Is Seller's efficient breach possible under English sale law

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Is a Seller’s Efficient Breach of Contract Possible In English Law?
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Abstract: Legal remedies play a significant role in shaping incentives for efficient breach. Most of the existing literature on the subject considers the possibility only of efficient breach in relation to individual remedies, with little discussion of whether efficient breach is possible with all of the remedies available to the promisee when the promisor commits a breach. The purpose of this paper is to fill the gap by examining the possibility of a seller’s efficient breach under English law when all possible legal remedies for breach are available to the buyer. It is argued that, under English law, a seller’s efficient breach is almost impossible in practice because either the buyer is inadequately compensated for his expectation losses, or the legal remedy undermines the seller’s incentive to breach.

Keywords: Efficient Breach, Sale of Goods, Contract Law, Law and Economics, Buyer’s Remedy, Seller’s Breach.

1. Introduction

Imagine the following scenario. A seller sells a buyer goods for £10, which are valued at £5 by the seller and £15 by the buyer. Therefore, the transaction generates for each of them a profit of £5. After making the contract but before the performance, a third party offers £25 for the goods that are by him valued at £30. The seller breaches the contract with the buyer by selling the goods to the third party, and then compensates the buyer for his expectation loss, £5. Should the seller be blamed for his breach?

Not surprisingly, some legal theorists, particularly those with a strong faith in moral philosophy and ethics will denounce the seller’s breach. For them, once a person has made a promise, he should not be excused for his breach unless some exceptionally unforeseeable events materialise. Otherwise it is morally wrong for the promisor to breach his promise.1

In contrast, for economists, the seller’s breach is not only excusable, but also desirable, and should be encouraged, because the breach is efficient. Compared with the situation where the seller performs the contract, the breach not only generates a £5 gain to both the seller and the third party; it also does not make the buyer worse off. This reasoning is well known in the law and economics literature as efficient breach of contract.

The theory of efficient breach of contract tries to answer the question – when should a promisor breach rather than perform his promise? According to this theory, when the promisor’s profit from his breach exceeds the loss to the promisee, the breach is to be permitted or encouraged, provided that the promisee is fully compensated for his expectation loss. After receiving the compensation, the promisee is in no different position than he would have been in, had the promisor appropriately fulfilled his promise.2 The breach, therefore, is said to be efficient

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in the sense that it is a Pareto improvement, making the promisor better off and the promisee no worse off.

It has been generally accepted that legal remedies play a vital role in shaping incentives for efficient breach. There is a range of academic literature examining whether a particular legal remedy provides promisors with a sufficient incentive for efficient breach. Some scholars have argued that expectation damages as a remedy for breach of contract can create an appropriate incentive, because it not only gives the promisor an option to decide whether to perform his promise or to breach and pay the compensation, but also guarantees that the value of compensation to the promisee is as same as that of the promisor’s performance. Others assert, in contrast, that the remedy of expectation damages is inefficient, because it cannot in practice adequately compensate the promisee’s expectation losses. Consequently it cannot be assumed that breaches under the expectation damages rule are always efficient. Conversely there is no such problem with the specific performance rule. Specific performance only deters breaches which are not voluntarily accepted by the promisee and encourages ex post negotiation thereby ensuring that each breach is Pareto efficient. Independently of the analysis of contract law remedies, it has also been recognized that both a disgorgement remedy and a tort law remedy for inducing breach of contract are incompatible with efficient breach.

However, most of the existing literature focuses only on efficient breach in relation to the individual remedy rule without taking the complexity of legal remedies in practice into consideration. This limitation becomes particularly acute when considering contracts for the sale of goods. Normally a seller breaching the contract with the buyer by selling the goods to a higher bidder is liable not only for the breach of the contract in contract law, but also for conversion in

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tort law. The buyer in this case can, instead of suing for breach of contract, claim account of the profit which the seller made from his breach in the action of waiver of tort, or sue the third party for inducing the breach of contract. Therefore the analysis of this topic should be put into a broader context by asking the question, whether the seller has an incentive to commit an efficient breach when all possible legal remedies for the breach are available to the buyer.

This paper fills the gap in the literature. After briefly introducing the conditions for an efficient breach of contract in section 2 and buyer’s legal remedies for the seller’s breach in section 3, I investigate in section 4 the possibility of efficient breach in three different circumstances: (1) the seller without having passed on the property to the buyer sells the goods to a bona fide purchaser; (2) the seller having passed on the property to the buyer sells the goods to a bona fide purchaser; and (3) the seller sells the goods to a third party who is not a bona fide purchaser. Section 5 concludes the discussion.

2. The Conditions for an Efficient Breach of Contract

One of the criteria for normative economic analysis of law is a so-called Pareto improvement. If a change from State A to State B makes at least one person better off and nobody worse off, the change is a Pareto improvement. The classical example of Pareto improvement legal institution is a contract. A rational person is willing to enter into contract, if and only if he believes the value of what he receives from the other party outweighs what he relinquishes. Therefore, the contract is a Pareto improvement in the sense that it generates a mutual benefit for the parties and creates no losers.

Another example of Pareto improvement is an efficient breach of contract. As illustrated by the scenario in the last section, if the profit to the seller from selling the goods to the third party exceeds the aggregate of the buyer’s and his own expectation interests from the first contract, the breach is a Pareto improvement, provided that he adequately compensates the buyer for the expectation loss, £5. The breach makes both the third party and the seller better off and does not make the buyer worse off.

An efficient breach is a unilateral action of Pareto improvement. In a sale contract if the seller’s breach can generate a higher profit by selling the goods to a third party and no loss to the buyer, no good economic reason can be found for condemning the breach. However, there are four conditions to meet in order for the seller’s breach to qualify as an efficient breach.

First, the profit which the seller makes from his breach must outweigh the profit he makes on the contract with the buyer, plus his liability cost, which is measured as the amount of compensation which the buyer is entitled to recover for the seller’s breach. A rational seller when facing the option between performing or breaching will adopt the latter option, if and only if he can make a higher profit, that is his motive for the breach. Thus, the higher profit is a prerequisite for the seller’s efficient breach.

Second, the law should legitimatise the seller’s efficient breach. This has two implications. In the first place, the seller should be entitled to the profit from the breach. The law must not grant

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7 Lamine v Dorrell (1701) 2 Ld. Raym.
8 Lumley v Gye [1853] 2 E & B 216.
the buyer any legal claim to the seller’s profit; otherwise the seller’s incentive for efficient breach will be undermined. In addition, the law must not grant any property rule protection for the buyer’s entitlement to the seller’s performance. To use the famous Calabresi-Melamed dichotomy, “entitlements” may be protected by either a property rule or a liability rule. If a right is protected by a property rule, it can be appropriated by a non-owner only if he first acquires permission to do so from the owner of the right. One who appropriates a right or entitlement protected by a property rule without the owner’s permission will always be subject to a specific sanction, typically a fine or imprisonment. If a right is protected by a liability rule, a non-owner who unilaterally appropriates it need, in contrast, only compensate the owner for any loss he suffers after the taking. The amount of compensation for which the taker is responsible will be decided by a court rather than by the owner of the right in a voluntary transaction between the owner and the taker.  

In contract law, the property rule remedy for breach of contract is specific performance which gives the promisee a right to insist on the actual (or specific) performance of the promise. The promisor can be excused for his non-performance only if the promisee consents. If the promisor acts unilaterally without the promisee’s consent, he will be compelled by an injunctive order to honour the owner’s entitlement to performance of the promise.  

This contrasts with the liability rule remedy for breach of contract is damages which permits the promisor to breach his promise provided he compensated the promisee by payment of money damages.

Specific performance undermines, and sometimes overcomes, the seller’s incentive for an efficient breach. Under the specific performance rule, the seller is unable to breach the contract in pursuit of a more profitable deal, unless he first obtains the buyer’s consent. Hence, the seller has to “bribe” the buyer into waiving the right to specific performance by offering a share of the profit to be made from the breach. The seller’s efficient breach is conditional on the success of the ex post agreement between the seller and the buyer. Under the specific performance rule, the seller has no incentive to unilaterally breach the contract, even if the breach is efficient. In contrast, under the damages rule, the seller is free to breach, as long as he decides to compensate the buyer for his expectation losses. In this sense, it can be argued that although efficient breach is still possible under the specific performance rule, a unilaterally efficient breach by the seller is only compatible with the damages rule.

Third, at least in theory, the buyer’s damages recoverable for the breach should just equal his expectation losses, no more and no less. As an efficient breach is a Pareto improvement, damages for breach of contract should put the buyer into the same position he would have been in had the contract been performed by the seller. If the buyer’s expectation losses are inadequately compensated, the breach is not a Pareto improvement. However, the buyer should not be allowed to claim more than his expectation losses. If there is an excessive award the efficient breach cannot be always secured, because the award by increasing the seller’s liability cost, thereby undermines his incentive for the efficient breach. This could happen when the breach is a Pareto improvement, but the seller’s profit from the breach after being deducted by the amount of excessive compensations to the buyer is less than the profit from his fulfilment of the contract.

Nevertheless, we should not take this condition to extremes. The truth is that no perfect financial damages for the buyer’s expectation losses exists in practice, it is impossible the court to
work out the exact amount of financial compensation which just equals the buyer’s dissatisfaction or disutility resulting from the seller’s breach, and therefore monetary damages can only be an approximation for perfect compensation of the buyer’s expectation losses. Some marginal errors in the assessment of the buyer’s expectation losses by the court have to be tolerated, as long as the damages can substantially compensate the buyer’s dissatisfaction. Otherwise, no efficient breach can exist in practice.

Finally, the third party should be immune from any legal claim by the buyer for contracting with the breaching seller. A contract is a reciprocal activity: it cannot be concluded if one of the parties does not intend to do so. If the law grants the buyer a cause of action against the third party, thereby depriving the latter of the profit from the transaction with the breaching seller, to, the third party will lose the incentive to bid. Consequently, the efficient breach cannot take place.

To sum up, legal remedies play a significant rule in shaping the incentives for efficient breach. An inappropriate remedy will create an inefficient incentive for the parties. In theory, an efficient breach is possible if and only if the four following conditions are satisfied: (1) the seller’s profit from the breach exceeds his profit from the performance plus his liability cost; (2) the law should legitimatisce efficient breaches by not providing property rule protection for the buyer’s entitlement to the seller’s performance; (3) the buyer’s damages recoverable for the seller’s breach should just equal his expectation losses, no more and no less; and (4) the third party should be immune from any legal claim of the buyer for contracting with the breaching seller.

3. Buyer’s Remedies

Under English law, when a seller, having made a sale contract, commits a breach by selling the goods to a third party for a higher profit, there are four possible legal remedies available to the buyer: (1) a damages claim against the seller for non-delivery; (2) a claim against the seller for specific performance; (3) a disgorgement claim against the seller; and (4) a damages claim against the third party for inducing breach of contract. This section provides a brief outline of when these four remedies may be ordered by the court.

A. Damages Claim against the Seller for Non-delivery

Where the seller after contracting with the buyer commits a breach by selling the goods to a third party, the buyer is entitled to claim damages from the seller in the action of non-delivery. The buyer’s damages may be measured in two ways.

First, if there is an available market for the goods, the buyer’s damages are normally measured by reference to section 51(3) of the Sale of Goods Act 1979, which provides:

“Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered or (if no time was fixed) then at the time of the refusal to deliver.”

When section 51(3) applies, it is irrelevant whether the buyer has already contracted to resell the goods at a price higher or lower than the contract price. The prima facie rule is that even if the buyer made a profitable sub-sale, his profit from the sub-sale would be unrecoverable from the 14 Rodocanachi v Milburn (1886) 18 QBD 67; Williams v Agius [1914] AC 510; James Finlay & Co. Ltd v NV Kwik Hoo Tong HM [1929] 1 K.B. 400 at 411; The Arpad [1934] P.189 at 214, 223, 230; Kwei Tek Chao v British Traders and Shippers Ltd [1954] 2 Q.B. 459 at 489-90.
seller. But the buyer can recover his profit from the sub-sale as damages for the seller’s non-delivery, if the seller should have contemplated, at the time when the original contract was made, both that the buyer was, or was probably, buying for resale, and that the buyer could perform his obligations under a contract of resale only by delivering the same goods.  

Secondly, if there is no available market for the goods in question, or the parties should, at the time of making the contract, have contemplated as reasonable men that the buyer’s damages for the seller’s non-delivery should be measured differently, section 51(3) is inapplicable; instead the buyer’s loss for the seller’s non-delivery are measured according to section 51(2). In this case, the buyer’s damages will be ascertained by reference either to the cost of acquiring the nearest equivalent or to the difference between the contract price and the resale price.

B. Specific Performance

Specific performance is a judicial order requiring the promisor to perform his contractual promise or forbidding him from performing the promise with any other party. In English contract law specific performance is an exceptional remedy for breach of contract and will only be ordered if damages are an inadequate remedy. In the case of sale, specific performance is nevertheless a possible remedy for seller’s non-delivery. Section 52(1) of the 1979 Act provides:

“Where there is a breach of contract to deliver specific or ascertained goods the court may, if it thinks fit, on the plaintiff’s application, by its judgement or decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment.”

Specific performance is an equitable remedy subject to the discretion of the court. Historically the courts have been reluctant to order specific performance; it is likely to be available only if the goods are unique. Furthermore, if the third party is a bona fide purchaser, the court rarely grants the remedy. It seems that the court is more inclined to protect the bona fide purchaser’s interests rather than those of the buyer, particularly in the case if the property in the goods has passed to the third party.

C. Disgorgement Remedy against the Seller

Subject to some conditions, it is possible for the buyer to recover from the seller, by way of disgorgement, the profit made from selling the goods to the third party. Academic opinion has been favourable to this remedy for some time. It has been suggested that when a promisor breaks the contract, the promisee should be free to decide to apply for disgorgement, instead of claiming damages.

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16 Thompson (W L) Ltd v Robinson (Gunmakers) Ltd [1955] Ch. 177.
19 Black’s Law Dictionary (5thed. 1979), 1024.
20 Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd [1998] A.C. 1 at 11.
23 For discussions on disgorgement, see D. Friedmann “Restitution of Profit Gained by Party in Breach of Contract” (1998) 104 Law Quarterly Review 383; A. Farnsworth “Your Loss or My Gain? The Dilemma of the
Judicial attitudes to these academic views, however, are very cautious. After a period of ambiguity, the law was clarified in *Attorney General v. Blake*.

In this case, George Blake had been a member of British government’s intelligence service. He had made a contract at the outset of his employment that restricted his right to publish any official information gained by him as a result of his employment, either in the press or in book form. Blake had broken the contract by publishing a book relating his activities as a secret-intelligence officer. The British Government sought disgorgement of Blake’s profit from the book. The House of Lords granted that remedy. Lord Nicholls wrote the leading opinions in this case. He stated:

“My conclusion is that there seems be no reason, in principle, why the court must in all circumstances rules out an account of profits as a remedy for breach of contract… when exceptionally, a just response to a breach of contract so requires, the court should be able to grant the discretionary remedy of requiring a defendant to account to the plaintiff for his benefits he has received from his breach 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”.

But, he further pointed out, the mere fact that the breach enabled the promisor to enter into a more profitable contract elsewhere cannot justify granting an account of profits. So, although it is clear that after *Attorney General v Blake*, disgorgement is a possible remedy for breach of contract, it is unlikely to be granted in a case where the seller simply commits a breach by selling the goods to a third party for a higher price.

However, if the property in the goods has passed to the buyer before the seller’s breach, a disgorgement remedy can be granted in an action for waiver of tort. A person selling another’s goods without authority to a third party is guilty of conversion in tort law. In theory, the buyer can sue him for the conversion instead of breach of contract, but the buyer cannot claim more compensation than would have been awarded for the seller’s breach. This is because in an action of conversion, the owner’s damages are normally measured by the market value of the goods, which cannot exceed the buyer’s damages recoverable for the seller’s non-delivery.

Although damages for conversion is not a superior remedy for the buyer, if the latter can establish this form of liability, he can, instead of suing for damages, claim account of the profit which the seller made from his wrongful sale on the basis of waiver of tort. This will enable the buyer to claim more compensation than damages recoverable for either non-delivery or conversion.

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25 Ibid. 390
26 Ibid.
27 *Martindale v Smith* (1841) 1 Q.B. 389.
28 *Center Optical (Hong Kong) Ltd v Jardine Transport Services (China) Ltd* [2001] 2 Lloyd’s Rep. 678.
The legal term “waiver of tort” is usually taken to refer to a situation where a claim is made for restitution, rather than compensatory damages.²⁹ Waiver of tort for wrongful selling was established as early as 1701 in Lamine v Dorrell.³⁰ The defendant without consent of the plaintiff sold some Irish debentures belonging to the plaintiff to the third party. The court held that if a man takes goods to which he has no right, and sells them, the owner may waive the tort, and recover the price at which they were sold in an indebitatus assumpsit. Furthermore, in Oughton v Seppings, a sheriff’s officer in executing a writ of fieri facias against a Mr Winslove had seized and sold some personal properties belonging to the plaintiff. The court held that the plaintiff could recover the sale proceeds. A more recent case as to waiver of tort for wrong selling is Chesworth v Farrar.³² The deceased landlord had committed a conversion by selling off the property belonging to his tenant and the latter successfully recovered the sale price of his property from the deceased’s administrators.

In summary, if the property in the goods has passed to the buyer before the seller’s breach, the seller is concurrently liable to the buyer in both contract and tort law. His wrongful sale constitutes both a breach of contract and a conversion in tort.

D. Damages Claim against the Third Party for Inducing Breach of Contract³³

It was established in Lumley v Gye, as refined in Thomson v Deakin, that a person is liable to another for the damages resulting from a third party’s breach of the contract which is attributable to his direct persuasion, procurement or inducement. This liability requires both that the defendant knows of the existence of the claimant’s contract and that intends to cause the breach of that contract. The claimant must show that there was an intentional invasion of his contractual rights as well as the breach of contract caused by the defendant’s conduct.

Some recent cases have illustrated that once it is proved that the defendant had knowledge of the claimant’s contract and had contracted with the claimant’s contracting partner in a way inconsistent with the claimant’s dealing, the requirement of intention to induce the breach is prima facie established. In Thomson v Deakin Jenkins LJ said, “if a third party, with knowledge of a contract between the contract breaker and another, had dealings with the contract breaker which the third party knows to be inconsistent with the contract, he has committed an actionable interference.” It has been further held that even though the contract breaker himself is a willing party to the breach without any persuasion by the third party, the third party is still liable as long as he has knowledge of the claimant’s contract. In BMTA v Salvadori, the defendant bought a car from the plaintiff’s co-contractor knowing that this sale constituted a breach by the

²⁹ United Australia Ltd v Barclays Bank Ltd, [1939], 1 All ER 676.
³⁰ (1701) 2 Ld. Raym.
³¹ (1830) 1 B&Ad 241.
³⁴ [1853] 2 E & B 216.
³⁵ [1952] Ch 646.
³⁶ L. Carty An analysis of the economic tort ( Oxford University Press, 2001) at 49.
³⁷ per Lord Diplock in Merkur Island Shipping corp. v Laughton [1983] 2 A.C. 570 at 608.
³⁸ H. Lauterpacht “Contracts to break a contract” (1936) 52 Law Quarterly Review at 494.
³⁹ [1952] Ch 646, at 694.
⁴⁰ [1952] Ch 646, at 694.
⁴¹ [1949] Ch 556.
co-contractor of his obligation not to sell the car within a year. In his judgement, Roxburgh J stated that inducement to breach of contract included offering a price high enough for the contract breaker to agree.

In an action of inducing breach of contract, the buyer can claim all of the consequential losses resulting directly from the third party’s inducement. The damages recoverable by the buyer will not be less than his losses recoverable from the seller for his non-delivery.42

4. Seller’s Efficient Breach under English Law

Efficient breach depends on legal remedies, which can shape and change the incentives of the parties. English law provides buyers with four possible remedies that allow the buyer to sue both the seller and the third party. Therefore the analysis of efficient breach should take full account of all possible remedies available to the buyer. This section shows that under English law an efficient breach by the seller is unlikely to happen, because either the breach itself is not a Pareto improvement, or the incentive for efficient breach is deterred by the legal remedy. Three different cases will be considered in turn: (1) where the property in the goods has not passed to the buyer and the third party is a bona fide purchaser (he has no knowledge of the contract between the seller and the buyer); (2) where the property has passed to the buyer, and the third party is a bona fide purchaser; and (3) the third party is not a bona fide purchaser (he has knowledge of the contract between the seller and the buyer).

A. Case (1): The Property has not passed to the Buyer and the Third Party is a Bona Fide Purchaser

When a seller, after contracting with the buyer but prior to the passing of property to the latter, breaches the contract by selling the goods to a bona fide third party, the buyer can only resort to contract law remedies against the seller, no legal claim against the third party is available. There are two possible remedies, damages for non-delivery and specific performance. The answer to the question whether efficient breach by the seller is possible in Case (1) depends on three factors. First, whether the buyer is entitled to specific performance; if the answer to this question is positive, the possibility of efficient breach is uncertain, as under the specific performance rule it is conditional on the success of ex post negotiation between the seller and the buyer on dividing the seller’s profit from the breach. The specific performance rule is incompatible with unilateral efficient breach by the seller. If the answer to the first question is negative it depends on the second factor, whether damages recoverable by the buyer can provide him with appropriate compensation, that is, put him in the position he would have been in had the contract been performed. If damages provide inadequate compensation for the buyer’s expectation loss, the buyer is made worse off by the seller’s breach, and the breach, is inefficient. The third factor is whether, after the contract between seller and buyer has been made, both the seller and the third party have an incentive to enter into a sale of the same goods. If either of them does not intend to contract, no efficient breach is possible.

As mentioned above, specific performance is a type of “property rule”. The seller’s efficient

42 Either loss on the contract in issue or loss due to prospective contracts: Jones v Fabbi (1973) 37 DIR (3d) 27. In Bent’s Brewery Co. v Hogan [1945] 2 All ER 570 where the trade union requested the plaintiff’s pub managers to reveal confidential information on wages, the potential harm was that of having to pay increased wages.
breach under this rule is subject to the buyer’s waiving the right to specific performance. If the promisor breaches the contract without obtaining the promisee’s consent, he will be compelled by the court to perform his promise. Therefore, if the seller, without the buyer’s consent, breaches the contract with the buyer by selling the goods to a third party for a higher price, not only can he not gain from his breach, but he is also liable to the third party for the breach of contract. Without making a profit, a rational seller will never breach the contract even though the breach is a Pareto improvement.

Although under the rule of specific performance the seller’s efficient breach is still possible if the seller can successfully “bribe” the buyer to waive the right to specific performance, the rule of specific performance may still be a barrier to the efficient breach.\(^\text{43}\) First, transaction costs may prevent the parties reaching an \textit{ex post} agreement on dividing the seller’s profit from the breach. A negotiation between the seller and the buyer inevitably generates transaction costs for both parties. Once the transaction costs turn out to be prohibitive on either side of the parties, agreement will not be reached.\(^\text{44}\) Second, there is a bilateral monopoly in the negotiations between the seller and buyer. It is reasonable to expect both parties will be eager to capture a larger share of the profit by behaving strategically. The bargaining problem may postpone or perhaps prevent agreement.\(^\text{45}\)

However specific performance under English contract law would not seem to be a primary obstacle to the seller’s efficient breach. As noticed above, specific performance is an exceptional remedy for breach of contract and unlikely to be awarded unless the goods in question are unique. Even if the goods are unique, specific performance will not be ordered if the court believes that damages can adequately compensate the buyer’s losses or a \textit{bona fide} third party has obtained the property in the goods. Therefore, specific performance only becomes a barrier to the seller’s efficient breach, if the goods in question, in the judge’s point of view, are considered to possess some unique features so that monetary damages provide inadequate compensation for the buyer’s expectation losses.

Turning next to the damages rule, it has been extensively argued in the economics of contract law literature that the expectation damages rule creates an appropriate incentive for efficient breach.\(^\text{46}\) Proponents of the expectation damages rule assert that under the expectation damages rule the promisee after receiving the compensation would be in no different position from that which would have occurred if the contract had been performed. A rational seller will balance his profit from the breach against the cost of his potential liability to the buyer when deciding whether to breach. The seller’s breach only takes place if his profit from the breach exceeds the liability cost, which is equal to the buyer’s expectation losses. If the buyer’s expectation losses are correctly measured and fully compensated by the seller, the expectation damages rule can ensure that every breach by the seller is a Pareto improvement. Thus, the law should give a seller the option of not performing the contract, so long as he is willing to pay the buyer’s expectation losses.

As Judge Oliver Wendell Holmes famously argued:

“\text{The only universal consequence of a legal binging promise is that the law make the promisor pay damages if he promised event does not come to pass. In every case it leaves him free from interference until the time for}\

fulfilment has gone by. And therefore free to breach his contract if he chooses.\textsuperscript{47}

The validity of the above argument nevertheless depends on two conditions: the buyer’s expectation losses should be (1) correctly measured and (2) fully compensated. In English law there are two ways of measuring the buyer’s losses from the seller’s non-delivery, sections 51(3) and 51(2) of the Sale of Goods Act 1979, but neither rule can satisfy the two conditions.

If section 51(3) applies, damages recoverable by the buyer are unlikely to be an adequate compensation for his expectation losses. Some scholars have argued that the provision provides an adequate remedy for the buyer’s expectation losses, because if the buyer can purchase the same goods in the market, awarding him the difference between the market price and the contract price will put him in the position he would have been in had the contract been performed.\textsuperscript{48} However, from the buyer’s perspective, the seller’s performance is more valuable than the compensation recoverable under section 51(3). The problem of inadequate compensation arises more clearly in cases where the buyer has some idiosyncratic value in the goods, exceeding the market price, or else has made a profitable sub-sale contract with a third party. Where section 51(3) applies, the buyer’s losses resulting from the seller’s non-delivery will be measured as the difference between the contract price and the market price, and he therefore can recover neither the idiosyncratic value nor the profit on the sub-sale. As a result, section 51(3) cannot adequately compensate the buyer’s expectation losses.

In addition, where the buyer resells the goods to a third party in reliance on the seller’s promise, he also incurs an obligation to perform the promise to the third party. If the buyer after the seller’s breach cannot find substitute goods for the resale contract, he also would be liable for non-delivery. The seller’s breach automatically imposes on the buyer a duty of mitigation to find the substitute goods. Although the buyer is entitled to recover the cost of mitigation along with his damages for the seller’s non-delivery, the aggregate compensation is still less valuable than the seller’s performance, because if the buyer fails to mitigate, he is not entitled to claim the loss which could have been prevented if the reasonable mitigation had taken place.\textsuperscript{49} So the seller’s breach forces the buyer to bear the risk of under-compensation. Obviously the burden of this risk is not treated as a recoverable loss by section 51(3). Furthermore mitigation costs are difficult to quantify. Because they consist primarily of the costs of finding and making a second deal and these generally involve the expenditure of time rather than cash; attaching a monetary value to such opportunity costs is difficult. The possibility of the buyer being under-compensated for this part of loss because of judicial error cannot be ruled out.\textsuperscript{50}

Finally, litigation following the seller’s breach is a costly activity for the buyer. Although the court would order the seller to reimburse such costs to the buyer, if the buyer wins the case, there is still a risk that the buyer may lose the case for one or another reason, for example if the court made an incorrect judgement due to the lack of information. If this happens, the buyer would not only be unable to recover his expectation losses; he would also have to bear in whole or in part the litigation costs.\textsuperscript{51}

For the reasons given, it can be said that damages recoverable under section 51(3) are less

\textsuperscript{47} O. Holmes, “The Path of the Law” (1879) 10 Harvard Law Review 457, at 462.
\textsuperscript{48} A. Guest, Benjamin’s Sale of Goods (London: Sweet & Maxwell, 2006) 17-004.
\textsuperscript{49} British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London [1912] AC 673, at 689, per Lord Haldane.
\textsuperscript{50} A. Schwartz “The Case for Specific Performance” (1979) 89 Yale Law Journal 271 at 275.
valuable to the buyer than performance by the seller. Section 51(3) cannot put the buyer in the position he would have been in if the contract had been performed and in consequence cannot guarantee that the seller’s breach is efficient.

If there is no available market for the goods, section 51(3) is inapplicable. Instead the buyer’s losses for the seller’s non-delivery are measured, according to section 51(2) by either the cost of acquiring the nearest equivalent substitute or the difference between the contract price and a resale price. Obviously, the problem of non-compensation for the buyer bearing the duty of mitigation and the risk of litigation still exists here. And, needless to say, if the buyer’s damages are measured as the cost of acquiring the nearest equivalent substitute, the seller’s breach cannot be assumed to be efficient, because the buyer may derive lower utility or profit from the equivalent substitute than the goods which he contracted for. Moreover, section 51(2) creates some degree of uncertainty for the damages measure, which will undermine the seller’s incentive for efficient breach. Where it is applied, courts may either allow the buyer to recover the difference between the contract price and the market value of the nearest equivalent or the difference between the contract price and the resale price. When the seller considers whether to breach, he is unable to assess his liability cost accurately ex ante, because of uncertainty about which measure will be applied. If the seller assesses his liability cost for the breach on the balance of probability that the court may apply each measure, a breach which is efficient ex ante may be inefficient ex post.

Assume, for example, that if the seller breaches the contract he will make £100 profit. And the buyer’s damages recoverable for the seller’s breach will be £50, if the court awards the difference between the contract price and the market price of the most equivalent, but £120, if the award is the difference between the contract price and the resale price. The seller cannot know ex ante which measure will apply. If the seller speculates that the chance of either rule being applied is equal, his liability cost ex ante is £85 ( £50 × 50% + £120 × 50% ). His breach will generate £15 net profit to him, but if he had breached the contract and the court had decided to award the difference between the contract price and resale price, his breach would have generated £20 costs. The breach profitable ex ante turns out to be unprofitable ex post. Therefore, the seller’s incentive for efficient breach is undermined by uncertainty of the measure of damages.

The final issue to be considered is the incentive of the seller and the third party in Case (1). The questions to be asked are whether the third party has a sufficient motivation to buy the goods from the seller and whether the seller is willing to accept the price offered by the third party. We should consider two different situations, first where the goods are generic and the third party can purchase them from other sellers in the market, and, secondly, where the goods are unique and the third party cannot find them other than from the seller. In fact, the seller’s efficient breach is unlikely to take place in either situation. If the goods are of generic type, and can be purchased from others in the market, the third party will not offer the seller a price higher than the market price. If the price offered by the buyer exceeds the market price, the seller obviously obtains more profit by performing rather than breaching; on the other hand, if the price offered by the buyer is lower than the market price, the buyer’s recoverable damages,
according to section 51(3), are the difference between the contract price and the market price, which just equals the seller’s private profit from the breach. Therefore, if the goods in question are of generic type, the damages rule of section 51(3) destroys the seller’s incentive to breach.

Where the goods are of unique type, as mentioned above, the courts will order specific performance. The seller’s efficient breach is only possible if the ex post agreement between the seller and the buyer on dividing the gain from the seller’s breach is reached. In other words, the seller’s unilaterally efficient breach is impossible. In addition, as will be illustrated later, as a consequence of the remedy for inducing breach of contract, the third party in most cases will purchase the goods directly from the buyer rather than inducing the seller to breach.

To sum up the arguments so far, it might be said that the seller’s efficient breach is unlikely to take place in Case (1). The damages remedy of section 51(3) is unable adequately to compensate the buyer for his expectation losses; in addition, it deters the seller’s incentive to breach where the goods in question are of generic type. If the goods in question are unique, specific performance will be ordered, and the seller cannot unilaterally commit an efficient breach. If section 51(2) applies, the uncertainty of the damage measure for the seller’s breach substantially undermines the seller’s incentive for efficient breach. Hence two conclusions can be drawn: first, the breach of the contract to sell generic goods by the seller can never be an efficient breach, and second, the seller’s efficient breach is only possible if the goods are unique, and the seller and the buyer reach agreement on dividing the profit from the seller’s breach.

B. Case (2): the Property Has Passed to the Buyer and the Third Party is a Bona Fide Purchaser

If the buyer had already obtained the property in the goods before the seller breaks the contract, the seller’s second sale would not only constitute a breach of contract, but also a tortious conversion. The buyer can, therefore, choose to sue the seller in the action of waiver of tort for account of the profit which the seller made from the breach instead of claiming damages for the breach of contract. The seller’s motive for breach is that he can make a higher profit from the breach than from performance. If the seller breaks the contract by selling the goods to a third party, the profit from the second sale will definitely exceed the buyer’s damages recoverable for the breach of contract. So, waiver of tort is clearly a superior remedy for the buyer.

Like specific performance, waiver of tort is a “property rule”, which substantially undermines the seller’s incentive to efficient breach. The effect of this rule is to violate the second condition for seller’s efficient breach outlined in Section 2: the law should legitimise the seller’s efficient breach. Therefore, it can be argued that in Case (2), even though the barriers to the seller’s efficient breach addressed in last section have completely disappeared, the seller’s efficient breach remains impossible, because of the remedy of waiver of tort.55

It is, however, not easy for the buyer to use waiver of tort in practice. To sue for the breach of contract, the buyer needs to prove nothing more than the seller’s non-delivery. But in the action of waiver of tort he must prove that the property in the goods had passed to him before the seller’s breach. In addition, the buyer must show that any term dealing with the passing of property in the contract is legally valid, and was not the consequence of duress or the like. Moreover, because the

burden of proof in civil litigation is on the claimant, the buyer should provide the court with valid evidence of the profits which the seller actually made from the second sale and that is nearly impossible for the buyer to obtain in most circumstances. If the seller intends to break the contract with the buyer to make a more profitable deal, he will be very careful to prevent divulging any information on the second sale to the buyer. It would be difficult for the buyer to know the details of such sale and even if he acquires some information, it is still hard for him to provide persuasive evidence of the actual profit the seller earned from the breach. The problem of information asymmetry between the seller and the buyer becomes acute in this situation.

We can find very few reported cases where the buyer sues the seller in the action of waiver of tort instead of damages for breach of contract when the seller breaches the contract by making a more profitable sale. In many waiver cases, the defendant does not intend to make a profit from his wrongful sale, and the claim arises rather from his misperception that he had a legal right to sell the goods. For instance, in Oughton v Seppings, the defendant’s employee, a sheriff’s officer, did not know that the property sold by him belonged to the plaintiff. In Chesworth v Farrar, the defendant, a landlord, incorrectly believed that he was an owner of the property belonging to the plaintiff, his tenant. It is reasonable to believe that the difficulty of proving the seller’s profit is a practical obstacle for the buyer establishing the action of waiver of tort.

Given these practical difficulties, it may be argued that although waiver of tort is an available remedy to the buyer, the deterrence effect of this rule for the seller’s incentive for breach only exists in theory, and that is not a serious barrier in practice. The remedy can only function effectively if the information asymmetry problem between the seller and the buyer can be resolved.

C. Case (3): The Seller Sold the Goods to a Bad Faith Third party

In English law, if the seller, having passed the property in the goods to the buyer, is still in the possession of the goods and sells them to a bona fide third party, the latter can assert title over them. In this case, the buyer has no legal claim against the third party and can sue only the seller for breach of contract or (in tort) conversion. However if the third party is not a bona fide purchaser, that is to say he has knowledge of the contract between the buyer and the seller, the buyer can sue him for inducing the breach of contract and the damages recoverable are at least equivalent to those awarded for the seller’s non-delivery. It has been argued that this claim of the buyer is an independent cause of action and is not barred by the fact that the buyer has sued the seller for damages for non-delivery or an account of profits.

The question has then to be asked, if the third party knew that the seller had sold the goods to the buyer, why rationally would he purchase the goods from the seller thereby risking liability for inducing breach of contract, when he could purchases the goods directly from the buyer? One possible answer would be that the transaction costs of purchasing directly from the buyer would

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56  (1830) 1 B & Ad 241.
58  Section 24 of the Sale of Goods Act 1979, which provides that where a person having sold goods continues or is in possession of the goods, or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of the previous sale, has the same effect as if the person making the delivery or transfer were expressly authorised by the owner of the goods to make the same.
59  Rice v. Reed [1900] 1 Q.B. 54.
be prohibitive and would exceed his liability cost for inducing the breach of contract. But this possibility is more theoretical than realistic as in practice the litigation costs are most unlikely to be lower than the transaction costs.

Another possible reason might be the buyer’s high subjective value and the third party can make an increased profit by inducing the seller to breach, rather than by purchasing the goods directly from the buyer. If the third party induces the seller to breach, the seller’s liability costs would implicitly shift to the third party in a form of contract price; in addition, the third party’s price after deducting the seller’s liability costs would also exceed the seller’s profit from selling the goods to the buyer. Independently of transaction costs, if the third party’s profit from inducing the seller to breach after deducting his own liability cost to the buyer exceeds the price which the buyer is willing to pay for the goods, the third party will induce the seller to breach rather than buy the goods from the buyer directly. However, there are serious problems with this reasoning both in theory and in practice. Inducing breach of contract is an intentional tort, for which, as a general principle, the victim can claim all consequential losses resulting from the tortfeasor’s wrongful action, even though the loss was not foreseeable when the tortfeasor committed the tort. Therefore, in theory, the damages recoverable in action of inducing breach of contract should reflect the buyer’s subjective value of the goods. In practice, if the buyer makes a profitable resale, the profit is obviously a loss resulting from the third party’s inducing behaviour and can be recovered from the latter. Furthermore if the buyer can provide evidence that he has some idiosyncratic value in the goods, that is also recoverable in the action for inducing breach of contract. Therefore, in Case (3), the third party has almost no incentive to induce the seller to break the contract with the buyer. In short, the seller’s efficient breach is impossible in Case (3).

5. Conclusion

This paper examines the possibility of seller’s efficient breach under English sale of goods law. As we have demonstrated, the legal remedies available to the buyer are a crucial factor. In theory, if damages for the seller’s non-delivery were adequate compensation for the buyer’s expectation losses, the seller’s efficient breach is possible under the expectation damages rule; but both specific performance and the disgorgement remedy can substantially undermine the seller’s incentive to breach. The tort law remedy for inducing breach of contract deters the third party’s incentive to contract with a breaching seller. Although both specific performance and disgorgement remedy are rarely ordered in practice, the seller’s efficient breach is still unlikely to take place because the buyer’s damages recoverable for the seller’s breach in practice cannot be adequate compensation for his expectation losses. In conclusion, under English law, the seller’s efficient breach is almost impossible in practice because either the buyer is inadequately compensated for his expectation losses, or the contracting party’s incentive for efficient breach is deterred by the legal remedy.

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