RESTITUTION FOR BREACH OF CONTRACT

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I INTRODUCTION

A significant event in the debate about disgorgement of profits for breach of contract has occurred with the recent House of Lords decision in *Attorney-General v Blake*.[1] In that case their Lordships decided to permit the award of damages based on the gains made by the defendant spy from publishing his memoirs in breach of his contract with the Crown, even though the Crown suffered no financial loss. The successful cause of action was in contract rather than breach of confidence as the information disclosed in the book was no longer confidential.

The decision is an exception to the conventional rule that the object of an award of damages for breach of contract is, so far as money can do it, to place the innocent party in the same position as if the contract had been performed.[2] Within this paradigm, damages represent compensation for the plaintiff's loss, which is measured in financial terms.[3] No damages will be awarded in the conventional view unless the plaintiff can prove loss in the accepted sense.

There is a theoretical difficulty, however, with the conventional rule that has become clear in the academic writings that have appeared in the last twenty or so years.[4] The difficulty is that conventional damages do not provide an adequate remedy in some circumstances. As a result there has been ambivalence, manifested in judicial decisions, about the status of the plaintiff's right to performance of the contract exactly as agreed ('the performance interest').

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[1] [2000] 3 WLR 625; [2000] 4 All ER 385 (hereinafter '*Blake*').

[2] *Robinson v Harman* (1848) 1 Exch. 850; 154 ER 363, 365.

[3] *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric (Railways) Co of London Ltd* [1912] AC 673, 689; [1911-13] All ER Rep 63, 69 (Viscount Haldane LC).

[4] See Gareth Jones, 'The Recovery of Benefits Gained From a Breach of Contract' (1983) 99 *Law Quarterly Review* 443; Peter Birks, 'Profits of Breach of Contract' (1993) 109 *Law Quarterly Review* 518; Brian Coote, 'Contract Damages, *Ruxley*, and the Performance Interest' [1997] *Cambridge Law Journal* 537; Catherine Mitchell, 'Remedial Inadequacy in Contract and the Role of Restitutionary Damages' (1999) 15 *Journal of Contract Law* 133.

Occasionally courts have in effect supported the performance interest by awarding 'disgorgement' damages for breach of contract where the plaintiff suffered no financial loss.[5] By disgorgement we mean payment to the plaintiff of the amount of the defendant's gain wrongfully obtained. '"Disgorgement" is preferred over "restitutionary damages" to better differentiate between this remedy and the remedy of restitution for subtractive unjust enrichment.'[6]

The view that contracts must be performed ('*pacta sunt servanda*') is reflected in a number of different situations, the primary example being the willingness of courts to order specific performance in defined cases. *Blake's* case represents a further example of this view, in that the award of a disgorgement of profits remedy may be seen as a punishment of Blake for his failure to perform his contractual obligation not to publish, and as a deterrent to other parties in similar circumstances from the same behaviour.

II ATTORNEY-GENERAL V BLAKE

A *Facts*

George Blake was a former British intelligence agent who gave state secrets to the Russians during the Cold War. Imprisoned in 1961, his subsequent escape and flight to Moscow embarrassed the British Government. It was further embarrassed when in 1990 the fugitive published his autobiography through a British publisher for a promise of £150,000. Blake had signed a contract promising not to divulge information learned in his employment, including in book form, during his employment and after it ceased. Before it learned of the magnitude of the publishing contract sum, the British Government had passed up the opportunity to seek an injunction to prevent publication.

An action was commenced to prevent Blake enjoying the 'fruits of his treachery'. The information in the book was no longer confidential or damaging. At the trial, and later in the Court of Appeal, disgorgement (unhappily called 'restitutionary'[7]) damages for breach of contract were not in issue. Judgment was given against Blake in the Court of Appeal on grounds later found by the House of Lords to be unsustainable. The restitutionary argument was advanced for the first time in the case in the House of Lords, though favourable *obiter* comments had been delivered without benefit of argument in the Court of Appeal.

The Court of Appeal in *obiter* comment tentatively thought that if a court was unable to award disgorgement damages for breach of contract in 'appropriate'

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[5] *Lake v Bayliss* [1974] 1 WLR 1073; [1974] 2 All ER 1114; *Penarth Dock Engineering Co. Ltd v Pound* [1963] 1 Lloyd's List Law Reports 359; *Samson & Samson Ltd v Proctor* [1975] 1 NZLR 655.

[6] Ross Grantham and Charles Rickett, *Enrichment and Restitution in New Zealand* (2000) 472-473; Graham Virgo, *Principles of the Law of Restitution*, Clarendon (1999) 8; Sarah Worthington, 'Reconsidering Disgorgement for Wrongs' (1999) 62 *Modern Law Review* 218, 218, fn 1.

[7] An expression Lord Nicholls preferred to avoid. See also Ross Grantham and Charles Rickett, above n 6, 473.

circumstances, then the law of contract would be seriously defective. Lord Woolf MR said:

> It means that in many situations the plaintiff is deprived of any effective remedy for breach of contract, because of a failure to attach a value to the plaintiff's legitimate interest in having the contract duly performed. [8]

The court then suggested 'appropriate' circumstances are at least two: first, skimped performance,[9] where the defendant fails to provide the full extent of the services contracted to be provided; secondly, where the defendant has obtained his profit by doing the very thing which he contracted not to do. For Lord Woolf, this second category covered the present case exactly. However, neither of these suggested categories found favour in the House of Lords.

B *The House of Lords Decision*

In the House of Lords, Lord Nicholls of Birkenhead, with whom Lords Goff, Browne-Wilkinson and Steyn agreed, delivered the leading judgment. Lord Hobhouse dissented. Lord Nicholls said the suggested categorisation would not assist.[10] The award of damages adequately remedied skimped performance (whether skimped supply of goods or services), he thought, and the second category was too wide. The second was apt to catch all negative covenants, but something more than mere breach of the particular covenant was needed.

The House of Lords proffered 'exceptional circumstances' and circumstances 'akin to fiduciary duty' as contexts within which a disgorgement remedy could be applied. The reasons for treating the case as exceptional, though not made explicit, can perhaps be inferred from Lord Nicholls' comments about the importance of members of the secret intelligence services having complete confidence in each other. No member, he said,[11] should have a financial incentive to break his undertaking. If this were not the case, it could undermine the service by making prospective informers less willing to co-operate, or reducing trust between members, jeopardising the effectiveness of the service. Chen-Wishart suggests that what may have made this case exceptional was the exceptional public interest.[12] This view is consistent with Lord Nicholls' comments.

C *Lord Nicholls' Judgment*

Lord Nicholls suggested a further reason why an account of profits was justified: that the relationship between the parties was 'closely akin' to a fiduciary relation-

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[8] [1998] 1 All ER 833, 845.

[9] Lord Woolf's example was *City of New Orleans v Firemen's Charitable Association* (1891) 9 So 486, which he said should have attracted an award of substantial damages (the court found no loss despite skimped performance). We agree.

[10] [2000] 3 WLR 625, 640.

[11] Ibid 641C.

[12] Mindy Chen-Wishart, 'Restitutionary Damages for Breach of Contract' (1998) 114 *Law Quarterly Review* 363, 366.

ship.[13] We think any extension of legal rules applicable to fiduciaries to ordinary contracts is revolutionary[14] and needs to be fully justified. The suggestion of kinship is an implied admission that the relationship was not in fact a fiduciary relationship, which, it is fair to say, His Lordship acknowledged.

After reviewing a number of cases, Lord Nicholls concluded that there was no reason in principle why an account of profits could not be a remedy for breach of contract when it was just and equitable to apply it. He said:

> In the same way as a plaintiff's interest in performance of a contract may render it just and equitable for the court to make an order for specific performance or grant an injunction, so the plaintiff's interest in performance may make it just and equitable that the defendant should retain no benefit from his breach of contract. [15]

He thought it would have been only a modest step for the law to recognise openly that it may have been the most appropriate remedy in exceptional cases other than damages, specific performance and injunction. His Lordship said:

> Normally the remedies of damages, specific performance and injunction, coupled with the characterisation of some contractual obligations as fiduciary, will provide an adequate response to a breach of contract. It will be only in exceptional cases, where those remedies are inadequate, that any question of accounting for profits will arise. No fixed rules can be prescribed. The court will 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.[16]

Lord Nicholls developed the argument that the performance interest was paramount in this case and that it should be recognised by stripping the defendant of his gains. He said the common law had long recognised that some exceptions to the general rule that damages were compensatory were justified.[17] For example, in trespass to land, damages are measured by the benefit received by the trespasser where there is no loss to the landowner. The damages are the price a reasonable person would pay for the right of use. Such awards have a restitutionary character and are probably best regarded, Lord Nicholls said, as an exception to the general rule.

The difficulty of assessing the extent of the loss, his Lordship pointed out, for example in an action for passing off, was the reason courts of equity regarded an injunction and account of profits as more appropriate remedies than damages. Gains were to be disgorged even though they could not be shown to correspond with any disadvantage suffered by the other party. His Lordship thought the difference in

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[13] [2000] 3 WLR 625, 641. Steyn LJ agreed.
[14] See also *Surrey County Council v Bredero Homes Ltd* [1993] 3 All ER 705, 709; [1993] 1 WLR 1361, 1364 (Dillon LJ).
[15] [2000] 3 WLR 625, 638.
[16] Ibid 639. The first part of this quote represents the classical hierarchical model as criticised by the Rt. Hon. Justice Thomas in 'An Endorsement of a More Flexible Law of Civil Remedies' (1999) 7 *Waikato Law Review* 23, 35.
[17] [2000] 3 WLR 625, 632.

remedial response between equity and the common law was an accident of history, not a matter of principle.[18] It was difficult, he said, to see why equity required the wrongdoer to account for all his profits in cases of passing off, infringement of trademarks, copyrights and patents, and breach of confidence, whereas the common law's response was to require a wrongdoer merely to pay a reasonable fee for use of another's land or goods. In all cases, rights of property were infringed.

A case of infringement of property rights from which Lord Nicholls drew some support was *Wrotham Park Estate Company v Parkside Homes Ltd.*[19] In that case the judge awarded damages based on the invasion of property rights, even though the value of the property was not diminished by the breach of covenant. Injunctive relief was denied where in contravention of a covenant a developer built more houses than a layout plan permitted. The *Wrotham Park* case 'shines', Lord Nicholls said, 'rather as a solitary beacon', showing that in a suitable case damages for breach of contract may be measured by the benefit gained by the wrongdoer from the breach.[20] The defendant must make a reasonable payment. In *Wrotham* this was assessed at five percent of the developer's profit.[21] It is clear that *Wrotham's* case was not a great deal of help to Lord Nicholl's argument (that damages may be measured by the defendant's gain) because in *Wrotham* disgorgement of the defendant's full profit was not ordered.

Lord Nicholls preferred the *Wrotham Park* decision to that in *Surrey County Council v Bredero Homes Ltd,*[22] a case having similar facts. In that case the Court of Appeal refused to award more than nominal damages where the plaintiff suffered, in the view of the Court, no loss.

In *Surrey*, two councils sold land to the defendant for the development of a housing estate. The latter covenanted to develop the land in accordance with the councils' planning scheme. The covenant enabled the councils to share in any gain if, as happened, a subsequent planning permission enabled the erection of a larger number of houses. It was intended by the councils that the defendant would pay for relaxation of the covenant, although payment was not explicitly stated.

Although aware of the breach, the councils did not seek an injunction or specific performance but waited until the defendant had sold all the houses and then sought damages. They sought either all the profits made on the building of the extra houses, or a part of the profit representing a 'reasonable' sum.

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[18] Ibid 634. For a contrary view see John Smillie, 'Certainty and Civil Obligation' (2000) 9 *Otago Law Review* 633, 634.

[19] [1974] 1 WLR 798; [1974] 2 All ER 321 (hereinafter '*Wrotham Park*').

[20] [2000] 3 WLR 625, 637.

[21] The relationship to the defendant's profit was later explained by Sir Thomas Bingham MR as follows: 'The judge ... paid attention to the profits earned by the defendants, as it seems to me, not in order to strip the defendants of their unjust gains, but because of the obvious relationship between the profits earned by the defendants and the sum which the defendants would reasonably have been willing to pay to secure release from the covenant.' See *Jaggard v Sawyer* [1995] 2 All ER 189, 202d; [1995] 1 WLR 269, 281H-282.

[22] [1993] 1 WLR 1361; [1993] 3 All ER 705. This case proved controversial and spurred much academic interest in the application of a disgorgement remedy. See, for example, Peter Birks, 'Profits of Breach of Contract', above n 4, 518.

Counsel relied in part on the 'reasonable' sum of five percent of the developer's profit that had been awarded in *Wrotham Park*. However, the Court of Appeal rejected the councils' appeal in *Surrey* on the ground that they had suffered no loss.

It rejected the argument that the councils had lost the 'opportunity to bargain' for a variation or relaxation in the terms of the covenant. This was a non-compensatable head of damage. It is fair to say, as others have done, that the straining to find a loss, as the 'lost opportunity to bargain' theory requires, is somewhat artificial. Burrows makes this point suggesting there is 'no sensible way of assessing what price the parties themselves would have agreed for the relaxation; and for that reason...[the] bargain theory would probably have been fictional.'[23]

The acceptance of disgorgement damages by the House of Lords in *Blake* substantially undermines the decision in *Surrey*. The fact that the plaintiff suffered no financial loss is no longer determinative as was thought in *Surrey*. The *Blake* reasoning does not depend on the lost opportunity to bargain theory. Rather, it is built on the interest of a plaintiff in performance of the contract.

Lord Nicholls then had to consider whether the measure of damages for breach of contract could ever be extended from the 'reasonable payment' to full disgorgement of profits. His Lordship knew of no case where the court had made an order for an account of profits on a claim for breach of contract,[24] but he found a 'light sprinkling' of cases where courts have made orders having the same effect.[25] These included *Reid-Newfoundland Co v Anglo-American Telegraph Co Ltd* [26] and *British Motor Trade Association v Gilbert.*[27]

The result of the majority decision was in effect that Blake was ordered to account to the Crown for all of his profits.

D *Lord Hobhouse's Dissenting Judgment*

Lord Hobhouse was unable to agree. In his view the majority had erroneously extended the principle of restitution to a case not involving the protection and enforcement of property rights, or rights 'closely analogous' to proprietary rights. 'Restitution', his Lordship said, 'concerns wealth or advantage which ought to be returned or transferred by the defendant to the plaintiff.'[28] Damages compensate for

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[23] Andrew Burrows, 'No Restitutionary Damages for Breach of Contract' [1993] *Lloyd's Maritime and Commercial Law Quarterly* 453, 455.

[24] Though it must be noted he did know of a case where the possibility was emphatically denied: *Tito v Waddell (No 2)* [1977] Ch 106, 332; [1977] 3 All ER 129, 316 (Sir Robert Megarry V-C).

[25] [2000] 3 WLR 625, 638.

[26] [1912] AC 555. The account of profits awarded in *Reid-Newfoundland* was based on an express term in the contract, not on a theory of disgorgement, so the case provides little support for Lord Nicholls' argument.

[27] [1951] 2 All ER 641. This case, though interpreted in different ways by others, does tend to support the disgorgement argument. See Gareth Jones, above n 4, 445.

[28] [2000] 3 WLR 624, 650F. This definition is broad enough to cover restitution in both senses of the word — see above, n 6. However, Lord Hobhouse fails to distinguish between the meanings, and therefore he may have misunderstood the thinking of Lord Nicholls (that the remedy was a gain-based remedy for a wrong).

contractual non-performance. 'The error is to describe compensation as relating to a loss as if there has to be some identified physical or monetary loss to the plaintiff.'[29]

In the negative covenant cases such as *Wrotham Park*, what the plaintiff has lost, Lord Hobhouse said, is the sum which he could have exacted from the defendant as the price of his consent to the development.[30] This is an example of compensatory damages, not restitution, he said. Thus, he agreed with the 'lost opportunity to bargain' theory, which, as we mentioned earlier, is seen by many as fictional.

His Lordship thought the majority decision went beyond the principle of assessment of a reasonable price to pay for permission to publish. The remedy of account for profits is based on proprietary principles when the necessary proprietary rights are absent, he said. The order proposed by their Lordships, he said, 'does not award to the Crown damages for breach of contract assessed by reference to what would be the reasonable price to pay for permission to publish.'

His Lordship was of the view that an allegation of breach of contract is not a claim for performance of the 'primary' contractual obligation, but is correctly understood as a claim for damages as a substitute for performance. This is the 'secondary' obligation referred to by Lord Diplock in *Photo Production Ltd v Securicor Transport Ltd*,[31] he said. This view is a restatement of the conventional view that a party has a choice of performing the contract or paying damages, a view we believe does not apply (and never has applied) in all circumstances.

Lord Hobhouse was concerned that if some more extensive principle of awarding non-compensatory damages for breach of contract is to be introduced into commercial law the consequences will be very far-reaching and disruptive. He did not believe that such was their Lordships' intention.

E *Analysis*

The test proposed by Lord Nicholls, we believe, will sufficiently limit the circumstances where disgorgement damages will be available so that the consequences will not be disruptive. Disgorgement becomes a remedy of last resort after other remedies have been considered, and exceptional circumstances apply.

We presume the main problem envisaged by Lord Hobhouse would be the introduction of greater uncertainty in commercial law. Justice Thomas of the New Zealand Court of Appeal has argued strongly that there would be no great uncertainty even if the law went further.[32] His radical view is that the law is now sufficiently mature to permit separation of liabilities from remedies. The courts in his view should be able to apply in their discretion any remedy appropriate to the circumstances, once liability has been established. This would include disgorgement of profits. Judges would not have to work down through a hierarchy beginning with

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[29] Ibid 651H.
[30] Ibid 652E.
[31] [1980] AC 827; [1980] 1 All ER 556.
[32] Thomas, above n 6.

compensatory relief. Thomas J thought there would be no greater uncertainty introduced, and indeed there may be less uncertainty.[33]

In Lord Hobhouse's view the majority wished to give effect to a policy of punishment of Blake. We think the policy underlying Lord Nicholls' judgment was mainly one of deterrence.

III CONCLUSION

The theoretical justification of the decision in *Blake* seems to be that in some cases conventional compensatory damages are inadequate when a remedy is nevertheless clearly desirable. This theory is sound. In *Blake* public policy reasons required the upholding of trust and morale in the intelligence service. Therefore the Crown's interest in performance of the contract needed to be upheld. This was done by depriving the defendant of his gains, thus sending a signal to all parties to secrecy agreements with the Crown that such contracts may not be breached with impunity.

In light of the calls from academics and some members of the judiciary for reform of the law of obligations, the decision in *Blake* seems to be an inevitable step in the evolution toward greater coherence. It fills a gap in contractual remedies in those situations where the conventional rule of compensation for lost expectations provides no adequate remedy.

[33] Thomas, above n 16, 42, 43.