Attitudes to Breach versus Performance

The next issue for discussion is the suggestion that performance is preferred by both lay people, and business people. Empirical studies purport to support this claim.³⁴² The 2009 study by Wilkinson-Ryan and Baron utilised questionnaires which were not completed by business people specifically.³⁴³ This casts doubt over the validity of the claims in terms of their application to the commercial context. The study carried out by Lewinsohn-Zamir is arguably more representative on the basis that its participants included business people. However, this was again questionnaire based and asked participants to choose between in-kind and monetary remedies in a variety of fictitious trading scenarios.³⁴⁴ The issue with this methodology is that it was limited to placing the participant in the “buyer” position and purported to show which remedy they would prefer to receive. It is noted that

³⁴⁰ Brennan (n 295) 103.

³⁴¹ This will be discussed in greater detail in Chapter 7.

³⁴² See Tess Wilkinson-Ryan and Jonathan Baron ‘Moral Judgment and Moral Heuristics in Breach of Contract’ (2009) 6 *Journal of Empirical Legal Studies* 405; See also Daphna Lewinsohn-Zamir, ‘Can’t Buy Me Love: Monetary Versus In-Kind Remedies’ (2013) *University of Illinois Law Review* 151.

³⁴³ *ibid*, 412

³⁴⁴ Daphna Lewinsohn-Zamir, ‘Can’t Buy Me Love: Monetary Versus In-Kind Remedies’ (2013) *University of Illinois Law Review* 151, 169-170.

where money provides a perfect substitute for redress, parties ‘should arguably opt for the in-kind option because it affords her a strategic advantage in future negotiations’.³⁴⁵ This is on the basis that ‘the injured party could exact additional payment by selling her right to in-kind redress’.³⁴⁶ The first flaw with this claim is that the buyer would be settling for monetary compensation, just that it would be inflated and potentially above the value of the commodity in question. Additionally, the approach does not place the participant in the position of the seller who may have the opportunity to benefit through paying monetary damages, as would be the case in an efficient breach scenario.³⁴⁷ This reduces the legitimacy of the study’s results though admittedly this is a natural limitation based on the approach which was adopted.

6.4.4 Conclusion

The key point here is that the suggestion that efficient breach would negatively impact the commercial system has been discounted on the basis that it is contract law, rather than a relationship of trust which facilitates reliance. It allows parties to operate in the knowledge that they will be able to pursue a remedy in the event of breach. It was set out that the nature of commercial agreements will impose limits on the potential that moral considerations can be drawn upon.³⁴⁸ In addition, the existence of relational contracts does not limit the functionality of the theory of efficient breach because the view that wealth maximisation requires that an efficient breach must take place when available, is flawed. The opportunity does not dictate that an efficient breach will take place, only that it could.³⁴⁹ This means that relational factors such as existing relationships or industry reputation could be considered. Finally, issues were raised regarding the suggestion that both lay people and business people will prefer contractual performance. This is on the basis that the studies were questionnaire based, offering participants choices based on a limited number of scenarios. Importantly, they did not offer the participant in the position of the seller who may have the opportunity to benefit through paying damages as would be the case in an efficient breach.³⁵⁰ This reduces the legitimacy of the study’s results.

³⁴⁵ *ibid*, 168.

³⁴⁶ *ibid*.

³⁴⁷ *ibid*, 169-170.

³⁴⁸ Brennan (n 295) 103.

³⁴⁹ This will be discussed in greater detail in Chapter 7.

³⁵⁰ Lewinsohn-Zamir (n 344) 169-170.

6.5 Issues relating to Practical Application

The final category of criticisms which will be considered concern whether efficient breach is possible in a practical sense. A flaw in the current analysis of the theory of efficient breach will be highlighted before moving on to discuss issues relating to bounded rationality, transaction costs and pre-breach predictions. It will be set out that there is clearly potential that an efficient breach can, and has taken place within English Law.

6.5.1 A Flaw in the Current Analysis of Efficient Breach

Much of the literature on efficient breach focuses on providing examples of efficient or inefficient breaches.³⁵¹ These could be perceived to be attempts to either validate, or invalidate the theory.³⁵² Eisenberg claimed that ‘the theory can only be understood and evaluated in the context of paradigm cases to which it might meaningfully be applied’.³⁵³ However, using hypothetical examples tells us nothing about the potential efficiency of an individual breach, though they are useful for illustrative purposes. The over-bidder paradigm concerns ‘a seller who has contracted to sell a commodity to a buyer breaches the contract in order to resell the commodity’.³⁵⁴ The loss paradigm concerns ‘a seller who has contracted to render a performance to a buyer breaches the contract because she determines that her cost of producing the performance would exceed the value that the buyer places on the performance’.³⁵⁵ Finally, the mitigation paradigm requires that ‘a buyer who has contracted to purchase a commodity that takes time to produce countermands performance by the seller because he determines that the value of the performance to him, if completed, will be less than the contract price’.³⁵⁶

Macneil sets out that ‘no conclusion can be deduced that breach is any more (or less) efficient than other ways of securing the efficient result of non-performance’.³⁵⁷ It would be impossible to set out

³⁵¹ See for example Posner (n 266) 131; See also Gregory Klass ‘Efficient Breach’ in Gregory Klass, George Letsas and Prince Saprai (eds), *Philosophical Foundations of Contract Law* (OUP2014) 364; Eisenberg (n 5).

³⁵² See for example Peter Linzer, ‘On the Amoralism of Contract Remedies - Efficiency, Equity, and the Second “Restatement”’ (1981) 81 *Columbia Law Review* 111, 114-115; See also Ian R Macneil, ‘Efficient Breach of Contract: Circles in the Sky’ (1982) 68 *Virginia Law Review* 947, 948 where Linzer’s illustration is used; Melvin A Eisenberg, ‘Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law’ (2005) 93 *California Law Review* 975, 990-999; Posner (n 266) 129-131.

³⁵³ Eisenberg (n 5) 997.

³⁵⁴ *ibid*, 998.

³⁵⁵ *ibid*, 1014.

³⁵⁶ *ibid*, 1016.

³⁵⁷ Ian R Macneil, ‘Efficient Breach of Contract: Circles in the Sky’ (1982) 68 *Virginia Law Review* 947, 950-951; See also Linzer (n 354) 114-115; TT Arvind, *Contract Law* (OUP 2017) 513-514.

all of the potential scenarios which could lead to an efficient breach. They may fit a description provided by one of the paradigm examples noted above, but equally they may not. Chapter 5 suggested that a simple approach should be adopted to define an efficient breach.³⁵⁸ This would involve a contract that is breached after comparing the cost of performance with the cost breach and the payment of compensatory damages because it is more cost effective to do so. This can either reduce losses or maximise gains.

6.5.2 Bounded Rationality, Transaction Costs and Pre-Breach Predictions

Bounded rationality was briefly discussed earlier.³⁵⁹ It is suggested that if a party's bounded rationality regarding potential transaction costs prevents them 'from choosing a sophisticated contract in light of future events, then they should also prevent parties from anticipating the effect of legal rules (which would be applied only in the contingent future) on the simple contract that they design'.³⁶⁰ Transaction costs are said to limit the potential for an efficient breach. They may include the costs of planning, litigation and acquiring information.³⁶¹ They could also extend to more relational costs such as damage to reputation or loss of future opportunities.³⁶² Criticism of the theory of efficient breach based solely on transaction costs is overly simplistic as well as underdeveloped. Inefficiency, in this case reduced profits or increased losses, may be influenced by more than simply transaction costs. However, one must always be aware of the existence of such costs. They could include 'initial planning in the first contract ... costs of planning ... after the new opportunity comes along, costs of potential or actual litigation ... information costs, costs of inertia, costs of uncertainty, relational costs, such as damage to reputation and loss of future opportunities to deal'.³⁶³ It is suggested that any questions about whether a rule requiring specific performance or a payment of damages is more efficient will be dependent on transaction costs. Also, that transaction costs may

³⁵⁸ See 5.9 Overall Conclusion.

³⁵⁹ See 5.5.2 Bounded Rationality; See also HA Simon, 'Theories of Bounded Rationality' in CB McGuire and Roy Radner (eds), *Decision and Organization: A Volume in Honor of Jacob Marschak* (North-Holland Publishing Co 1972) 162; See also HA Simon, *Models of Bounded Rationality: Empirically Grounded Economic Reason* (MIT Press 1982); VP Goldberg 'Relational Exchange' (1980) 23 *American Behavioural Scientist* 337, 339.

³⁶⁰ Eric A Posner, 'Economic Analysis of Contract Law after Three Decades: Success of Failure' (2002) 112 *Yale Law Journal* 829, 867

³⁶¹ See Generally DW Allen, 'Transaction costs' In Boudewijn Bouckaert and Gerrit De Geest (eds) *Encyclopedia of Law and Economics* (Edward Elgar 2000) 893; See also Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 372.

³⁶² Macneil (n 357) 958; See also Posner (n 266) 866; TT Arvind, *Contract Law* (OUP 2017) 513-514.

³⁶³ *ibid*; See also Posner (n 266) 866; DW Allen (n 361) 893; Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 372.

only be deduced based on empirical evidence.³⁶⁴ Therefore, to claim that unknown transaction costs impact on efficiency one way or another is clearly incorrect.

Campbell notes that where ‘each party was fully informed about all the circumstances and could accurately predict the future and negotiation was costless, the parties would draw up a completely contingent contract’.³⁶⁵ This would include setting out all potential rights and obligations as well as outlining the required course of action in any scenario concerning non-performance.³⁶⁶ Parties would be better positioned to make decisions regarding their best interests. In reality, this is impossible because accessing and incorporating all relevant information into an agreement incurs costs. The suggestion is that ‘contracts cannot be the completely contingent products of perfect rationality but are the incomplete products of bounded rationality’.³⁶⁷ It is also possible that by drafting agreements that are not fully contingent, parties are acquiescing to the default rules of contract. However, it is possible to make predictions which influence a decision to breach. Risks relating to cost may be calculated. A party considering breach may be advised by lawyers or accountants for example. Additionally, pre-existing knowledge of industries or individual contracting relationships could aid predictions. Case law evidence supports this assertion because the fact that parties made the decision to breach and pay damages outlines that they considered the information they possessed was adequate in reaching their decision.³⁶⁸ There is the risk that a decision to breach based on efficiency motivations could prove to be inefficient. Whilst this would be unfortunate, it is notable that the breaching party would bear that cost.³⁶⁹ Damages in line with the expectation measure would still be paid to the party who suffers the breach and, thus, their interests would be protected.

6.5.3 Conclusion

The intention here was to deal with potential issues which could arise out of the practical application of the theory of efficient breach to commercial contracts. It was set out that hypothetical scenarios customarily used within efficient breach literature should not be considered to prove or disprove the functionality of the theory. They are, however, useful in an explanatory sense. The efficiency of a damage award will be dictated by transaction costs. Such costs can only be ascertained based on empirical evidence.³⁷⁰ Making claims about how unknown transaction costs will impact efficiency is

³⁶⁴ *ibid*, 957.

³⁶⁵ David Campbell and Donald Harris, ‘In Defence of Breach: A Critique of Restitution and the Performance Interest’ (2002) 22 *Legal Studies* 208, 218.

³⁶⁶ *ibid*.

³⁶⁷ *ibid*

³⁶⁸ See 5.3.3 Examples of Efficient Breach in English Case Law.

³⁶⁹ See 6.2.1.1 Are Inherent Difficulties in Calculating Damages Problematic?

³⁷⁰ Macneil (n 357) 957.

impossible. There is evidence that the opportunity to breach efficiently may arise in practice. By virtue of this, it is clear that parties are able to make pre-breach predictions. Parties will sometimes view breach to be more cost-effective than performance. This reasoning is demonstrated by the case law which has been discussed in Chapter 5. The fact that contracting parties have taken the decision to breach outlines that in their view, the information available was sufficient to make predictions upon which they could rely.³⁷¹

6.6 Overall Conclusion

The intention of this chapter was to outline a number of criticisms which have been directed at the theory of efficient breach. This was done in order to demonstrate why they are inapplicable with respect to the claims which this thesis makes. The original contribution comes in outlining why these criticisms do not derail the application of the theory of efficient breach with respect to commercial contracting. The approach which has been adopted includes categorising each of the criticisms amongst four key themes including potential clashes with existing legal doctrines, criticisms relating to the application of what is an instrumentalist approach to the law, issues relating to existing commercial practices and issues relating to the theory's practical application.

It was first set out that the potential clashes between the efficient breach of commercial contracts and existing legal doctrines including issues relating to the calculation of damages, a likeness with torts, infringements on property rights and good faith in commercial contracting and a contrast with trust law, do not limit the legitimacy of the theory. Second, it was outlined that in the commercial contracting context, it is legitimate to utilise the instrumentalist approach of wealth maximisation in applying the theory of efficient breach. This is because the parties' overriding intention is profit generation.³⁷² Importantly, these claims regarding the theory's legitimacy do not require that it should take place. The only claim is that it could be pursued legitimately. Third, potential clashes based on existing commercial practice were discussed. It was suggested that the efficient breach of commercial contracts would cause no negative impact on the functionality of the commercial system due to the erosion of trust. This is on the basis that contract, rather than trust supports that system in that it allows parties to operate safe in the knowledge that they will be able to pursue a remedy in the event of breach. The practical influence of moral considerations on business dealing was also played down before setting out that factors relating to relational contracts do not negate the theory's functionality in the context of commercial contracting. The suggestion that contractual performance will be preferred by both lay people and business people was then discounted due to the limitations which

³⁷¹ See 5.3.3 Examples of Efficient Breach in English Case Law.

³⁷² See 2.8 Overall Conclusion.

were evident in the relevant study.³⁷³ The fourth category related to the practical application of the theory of efficient breach. It was explained that hypothetical scenarios customarily used within efficient breach literature do not prove or disprove the theory's functionality. It is also important to be aware that the efficiency of an award of damages will be dictated by transaction costs which can only be ascertained based on evidence.³⁷⁴ With this in mind, making any claims regarding how unknown transaction costs will impact efficiency is impossible. However, it will be possible for parties to make pre-breach predictions based upon pre-existing knowledge and experience as well as advice from third parties such as lawyers or accountants. Accordingly, there is evidence that the opportunity to breach efficiently may arise in practice. Parties will view breach to be more cost-effective than performance. On this basis, breach is considered efficient. This reasoning is demonstrated by the case law which has been noted. On the basis that parties have taken the decision to breach outlines that this is possible.³⁷⁵

Ultimately, the intention was to set out that the criticisms noted fail to derail the theory of efficient breach with respect to commercial contracts. By dealing with each of these criticisms of the theory of efficient breach effectively, it will now be possible to discuss how it may function legitimately. Chapter 7 will therefore be focused on making the case for efficient breach within the specific context of commercial contracting.

³⁷³ Lewinsohn-Zamir (n 344) 169-170.

³⁷⁴ Macneil (n 357) 957.

³⁷⁵ See 5.3.3 Examples of Efficient Breach in English Case Law.

Chapter 7

Making the Case for Efficient Breach in a Commercial Context

7.1 Introduction

The intention of this chapter is to make clear that efficient breach is theoretically sound when it is considered within the context of commercial contracting. No inferences should be made regarding non-commercial contracts. The formulation of efficient breach that will be advanced is an original approach based on the specifically commercial contracting context within which it is to be applied.

The first element of originality that must be noted relates to the foundation upon which this formulation of efficient breach is built. This concerns the material covered in the preceding chapters of this thesis. Chapter 2 outlined the commercial distinction in contract law, namely that a commercial party is identifiable based on business activity which is intended to generate profit and that a commercial contract will feature only commercial parties.¹ Chapter 3 highlighted that the distinction stems from the reasoning behind a party pursuing enforcement of a particular right. When done primarily for profit driven reasons, the court's approach differs from when enforcement is pursued for personal reasons. In commercial transactions, the fact that the primary reason for their operation is profit generation must be accounted for.² Chapter 4 clarified that it would be inaccurate to suggest that English contract law is built on the promise principle. Also, that contracting should be considered in light of its domain of operation and that the normative power of a commercial contract will be different to that of a promise.³ Chapter 5 set out that within commercial contracting, efficiency may legitimately be judged based on wealth maximisation based on monetary value.⁴ This

¹ See 2.8 Overall Conclusion.

² See 3.7 Overall Conclusion.

³ See 4.9 Overall Conclusion.

⁴ See 5.9 Overall Conclusion; See also RM Dworkin, 'Is Wealth a Value' (1980) 9 *The Journal of Legal Studies* 191; See also RA Posner, 'The Value of Wealth: A Comment on Dworkin and Kronman' (1980) 9 *Journal of Legal Studies* 243; Anthony T Kronman and RA Posner, *The Economics of Contract Law* (Little, Brown and Company 1979) 1; Frank I Michelman, 'Norms and Normativity in the Economic Theory of Law' (1978) 62 *Minnesota Law Review* 1015, 1032; Anthony T Kronman, 'Wealth Maximization as a Normative Principle' (1980) 9 *Legal Studies* 227, 240; Jules Coleman 'The Normative Basis of Economic Analysis: A Critical Review of Richard Posner's *The Economics of Justice*' (1982) 34 *Stanford Law Review* 1105, 1115; David Campbell, 'On What is Valuable in Law and Economics' (1996) 8 *Otago Law Review* 489; Jonathan Klick and Francesco Parisi, 'Wealth, Utility, and the Human Dimension' (2005) 1 *New York Journal of Law and Liberty* 590, 602.

will align with the Kaldor-Hicks criterion featuring the caveat that compensation is actually paid.⁵ Further, that a simple approach to identifying an efficient breach where the contract breaker's gain exceeds the losses of the party who suffers the breach after the payment of expectation damages was outlined.⁶ Chapter 6 dealt with criticisms directed at the theory of efficient breach. It was set out that these criticisms do not adequately explain why efficient breach is either impermissible or impossible.⁷

With this grounding in mind, it is possible to outline this approach to the theory of efficient breach. First, it will be set out that this formulation of efficient breach differs from the classic Holmes inspired iteration. This is in the sense that it is limited to solely commercial contracting, rather than all forms of contract. Relevant prerequisites will be outlined before making clear that the opportunity to breach and pay damages should not be available within all contracting relationships. The focus is solely on commercial contracts.

Second, the limitations which this formulation has in place will be outlined. These include the commercial context and wealth maximisation, the criticism of wealth maximisation by corporate lawyers, the contrast between commercial versus non-commercial contracts, the rationality of commercial parties, the understanding which commercial parties possess, the legitimacy of monetary quantification and the specifics of damage calculation in this context.

Third, it will be outlined that in the commercial context, an instrumentalist approach to contract law is legitimate. The rationale is that because the overriding intention behind commercial contracts is profit generation and, by proxy, wealth maximisation, that objective can be achieved by utilising an instrumentalist approach. Importantly, nothing is being implied regarding the legitimacy of instrumentalist approaches in other settings.

Fourth, on the decision to breach efficiently it will be set out that the opportunity to breach affords contracting parties the flexibility to adapt to unforeseen contingencies cost-effectively. Also, that it would be wrong to disallow such behaviour where the parties entered into the contract in question in order to generate a profit. Further, that any decision may take into account factors which could lead to a decision not to breach, even where it would be economically efficient to do so. This could include protecting an existing relationship or reputation within a particular industry for example. As such, parties could opt to utilise alternative approaches. These could include performing despite the

⁵ See 5.4.2 The Kaldor-Hicks Criterion; See also N Kaldor, 'Welfare Propositions of Economics and Interpersonal Comparisons of Utility' (1939) 49 *The Economic Journal* 549, 550; See also RH Coase, 'The Problem of Social Cost' (1960) 3 *The Journal of Law and Economics* 1, 2; RA Posner, *The Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) 14; Wolfgang Weigel, *Economics of the Law: A Primer* (Routledge 2008) 15; Jules L Coleman, 'Efficiency, Utility and Wealth Maximisation' (1980) 8 *Hofstra Law Review* 509, 513.

⁶ See 5.9 Overall Conclusion.

⁷ See 6.6 Overall Conclusion.

opportunity to make an efficiency gain. In addition, they could also seek to renegotiate the agreement in light of a particular contingency or a change of circumstances. Acknowledging that factors beyond purely economic efficiency may play a part is an approach to efficient breach which has not been touched on previously.

Fifth, contrasts with existing defences of efficient breach will be discussed. These include proposals based on adapting to unforeseen contingencies which are inevitable based on the incomplete nature of contracts raised by Shavell, as well as the altered view of performance noted by Markovits and Schwartz. It will be set out that the approach being proposed here differs from each of these approaches. This is due to the focus on commercial contracting which allows expectation damages to be justified based on the underlying profit generation intent which underpins them.

Sixth, Epistemic and Normative Justifications will be considered briefly. This will further advance the case which is being made for efficient breach. The epistemic element concerns the problematic nature of prescriptive approaches. This is on the basis that until individual facts become evident, it is impossible to outline whether breaching would be appropriate. Normative elements concern the fact that claims that utilitarian principles can be satisfied in advance of the facts of each potential efficient breach scenario becoming evident cannot be made. Also, it will be set out that a prescriptive approach in this setting would undermine individual autonomy.

Finally, it will be concluded that when a party is presented with the opportunity to breach efficiently this will not mean that breach must take place. However, should a party opt to breach they will be justified in doing so. To be clear, this justification applies to the relevant party's choice to breach efficiently, as well as to the law's approach in terms of limiting the available remedy to expectation damages in commercial contract disputes which effectively condones the breach. In addition, it will be set out that efficient breach requires that a damage award reflects the expectation interest in order to provide adequate compensation. Further, that the costs attached to paying damages should factor into any calculations carried out prior to a breach.

7.2 This Formulation of Efficient Breach

The intention here is to set out the facets of this adapted, and original approach to the theory of efficient breach. Chapter 5 noted Holmes' suggestion that 'the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else'⁸ is the inspiration for the theory of efficient breach. This can be seen to cast aside any contractual

⁸ Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995.

requirement other than the need to pay damages following breach.⁹ This is not accurate however. The fact that specific performance,¹⁰ or an injunction,¹¹ may be available following breach of contract highlights that occasionally the payment of damages may not suffice. Additionally, the version of efficient breach that is advanced here differs from the classic Holmes inspired iteration on the basis that it is limited to commercial contracts only. Next, in contrast with more prescriptive approaches, this iteration of efficient breach does not require that it should be pursued whenever it is available. The only claim is that it may justifiably be pursued where the breaching party deems it to be in line with their preferences. It is a permissive, rather than a mandatory approach, providing what can be described as efficient optionality. In this way, the approach provides what may be described as efficient optionality. This allows parties to make decisions based on what suits them best. Of course, this assumes that the party who suffers the breach is compensated in line with the expectation measure of damages, which is justifiable in this case.

7.3 The Limitations in Place

Having set out how this version of efficient breach is formulated, it is now important to make clear that certain limitations are in place with regard to its application. This includes discussing why it is legitimate to apply the theory within the commercial context, as well as outlining why awarding damages for an efficient breach is appropriate in this setting.

7.3.1 The Commercial Context and Wealth Maximisation

The first obvious limitation concerns the fact that efficient breach requires that an economic style of reasoning is adopted. This involves accepting that efficiency is a legitimate goal and also, that

⁹ See for example RA Posner *Economic Analysis of Law* (1st edn, Little, Brown and Company 1972); See also Gregory Klass, 'Efficient Breach' in Gregory Klass, George Letsas and Prince Saprai (eds) *The Philosophical Foundations of Contract Law* (OUP 2014) 362; Richard RW Brooks, 'The Efficient Performance Hypothesis' (2006) 116 *The Yale Law Journal* 568, 571; Melvin A Eisenberg, 'Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law' (2005) 93 *California Law Review* 975, 1018; Charles J Goetz and Robert E Scott, 'Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach' (1977) 77 *Columbia Law Review* 554, 558.

¹⁰ See for example Hugh G Beale, *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2015) 26-042; See also *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1, 11 (Hoffmann LJ).

¹¹ *ibid*, 27-065; *Lumley v Wagner* (1852) 42 ER 687; (1852) 1 De Gex Macnaghten & Gordon 604, 619; *Warner Brothers Pictures, Incorporated v Nelson* [1937] 1 KB 209, 220 (Branson J); *Grimston v Cunningham* [1894] 1 QB 125, 130 (Wills J); *Warner Brothers Pictures, Incorporated v Nelson* [1937] 1 KB 209, 221.

efficiency concerns maximising wealth.¹² There has been debate over whether the pursuit of wealth is a legitimate course of action in a broader sense. There is also a suggestion that contract law has a role in terms of restraining the maximising impulse. This is in the sense that parameters exist geared towards productive exchange.¹³ However, this thesis is focused only on commercial contracting and as such, broader issues regarding the legitimacy of a wealth maximising approach in other settings are not problematic because, as was set out previously, parties enter into contracts with the intention of generating profit.¹⁴ This is not to say that alternative approaches should not be utilised, such as the examples provided within literature on corporate governance.¹⁵ However, the intention here is to set out that wealth maximisation is legitimate in this context, but that it is not a pre-requisite.

7.3.1.1 Criticism of Wealth Maximisation by Corporate Lawyers

Wealth maximisation (or profit maximisation) has been criticised on the basis that it can be seen as synonymous with the classic shareholder wealth maximisation which is entrenched within corporate law.¹⁶ This is something which society, through the legal system allows. However, there is a suggestion that there are better ways in which corporate bodies could operate.¹⁷ For example, the shareholder wealth maximisation approach is criticised on the basis that it ‘encourages the sort of short-term obsessions that continually undermine the ability of American and British companies to compete in world markets over the long term’.¹⁸ However, the Companies Act 2006 offers the potential to consider factors beyond wealth maximisation. These may include long term impacts of a decision, the interests of employees, relationships with suppliers, customers and others, community and environmental impacts, reputation and fairness between company members.¹⁹ This allows directors to consider the interests of all stakeholders rather than solely shareholders. It is suggested

¹² RA Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) 13-17.

¹³ Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (2nd edn, CUP 2006) 8.

¹⁴ See Ronald Dworkin, ‘Is Wealth a Value?’ (1980) 9 *Journal of Legal Studies* 191.

¹⁵ See for example Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Berrett-Koehler 2012); See also R Edward Freeman, *Strategic Management: A Stakeholder Approach* (CUP 2010); Victoria S Baumfield, ‘Stakeholder Theory from a Management Perspective: Bridging the Shareholder/Stakeholder Divide’ (2016) 31 *Australian Journal of Corporate Law* 187; Collins C Ajibo, ‘A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory’ (2014) 2 *Birkbeck Law Review* 37; Margaret M Blair and Lynn A Stout, ‘A Team Production Theory of Corporate Law’ (1999) 85 *Virginia Law Review* 247; Martin Lipton and Steven A Rosenblum, ‘A New System of Corporate Governance: The Quinquennial Election of Directors’ (1991) 58 *The University of Chicago Law Review* 187.

¹⁶ See for example Bernard S Sharfman, ‘Shareholder Wealth Maximization and Its Implementation Under Corporate Law’ (2014) 66 *Florida Law Review* 389, 396.

¹⁷ See for example Stout (n 15); See also Margaret M Blair and Lynn A Stout, ‘A Team Production Theory of Corporate Law’ (1999) 85 *Virginia Law Review* 247.

¹⁸ Martin Lipton and Steven A Rosenblum, ‘A New System of Corporate Governance: The Quinquennial Election of Directors’ (1991) 58 *The University of Chicago Law Review* 187, 253.

¹⁹ Companies Act 2006, s 172.

that ‘failure to consider the effect of corporate decisions and policies on a firm’s stakeholders could and likely will lead to harm to the firm’.²⁰ With this in mind, the enlightened shareholder value is cited as an example of a way to balance shareholder primacy with stakeholder based considerations.²¹ Principles based on corporate social responsibility are also noted in this respect.²² The case has been made that it is not only morally correct for businesses to take into account how their activities would affect their stakeholders, but that it is also strategically in their interests to do so.²³ It is suggested that section 172 is limited due to an inability of both shareholders and stakeholders to enforce it.²⁴ However, company directors are required to act in a way which they consider ‘in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole’.²⁵ Their duty is to the company and its members as a whole and, thus, their actions should reflect this.

Importantly, these factors do not negate the legitimacy of the wealth maximisation approach with regard to the efficient breach of commercial contracts. Again, nothing is being said about how commercial parties should act. All that is being advanced is that the option to breach efficiently should be available should a party deem it to be the most attractive option. It is important to highlight that this is also not intended to question the legitimacy of approaches which are not in line with the wealth maximisation approach. The key point is that the freedom to choose a course of action which a commercial party has a preference for should be available to them. Of course, this is assuming that such actions are legally acceptable.

7.3.1.2 Commercial versus Non-Commercial Contracts

How and why commercial contracts are treated differently to non-commercial contracts will now be recapped briefly. This is done in order to make clear why efficient breach may legitimately be applied to commercial contracts. There is a clear distinction between commercial and non-commercial contracts in terms of how they are treated by the courts. This was established earlier.²⁶ In a similar vein, Barton acknowledged the difference between market and non-market transactions.²⁷ Farber also

²⁰ Victoria S Baumfield, ‘Stakeholder Theory from a Management Perspective: Bridging the Shareholder/Stakeholder Divide’ (2016) 31 *Australian Journal of Corporate Law* 187, 207

²¹ *ibid.*

²² *ibid.*

²³ R Edward Freeman, *Strategic Management: A Stakeholder Approach* (CUP 2010).

²⁴ Collins C Ajibo, ‘A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory’ (2014) 2 *Birkbeck Law Review* 37, 58.

²⁵ Companies Act 2006, s 172(1).

²⁶ See 2.8 Overall Conclusion; See also 3.7 Overall Conclusion.

²⁷ John H Barton, ‘The Economic Basis of Damages for Breach of Contract’ (1972) 1 *The Journal of Legal Studies* 277, 300.

noted that ‘market transactions are only one among a group of important economic institutions’.²⁸ This leads on to the idea that ‘efficiency is the only institutionally feasible and normatively attractive goal for a contract law that regulates deals between firms’.²⁹ These firms exist within a market which has the function of maximising wealth, subject to certain constraints. This is based on an implicit acceptance of the principle that when resources go through market exchanges, they will find their way into the hands of those who value them the most.³⁰ Also, it is simpler to place value on wealth (using monetary value) rather than welfare due to problems of interpersonal comparability.³¹ This is because welfare could account for individual preferences or satisfactions.³² The claim is that the role of commercial contracting should be to facilitate the maximisation of the value which flows from them and that this is quantifiable based on monetary value. This is on the basis that commercial contract law is focused on efficiency.³³

Next, it is possible to allay moral concerns regarding breach of contract stemming from distaste for promise breaking in a commercial setting.³⁴ By focusing on the profit oriented intent which commercial parties possess, it is possible to legitimately assess efficiency based on wealth. Wider concerns regarding the breach are considered differently than would be the case in the context of non-commercial contracting.³⁵ Mitchell notes that ‘contracts and contract law are a natural subject for analysis for the economist’.³⁶ Also, that ‘contracting is a method of private ordering that allows satisfaction of preferences, and thereby is assured to be a central institution facilitating the transfer of goods to their most valued use’.³⁷ This is legitimate as value can be objectively assessed based on one party’s willingness to pay, and a preference for a higher value of another.

Finally, there is a view that ‘contract is primarily the domain of business people, companies and corporations ... and not something which comprehensively or profoundly shapes the lives of members of society qua members of society or which ought to be of particular concern to them’.³⁸

²⁸ Daniel A Farber, ‘Contract Law and Modern Economic Theory’ (1983) 78 *Northwestern University Law Review* 303, 338.

²⁹ Alan Schwartz and Robert E Scott, ‘Contract Theory and the Limits of Contract Law’ (2003) 113 *Yale Law Journal* 541, 546.

³⁰ See John Sloman and Dean Garratt, *Essentials of Economics* (7th edn, Pearson 2016) 21; See also John Sloman, Alison Wride and Dean Garratt, *Economics* (9th edn, Pearson 2015) 315; Michael Parkin, Melanie Powell and Kent Matthews, *Economics* (9th edn, Pearson 2014) 110-111; Anthony T Kronman and RA Posner, *The Economics of Contract Law* (Little, Brown and Company 1979) 1; David Campbell, ‘On What is Valuable in Law and Economics’ (1996) 8 *Otago Law Review* 489.

³¹ See 5.4.4 Economic Efficiency; See also G Lawson, ‘Efficiency and Individualism’ (1992) 42 *Duke Law Journal* 53, 82; Jonathan Klick and Francesco Parisi, ‘Wealth, Utility, and the Human Dimension’ (2005) 1 *New York Journal of Law and Liberty* 590, 602.

³² G Lawson, ‘Efficiency and Individualism’ (1992) 42 *Duke Law Journal* 53, 80.

³³ Schwartz and Scott (n 29) 556.

³⁴ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

³⁵ Eyal Zamir and Barak Medina, *Law, Economics, and Morality* (OUP 2010) 257.

³⁶ Catherine Mitchell, *Contract Law and Contract Practice* (Hart 2013) 150.

³⁷ *ibid*, 151.

³⁸ Dori Kimel, ‘The Morality of Contract and Moral Culpability in Breach’ (2010) 21 *Kings Law Journal* 213, 214.

However, it is important to keep in mind that contract law's role extends beyond the commercial sector. Examples include consumer contracts, personal contracts, contracts for the sale of goods and employment contracts where damages are assessed differently than in commercial cases.³⁹ Whilst it is not disputed that a large volume of contractual disputes emanate from the commercial sector, it is important not to ignore the existence of non-commercial contracts. However, in this case the focus is, of course, solely on commercial contracting.

7.3.1.3 The Rationality of Commercial Parties

The next point of note is how a key principle within economic analysis can be applied to commercial contracting with respect to efficient breach. The suggestion is that the economically rational decision maker model is in line with the characteristics of commercial parties. This approach to decision making has been noted previously.⁴⁰ Assumptions are made regarding their rationality and preferences.⁴¹ They focus on their own interests and satisfactions and act to improve their position.⁴² It has been set out that 'the first principle of Economics is that every agent is actuated only by self-interest'.⁴³ This is said to explain the way in which parties respond to legal rules as they will account for the legal consequences of their decisions.⁴⁴ They are a creation of economics based on a weighted average of the behaviour of individuals. However, it is acknowledged that not all individuals act in this way.⁴⁵ The paradigm may be applied to commercial parties because their primary focus is profit production. With this in mind, it is noted that contracts are 'viewed by parties ... as instruments useful in pursuing antecedent and independent purposes'.⁴⁶ It is noteworthy that even rationality in this sense will be limited (or bounded) to a degree. This is because any decision may only be rational to the extent that it can account for information which is known to the decision maker.

Considerations may go beyond solely rational behaviour in an economic sense. It has been suggested that to exclude 'any consideration other than self-interest seems to impose a wholly arbitrary

³⁹ See 3.5.2 Loss of Amenity and the Consumer Surplus.

⁴⁰ See 5.2.2 Rationality and the Preferences of Decision Makers.

⁴¹ Lewis A Kornhauser 'An introduction to the economic analysis of contract remedies' (1986) 57 *University of Colorado Law Review* 683, 687; See also Francesco Parisi, 'Positive, Normative and Functional Schools in Law and Economics' (2004) 18 *European Journal of Law and Economics* 259, 262.

⁴² RA Posner, 'The Economic Approach to Law' (1975) 53 *Texas Law Review* 757, 761; Werner Z Hirsch, *Law and Economics: An Introductory Analysis* (3rd edn, Academic Press 1999) 12.

⁴³ FY Edgeworth, *Mathematical Psychics: An Essay on the Application of Mathematics to the Moral Sciences* (CK Paul & Co 1881) 16.

⁴⁴ Kornhauser (n 41) 690.

⁴⁵ See Gary S Becker, *The Economic Approach to Human Behavior* (The University of Chicago Press 1976) 153; See also Paul Burrows and Cento G Veljanovski, *The Economic Approach to Law* (Butterworths 1981) 3.

⁴⁶ Daniel Markovits and Alan Schwartz, 'The Myth of Efficient Breach: New Defenses of the Expectation Interest' (2011) 97 *Virginia Law Review* 1939, 2003.

limitation on the notion of rationality'.⁴⁷ Further, that when it comes to the rigid pursuit of self-interest, calling such behaviour 'rational, or departures from it irrational, does not change the relevance of these criticisms, though it does produce an arbitrarily narrow definition of rationality'.⁴⁸ With this in mind, there is the potential that a party may have other concerns which influence their decision making. In this case, commercial parties will be capable of assessing whether implications beyond the financial impact of breach are substantial enough to deter it. For example, preserving business relationships or protecting industry reputation could be influential. This is an issue which will be discussed in greater depth later. For now, it is sufficient to note that an approach which is driven by wealth maximisation may legitimately be applied in the commercial setting. However, it is important to note that nothing is being said about how parties do, will, or should act. The only claim is that acting in an economically rational manner is legitimate in this context.

7.3.1.4 The Understanding which Commercial Parties Possess

Finally, a commercial party is likely to possess a greater understanding of the law's operation following a breach of contract. This is on the basis that where parties are experienced, or where it is reasonable to expect that they are experienced, the presumption is that they are familiar with the relevant elements of contract law.⁴⁹ Morgan notes the presumption that despite bounded rationality, 'commercial parties presumptively remain better placed to decide on their best interests than the (also 'bounded') courts'.⁵⁰ Commercial parties will be likely to be more familiar with the default position the law adopts in enforcing a payment of damages when they enter into agreements on a routine basis.⁵¹ This is a likely contrast with non-commercial parties. It has already been set out that interpretation of contractual terms differs between commercial and non-commercial contracts. This is often in terms of assessing reasonableness.⁵² Mitchell has noted 'tacit understandings'⁵³ within certain industries with regard to particular customs. For example, the 'understanding of shipping lawyers about the extent of a charterer's liability for damages for late redelivery'⁵⁴ was noted. With this in mind, it does not seem particularly problematic to suggest that should parties be capable of

⁴⁷ Amartya K Sen, 'Rational Fools: A Critique of the Behavioural Foundations of Economic Theory' (1977) 6 *Philosophy & Public Affairs* 317, 342.

⁴⁸ *ibid*, 343.

⁴⁹ See Robert Bradgate, 'Contracts, Contract Law and Reasonable Expectations' in Sarah Worthington (ed), *Commercial Law and Commercial Practice* (Hart 2003) 687.

⁵⁰ Jonathan Morgan, *Contract Law Minimalism* (CUP 2013) 57.

⁵¹ However, it is accepted that newer or smaller commercial parties may have a more limited level of understanding in this respect.

⁵² See 3.3 The Commercial Distinction in Contract Law.

⁵³ Catherine Mitchell, 'Obligations in Commercial Contracts: A Matter of Law or Interpretation?' (2012) 65 *Current Legal Problems* 455, 466.

⁵⁴ *ibid*, 467.

operating with industry norms and customs in mind, they will have a grasp of how breach of contract is dealt with by the courts. It follows that a commercial party expecting enforced performance, rather than payment of compensatory damages in the event of a breach of a commercial contract, will be unrealistic on the basis that they are a default rule.⁵⁵

7.3.2 The Legitimacy of Monetary Quantification

Having set out that this version of efficient breach may legitimately be applied to commercial contracting, it is now necessary to move on to discuss the legitimacy of monetary quantification in terms of damage awards. In commercial settings the focus is profit production. As such, losses can legitimately be quantified in monetary terms. This is because transactions will customarily involve money, or an equivalent.⁵⁶ The suggestion is that in this setting, no issues are presented by utilising this approach.

The payment of damages will fulfil the expectations of a party who suffers a breach while avoiding the type of moral issues which are said to arise from promise breaking.⁵⁷ Further, in a commercial setting it is possible for parties take cover in the way which Campbell describes.⁵⁸ This is because ‘capitalist economies are characterized by the ready availability of goods in competitive supply, including a margin of excess capacity’.⁵⁹ On this point, Eisenberg has criticised the use of market value in relation to differentiated commodities. The suggestion is that this would require the use of information from roughly comparable transactions, which concern roughly comparable commodities, and that this would not accurately reflect a party’s subjective valuation of a commodity.⁶⁰ However, in commercial settings, where replacements are available, subjective valuation is irrelevant.

⁵⁵ See for example Randy E Barnett, ‘The Sound of Silence: Default Rules and Contractual Consent’ (1992) 78 Virginia Law Review 821, 865-866; See also CA Riley, ‘Designing Default Rules in Contract Law: Consent, Conventionalism, and Efficiency’ (2000) 20 OJLS 367, 369.

⁵⁶ Zamir and Medina (n 35) 257.

⁵⁷ See 4.9 Overall Conclusion.

⁵⁸ David Campbell, ‘Breach and Penalty as Contractual Norm and Contractual Anomie’ (2001) Wisconsin Law Review 681, 690.

⁵⁹ *ibid*, 690-691.

⁶⁰ Melvin A Eisenberg, ‘Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law’ (2005) 93 California Law Review 975, 990.

7.3.2.1 Damages for Breach of Contract

The key consideration here is the way in which damages for breach of contract will be assessed. This is a major factor in terms of justifying the application of the theory of efficient breach because should damages be incorrectly assessed, claims regarding the efficiency of a breach would be undermined. The discussion to follow will include highlighting the approach adopted in commercial cases, the exceptions and limitations placed on damage awards, as well as the reasons why damages are preferred to specific performance. That contract law should be geared towards providing efficient awards will also be considered.

It will be set out that damages for breach of commercial contracts are assessed based on market value.⁶¹ Also, that where there is a market for a replacement, damages will be preferred. It will be noted that law and economics views that awards of damages should be efficient and thus cost-effective. It will be made clear that should an award be incorrectly calculated, their compensatory aim would be undermined. Finally, that intangible loss is inherently difficult to quantify but that this is not an issue in commercial contracting. This simplifies the damage calculation process.

7.3.2.2 Calculating an Award of Damages

Where substitute performance is available, damages will be calculated based on the market price of a replacement. This is then compared with the original contract price.⁶² A net loss approach is adopted which offsets any gains made by the claimant against their losses.⁶³ Damage awards made by UK courts in commercial cases will focus on the market value of the asset in question to calculate a claimant's loss.⁶⁴ Furthermore, non-pecuniary losses such as loss of amenity or injury to feelings are not considered.⁶⁵

Damages are subject to exceptions set out in *Attorney General v Blake*.⁶⁶ These apply where usual remedies would prove inadequate.⁶⁷ A court may only consider a defendant's legal obligations. They

⁶¹ See *The Rozel* [1994] CLC 168; *The Alecos M* [1991] 1 Lloyd's Rep 120; *The Maersk Colombo* [2001] EWCA Civ 717.

⁶² Beale (n 10) 27-005; See also Harvey McGregor, *McGregor on Damages* (19th edn, Sweet & Maxwell 2014) 4-002.

⁶³ Beale (n 10) 26-001; See also *British Westinghouse Electric and Manufacturing Company v Underground Electric Railways Company of London* [1912] AC 673, 691 which set out a need 'to balance loss and gain'; See also *Westwood v Secretary of State for Employment* [1985] AC 20, 44.

⁶⁴ See 3.3 The Commercial Distinction in Contract Law.

⁶⁵ *Johnson v Unisys Ltd* [2001] UKHL 13; [2003] 1 AC 518 [70] (Lord Millet).

⁶⁶ *Attorney General v Blake* [2001] 1 AC 268.

⁶⁷ See Beale (n 10) 26-046.

will not be concerned by 'the expectations, however reasonable, of one contractor that the other will do something that he has assumed no legal obligation to do'.⁶⁸ Rules regarding mitigation, as well as remoteness places limitations on losses which may be recovered.⁶⁹ The mitigation rule sets out that a claimant may not recover for losses which were reasonably avoidable.⁷⁰ The remoteness rule requires that only losses which arise in the usual course of dealing, or which were contemplatable by the parties when the contract was concluded can be remedied.⁷¹

Following the ruling in *The Achilles*,⁷² a claimant will be unable to claim for losses for which the defendant could not be assumed to have taken responsibility for. Also, in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd*,⁷³ Lord Hoffmann set out the reasons why specific performance may be inappropriate.⁷⁴ It was noted that 'the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance. A remedy which enables him to secure, in money terms, more than the performance due to him is unjust'.⁷⁵ Finally, that from a public interest perspective, it cannot be appropriate for a court to require parties to carry on a business operation at a loss where there is a suitable alternative available by which the other party may be compensated.⁷⁶

7.3.2.3 Calculating Efficient Awards

At the core of the theory of efficient breach is the requirement that efficient awards of compensatory damages are calculated. Posner notes that 'the objective of giving the promisor an incentive to fulfil his promise unless the result would be an inefficient use of resources can usually be achieved by giving the promisee his expected profit on the transaction'.⁷⁷ Cooter characterised the dispute regarding efficient breach as 'a disagreement about whether damages are a sanction for wrongdoing or the price of breach'.⁷⁸ It was noted that justifications for efficient breach are part of an open ended list and may include impossibility, changed circumstances, mutual mistake or a situation where

⁶⁸ *ibid*, 26-001.

⁶⁹ *ibid*, 26-002 - 26-107; See also *Hadley v Baxendale* (1854) 9 Ex 341; *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2009] 1 AC 61: A claimant will be unable to claim for losses for which the defendant could not reasonably be assumed to have taken responsibility for.

⁷⁰ *ibid*, 26-079; Harris, Campbell and Halson (n 13) 109-120.

⁷¹ *ibid*, 26-107; See also Harris, Campbell and Halson (n 13) 88-97; *Hadley v Baxendale* (1854) 9 Ex 341.

⁷² *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2009] 1 AC 61.

⁷³ [1998] AC 1.

⁷⁴ *ibid*, 11 (Hoffmann LJ).

⁷⁵ *ibid*, 15 (Hoffmann LJ).

⁷⁶ *ibid*.

⁷⁷ Posner (n 12) 130; See also Paul G Mahoney, 'Contract Remedies: General' in Gerrit De Geest (ed) *Contract Law and Economics* (Edward Elgar 2011) 155.

⁷⁸ Robert Cooter, 'Prices and Sanctions' (1984) 84 *Columbia Law Review* 1523, 1545.

performance would impose hardship on the promisor whilst producing only a small advantage to the promisee. However, it is submitted that opponents of efficient breach would insist that efficiency is excluded from this list.⁷⁹ This is a view which clearly clashes with the approach to efficient breach which this thesis advocates.

Campbell notes that a breach will be efficient where ‘in anticipation of paying full compensation ... the defendant still decides to break his promise’.⁸⁰ It is highlighted that the most efficient remedies will offer the closest thing to exact compensation because they will deter inefficient breaches whilst permitting efficient ones.⁸¹ The implication is that in such situations resources will be allocated to a more efficient use.⁸² If damages are adequate, a claimant should be indifferent between payment and performance. Theoretically, damages will protect expectation more cheaply because ‘no benefit will be conferred by making the defendant protect the claimant's expectation by the more expensive method of literal enforcement’.⁸³ It follows that a defendant should be able to opt for the most cost effective method. On the issue of maximising profit and minimising loss, a paradox is said to exist which stems from a belief that contract law remedies are intended to encourage primary obligations through providing a deterrent for breach.⁸⁴ The response is that breach of contract ‘is a legitimate legal institution, governing a rational economic response to the limitations of bounded rationality, which it is the function of compensatory damages to allow’.⁸⁵

Yorio notes that criticism of incorrectly calculated money damages is legitimate on the basis that it undermines contract law's underlying aim.⁸⁶ Further, that the defects which exist within the system of compensatory damages may be cured through adjusting the rules which govern them. This would include balancing moral considerations with efficiency goals. The claim is that this would allow contract law to benefit from any efficiency gains which specific performance is said to generate whilst avoiding efficiency losses which its application would produce.⁸⁷ The difficulty with this approach is the quantification of what are effectively intangible losses. This is not to dispute that they may be a relevant concern in some areas of contracting. However, in commercial contracting the courts are unwilling to compensate this type of loss.⁸⁸ In addition, the underlying intent upon

⁷⁹ *ibid.*

⁸⁰ David Campbell and Donald Harris, ‘In Defence of Breach: A Critique of Restitution and the Performance Interest’ (2002) 22 *Legal Studies* 208, 218.

⁸¹ Richard Craswell, ‘Contract Remedies, Renegotiation and the Theory of Efficient Breach’ (1988) 61 *Southern California Law Review* 629, 663.

⁸² Campbell and Harris (n 80) 218.

⁸³ *ibid.*, 219.

⁸⁴ *ibid.*, 221.

⁸⁵ *ibid.*

⁸⁶ Edward Yorio, ‘In Defense of Money Damages for Breach of Contract’ (1982) 82 *Columbia Law Review* 1365, 1424.

⁸⁷ *ibid.*

⁸⁸ See 3.5.2 Loss of Amenity and the Consumer Surplus.

which commercial contracting is built is to generate profit.⁸⁹ With this in mind, moral considerations should not play a part in the quantification of damages following a breach.

7.3.2.4 The Legitimacy of Awards of Damages for an Efficient Breach

Some of the issues regarding the legitimacy of awarding damages for an efficient breach of contract were discussed earlier.⁹⁰ These included whether damages aimed to reflect the expectation interest of a party can truly compensate their loss. This would mean that the party would be indifferent between performance and damages. It was set out that costs are attached to any form of litigation and that it would be flawed to discount the theory of efficient breach simply because of those costs.

The next issue discussed was whether any loss accrued during the time period between the point of breach and a judgment.⁹¹ It was suggested that this could be dealt with by awarding interest to reflect the rate which would be attached to borrowing funds during that time.⁹² Also, that performance negates the risk of the breaching party going into insolvency during the period between breach and the payment of damages.⁹³ This risk was discounted on the basis that there is always that potential and whilst this is unfortunate, this does not provide sufficient reason to discount the theory of efficient breach.

The inherent difficulties which are attached to measuring damages were also considered.⁹⁴ It was noted that it would be bold to discount the damage calculation process based on this. The potential that difficulties may arise where breaching parties delay payment was noted. It was set out that such issues would be allayed were they to act proactively rather than waiting for an action for breach of contract to be brought. This would be efficient in terms of time and cost. Further, that the costs attached to paying damages should factor into any calculations carried out prior to a decision to breach.

Finally, issues relating to the position of the court were considered. These included concerns over hard-to-measure elements such as lost profit or idiosyncratic losses, as well as the limits placed on awards such as mitigation and remoteness.⁹⁵ Again, these issues were discounted on the basis that damage awards in commercial cases will not take into account non-pecuniary losses. Market value

⁸⁹ See 2.8 Overall Conclusion.

⁹⁰ See 6.2.1 On Damages.

⁹¹ See 6.2.1.1 Are Inherent Difficulties in Calculating Damages Problematic?

⁹² See Eisenberg (n 60) 995; The Council Directive 2011/7/EC of 16 February 2011 On combating late payment in commercial transactions (3); Late Payment of Commercial Debts (Interest) Act 1998, s 1; Sir Geoffrey Vos, *Civil Procedure White Book* (Sweet & Maxwell 2018) Section 16A.6.

⁹³ Eisenberg (n 60) 996.

⁹⁴ See 6.2.1.1 Are Inherent Difficulties in Calculating Damages Problematic?

⁹⁵ *ibid.*

will be the default measure which is adopted, meaning that subjective valuation of such factors will not be an issue.⁹⁶ Also, that rules relating to mitigation and remoteness are foundational in terms of calculating contract damages and that to suggest they are flawed raises issues which are greater than simply the functionality of efficient breach.

7.3.2.5 Is Performance Preferred?

It has been suggested that there is a consensus in terms of viewing breach of contract as immoral. The result is the suggestion that there is a general preference for performance rather than an award of damages following breach. A study by Wilkinson-Ryan and Baron which concerned specifically intentional breaches set out that its subjects considered causing harm by breaching a contract 'more immoral and should feel more guilt than a person who caused harm via negligence'.⁹⁷ The view was that a promisor should always perform, even where breaching and paying damages would be profitable.⁹⁸ Also, in cases of intentional breach there was a call for punitive damages.⁹⁹ Next, Lewinsohn-Zamir suggested that there is a preference for in-kind remedies over monetary compensation.¹⁰⁰ This will mean that people will prefer to receive what was promised rather than its value no matter how accurate the valuation.¹⁰¹ There is a perception that a decision to breach should be viewed differently should it take place in fortunate rather than unfortunate circumstances.¹⁰² This conflicts with the economic approach which does not 'distinguish between a case where performance becomes overly difficult for the promisor and one in which breach is due to the availability of a more

⁹⁶ See Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* (2nd edn, CUP 2006) 171; See also *The Rozel* (n 61); *The Maersk Colombo* (n 61); *The Alecos M* (n 61).

⁹⁷ Tess Wilkinson-Ryan and Jonathan Baron 'Moral Judgment and Moral Heuristics in Breach of Contract' (2009) 6 *Journal of Empirical Legal Studies* Volume 405, 419.

⁹⁸ *ibid*, 420.

⁹⁹ *ibid*, 422.

¹⁰⁰ Daphna Lewinsohn-Zamir, 'The Questionable Efficiency of the Efficient-Breach Doctrine' (2012) 168 *Journal of Institutional Theoretical Economics* 5, 16; See also Daphna Lewinsohn-Zamir, 'Can't Buy Me Love: Monetary Versus In-Kind Remedies' (2013) *University of Illinois Law Review* 151, 162; Seanna Shiffrin, 'Could Breach of Contract be Immoral' (2009) 107 *Michigan Law Review* 1551, 1565: Shiffrin argues that in entering into a contract one does so seeking 'the specific good or service, not a voucher that will allow one to contract to obtain the good or service at a later date (even at a discount)'.

¹⁰¹ Daphna Lewinsohn-Zamir, 'Can't Buy Me Love: Monetary Versus In-Kind Remedies' (2013) *University of Illinois Law Review* 151, 180-181.

¹⁰² See Daniel Friedmann, 'The Efficient Breach Fallacy' (1989) 18 *The Journal of Legal Studies* 1, 2-3; See also Joseph M Perillo, 'Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference' (2000) 68 *Fordham Law Review* 1085, 1095; Oren Bar-Gill and Omri Ben-Shahar, 'An Information Theory of Willful Breach' (2009) 107 *Michigan Law Review* 1479, 1499; Adam Rigoni, 'The Chameleon's Dish: Against The Dual Performance Hypothesis' (2018) 28.

<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800446> accessed 24 September 2018.

lucrative contract'.¹⁰³ There was also a suggestion that alongside maximising wealth, other preferences may be influential. It is claimed that:

People prefer an unqualified entitlement to receive delivery in kind over an entitlement to either delivery or monetary damages. The questionnaire emphasized that the monetary award would fully compensate the buyer not only for her losses due to the delay in supplying the iron, but also for the inconvenience of purchasing substitute iron from another importer and the increase in the market price of the iron. However, in real life, some of these losses would not be compensated for. To operate smoothly, a factory must be assured that all the inputs it needs for production will be delivered on time. Therefore, a higher priced contract guaranteeing a right to performance in kind on a certain date may enhance the factory's wealth better than a lower-priced contract sufficing with a monetary substitute. In addition, the higher-priced specific-performance contract gives promisees (managers) the bargaining power to share in the profits from future renegotiations.¹⁰⁴

There are two obvious problems with this claim. First, that if some losses would not be compensated, the breach is by proxy inefficient. Second, that should a party wish to attempt to ensure performance will take place in specie, a high value liquidated damages clause could be included within the contract. Whilst this would not necessarily enforce performance, it could make non-performance so expensive that parties would be unlikely to breach. Liquidated damages clauses will be enforceable assuming they are not considered to be penalty clauses.¹⁰⁵ It is set out that where a clause is held to be a liquidated damages clause rather than a penalty clause, it 'will be valid and it will fix the liability of the party in breach, in the sense that the sum stipulated in the clause will be the sum that must be paid, irrespective of the loss that is actually suffered on the facts of the case'.¹⁰⁶

There is a suggestion that the preference for in-kind remedies extends to business transactions.¹⁰⁷ This is due to concerns regarding reputational preservation.¹⁰⁸ The claim is that assumptions of extreme greediness are not necessarily correct, and that parties will seek to cooperate with one another rather than exercising practices such as holdout power.¹⁰⁹ Also, that decisions regarding

¹⁰³ Lewinsohn-Zamir (n 100) 9.

¹⁰⁴ *ibid*, 22.

¹⁰⁵ See *Clydebank Engineering and Shipbuilding Company, Limited v Don Jose Ramos Yzquierdo Y Castaneda* [1905] AC 6.

¹⁰⁶ Ewan McKendrick, *Contract Law: Text, Cases, and Materials* (8th edn, OUP 2018) 899.

¹⁰⁷ Lewinsohn-Zamir (n 101) 193-194.

¹⁰⁸ Lewinsohn-Zamir (n 100) 22.

¹⁰⁹ *ibid*, 7; See also JJ Mansbridge, *Beyond Self-Interest* (The University of Chicago Press 1990); H Margolis, *Selfishness, Altruism and Rationality: A Theory of Social Choice* (Cambridge University Press 1982); A Etzioni, *The Moral Dimension: Toward a New Economics* (Free Press 1988); D Kahneman, J Knetsch and RH Thaler (1986), 'Fairness and the Assumptions of Economics' in RM Hogarth and MW Reder (eds), *Rational Choice: The Contrast between Economics and Psychology* (The University of Chicago Press 1986) 101-116; CR Sunstein and R Thaler 'A Behavioral Approach to Law and Economics' (1998) 50 *Stanford Law Review* 1471; C Jolls, 'Behavioral Law and Economics' in P Diamond and H Vartiainen (eds),

breach may not be informed solely by the potential for a monetary incentive, meaning that other factors may influence behaviour.¹¹⁰ In 1963, Macaulay set out that the reputation of a commercial party will have an impact on whether other parties will be willing to rely on their assurances.¹¹¹ Morgan has also highlighted concerns, suggesting that the ‘gleefully amoral attitude arguably fits that of business contractors, for whom contract’s supposed “sanctity” is irrelevant’.¹¹² Further, that even in a commercial context, breach is condemned by business people who prefer performance to monetary damages.¹¹³ Factors such as cooperation and trust are said to be key and that ‘the importance of ongoing cooperative relationships in business can hardly be doubted’.¹¹⁴ For example, there is a claim that ‘contracting parties routinely disregard the incentives set forth by the legal system and adhere to the dictates of the applicable social norm’.¹¹⁵

Ultimately, these issues do not diminish the legitimacy of the claims which this thesis makes regarding the decision making of parties with the opportunity to breach a commercial contract efficiently. They may opt to attach value to factors other than financial gain. These may include reputation and the protection of existing contracting relationships. Nothing is being said about what a party should do when the opportunity to breach efficiently presents itself. The only claim is that should breaching efficiently be the preferred option, it would be legitimate to pursue it.

7.3.3 Conclusion

The first limitation concerned the commercial contracting context, and the fact that wealth maximisation is legitimate within this setting. It is the case that within commercial contracting the intention is generally to maximise the wealth which flows from individual transactions. This is despite criticism which has been levelled at the approach by some corporate lawyers. The clear contrast with non-commercial contracts in terms of a profit oriented focus was also reiterated. On this basis, the rational decision maker paradigm is applicable to commercial parties. Finally, commercial parties are likely to possess, or may reasonably be expected to possess, a more developed

Behavioral Economics and its Applications (Princeton University Press 2007) 115–145; RH Thaler, *The Winner’s Curse: Paradoxes and Anomalies of Economic Life* (Princeton University Press 1992).

¹¹⁰ Yuval Feldman and Doron Teichman, ‘Are All Contractual Obligations Created Equal?’ *The* (2012) 100 *Georgetown Law Journal* 5, 49: These are said to include moral obligations, motivated reasoning and social norms.

¹¹¹ See Stewart Macaulay, ‘Non-Contractual Relations in Business: A Preliminary Study’ (1963) 28 *American Sociological Review* 1; See also Morgan (n 50) 79.

¹¹² Morgan (n 50) 44.

¹¹³ *ibid* 46; See Lewinsohn-Zamir (n 101) 172; Adam Rigoni, ‘The Chameleon’s Dish: Against The Dual Performance Hypothesis’ (2018) 12. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800446> accessed 24 September 2018.

¹¹⁴ Morgan (n 50) 69.

¹¹⁵ Feldman and Teichman (n 110) 14-15. Citing Macaulay (n 111).

understanding of contract law's function following breach.¹¹⁶ This concerns the default position of enforcing a payment of damages over specific performance.

The next key point is that in a commercial setting damage awards may legitimately be quantified in monetary terms. This is because transactions will generally involve money or its equivalent. Also, whenever damage awards are quantified there is potential difficulty. This applies in any area of the law. However, an approach based on market value to assessing damages is adopted within commercial contract cases.¹¹⁷ This simplifies the process as intangible losses which are inherently difficult to quantify are not considered. There are potential problems when non-market transactions concerning differentiated commodities are considered. However, where a replacement may be acquired within the market, an award of damages will adequately compensate a claimant. It would also be bold to claim that the process by which damages are calculated should be discounted based on the difficulties which are inherent in terms of quantification.

The view within law and economics that awards of damages should be efficient on the basis that they would be cost-effective within market transactions was supported. It was also pointed out that should an award be calculated incorrectly, their compensatory aim would be undermined. Finally, that a commercial party is best placed to make decisions in their own interests. It follows that they are capable of assessing whether the ramifications beyond the breach in isolation are substantial enough to deter it. Where a party views breaching and paying damages as the most attractive option, it will be appropriate. Equally, a want to preserve ongoing cooperative business relationships could feed into their decision making process.

7.4 The Legitimacy of an Instrumentalist Approach

Having set out the specifics of the formulation of efficient breach that is being advanced, as well as highlighting the limitations upon which its application is contingent, it is now necessary to justify the method which is to be applied. The approach which is being suggested is instrumentalist in nature. These approaches aim to encourage actions based on a particular objective, in this case the pursuit of economic efficiency.¹¹⁸

¹¹⁶ See *Bradgate* (n 49) 687; See also *Morgan* (n 50) 57.

¹¹⁷ See *The Rozel* (n 61); *The Maersk Colombo* (n 61); *The Alecos M* (n 61).

¹¹⁸ See 5.4.4 Economic Efficiency.

These approaches have been criticised.¹¹⁹ A prominent criticism is that instrumentalist approaches conflict with the requirements of corrective justice. As Weinrib set out, ‘corrective justice is the idea that liability rectifies the injustice inflicted by one person on another’.¹²⁰ It is said to feature:

[T]he maintenance and restoration of the notional equality with which the parties enter the transaction. This equality consists in persons’ having what lawfully belongs to them. Injustice occurs when, relative to this baseline, one party realizes a gain and the other a corresponding loss. The law corrects this injustice when it re-establishes the initial equality by depriving one party of the gain and restoring it to the other party.¹²¹

This has frequently been discussed with regard to tort law.¹²² Within tort, the intention is to attempt to compensate injuries to a person or their property caused by another. Nothing should be inferred with regard to whether this approach is legitimate or not within tort law. It is simply being noted as an illustrative example with regard to the application of corrective justice. The difference between tort and contract with respect to the suitability of compensation was noted earlier.¹²³ The conclusion was that utilitarian approaches which consider only increases in total utility, welfare or wealth should be applied in limited circumstances only.¹²⁴

There is evidence of attempts to extend the approach to all elements of private law, including contract.¹²⁵ Weinrib sets out that:

[T]he concepts and many of the principal doctrines of the common law—for example, offer and acceptance, consideration, unconscionability, and expectation damages in contract law, and causation, fault, and compensatory damages in tort law — reflect the bipolarity of private law relationships. Inasmuch as such relationships are coherent, the justificatory considerations that underlie them have the structure of corrective justice. And if courts are to maintain this coherence, their reasoning about these relationships will also have to adhere to the contours of corrective justice.¹²⁶

¹¹⁹ See 6.3 Clashes with the Application of an Instrumentalist Approach.

¹²⁰ Ernest J Weinrib, ‘Corrective Justice in a Nutshell’ (2002) 52 *The University of Toronto Law Journal* 349; See also Aristotle’s *Nicomachean Ethics* V.iv 1130.

¹²¹ *ibid.*

¹²² See Benjamin Shmueli, ‘Legal Pluralism in Tort Law Theory: Balancing Instrumental Theories and Corrective Justice’ (2015) 48 *University of Michigan Journal of Law Reform* 745, 751; See also Ernest J Weinrib, *Corrective Justice* (OUP 2012) 72-75; See also Ernest J Weinrib, ‘Correlativity, Personality, and the Emerging Consensus on Corrective Justice’ (2001) 2 *Theoretical Inquiries in Law*, 107, 108.

¹²³ See 6.2.1.8 Conclusion.

¹²⁴ See John Stuart Mill, *Utilitarianism* (Roger Crisp ed, OUP 1998) 55; See also Anthony T Kronman, ‘Wealth Maximization as a Normative Principle’ (1980) 9 *Legal Studies* 227, 232; Ernest J Weinrib, ‘Utilitarianism, Economics and Legal Theory’ (1980) 30 *University of Toronto Law Journal* 307, 309.

¹²⁵ See Ernest J Weinrib, *The Idea of Private Law* (OUP 2012) 20.

¹²⁶ *ibid.*, 74.

Also, on contract specifically, it is suggested that ‘the central doctrines the law of contract (offer and acceptance, consideration, unconscionability, and expectation damages) allow the parties, through the mutuality their conduct, to create in the plaintiff a right to the defendant’s performance of the promised act’.¹²⁷ It is this suggestion which is problematic when we attempt to apply it to modern contract law. This is on the basis that damages for breach of contract are based on interests owing to a loss, rather than interests owing to performance. This is embodied in the limited availability of remedies such as restitution and specific performance within contract. On this point, there have been attempts to carry the corrective justice approach further with respect to its application to contract. For example, on punitive damages Lee suggested that the ‘infusion of punishment into contract law may not appear as offensive as tradition has made it out to be’.¹²⁸ This was based on the view that need not be restricted to the ‘compensate, not punish’ approach.¹²⁹ In addition, Botterell’s approach concerned the suggestion that ‘even if a contract gives the promisee a right to only the promisor’s performance of the contract, such a right can sometimes entail the acquisition by the promisee of certain rights of ownership’.¹³⁰ As a result it is claimed that ‘where such rights are acquired, a disappointed promisee is entitled to any gains realized by the ... by reason of the fact that such gains are something to which the promisee has an antecedent normative entitlement’.¹³¹ However, in Weinrib’s view, expectation damages fulfil the requirements of corrective justice because they ‘represent the value of the promisor’s performance’.¹³² It is suggested that:

From the standpoint of corrective justice, private law is a distinct form of practical reason, in which justification reflects the correlative situation of the parties as doer and sufferer of the same injustice. One-sided considerations, no matter how appealing, such as that the party in breach should disgorge profits made from its wrong or should be punished for its malevolent conduct, do not conform to this correlativity. Such considerations can be incorporated only if private law is willing to countenance unfairness as between the parties and the disturbance of the law’s internal coherence. Perhaps sensing this, the common law traditionally did not use damage awards to punish the breaching party or to force disgorgement of the gains from breach.¹³³

In this way, Weinrib is critical of instrumental approaches, rather than the use compensatory damages. However, as was set out earlier, the efficient breach of commercial contracts would utilise

¹²⁷ Weinrib (n 120) 353.

¹²⁸ Pey-Woan Lee, ‘Contract Damages, Corrective Justice and Punishment’ (2007) 70 MLR 887, 907.

¹²⁹ *ibid*, 895.

¹³⁰ Andre Botterell, ‘Contractual Performance, Corrective Justice, and Disgorgement for Breach of Contract’ (2010) 16 Legal Theory 135.

¹³¹ *ibid*, 135-136.

¹³² Ernest J Weinrib, ‘Punishment and Disgorgement as Contract Remedies’ (2003) 78 Chicago-Kent Law Review 55, 102.

¹³³ *ibid*, 103.

the wealth maximisation, in line with the Kaldor-Hicks criterion where compensation is paid.¹³⁴ This is legitimate because only detriment that can be compensated has been caused. This is because an award of damages in line with the expectation measure can adequately protect interests stemming from commercial contracts. In tort, as well as in non-commercial contracting, this would not necessarily be true. In this case, an instrumentalist approach to commercial contracting is legitimate. This is on the basis that the overriding intention of their existence is profit generation and, by proxy, wealth maximisation. This objective can be achieved by utilising such an approach. This is in line with the claims regarding appropriate domains made earlier.¹³⁵ It is important to note, however, that this claim is confined only to this context. Nothing is to be inferred with regard to the legitimacy of instrumentalist approaches in other settings.

7.5 The Decision to Breach Efficiently

Having set out the parameters which are to be applied to this approach to efficient breach, it is now possible to move on to discuss it in more detail. It is important to clarify that this is not a defence for all intentional breaches, only those which are inspired by the pursuit of efficiency. There is, of course, the potential that parties may wish to breach for reasons which do not pertain to efficiency. However, nothing should be inferred with regard to intentional breaches generally. The focus here is solely on the efficient breach of commercial contracts.

A key consideration is the decision which the breaching party will make regarding a potential breach. In this way, an efficient breach is effectively a one party decision. It will be based on risk predictions as well as individual preferences.¹³⁶ It is also notable that the eventual efficiency of the breach is relatively inconsequential with regard to its justification. This may seem counterintuitive on the basis that the classic justification for efficient breach is that it will lead to an increase in total wealth. However, on the basis that the breaching party will bear the cost should it transpire that the breach was ultimately inefficient, this is not overly problematic.¹³⁷ Their risk would not have paid off, and they would be responsible for the costs. Of course, this is only legitimised where the breaching party pays the required damages.

It is important to again make clear that this thesis does not make any claims about what a party should do when faced with the opportunity to breach efficiently. Framing an efficient breach in this way is a novel approach top take to the theory's application which contrasts with more prescriptive methods.

¹³⁴ See 5.4.2 The Kaldor-Hicks Criterion.

¹³⁵ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

¹³⁶ See 6.5.2 Bounded Rationality, Transaction Costs and Pre-Breach Predictions.

¹³⁷ See 6.2.1.1 Are Inherent Difficulties in Calculating Damages Problematic?

A potential flaw in the way that literature on efficient breach could be interpreted is the idea that it outlines how decisions should be made. This approach would be based in positive economics. The claims advanced here are more in line with normative economics. The intention is to outline that in a particular setting, a course of action will be economically justified. There is also a claim that the model suggests relationships between contracting parties will not impact their behaviour. It is suggested that this displays a bias in favour of uncooperative, inefficient behaviour and that this type of bias is inevitable within the neo-classical economics model.¹³⁸ Macneil suggested that Posner's approach is one which advocates breaching first and talking afterwards, despite the suggestion that talking post breach 'may be one of the more expensive forms of conversation to be found, involving, as it so often does, engaging high-priced lawyers, and gambits like starting litigation, engaging in discovery, and even trying and appealing cases'.¹³⁹ However, the potential for breach can, in fact, be seen to provide the necessary leverage to trigger renegotiation on the basis that it may encourage a party who may be unwilling to negotiate to reconsider.¹⁴⁰ If this proved to be unrealistic, a breach on efficiency grounds may take place as a final option.

The decision to breach may also account for other factors which could lead to a decision not to breach where it would be economically efficient to do so. These may include the protection of an existing relationship, or reputation within a particular industry. A party could opt to perform despite the opportunity to make an efficiency gain, or attempt to renegotiate the agreement in light of an unforeseen contingency or change of circumstances.¹⁴¹

As Campbell and Harris suggest, the only question should be whether that party will perform or choose to pay compensatory damages, and that this decision will be based in part on cost.¹⁴² Additionally, criticism has been directed at the perceived narrow view which is focused on wealth. The claim is that individuals may not be focused solely on improving their own position, meaning that they may account for other factors such as social norms or their relationships with other parties.¹⁴³

A party may legitimately decide based on their own preferences that a relationship is worth protecting. They could opt to perform and effectively write-off any efficiency gains which they could have made. They could also attempt to renegotiate in light of an unforeseen contingency or change of circumstances. On renegotiation, it is suggested that scholars who (based on non-economic reasoning) prefer remedies which punish breach of contract will 'assert that their remedies are not

¹³⁸ Ian R Macneil, 'Efficient Breach of Contract: Circles in the Sky' (1982) 68 *Virginia Law Review* 947, 969.

¹³⁹ *ibid.*

¹⁴⁰ See 6.2.1.2 Are Awards of Damages Under Compensatory?

¹⁴¹ See 6.5.2 Bounded Rationality, Transaction Costs and Pre-Breach Predictions.

¹⁴² Campbell and Harris (n 80) 219.

¹⁴³ Lewinsohn-Zamir (n 100) 9.

inconsistent with economic efficiency because the parties can always renegotiate to permit an efficient breach'.¹⁴⁴ Key is that 'if renegotiation costs are low, all remedies are equally efficient'.¹⁴⁵ However, this claim assumes that renegotiation is both a possibility, as well as potentially fruitful. This may or may not be the case. Also, it is possible that the threat of breach will provide the necessary leverage which will trigger renegotiation. This is on the basis that it could encourage a party who was initially unwilling renegotiate, to reconsider their position.¹⁴⁶ Finally, a party could opt to breach and pay compensatory damages which are in line with the expectation measure.

The opportunity to breach will afford contracting parties the flexibility to adapt to an unforeseen contingency in a cost-effective manner. It would be wrong to disallow such behaviour where the parties to an agreement entered into it to generate a profit. Enforcing performance where total wealth would not be maximised or, worse, where it would be reduced would be counterproductive. Additionally, there is a view that it is not appropriate to require a party to carry on a business activity which results in a loss should an alternative route which provides compensation is available.¹⁴⁷ It is also notable that the intention of contract law is satisfying legitimate expectations rather than punishing wrongdoing.¹⁴⁸

7.6 Contrasts with Existing Defences of Efficient Breach

The main justification which is raised for the theory of efficient breach is that pursuing economic efficiency is legitimate.¹⁴⁹ This involves maximising wealth by moving resources into the possession of the party who values it most.¹⁵⁰ Clearly this requires that maximising wealth is considered to be a legitimate goal. However, this cannot be said to be the case in all contractual settings. As has been noted throughout, this approach to efficient breach is limited in the sense that the claims which this thesis makes are based on wealth maximisation's legitimacy within commercial contracting only. This is due to the intention to generate a profit which underpins them.

There are some relatively recent examples of defences for efficient breach which have been raised. These include Shavell's defence based on unforeseen contingencies which may flow naturally from the incomplete nature of contracts, as well as an alternative attitude to contractual performance

¹⁴⁴ Craswell (n 81) 632.

¹⁴⁵ *ibid*, 635.

¹⁴⁶ See 6.2.1.2 Are Awards of Damages Under Compensatory?

¹⁴⁷ *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* (n 73) 15 (Hoffmann LJ).

¹⁴⁸ *ibid*.

¹⁴⁹ See Posner (n 12) 129.

¹⁵⁰ See 5.4.4 Economic Efficiency.

known as the dual performance hypothesis raised by Markovits and Schwartz.¹⁵¹ Whilst these approaches are interesting, they are somewhat underdeveloped. As such, the formulation of efficient breach that this thesis advances provides a more functional approach that applies specifically within the commercial contracting context.

7.6.1 A Defence based on the Incomplete Nature of Contracts

Shavell suggests that a breach of contract may be permissible in light of an unforeseen contingency. Further, that when damages are fully compensatory, breach will be moral on the basis that it would have been allowed had the parties been aware at the initial negotiation stage.¹⁵² Also, that any belief that a moral reason ensures that contracts are performed stems from an oversimplification of moral requirements, as well as a misunderstanding of the incomplete nature of contracts.¹⁵³ More recently, Shavell outlined that his argument is based on the incomplete nature of contracts. This is due to the time and cost of attempting to account for any possible contingency.¹⁵⁴ It is suggested that where a contingency is not provided for 'then the moral duty to perform ... is governed by what a completely detailed contract addressing the contingency would have stipulated'.¹⁵⁵ Also, that where a particular contingency has been provided for there will be a moral duty to perform based on the contract's terms.¹⁵⁶

Shavell's position is that opting to breach and pay damages which reflect the expectation interest is not immoral 'when performance would not have been specified in a complete contract'.¹⁵⁷ It is set out that most individuals (citing Shiffrin as an example) hold a view that breach of contract features a moral element. The reasoning is that 'they regard contracts as simple promises and ignore the incompleteness of contracts - individuals tend to confuse the violation of a contract with the breaking of an explicit promise'.¹⁵⁸ The focus placed on unforeseen contingencies highlights that the incomplete nature of contracts is an inherent problem.

¹⁵¹ See Steven Shavell, 'Is Breach of Contract Immoral?' (2006) 56 *Emory Law Journal* 439; See also Steven Shavell, 'Why Breach of Contract may not be Immoral given the Incompleteness of Contracts' (2009) 107 *Michigan Law Review* 1569; Markovits and Schwartz (n 46); Daniel Markovits and Alan Schwartz 'The Expectation Remedy Revisited' (2012) 98 *Virginia Law Review* 1093.

¹⁵² *ibid*, 450.

¹⁵³ *ibid*, 460.

¹⁵⁴ Steven Shavell, 'Why Breach of Contract may not be Immoral given the Incompleteness of Contracts' (2009) 107 *Michigan Law Review* 1569, 1569-1570.

¹⁵⁵ *ibid*, 1570.

¹⁵⁶ *ibid*.

¹⁵⁷ *ibid*, 1580-1581.

¹⁵⁸ *ibid*, 1581; See also Seana V Shiffrin, 'The Divergence of Contract and Promise' (2007) 120 *Harvard Law Review* 708; Seana V Shiffrin, 'Could Breach of Contract be Immoral?' (2009) 107 *Michigan Law Review*

Where a better opportunity presents itself, it is legitimate to pursue it, pay damages and enjoy any benefits. The opportunity to breach efficiently would afford parties the flexibility to adapt should contracts which they have entered into become economically inefficient.¹⁵⁹ This is on the basis that the contract would not have been agreed had the opportunity in question had it been predicted, and had all the relevant information been available. This squares with the attitude that contract law should facilitate efficient exchanges by providing optimal incentives to maximise surplus from transactions.¹⁶⁰ It follows that a rational commercial party would prefer to have this option available to them.¹⁶¹ Furthermore, despite the best efforts of those drafting contracts, coupled with the expertise of commercial parties who operate within a particular industry, it is impossible to prepare for all potential eventualities.

The claims which this thesis makes represent a development of Shavell's approach. This involves restraining the ability to adapt to unforeseen contingencies through breach by limiting it only to commercial contracts. Restricting this analysis has an impact on damage calculation by focusing on market value,¹⁶² as well as on claims regarding any moral force which is believed to be embodied within contracts.¹⁶³

7.6.2 A Defence based on an Alternative Approach to Contractual Performance

Markovits and Schwartz claim that protecting expectation through an award of damages is justified because there is a 'difference between a promisor who refuses to trade but voluntarily transfers ... and a promisor who declines both to trade and to transfer'.¹⁶⁴ They suggest that dual performance will provide one of two things which have been contracted for because performance is said to include both trade, and transfer.¹⁶⁵ This 'commits a promisor to performance just as surely as a promise of the form Shiffrin prefers; it just changes what counts as performance'.¹⁶⁶ While this approach is original, it risks attempting to justify efficient breach based on the terminology which is used, rather than outlining that the theory is itself functional. The use of "trade or transfer", rather than "perform or pay" falls into this trap. It is more appropriate to adopt an approach which seeks to deal directly

1551; Seana V Shiffrin, 'Must I Mean What You Think I Should Have Said?' (2012) 98 Virginia Law Review 159.

¹⁵⁹ *ibid*, 1569.

¹⁶⁰ Zamir and Medina (n 35) 259.

¹⁶¹ See Markovits and Schwartz (n 46)2001.

¹⁶² See 3.3 The Commercial Distinction in Contract Law.

¹⁶³ See 4.3 Contract is distinguishable from Promise based on the Domain in which it is utilised.

¹⁶⁴ Markovits and Schwartz (n 46)1988.

¹⁶⁵ *ibid*, 1984.

¹⁶⁶ Daniel Markovits and Alan Schwartz 'The Expectation Remedy Revisited' (2012) 98 Virginia Law Review 1093, 1101; See also Seana V Shiffrin, 'Must I Mean What You Think I Should Have Said?' (2012) 98 Virginia Law Review 159.

with the concerns which have been raised in respect of efficient breach. Simply altering the terminology used does little to legitimise the theory generally.

Criticism has stemmed from the use of specific market conditions by Markovits and Schwartz. Rigoni outlines that the payment of damages is justified based on these assumptions.¹⁶⁷ They are as follows:

- (i) [T]he buyer has bargaining power ex post [i.e., he can extract a bribe];
- (ii) the seller can charge a price that at least equals her expected cost; and
- (iii) the seller's ability to price ex ante is constrained by the existence of other potential suppliers. The first two of these factors hold everywhere and the last holds unless a seller has strong monopoly power.¹⁶⁸

It is suggested that in Markovits and Schwartz's model the 'secondary sale of the contracted good or service to a third party, essential to fortunate circumstance efficient breach, cannot happen in a competitive market'.¹⁶⁹ Finally, Rigoni is critical of the use of expectation damages as a default remedy for breach of contract.

Markovits and Schwartz acknowledge that the setting in which efficient breach may legitimately function is a competitive market. It is suggested that 'business firms ... commonly attempt to maximize expected profits, and it is widely assumed that many of them are capable of doing so'.¹⁷⁰ This attitude is in line with the position that individual parties will be best placed to make decisions which impact on their own position. However, they stop short of outlining that the theory is applicable only to contracting parties who are operating in a commercial manner. This is a clear contrast with the model which this thesis proposes.

Arguably the dual performance hypothesis better facilitates the profit increasing, or loss limiting approach. This is because it is based on taking an efficient course of action in terms of a contractual agreement. This is based on either an opportunity for increasing profit, or decreasing loss. However, it is important to ensure that the proposed remedy will effectively compensate the party that suffers a breach. As has been noted throughout, the commercial contracting context provides a setting where contracting parties can be compensated legitimately using damage awards assessed in line with the expectation interest.

¹⁶⁷ Adam Rigoni, 'The Chameleon's Dish: Against The Dual Performance Hypothesis' (2018) 17. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800446> 24 September 2018.

¹⁶⁸ Markovits and Schwartz (n 46) 1968.

¹⁶⁹ Adam Rigoni, 'The Chameleon's Dish: Against The Dual Performance Hypothesis' (2018) 20. <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800446> accessed 24 September 2018.

¹⁷⁰ Markovits and Schwartz (n 166) 1097.

7.6.3 Conclusion

The defences of efficient breach provided by Shavell, as well as by Markovits and Schwartz are deserving of credit based on their originality. Both feature elements that contribute in terms of seeking to provide a justification for efficient breach. However, these elements require development in order to be functional. The approach that this thesis advances achieves this by focusing specifically on commercial contracting. This allows the use of expectation damages to be justified based on the underlying profit generation intent that underpins commercial contracts.

7.7 Epistemic and Normative Justifications

The final point to note is that this approach to efficient breach can be justified in both an epistemic, and a normative way. Through discussing both of these approaches, the case that is being made for efficient breach within the context of commercial contracting will be advanced further.

7.7.1 The Epistemic Justification

From the epistemic perspective, approaches that seek to prescribe a course of action with respect to efficient breach are not functional. This is on the basis that any blanket requirement to breach, or not to breach, would be problematic. Until the facts of each individual case become evident, it is impossible to know whether or not to breach would be appropriate. It is clear that the efficiency of a breach cannot be predicted without the relevant information and evidence.¹⁷¹ Also, it is impossible to say that the potential for efficient breaches does not exist due to factors such as transaction costs.¹⁷² The only conclusion which can be made is that there exists the potential that the opportunity to breach efficiently may arise.¹⁷³ This means that any formulations or criticisms of efficient breach which purport to prescribe a course of action, cannot be applied.

In each case where the potential opportunity to breach efficiently arises, it will fall to the individual party to assess whether or not they will choose to pursue it.¹⁷⁴ They will be best placed to make that

¹⁷¹ See 6.5.2 Bounded Rationality, Transaction Costs and Pre-Breach Predictions; See also Macneil (n 138) 957.

¹⁷² See for example RH Coase, 'The Problem of Social Cost' (1960) 3 *The Journal of Law and Economics* 1, 15-16; See also Macneil (n 138) 958; Eric A Posner, 'Economic Analysis of Contract Law after Three Decades: Success of Failure' (2002) 112 *Yale Law Journal* 829, 866.

¹⁷³ See 5.3.3 Examples of Efficient Breach in English Case Law.

¹⁷⁴ See 7.5 The Decision to Breach Efficiently.

decision as they will be capable of assessing the costs versus the benefits, informed by their own position and preferences.¹⁷⁵ With this in mind, they should be allowed to make this decision, rather than having their hand forced by overly prescriptive requirements regarding contractual performance.

7.7.2 The Normative Justification

From the normative perspective there are two key points to note. First, in relation to a need for empirical evidence regarding the circumstances of a potential breach, it is impossible to claim that utilitarian principles can be satisfied in advance of the individual circumstances of each potential efficient breach scenario becoming evident.¹⁷⁶ This has a societal link in the sense that whether or not overall wealth can be improved based on individual efficient breach, opportunities must be assessed on the individual facts and on a case by case basis. Second, a prescriptive approach to efficient breach would clash with requirements regarding individual autonomy.¹⁷⁷ This is in relation to the right to make decisions based on individual positions and preferences noted earlier.¹⁷⁸ Prescribing contract rules in this regard could be perceived as insulting the autonomy of the contract breaker.¹⁷⁹ These normative elements add weight to the legitimacy of efficient breach in the commercial context.

7.7.3 Efficient Optionality

This approach to the efficient breach of commercial contracts is not a prescriptive one. It offers efficient optionality to commercial contracting parties. This builds upon the point regarding the difficulty in assessing whether a breach should take place without understanding the entirety of the facts and the context, as well as the point regarding individual autonomy. The law facilitates the case by case nature of efficient breach through providing this form of optionality giving parties the scope to act in their own best interests, adapting to the circumstances in which they find themselves.

This approach is efficient in the sense that compensation in line with the expectation measure will ensure that the interests of the party who suffers the breach are protected.¹⁸⁰ This is not to say that the system by which damages are calculated is perfect. However, it is functional for the purposes for

¹⁷⁵ See 5.5 Efficiency Based Decision Making; See also 7.5 The Decision to Breach Efficiently.

¹⁷⁶ See 5.4.3 Welfare Maximisation and Utilitarianism.

¹⁷⁷ See 6.2.2.1 Tortious Interference with Contract.

¹⁷⁸ See 7.5 The Decision to Breach Efficiently

¹⁷⁹ See for example David Howarth, 'Against Lumley v Gye' (2005) 68 MLR 195, 206.

¹⁸⁰ See 5.8 Measures of Damages; See also 6.2.1 On Damages.

which it is required. This is particularly evident in the commercial setting where market value can be utilised as an effective measuring tool.¹⁸¹ The contract is binding, though it binds parties in a way which facilitates an appropriate level of flexibility with respect to efficient breach. The nature of a commercial contract is key in this respect. This is because they exist to protect the interests of the parties in entering into a transaction with the underlying intention of generating a profit. They do not exist to enforce performance, only to provide adequate compensation where performance does not take place.

7.7.4 Conclusion

By considering additional epistemic and normative justifications, the case which is being made for efficient breach within the context of commercial contracting has been advanced. The epistemic element concerns the fact that a prescriptive approach which directs whether or not a breach should take place, would be problematic. This is because until individual facts become evident, it is impossible to outline whether breaching would be the best option. The normative element relates to the fact that claiming that utilitarian principles can be satisfied in advance of the individual circumstances of each potential efficient breach scenario becoming evident, is impossible. Also, a prescriptive approach in this setting risks undermining individual autonomy.

7.8 Overall Conclusion

This original formulation of efficient breach differs from the classic Holmes inspired iteration. This is because it specifies the circumstances and setting in which it may occur, namely commercial contracting. By focusing on this context, it is possible to demonstrate how efficient breach may function legitimately. This is because its intention is profit production meaning that maximising the level of wealth that flows from those contracts is the parties' focus.

Focusing on the commercial context allows the rational decision maker paradigm to be applied, as the primary focus of commercial parties is producing profit. These parties are also best placed to make decisions in their own interests. It is asserted that they will be able to assess whether any ramifications extending beyond the breach in isolation are impactful enough to deter it. Also, the suggestion is that commercial parties (in comparison to non-commercial parties) are likely to possess, or may reasonably be expected to possess a more developed understanding of contract law's default

¹⁸¹ See 3.3 The Commercial Distinction in Contract Law.

rules regarding breach of contract, which involves enforcing a payment of damages over specific performance.

It was set out that in this setting, awards of damage may legitimately be quantified in monetary terms. This is because transactions will generally take place in a market where replacements may be acquired. As such, value can be objectively assessed based on market value. These transactions will also tend to involve money or an equivalent. It is because of the existence of a market for a replacement, that damages will be preferred to specific performance. Furthermore, intangible losses which are inherently difficult to quantify will not be considered. This is standard practice within commercial contracting which simplifies the damage calculation process.

Additionally, in contrast with more prescriptive approaches, this iteration of efficient breach does not require that it should be pursued where it is available. Importantly, it does not suggest that the opportunity to breach and pay damages should be available in all contracting relationships. Its prerequisites include that a damage award must reflect the expectation interest as it is essential that the party who suffers a breach is compensated effectively. The breaching party should account for this cost. Next, a decision to breach the terms of a contract should be inspired only by efficiency. An efficient breach may be pursued where the breaching party deems it to suit their preferences. Finally, this approach is permissive, rather than mandatory, providing efficient optionality.

It was outlined that in the commercial context, an instrumentalist approach may be applied with regard to an efficient breach. This is on the basis that the overriding intention behind commercial contracts is profit generation and, by proxy, wealth maximisation. As such, that objective can be achieved by utilising an instrumentalist approach. Most importantly, nothing is to be inferred regarding the legitimacy of instrumentalist approaches in other legal settings.

It was suggested that the opportunity to make a decision to breach efficiently offers flexibility. This is in the sense that parties can adapt to unforeseen contingencies cost-effectively. Further, that it would be wrong to disallow such behaviour on the basis that the parties entered into the contract seeking to generate a profit. Importantly, the availability of efficiency gains will not necessarily mean that breach must take place. This decision may account for factors such as protecting existing relationships or a reputation within a particular industry. With this in mind, the decision to perform or to attempt to renegotiate the agreement could be made. However, should a party opt to breach, they will be justified in doing so. This justification applies both to the relevant party's choice to breach efficiently, and also, to the law's approach in limiting the available remedy to expectation damages. The use of this remedy in commercial contract disputes effectively condones the breach.

Existing defences of efficient breach were then discussed. This was examined in order to outline how this version of efficient breach differs from those which preceded it. They included Shavell's defence based on adapting to unforeseen contingencies which are inevitable based on the incomplete nature

of contracts, as well as the altered view of contractual performance noted by Markovits and Schwartz. It was made clear that this approach is original based on the focus on commercial contracting which allows expectation damages to be justified based on the underlying profit generation intent underpinning them.

Finally, epistemic and normative justifications add weight to the case for efficient breach within the context of commercial contracting which has been made. The epistemic element relates to the fact that a prescriptive approach, which directs whether or not a breach should take place, is problematic. Until individual facts become evident, it is impossible to outline whether breaching would be the best option in a particular case. The normative issues are twofold. First, claims that suggest that utilitarian principles can be satisfied in advance of the individual circumstances of each potential efficient breach scenario becoming evident cannot be made. Secondly, a generally prescriptive approach runs the risk of undermining individual autonomy.

Chapter 8

Conclusion: The Functionality of Efficient Breach in the Commercial Context

8.1 Introduction

The intention of this thesis was to outline the functionality of the theory of efficient breach within the context of commercial contracting. To achieve this, six questions were considered. These concerned outlining the characteristics of a commercial contract, why commercial contracts are treated differently to non-commercial contracts, whether English contract law is based on promising, what is an efficient breach, whether the criticisms directed at the theory of efficient breach derail it, and finally, when and where may efficient breach function. The methodology that was adopted consisted of looking at efficient breach through a commercial lens. However, in order to answer each of the questions at hand, a number of varying approaches were utilised, though they were broadly doctrinal.

Broadly, this thesis made two primary original contributions. The first concerned the commercial context within which efficient breach was analysed. This approach has not been applied previously. Based on this it was set out that the efficient breach of commercial contracts is legitimate based on the underlying profit generation intent that is exhibited by parties to commercial contracts. As a result, commercial contracting is the natural environment in which efficient breach may be applied. The second concerned the fact that this is the first major discussion of efficient breach which applies the theory to the English law of contract as a large quantity of the relevant literature has emerged from the American schools of law and economics. It was set out that English contract law is an appropriate realm for this discussion to take place within. This is on the basis that the UK is a major centre for the hearing of commercial disputes, and that a large volume of English contract law emanates from the commercial sector.

8.2 Chapter 2: The Commercial Distinction in English Contract Law

Chapter 2 established a definition of “commercial” within contract law. This definition was not intended to be all-encompassing and was not meant to be applicable in all settings. The focus was on identifying the characteristics embodied by an archetypal commercial contract in order to ground the

analysis of efficient breach that followed. It was set out that a commercial distinction exists within contract law despite it being unsatisfactorily defined. This distinction was highlighted by reference to the construction and interpretation of commercial contracts, as well as by analysing relevant case law. The next task was outlining what ‘commercial’ is perceived to mean. Areas of interest included the Commercial Court, as well as legal history, namely the development of what has been described as commercial law. It was evident that commercial parties have historically been treated as distinct from the general public. However, it was clear that the evident characteristics of such a party, namely being a member of the merchant class, were outdated. This is because of the wider range of commercial parties that exist today.

A modern definition of commercial was reverse engineered by identifying common themes relating to a commercial distinction shared by tax law, the law of partnership, company law and patent law. Non-commercial contracts were then discounted. As regards consumer contracts, it was set out that a consumer will be clearly distinct from commercial parties. This is based on the definitions offered in the Consumer Rights Act 2015 and the Consumer Insurance (Disclosure and Representations) Act 2012. The other forms of contract that were discounted were of a personal nature. These included contracts of employment and non-commercial contracts for the sale of goods. There was also a note on government bodies, which are able to enter into contracts of both a commercial and non-commercial nature. Mutuals, Co-operatives, Social Enterprises and Community Interest Companies were also be discussed. This was because they provided examples where the boundary between commercial and non-commercial is less clear. This discussion was carried out to acknowledge that this blurred line exists in some cases. However, this was not problematic, as the definition of commercial that was advanced was not intended to be an all-encompassing one that could be applied in all settings.

It was established that the key elements when defining a commercial party are that an organised business activity is carried out with the overriding intention of generating a profit. This business activity will usually take place as part of a party’s trade, profession or vocation. It will often be done through business forms including sole traders, partnerships or companies. It was also asserted that a commercial contract will feature only commercial parties who are acting with an overarching business activity in mind. This will apply both in a general sense, as well as with respect to the activity (in this case a contract) in question.

8.3 Chapter 3: The Rationale behind the Commercial Distinction in English Contract Law

Chapter 3 outlined why commercial contracts are treated differently to non-commercial contracts. To achieve this, literature on the process of judicial decision-making as well as the work of the

American Legal Realists, was considered. It was highlighted there exists the potential that non-legal norms could factor into judicial decision making in commercial cases. It was noted that within the English common law system the importance of existing precedent cannot be discounted. This is because judges are bound to follow the rulings of previous courts, as well as to adhere to the reasoning provided.

It is the case that the fundamental structure of English contract law will remain the same whether a dispute concerns a commercial contract or otherwise. However, there is a difference in approach where a right is being pursued for commercial reasons. This is necessary in order to ensure that certainty and predictability in commercial dealing can be guaranteed. Predictability is based on commercial norms and practices that are influenced by context. When rights are being protected or enforced for commercial purposes, intended to generate profit, the courts will account for factors including commercial reasonableness, as well as industry customs and practices. In contrast, the courts treat the pursuit of rights that are of an individual or personal nature differently. These may include those that are intended to create pleasure or facilitate enjoyment. Ultimately, an interest-based approach is adopted where courts will consider personal preferences ahead of what would generally be considered to make commercial sense. Such factors will not be considered in commercial cases.¹

This approach can also be seen in equity in the case of proprietary estoppel, as well as in the application of fiduciary duties. There is a distinction in the way a court will treat disputes arising from commercial and non-commercial relationships. Again, this concerns rights of a personal nature, in contrast with attempts to make a commercial gain. The clearest example of this can be seen in the decisions of *Cobbe v Yeoman's Row Management Ltd*² and *Thorner v Major*.³ In *Cobbe v Yeoman's Row Management Ltd*, it was set out that in a commercial case, the court will seek to avoid the uncertainty which promissory estoppel may introduce.⁴ In *Thorner v Major* promissory estoppel was allowed based on the familial nature of the dispute. In addition, fiduciary duties will only be applied by the courts in commercial relationships which require them. This could include trusts, agency relationships, partnerships and joint ventures for example.⁵ These feature varying rights, interests and expectations which require varying levels of protection and enforcement.⁶

¹ See 3.7 Overall Conclusion.

² [2008] 1 WLR 1752.

³ [2009] UKHL 18.

⁴ *Cobbe v Yeoman's Row Management Ltd* [2008] 1 WLR 1752 [81] (Walker LJ); See also *Motivate Publishing FZ LLC v Hello Ltd* [2015] EWHC 1554 (Ch) [74].

⁵ See *Boardman v Phipps* [1967] 2 AC 46; *Re Goldcorp Exchange Ltd* [1995] 1 AC 74; *Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676; See also A Mason 'The place of equity and equitable remedies in the contemporary common law world' (1994) 110 Law Quarterly Review 238, 245; See also Steven White 'Commercial Relationships and the Burgeoning Fiduciary Principle' (2000) 9 Griffith Law Review 98, 99.

⁶ See 3.6 A similar approach in Equity.

8.4 Chapter 4: An Argument against Promise as the Basis of English Contract Law: Allaying Concerns Regarding Efficient Breach in the Commercial Contracting Context

Chapter 4 offered a number of contributions regarding issues which relate to a perceived likeness between breaking a promise, and a breach of contract. The moral issues that are raised regarding efficient breach were dealt with. These issues may lead to the belief that breach of contract is fundamentally wrong because it is perceived to be synonymous with breaking a promise. However, it is the case that promising requires an existing relationship of trust and confidence between promisor and promisee. The existence of such a relationship contributes to any moral force which influences whether or not a promise will be kept. Unlike promises, contracts invoke reliance without the necessity for a pre-existing relationship of trust and confidence between those involved. Their primary function is to provide a method for one party to seek an enforceable remedy following a breach, a feature which promises lack. As such, promise is not, and moreover, should not be considered to form the basis of contracting within English law. In addition, the domain in which contracting operates differs from that of promising. This is reflected by the state's role in enforcing contracts. They are not enforcing a standard morality between individuals. They are protecting reciprocal exchanges using the court system. This is particularly resonant within the commercial contracting context.

It is the case that English contract law has developed with reciprocity in mind. It is practically detached from promising, based on its tortious roots. This is unlike the contract law of other jurisdictions which appear to feature promise as a foundational principle. The result is that it is naturally consequentialist in a positive sense. This is particularly apparent with regard to the approach to assessing damages for breach of contract. Damages intend to provide compensation for any damage, loss, or injury suffered because of a breach. They seek to place a party, as far as is possible, in the position that they would have been in, had the contract been performed. Clearly, this method is based on consequentialism as it provides compensation based on the actual loss suffered. Also, in any contract it is the consequences of entering into it which provides the reason for doing so. Specifically, commercial contracts are entered into primarily to generate a profit. Resultantly, an act consequentialist approach is legitimate as it allows scope to maximise levels of profit, or equally minimise loss. Further, it is clear that the theory of efficient breach requires that a consequentialist approach is adopted.

Finally, the negative view of promise breaking and to breach of contract in a general sense appears to be as a result of some intangible standard of ethics or virtues regarding the type of behaviour that is right or wrong. However, this standard is intuitive, rather than evidenced. Commercial contracting is geared towards profit generation. As such, it is reasonable to assert that a different standard should

be applied to assessing any moral requirements which parties are held to. It follows that an efficient breach in the context of commercial contracting cannot be discounted based on issues of morality arising from promise breaking.

Ultimately, the suggestion is that by focusing on commercial contracting which is geared towards profit generation, it is reasonable to assert that a different approach should be applied to assessing any moral standard to which parties should be held. This will mean that efficient breach in the context of commercial contracting cannot be discounted based purely on issues of morality which are linked to promise breaking.⁷

8.5 Chapter 5: The Economic Analysis of Law and the Theory of Efficient Breach

Chapter 5 outlined the economic analysis of law before briefly setting out some of its criticisms. It was made clear that these are not problematic. This is on the basis that the claims which are made relate only to the breach of commercial contracts. The theory of efficient breach was introduced in order to ensure that it was fully understood. This was followed by a discussion of efficiency which was carried out in order to highlight the different approaches to efficiency which are adopted in various settings. Furthermore, it was important to justify which approach, or approaches should be utilised in this context. This included discussing the role which efficiency may play within decision-making. Issues which may potentially stem from the law's pursuit of efficiency were also highlighted. This included the idea that the value of the legal process may extend beyond it.

It was set out that the pursuit of efficiency may be implemented in appropriate settings. Also, that the efficient breach of commercial contracts is such a setting. Within the context of commercial contracting, efficiency may be judged legitimately based on the principle of wealth maximisation where monetary value is the appropriate measure, as well as by utilising the Kaldor-hicks criterion featuring the caveat that actual compensation is provided for losses suffered. It was important to make clear that this claim is limited to commercial contracts only. It was also set out that a simplistic approach to defining an efficient breach would be adopted. This involves the breach of a contract's terms where it is more cost effective to do so. It will take into account the total cost of performance versus the costs of breach and the payment of compensatory damages. This may be done either to reduce losses, or to maximise gains.⁸

⁷ See 4.9 Overall Conclusion.

⁸ See 5.9 Overall Conclusion; See also Melvin A Eisenberg, 'Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law' (2005) 93 California Law Review 975, 997: 'The theory of efficient breach holds that breach of contract is efficient, and therefore

8.6 Chapter 6: Criticisms of the Theory of Efficient Breach

Chapter 6 outlined criticisms which have been directed at the theory of efficient breach. This was done in order to demonstrate why they are inapplicable with respect to the claims which this thesis makes regarding the efficient breach of commercial contracts. A thematic approach which involved categorising each of the criticisms between four key themes. These included potential clashes with existing legal doctrines, criticisms relating to the application of what is an instrumentalist approach to the law, issues relating to existing commercial practices and issues relating to the theory's practical application.

First, it was set out that the potential clashes between the efficient breach of commercial contracts and existing legal doctrines, including issues relating to the calculation of damages, a likeness with torts, infringements on property rights and good faith in commercial contracting and a contrast with trust law, do not negate the legitimacy of the theory.⁹ Second, it was outlined that it is legitimate to utilise the instrumentalist approach of wealth maximisation. This involves applying the theory of efficient breach within the commercial contracting context. This is legitimate as a result of the parties' overriding profit generating intent. A key point was that this does not require that it should take place, only that it legitimately could.¹⁰ Third, discussion centred on potential clashes based on existing commercial practices. The suggestion was that the efficient breach of commercial contracts would cause no negative impact on the functionality of the commercial system in terms of eroding trust. This is on the basis that it is contract, rather than a relationship of trust and confidence that supports the commercial system. This is because it allows parties to operate in the knowledge that they will be able to pursue a remedy following a breach. The suggestion that contractual performance will be preferred by both lay people and business people was also discounted.¹¹ The final category concerned the practical application of the theory of efficient breach. It was set out that hypothetical scenarios customarily used within efficient breach literature do not prove or disprove the theory's functionality. It was also made clear that the efficiency of an award of damages will be dictated by transaction costs attached. Importantly, these costs can only be ascertained based on evidence. As a result, any claims regarding how unknown transaction costs will impact efficiency cannot be proved. However, it is the case that contracting parties will be able to make pre-breach predictions. These will be based upon pre-existing knowledge and experience, as well as advice from parties such as lawyers or accountants. Importantly, there is clear evidence that the opportunity to breach efficiently

desirable, if the promisor's gain from breach, after payment of expectation damages, will exceed the promisee's loss from breach'.

⁹ See 6.2.6 Conclusions Regarding Potential Clashes and Contrasts with Legal Doctrines.

¹⁰ See 6.3.3 Conclusion.

¹¹ See 6.4.4 Conclusion.

may arise. Parties will sometimes view breach to be more cost-effective than performance and, on this basis, breach is efficient. This reasoning is demonstrated by the relevant case law.¹²

Ultimately, the original contribution made by chapter 6 came in setting out, in a thematic, as well as systematic fashion, why these criticisms of the theory of efficient breach are inapplicable with respect to commercial contracts. This allowed the case for the theory's application to be made in chapter 7.

8.7 Chapter 7: Making the Case for Efficient Breach in a Commercial Context

Chapter 7 set out that this iteration of efficient breach differs from the version which is inspired by Holmes.¹³ This is in the sense that it specifies the circumstances and setting where an efficient breach may take place, namely commercial contracting. The focus on the commercial context meant that it was possible to demonstrate how efficient breach may function legitimately. This was based on the fact that commercial contracts exist in order to facilitate profit production. The result is that the intention of the parties is to maximise the wealth which flows from them. This allows the rational decision maker paradigm to be applied. Furthermore, the suggestion was that individual commercial parties are best placed to make decisions based on their own interests and that in comparison to non-commercial parties, they are likely to possess, or may reasonably be expected to possess, a deeper understanding of contract law's default rules which concern compensatory damages following a breach of contract. Here it is legitimate to quantify awards of damages in monetary terms. This is because the transactions in question tend to occur in a market, meaning that replacements are likely to be available. This will mean that value may be objectively assessed based on market value. In addition, the transactions in question tend to involve money or an equivalent. This means that damages will be preferred to specific performance. In addition, intangible losses are not considered within commercial cases.

This iteration of efficient breach contrasts with more prescriptive approaches. It does not require that it should always be pursued. What it provides is efficient optionality. The claim is simply that it may legitimately be utilised where the breaching party deems it to be the most attractive option. It is also important to note that there is no suggestion that the opportunity to breach and pay damages should be available in all contracting relationships. The commercial focus allows that an instrumentalist approach may be applied regarding efficient breach. Again, this is due to the fact that the overriding intention behind commercial contracting is profit generation. This means that a wealth maximisation based approach may be utilised here. Again, nothing is to be inferred regarding the legitimacy of

¹² See 6.5.3 Conclusion.

¹³ Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 462. Reprinted in (1997) 110 Harvard Law Review 991, 995.

instrumentalist approaches in other legal settings. The ability to breach efficiently offers flexibility in the sense that parties can adapt to unforeseen contingencies. In addition, it would be inappropriate to disallow such behaviour as the parties entered into the contract with the intention of generating profit. However, the fact that efficiency gains may be available does not necessitate that a breach takes place. Other factors such as protecting existing relationships or a reputation within a particular industry may influence the decision. This could mean that performance or renegotiation could also occur. Next, existing defences of efficient breach were discussed in order to highlight the originality of this approach. Again, this is based on the focus on commercial contracting. Finally, it was set out that there are additional epistemic and normative justifications which support the case which is being made for efficient breach within the context of commercial contracting. The epistemic element concerns the fact that a prescriptive approach is problematic because until individual facts become evident, a case for, or against breach, cannot be made. The normative issues concern the fact that claims suggesting that utilitarian principles can be satisfied in advance of the individual circumstances of each potential efficient breach scenario becoming evident cannot be made. Also, that the application of prescriptive approaches in this contracting context runs the risk of undermining individual autonomy requirements.

Appendix

List of Statutes

UK Statutes

Charities Act 2011.

Companies (Audit, Investigations and Community Enterprise) Act 2004.

Companies Act 2006.

Consumer Insurance (Disclosure and Representations) Act 2012.

Consumer Rights Act 2015.

Co-operative and Community Benefit Societies Act 2014.

Corporation Tax Act 2009.

Corporation Tax Act 2010.

Employment Rights Act 1996.

Finance Act 2010.

Income Tax (Trading and Other Income) Act 2005.

Income Tax Act 2007.

Late Payment of Commercial Debts (Interest) Act 1998.

Partnership Act 1890.

Patents Act 1977.

Sale of Goods Act 1979.

State Immunity Act 1978.

Statute of Monopolies 1623.

Theft Act 1968.

Trade Disputes Act 1906.

Trustee Act 1924.

Unfair Contract Terms Act 1977.

Other Statutes, Codes, etc.

Communication from the Commission, ‘Social Business Initiative Creating a Favourable Climate for Social Enterprises, Key Stakeholders in the Social Economy and Innovation’, COM (2011).

Community Patent Convention 76/76/EEC of 18 May 1976 for the European patent for the common market [1976] OJ L129/30, Article 31.

Council Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC [2005] OJ L 149/22. Article 2(a).

Council Directive 2011/7/EC of 16 February 2011 On combating late payment in commercial transactions (3).

European Convention on State Immunity, May 16, 1972, 74- European Treaty Series No. 74, Article 7(1).

The French Code Civil – Articles 1104, 1184, 1217, and 1221.

The German Civil Code – Section 241.

Patent Act 1981 (Germany) Section 11.

Vienna Convention on Diplomatic Relations 1961, Article 31 s 1(c).

List of Cases

Cases from England & Wales:

- AB Corporation v CD Company (The Sine Nomine)* [2002] 1 Lloyd's Rep 805.
- Addis v Gramophone Co Ltd* [1909] AC 488.
- AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58; [2015] AC 1503.
- Allen v Flood* [1898] AC 1.
- Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602.
- Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676.
- Anglia TV v Reed* [1972] 1 WB 60; [1971] 3 WLR 528.
- Antaios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191.
- Arklow investments v Maclean* [2000] 1 WLR 594.
- Arnold v Britton* [2015] AC 1619.
- Attorney General v Blake* [2001] 1 AC 268.
- Auchincloss v Agricultural & Veterinary Supplies Ltd* [1999] RPC 397.
- AXA Insurance UK Plc v Cunningham Lindsey United Kingdom* [2007] EWHC 3023 (TCC).
- Baird Textile Holdings Ltd v Marks & Spencer Plc* [2001] EWCA Civ 274; [2002] 1 All ER (Comm) 737.
- Beaumont v Greathead* (1846) 2 CB 494.
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