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## **DISGORGEMENT AND “LICENCE FEE DAMAGES” IN CONTRACT**

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### **Introduction**

The recent English Court of Appeal case of *Experience Hendrix v PPX Enterprises Ltd*<sup>1</sup> is the latest to consider the law concerning the liability of a contracting party in respect of the profits of a breach of contract, following the decision of the House of Lords in *Attorney-General v Blake*.<sup>2</sup> The issue is of practical importance and theoretical interest. In this note I will outline what I argue is the best interpretation of *Blake* and its theoretical basis,<sup>3</sup> and consider its implications for *Hendrix*. I will deal first with the claim for all the profits of a breach, and then with the lesser claim for some fraction of the defendant’s benefit, conceived of as a sort of deemed licence fee or quid pro quo for breach. The former was described in *Blake* and *Hendrix* as an “account of profits”, but I will refer to it as “disgorgement”.<sup>4</sup> The latter I will refer to as “licence fee damages”.<sup>5</sup> I will argue that these are distinct types of claim, although in *Blake* and *Hendrix* they were regarded as variants of a single type of claim.

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<sup>1</sup> [2003] EWCA Civ 323, [2003] EMLR 25, [2003] 1 All ER (Comm) 830.

<sup>2</sup> [2000] 3 WLR 625.

<sup>3</sup> This is based on the approach in P Jaffey, *The Nature and Scope of Restitution* (Hart, 2000).

<sup>4</sup> See below n23.

<sup>5</sup> The expression “restitutionary damages” is commonly used, although this expression is often used to encompass disgorgement as well. Elsewhere I have used the expression “use claim”: see P Jaffey, *ibid*, Chapter 4.

## **Disgorgement for breach of contract**

### *A guideline and some illustrations*

The historical position is that disgorgement is never available in contract (unless the contract is fiduciary). On the other hand, once the possibility of disgorgement is accepted in principle, the question arises why it should not be available in all cases where the defendant has made a profit through his breach of contract. Most commentators have taken the view that disgorgement should be available for some but not all breaches of contract,<sup>6</sup> but there is no consensus on how these breaches should be identified. *Blake* establishes that in English law disgorgement is available for breach of contract in exceptional circumstances, but subsequent cases, including *Hendrix*, have shown considerable uncertainty over what these exceptional circumstances are.

One guideline offered by Lord Nicholls in *Blake* (which some might say verges on the tautologous) is that disgorgement is appropriate where damages or specific performance (or an injunction) is an inadequate remedy.<sup>7</sup> This of course echoes the traditional rule that specific performance is available if “damages are inadequate”. In some cases where “damages are inadequate” it may be that no sum that the defendant is likely to be able to pay could measure up to the claimant’s loss. But generally the expression must be understood to mean that it is not possible to make a reliable estimate of the measure of loss, so that the claimant is liable to be seriously undercompensated. In a contract case, the claimant’s loss is the non-receipt or non-completion of the contracted-for benefit, and in the usual case of ordinary goods or services this loss can be measured quite precisely as the cost of substitute

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<sup>6</sup> See below n25.

<sup>7</sup> At 639. “Damages” in the expression “damages are inadequate” means compensation, although this is not so in all contexts, e.g. with respect to exemplary damages, restitutionary damages, or licence fee damages.

performance or completion to be procured from other suppliers.<sup>8</sup> But where the benefit cannot be obtained from other suppliers, and only the defendant himself can provide or complete it, this measure of damages is unavailable, and it is reasonable that specific performance of the contract should be awarded to avoid the risk of undercompensation.<sup>9</sup> In the circumstances, damages are an inadequate alternative.<sup>10</sup>

A good example of a case where the contractual benefit can only be obtained from the defendant is where an employer has disclosed information to an employee subject to a contractual obligation of confidentiality, as in *Blake*.<sup>11</sup> If the information is disclosed, it will usually be hopelessly difficult to try and quantify the loss in pecuniary terms. The employer has become dependent on the employee for the benefit contracted for, since this benefit – non-disclosure by the employee – cannot now be obtained from anyone else. An injunction would certainly be ordered if the issue arose before disclosure had occurred. However, after disclosure, specific enforcement is no longer possible, and it may not be immediately apparent why disgorgement is justified. Whereas specific performance overcomes the inadequacy of damages by compelling the defendant to provide the benefit contracted for, disgorgement does not overcome the inadequacy of damages in this way: disgorgement is clearly not a

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<sup>8</sup> This measure is accepted as generally appropriate: *Radford v De Froberville* [1977] 1 WLR 1262. In the recent reported decision of an arbitration tribunal in *AB Corp v CD Company (The "Sine Nomine")* [2003] Lloyd's Reps 805 concerning a claim for disgorgement, the defendant shipowner had withdrawn its ship from a contract of hire with the claimant charterer and it was held that the provision of a ship for hire is an "ordinary commodity" in the sense that it is a service available on a market, so pecuniary compensation was a perfectly adequate remedy.

<sup>9</sup> Whether there is a genuine substitute for the contracted-for benefit is a matter of degree and judgement. Where the cost of repair is disproportionate because of the need to undo and re-do the defendant's part performance it may be denied as unduly harsh to the defendant: e.g. *Ruxley Electronics & Construction v Forsyth* [1966] AC 344. Conversely, even if the contractual benefit is not available from elsewhere it may be possible to quantify the loss precisely.

<sup>10</sup> In tort, where physical harm has been done and cannot be undone, no other remedy is possible and damages must suffice, however difficult the problem of measurement. Where damages are regarded as inadequate in contract the difficulty of measuring loss is presumably no greater than in these tort cases, but in contract the remedy of specific performance may be available. In other words, adequacy of damages is relative to the possible alternative remedies.

substitute for compensation, in the sense that the defendant's gain is a proxy measure of the claimant's loss.<sup>12</sup> There is no necessary connection between the two measures.<sup>13</sup>

More plausibly, disgorgement is based on the principle that the wrongdoer should not be allowed to profit from the wrong. But, on this basis, why should the test be inadequacy of damages? How can difficulties in measuring compensation be relevant to the principle? It would appear that disgorgement should always be imposed where the defendant has made a profit (after paying damages as compensation). Can it be, then, that the court imposes disgorgement simply because it seems to be the only practicable measure left open to it? This would be no justification at all.

Nevertheless, despite these apparent difficulties, which I will return to below, it appears that the guideline that disgorgement should be ordered where damages are inadequate does account for various types of case where disgorgement has been awarded. *Blake* is one example, and the guideline applies generally to negative obligations, of which an obligation of non-disclosure is an example. If the defendant contracted not to do something, the claimant cannot go to someone else for a substitute, and generally damages are inadequate as a remedy. An injunction is indeed

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<sup>11</sup> *Blake* did not strictly concern confidential information protectable as such, which would have been governed by the action for breach of confidence for which disgorgement has always been available. But the distinction is not relevant for present purposes.

<sup>12</sup> Commentators who have assumed that disgorgement granted on the ground of the inadequacy of damages must be intended as an indirect form of compensation have not surprisingly been unconvinced by *Blake*: see e.g. J. O'Sullivan, "Reflections on the Role of Restitutionary Damages to Protect Contractual Expectations" in D Johnston & R Zimmermann, eds, *Unjustified Enrichment* (CUP, 2002). See also A Phang & Pey-Woan Lee, "Rationalising Restitutionary Damages in Contract Law – An Elusive or Illusory Quest?" (2001) 17 JCL 240; C Mitchell, "Remedial Inadequacy in Contract" (1999) 15 JCL 133.

<sup>13</sup> The claimant's loss and the defendant's gain correspond in certain cases, e.g. where the defendant's cost saving from incomplete performance is the same as the claimant's cost of completion. Consideration of this type of case may have led to the misconception that the measure of the defendant's gain is a proxy measure of the claimant's loss.

normally granted to enforce a negative stipulation.<sup>14</sup> In the Court of Appeal in *Blake* it was suggested that the breach of a negative obligation should generally attract disgorgement.<sup>15</sup>

*Hendrix* also concerned a negative stipulation. The claimant, the estate of Jimi Hendrix, contended that the defendant was in breach of a settlement agreement that had been entered into between the two parties following litigation between them over an earlier agreement. The settlement agreement provided that the defendant was not to grant any further licences in respect of certain records featuring Hendrix, in which the defendant had the copyright, and was to surrender the master copies of the records to the claimant. In fact, the defendant retained the master copies and continued for many years to grant licences contrary to the agreement. An injunction had already been granted against further breach.<sup>16</sup> Again, the claimant could not of course go elsewhere to procure the performance of the provision. The claimant was dependent on the defendant alone, and pecuniary compensation could not serve to procure the contracted-for benefit. This suggests that *Hendrix* was an apt case for disgorgement, although in *Hendrix* only a lesser claim in the licence fee measure was granted. However, one might argue that in *Hendrix*, unlike in *Blake*, there was no loss at all from the breach, because the defendant's breaches of contract did not affect the claimant's income in any way, rather than a loss that was difficult or impossible to

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<sup>14</sup> J Beatson, *Anson's Law of Contract* (OUP, 28<sup>th</sup> edn, 2002), 638. It is sometimes said that there is no hard and fast distinction between negative and positive obligations. There may be some cases where the distinction is problematic, but this does not bring into question the general utility of the distinction in the light of the larger issue, which is whether only the defendant can provide the benefit contracted for or whether it can be obtained from elsewhere.

<sup>15</sup> [1998] 2 WLR 805, 818. In the House of Lords, Lord Nicholls said, at 639, that this was too broad. It may be that sometimes the loss caused by the breach is readily quantifiable other than by way of substitute performance, and so damages are adequate even though the contractual benefit cannot be procured from someone else, but presumably this would never be true for the breach of a confidentiality agreement.

<sup>16</sup> Para 36.

quantify.<sup>17</sup> Where there is no loss at all, it might seem better to say that no remedy at all is required, or at least not a potentially severe remedy like disgorgement, rather than that damages are an inadequate remedy.<sup>18</sup> I will return to this point below.

Another type of case is where the claimant contracts for the supply of a product from the defendant, and, although at this point the claimant could have chosen to contract with any one of a number of suppliers, once he has chosen the defendant as his supplier he can get supplies only from him. This might be because the claimant has had to adapt his business to work with the defendant's particular product, rather than one of the alternative products he might originally have chosen instead, or because he sometimes needs products immediately under a continuing arrangement with the defendant and does not have time to make alternative arrangements at this point. In such cases the contractual benefit can only be obtained from the defendant and in cases of this sort specific performance and disgorgement have been granted.<sup>19</sup>

A further illustration concerns benefits to be provided by the defendant to a third party under a contract with the claimant. Sometimes, once the contract has been entered into, the benefit to the third party can only be provided by the defendant. Pecuniary compensation paid to the claimant will not enable him to arrange for the same benefit by other means. Then specific performance will be ordered,<sup>20</sup> and if this

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<sup>17</sup> See para 14.

<sup>18</sup> The recent case of *World Wide Fund for Nature v World Wrestling Federation Entertainment Inc* [2002] FSR 32 also concerned a negative stipulation. The defendant breached a prohibition in a settlement agreement following a trade mark dispute not to use the letters "WWF" as a trade mark. The judge rejected a claim for disgorgement based on *Blake*. As in *Blake*, however, substitute performance could not be obtained from elsewhere, and it is clear that, as in *Blake*, it would have been hopelessly difficult to predict all the ramifications of the breach or try to quantify the loss caused by it. An injunction would certainly have been granted to enforce the agreement. Subsequently in *Hendrix* it was suggested that the *WWF* case might have to be reconsidered: see para 32.

<sup>19</sup> e.g. in the US, *Seaman's Direct Buying Service v Standard Oil* 686 P.2d 1158 (Cal 1984) concerning punitive damages rather than disgorgement: see below n23. Also *Sky Petroleum Ltd v VIP Petroleum Ltd* [1974] 1 WLR 576 concerning specific performance. See H Collins, *The Law of Contract* (Butterworths, 4<sup>th</sup> edn 2003), 430.

<sup>20</sup> *Beswick v Beswick* [1968] AC 58.

is no longer possible arguably disgorgement of any profit or saving made by the defendant is appropriate. An example might be where the defendant contracts with the claimant to provide palliative care to a third party, a dying relation of the claimant. The defendant fails to provide the care, which cannot now be provided by anyone else because the third party has died.<sup>21</sup> Compare the recent case of *Esso Petroleum v Niad Ltd*,<sup>22</sup> where the contract between the claimant petrol company and the defendant petrol station owner provided that the defendant was to follow directions from the claimant to lower prices to consumers issued as part of the claimant's scheme for controlling the prices at all of its petrol stations. The defendant did not follow a series of such directions and made a profit as a result. The court made an order for disgorgement. Of course, this was not a case where the claimant's ultimate objective was to confer a benefit on a third party. The scheme was ultimately designed to benefit the claimant itself by maintaining petrol sales. But it was intended to operate through its effect on petrol consumers, and the direct and measurable benefit of the contractual performance was to these consumers. Once the defendant had failed to comply with the directions it was obviously impossible for the claimant to make arrangements with the defendant or anyone else to remedy the effect on consumers.

### *The rationale*

The principle outlined above, that disgorgement is appropriate where damages are inadequate, is open to misinterpretation, and its true rationale may not be apparent. As pointed out above, the defendant's gain is no measure of the claimant's loss: disgorgement cannot be justified as a crude substitute for compensation where compensation cannot be measured.

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<sup>21</sup> The transaction itself may have the effect that the defendant is the only person who can now provide the benefit, as in *Beswick*.

It is much more plausible to say that the principle behind disgorgement is the principle that a wrongdoer must not be allowed to profit from his wrongdoing (whether this is understood in terms of deterrence or desert).<sup>23</sup> The problem with this is, as noted above, that it seems to require that the defendant's profit should be removed in all cases where he has made a profit (after payment of compensation) as a result of not performing the contract, whatever the position concerning loss suffered by the claimant, and whether or not there is any difficulty in determining the measure of compensation. This would include perfectly standard contract cases concerning ordinary goods or services, where it is certainly possible that the defendant might make a profit or a cost-saving through non-performance.<sup>24</sup>

The principle against allowing a wrongdoer to profit through his wrongdoing has received much attention in the restitution and unjust enrichment literature.<sup>25</sup> Most

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<sup>22</sup> Unreported, 22 Nov 2001 (Ch D).

<sup>23</sup> Disgorgement, defined as the removal of the defendant's profit, *for the purpose of* preventing the defendant from profiting through a wrong, is not strictly speaking a *remedy*, in the sense that it is not designed to rectify the breach of duty from the claimant's point of view. It is, like punishment, designed to promote the public good by removing the profit of a wrong, whether this is understood in terms of utility or desert. Thus disgorgement is closely related to punishment, since adequate punishment will at the least remove the profit of the wrong for the same reason. There are possible objections to punishment in civil proceedings and some of these may extend to disgorgement. GH Treitel, *The Law of Contract* (Sweet & Maxwell, 11<sup>th</sup> edn, 2003), 932, notes one objection to disgorgement for breach of contract, viz., that it confers a windfall. If by this it is meant that disgorgement is an inapt remedy because it fails to serve the purpose of compensation, this is a version of the misconceived argument mentioned above, n12. If the point is that a civil court should only dispense compensation or specific enforcement then it has some support: it is an aspect of the more general question concerning disgorgement and punishment in civil proceedings: see further P Jaffey, above n3, Chapter 11. Not all cases where the defendant is required to surrender a benefit are examples of disgorgement as defined; this is the problem with the expression "account of profits", preferred by Lord Nicholls in *Blake*, which is used for any personal claim in equity where the measure of recovery is the measure of the defendant's receipt, not necessarily disgorgement as defined.

<sup>24</sup> For example, a defendant who has contracted to supply ordinary goods or services to the claimant might get a premium on the market price for supplying immediately to a third party in urgent need. Or because of difficulties in his own business not affecting other suppliers the defendant might find that he can supply ordinary goods or services only at a price above the market price, so that he can make a saving by withdrawing from the contract and paying the market price as damages.

<sup>25</sup> Including e.g. G Jones, "The Recovery of Benefits Gained from a Breach of Contract" [1983] LQR 472; P Birks, "Restitutionary Damages for Breach of Contract: *Snepp* and the Fusion of Law and Equity" [1987] LMCLQ 421; D Friedmann, "The Efficient Breach Fallacy" 18 JLS 1 (1989); LD Smith, "Disgorgement of the Profits of a Breach of Contract: Property, Contract and 'Efficient Breach'" 24 Can Bus LJ 21 (1994); NJ McBride, "A Case for Awarding Punitive Damages in Response to Deliberate Breaches of Contract" [1995] Anglo-American LR 369; J Edelman,



commentators have not argued that disgorgement should be imposed whenever the defendant has made a profit by not performing the contract, but there has been no consensus on how or why the principle should be qualified. One suggestion has been that the test should be whether the breach is deliberate or cynical, meaning with a view to profit.<sup>26</sup> But again this could cover perfectly standard contracts to supply ordinary goods and services. In the light of this literature, and given that *Blake* appears to have recognised the possibility of applying the principle but without identifying a clear rationale for limiting its application, it is understandable that some commentators should have expressed concern that disgorgement might become generally available in contract.<sup>27</sup> However, *Blake* itself is clear that disgorgement should be available only exceptionally and not as a matter of course where the defendant has made a profit, and that it is insufficient that the breach was deliberate or cynical.<sup>28</sup>

Disgorgement in contract is indeed based on the principle that a wrongdoer should be stripped of his profit, but the inadequacy of damages test is also correct. The connection between the two is that the inadequacy of damages test is relevant not to whether disgorgement is an appropriate response to the wrong, but to whether the defendant acted wrongfully in not performing. This becomes clear on the following understanding of contract. First, there is ordinarily no duty to perform a contract, and it is not wrongful not to perform it.<sup>29</sup> More precisely, a contracting party generally incurs a duty to perform the contract only when he knows or ought to know that in the absence of performance by him the other contracting party will be unable to procure a

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“Restitutory Damages and Disgorgement Damages for Breach of Contract” [2000] RLR 129; D Fox “Restitutory Damages to Deter Breach of Contract” [2001] CLJ 33.

<sup>26</sup> Birks, *ibid.*

<sup>27</sup> See e.g. D Campbell and D Harris, “In Defence of Breach: a Critique of Restitution and the Performance Interest” (2002) 22 Legal Studies 208.

<sup>28</sup> Per Lord Nicholls at 640.

substitute for the contractual benefit from elsewhere, i.e., that he will incur loss for which damages are an inadequate remedy in the sense explained above. In such circumstances, as in the various cases considered above, the defendant has acted wrongfully and should be subject to disgorgement on the principle that a wrongdoer should not be allowed to retain his wrongful profits.<sup>30</sup> In the usual case, however, the contractor is free not to perform. If he does not perform he will not be subject to disgorgement, because he has not acted wrongfully. He will incur a liability to pay compensation, but this is not because he has committed a breach of duty.<sup>31</sup> This is the only way to look at contract that makes sense of the law of disgorgement following *Blake*.

Furthermore, this approach makes sense of the law of specific performance. If, as on the conventional view, a contractor always has a duty to perform and so always acts wrongfully by not performing, it would appear that the court should always order him to perform (subject to very limited exceptions).<sup>32</sup> Invariably a court will order a defendant to fulfil his duty not to commit a tort or a trespass, where the issue arises.<sup>33</sup> So why not in contract? No doubt the claimant would often prefer damages to an order of specific performance against a contracting party who has not proved satisfactory. But this is a matter for him, and he might consider damages inadequate when the court would not. But the rule that specific performance is justified only when damages are inadequate makes perfect sense if, as suggested, the defendant has

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<sup>29</sup> This means it is generally better to refer to “non-performance”.

<sup>30</sup> A rule in more or less these terms has been formulated for punitive damages for breach of contract in the US: *Freeman & Mills v Belcher* 900 P.2d 669, 689, per Mosk J (Cal 1995).

<sup>31</sup> See below n38.

<sup>32</sup> e.g. where there are special problems concerning supervision of the order or restriction on liberty in particular types of case.

<sup>33</sup> Normally it is too late to make any such order when the matter reaches court.

a duty to perform only when the claimant is unable to procure substitute performance and so is liable to suffer uncompensatable loss as a result of non-performance.<sup>34</sup>

To reiterate, with respect to specific performance the court asks whether damages are inadequate in order to determine whether specific performance is necessary to achieve what damages cannot in the circumstances reliably do, viz, protect the claimant from loss caused by non-performance. With respect to disgorgement, the relevance of the inadequacy of damages is not that disgorgement acts as a substitute for compensation and so functions like specific performance as a remedy in respect of loss caused by non-performance. Neither is it that, where damages are inadequate, the court crudely casts around for an alternative practicable remedy as a way of doing half-baked justice. The point is that, at the time when the defendant failed to perform, he had incurred a duty to perform only if the claimant could not obtain the contractual benefit from elsewhere, so that only actual performance could reliably protect the claimant from loss. Then the defendant was no longer free, as a contracting party normally is, to withdraw and pay damages. It is because in such circumstances (but not ordinarily) the defendant acts wrongfully by not performing that he should be subject to disgorgement on the basis of the principle that a wrongdoer should not be allowed to retain the profit of his wrongdoing.

### *A reliance approach*

The idea that there is ordinarily no duty to perform a contract and that it is ordinarily not wrongful not to perform a contract may seem obviously misconceived: surely the

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<sup>34</sup> If there were generally a specifically enforceable duty to perform, the claimant would be able to exact more from the defendant than the amount necessary to procure the contractual benefit from elsewhere. Also, if the defendant had a duty to perform, it is difficult to see why the claimant should be subject to the doctrine of mitigation. Mitigation is easier to explain on the basis that the defendant had no duty to perform, merely a responsibility for loss: see PS Atiyah, *Essays on Contract* (Clarendon Press, 1986), 124.

basis of contract is that a contractor has promised to perform, and the legal recognition of the contract means that the promise is given legal effect as a legal duty to perform. And if a contracting party does not have a duty to perform, does this not mean that the contract is of no legal effect? But the suggested approach is explicable on the basis that the function of contract law is to protect contractual reliance.<sup>35</sup> The agreement generates in law a responsibility for contractual reliance, which means that a contracting party is responsible for ensuring that the other party does not lose out from proceeding in reliance on the contract, i.e., on the assumption that the contract will be performed as agreed. This responsibility for reliance is normally fulfilled by the performance of the contract, but in the absence of actual performance it gives rise to a liability to pay compensation, generally in a measure such as to enable the other party to procure the contractual benefit from elsewhere.<sup>36</sup> Only where the claimant has become dependent on the defendant for actual performance, because the contracted-for benefit cannot be obtained elsewhere, does the defendant's responsibility for the claimant's reliance generate a duty actually to perform the contract.<sup>37</sup>

The damages measure referred to above is the "expectation measure", and one might object that expectation damages are justified only on the basis that they are a measure of the loss resulting from the breach of a duty to perform the contract, and

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<sup>35</sup> This version of the reliance theory is set out in Jaffey, above n3, Chapter 2. There are of course a number of versions of reliance theory, and there are other theories that seek to explain the pattern of contract remedies: e.g. SA Smith, "Performance, Punishment and the Nature of Contractual Obligation" [1997] MLR 360.

<sup>36</sup> Thus the liability to pay compensation is not based on the breach of a duty to perform, but on the assumption of a responsibility for reliance.

<sup>37</sup> It is often said that disgorgement for breach of contract is economically inefficient because it will discourage withdrawal from a contract when this would be efficient. There is of course a large literature on the "efficient breach hypothesis": e.g. RA Posner, *Economic Analysis of Law* (Aspen, 1998) 133-34. But there is no reason to think that it is efficient to allow withdrawal in cases where the claimant cannot be adequately compensated, nor that the parties would have agreed to such an arrangement if they applied their minds to the point when they were making the agreement: see further as to this P Jaffey, "Efficiency, Disgorgement, and Reliance in Contract: a Comment on Campbell and Harris" (2002) 22 *Legal Studies* 570.

that if the law instead protects only contractual reliance there can be no justification for awarding expectation damages. But, as has often been pointed out,<sup>38</sup> even though it may sometimes overcompensate,<sup>39</sup> using the expectation measure as a proxy for contractual reliance loss is a reasonable way of overcoming the evidential difficulties that arise in directly measuring reliance loss, and in particular the opportunity cost of alternative transactions that the claimant would have been able to make instead of contracting with the defendant.

This approach explains the principle behind *Blake* and the other cases above. The approach also provides an interpretation of another guide suggested by Lord Nicholls, that disgorgement is appropriate where the claimant “had a legitimate interest in preventing the defendant’s profit-making activity, and hence, of depriving him of his profit”.<sup>40</sup> It is not entirely clear why the claimant should have a legitimate interest in preventing the defendant’s profit-making activity other than because it is incompatible with the performance of the contract, or in other words why the guide means anything other than that the claimant must have a legitimate interest in the performance of the contract. Conventionally the claimant has a right to performance and the defendant a duty to provide it, and it is difficult to see on this understanding why the claimant does not always have a legitimate interest in the performance of the contract. On the reliance analysis, by contrast, the claimant has a legitimate interest in the performance of the contract (as opposed to an interest in being protected by damages in respect of his reliance) only where actual performance is necessary to save him from loss for which damages are inadequate in the sense explained above.

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<sup>38</sup> Ever since LL Fuller & WR Perdue, “The Reliance Interest in Contract Damages” 46 Yale LJ 52 and 373 (1936).

<sup>39</sup> See further Jaffey above n3, Chapter 2. In particular where the contract is executory, it may be that the claimant has not yet adjusted his position in any way in reliance on the contract. Nevertheless because of difficulties of proof it may be reasonable to presume that from the time of contracting the parties have incurred a reliance loss approximating to the expectation measure.

*Some further illustrations*

It is interesting to consider at this point some further examples that raise a particular difficulty adverted to above in connection with *Hendrix*. First, take the case where the claimant contracts for a service that is designed to reduce a risk of harm. An example might be the provision of security guards.<sup>41</sup> Say the defendant contracts to provide ten security guards but actually provides only five. It may be that the claimant suffers no loss from this at all because nothing actually happens that five guards are unable to cope with satisfactorily. However, the defendant has clearly made a profit in the form of his saving from supplying only five guards and not ten. Is disgorgement of the cost saving appropriate? One might say that in this case it is not so much that damages are an inadequate remedy, but that no remedy at all is required because there has been no loss. And one might object also that if disgorgement is appropriate here, where the loss is nil, it must equally be appropriate in the simple and standard case where the defendant fails to deliver ordinary goods or services and the claimant suffers no loss because an equivalent product is available on the market at the same price.<sup>42</sup>

But in the case of the contract to provide security, if one looks at the position when the defendant fails to perform, it seems to me that (applying the approach above) the defendant has a duty to perform the contract as specified, and not merely a responsibility for loss caused by a failure to perform, so that if he fails to perform as specified he should be subject to disgorgement whether or not his failure to perform

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<sup>40</sup> At 639.

<sup>41</sup> See J Beatson, *Anson's Law of Contract* (OUP, 28<sup>th</sup> edn, 2002), 655. The Court of Appeal in *Blake* appeared to have this type of case in mind when it referred (above n15) to cases of "skimped performance" as appropriate for disgorgement, citing the US case of *City of New Orleans v Firemen's Charitable Association* (1891) 9 So 486. But the expression has not surprisingly been understood to refer to any case where the defendant has provided incomplete or below standard performance: see Lord Nicholls in *Blake* at 639-40. This includes standard cases involving ordinary goods and services where disgorgement is not justified.

<sup>42</sup> See n24 above.

actually causes any harm. The defendant cannot say at this time whether the additional risk created by the shortfall in the number of guards will materialise into an actual harm to the claimant. He will be liable to compensate the claimant for any harm actually suffered, if it is due to the lower level of security actually provided. But the purpose of the contract is not simply to ensure that the claimant will get compensation in the event that he suffers any such loss, but to reduce the risk of such a loss. The two are different because the claimant would not equate compensation for the type of harm in question with its prevention. To equate the two is to confuse the contract for security with a contract of insurance. For the defendant to be free to choose to provide a lower level of security and take the risk of paying compensation instead of providing the agreed level of security would be for him to be able to convert the contract for security (to the extent of the additional risk) into a contract of insurance. Furthermore, the defendant knows that once the additional risk has been incurred by the claimant it will be too late for the claimant to get the contractual benefit – the level of risk that the contract was meant to provide – from elsewhere. By contrast, in the standard contract for the supply of ordinary goods and services, the defendant does not incur a duty to supply because the contractual benefit, or completion of it, is always available on the market.

A similar issue arises in the well-known case of *Teacher v Calder*,<sup>43</sup> which was a standard authority against disgorgement in contract before *Blake*. Here the claimant lent a sum of money to the defendant for use in his business, and a condition of the contract was that the defendant would not withdraw his own capital from the business. The defendant did exactly this, however, and the claimant made a claim for the value of the profits made by the defendant through the use of the capital

withdrawn, which was likely to exceed any loss incurred by the claimant. The claim was denied, and it was said that for the defendant to withdraw his capital “was, of course, wrong on the [defendant’s] part, as it exposed [the claimant’s] loan to unnecessary risk, but his loan has now been paid in full ...”<sup>44</sup> The implication is that, because the claimant’s loan was fully repaid on the agreed terms, so that he had suffered no loss, there was no call for any further sanction. But the provision was designed to reduce the risk of default and thereby safeguard the claimant’s investment, and accordingly the defendant had a duty not to withdraw the capital, not merely a responsibility for any loss that might be caused by its withdrawal. And of course the claimant was entirely dependent on the defendant for the contractual benefit.<sup>45</sup> Although *Teacher v Calder* was the standard authority against disgorgement in contract, it is not a standard type of case, and over-ruling it would not imply that disgorgement should be available other than in exceptional cases.<sup>46</sup>

Thus, even if it is clear that the claimant has actually suffered no loss at all, if the defendant had a duty to perform because he knew or ought to have known that the claimant was dependent on him for the receipt of the contractual benefit, disgorgement is justified. Returning to *Hendrix*, the provision against licensing by the defendant may have been intended to prevent a possible harm to Hendrix’s reputation from the release of the old records. Then the defendant acted wrongfully in inflicting the risk of such harm on the claimant, even if as it turned out there was no such harm, or none provable. Alternatively, it may have been that the provision was not intended

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<sup>43</sup> [1899] AC 451. The disgorgement issue actually received very little attention. For a different approach to *Teacher v Calder* in the light of *Blake*, see D Campbell, “The Treatment of *Teacher v Calder* in *AG v Blake*” (2002) 65 MLR 256.

<sup>44</sup> 468, per Lord Davey.

<sup>45</sup> Also the provision imposes a negative obligation.

<sup>46</sup> A similar point arises in relation to the case of third party benefits mentioned above. If the benefit can be provided to the third party only by the defendant, the defendant will incur a duty to perform, and should be subject to disgorgement, even if it is right to say (as some would argue) that the claimant incurs no loss if the contract is not performed.



to prevent harm to the claimant at all, but to create a restriction that the claimant could subsequently charge the defendant a fee for waiving. In that case the defendant had no reason to think that breaching the provision would cause any loss to the defendant.<sup>47</sup> But nevertheless the defendant knew that the claimant was dependent on the defendant for performance because the contractual benefit – the negative constraint on licensing by the defendant – could not of course be obtained from elsewhere.

### *Restitution and unjust enrichment*

The modern explosion of interest and writing on restitution and unjust enrichment has diverted attention from the importance of reliance in contract by offering a different approach to some of the same phenomena.<sup>48</sup> The principle that a wrongdoer should not be allowed to profit through his wrongdoing has been much advocated in the restitution and unjust enrichment literature, but as discussed above it cannot on its own explain *Blake*: taken at face value, in conjunction with a conventional understanding of contract, it implies that disgorgement should always be available, and, as mentioned above, this has naturally given cause for concern.<sup>49</sup> The real issue is the one addressed above, viz, when it is wrongful not to perform a contract, for the purposes of applying the principle, and the answer to this lies in the field of contract law and is by-passed in the restitution and unjust enrichment literature. It seems to me that only an approach based on the protection of reliance in contract can make sense

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<sup>47</sup> The loss of a licence fee is not caused by breaching the provision: see n62 below. As argued below, the breach would generate a right to licence fee damages, but this is not compensation for loss.

<sup>48</sup> One reason why reliance as the basis for claims in contract may have gone out of fashion is that it is thought to be equivalent to the “death of contract” theory that denies that the agreement is really the source of the legal relation between the parties, generally associated with G Gilmore, *The Death of Contract* (Ohio State University Press, 1974) and PS Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon Press, 1979). But there are various forms of reliance theory and they do not all have this implication.

<sup>49</sup> Above n27.

of *Blake*. In my view, the same is true of certain other aspects of contract law that are taken to be governed by principles of restitution or unjust enrichment.<sup>50</sup>

*A new start?*

It was said in *Hendrix* that *Blake* “marks a new start in this area of law”.<sup>51</sup> This is of course true to an extent, but the emphasis on the law of restitution and unjust enrichment has obscured the support to be found for it in contract law. There is, first, the law of specific performance as discussed above, which is only explicable on the basis that a duty to perform the contract arises only where non-performance is likely to cause loss for which damages are inadequate, in the sense explained above.

Secondly, there is the law of fiduciaries. Where a contract is fiduciary, disgorgement has always been available. In a fiduciary contract, the contract provides for the defendant fiduciary to act in some general way for the benefit of the claimant principal, for example by managing his business or property, which leaves it to the defendant to judge how best the task is to be carried out. In this type of case damages are generally inadequate because of the difficulty in specifying exactly how the task is best carried out, for example how the business or property is best managed, and so what benefit the claimant ought to have received and how much he has lost. In other words, the fiduciary is not free to opt out of doing his best for the principal and simply pay compensation for any resulting losses. He has a duty to promote the principal’s interests – this is the fiduciary duty of loyalty or good faith. It is because the fiduciary has a duty, and not merely a responsibility for any loss caused by his failure to

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<sup>50</sup> In particular the recovery of contractual payments and the contractual quantum meruit on contractual termination. For a reliance approach to the recent Australian case of *Roxborough v Rothmans* [2001] HCA 68 concerning recovery of a contractual payment, see P Jaffey, “Failure of Consideration” (2003) 66 MLR 284.

<sup>51</sup> Para 16.

promote the principal's interests, that, consistently with the approach above, disgorgement has always been available for breach of fiduciary duty.<sup>52</sup>

In *Blake*, the court relied on an analogy with the case of a fiduciary relationship. It may well be that the defendant in *Blake* was a fiduciary of the Crown at one time, but clearly a contracting party does not have to be a fiduciary for him to have confidential or sensitive information, or for disgorgement to be appropriate as a response to his unauthorised disclosure of information contrary to a contractual prohibition. The analogy lies only in the fact that a fiduciary contract is an example of a contract for breach of which damages are liable to be inadequate, in the sense explained above. In *Hendrix*, the court said that there was no analogy with a fiduciary relationship, and this seems to have been a factor in denying disgorgement.<sup>53</sup> But the rule that disgorgement is available for fiduciary contracts supports the general argument for disgorgement where damages are inadequate in the sense explained above, and this does not imply that disgorgement is not appropriate for a case like *Hendrix* that does not involve a fiduciary at all, if the inadequacy of damages argument applies.

### **The claim for a deemed licence fee**

According to Lord Nicholls in *Blake*,<sup>54</sup> it was just a matter of historical accident that the common law awarded a licence fee measure and equity a full disgorgement measure. The implication is that there is essentially one type of claim arising from the receipt of a benefit in contract, the criteria for which will indicate whether the appropriate measure in a particular case is disgorgement of the defendant's profits or

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<sup>52</sup> See further Jaffey, above n3, Chapter 13. The misconception that a fiduciary contract is in some way more than a type of contract tends to obscure the fact that the availability of disgorgement for breach of fiduciary duty supports the general rule for disgorgement proposed.

<sup>53</sup> Para 37.

a liability for some fraction of it. This understanding is reflected in *Hendrix*, where the court declined to order disgorgement but awarded licence fee damages, and the discussion of the two was not differentiated. This approach is supported by much of the restitution and unjust enrichment literature, inasmuch as disgorgement and licence fee damages have generally been treated as two different measures for the same category of claim, described as “restitution for wrongs” and understood to be based on the principle that a wrongdoer should not profit from his wrongdoing.<sup>55</sup>

As discussed above, disgorgement is based on this principle, which is why all the profits of the wrong are removed. There is some support for the proposition that the claim for licence fee damages is also based on it: for example, in a case concerning the unauthorised use of the claimant’s goods, Lord Denning justified a claim for licence fee damages on the ground that the defendant “cannot be better off because he did not ask permission. He cannot be better off by doing wrong than he would be by doing right. He must therefore pay a reasonable hire.”<sup>56</sup> But this approach is, with respect, completely mistaken. It makes no sense to say that, where a defendant has obtained a profit through a wrong, in order to give effect to the principle that a wrongdoer should not profit from his wrongdoing he will be required to surrender some small fraction of his profit and be allowed to keep the rest. A liability for a fraction of the profit, such as might hypothetically have been agreed by way of a licence fee, must be based on a quite different principle from disgorgement.

Furthermore, it seems to me that the two claims were approached quite differently in the traditional case law. Disgorgement was awarded in equity in the form of an account of profits or a constructive trust and it is clear from the judgments that the rationale is the principle that a wrongdoer should not profit from his wrong.

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<sup>54</sup> At 634.

<sup>55</sup> See e.g. A Burrows, *The Law of Restitution* (Butterworths, 2<sup>nd</sup> edn, 2002), Chapter 14.

Leading modern examples are *Attorney-General for Hong Kong v Reid*<sup>57</sup> and *Spycatcher*.<sup>58</sup> The closest common law equivalent was exemplary damages awarded on the “profit motive” ground.<sup>59</sup> Licence fee damages were awarded in the form of damages at common law for the unauthorised use of property by trespass to land or goods or infringement of intellectual property rights.<sup>60</sup> It seems to me that on the whole the emphasis here is not on the need to strip the defendant of a wrongful profit.

The true rationale for this type of claim remains controversial.<sup>61</sup> It is still argued by some that the licence fee measure is compensatory (even though at the same time it is always said to be available where the claimant has suffered no loss). This approach seems to me unsustainable,<sup>62</sup> and it is now a minority view amongst the various judges who have pronounced on the point.<sup>63</sup> In my view, the licence fee measure is not explicable in terms of removing the profits of wrongdoing or compensating for loss. In these property cases concerning trespass to land or goods or the infringement of intellectual property, the claim simply serves to protect the

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<sup>56</sup> *Strand Electric & Engineering v Brisford Entertainments* [1952] 2 QB 246, 254 per Denning LJ.

<sup>57</sup> [1994] 1 AC 324.

<sup>58</sup> *Attorney-General v Guardian Newspapers (no 2)* [1990] 1 AC 109.

<sup>59</sup> e.g. *Rookes v Barnard* [1964] AC 1129.

<sup>60</sup> e.g. *Whitwham v Westminster Brymbo Coal & Coke Co* [1896] 2 Ch 538, *Watson Laidlaw & Co Ltd v Pott, Cassels & Williamson* (1914) 31 RPC 104, *Strand Electric & Engineering v Brisford Entertainments* [1952] 2 QB 246.

<sup>61</sup> See e.g. RS Sharpe & SM Waddams, “Damages for Lost Opportunity to Bargain” [1982] OJLS 290; D Friedmann, “Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong” 80 Colum LR (1980); IM Jackman, “Restitution for Wrongs” [1989] CLJ 302; S Worthington, “Reconsidering Disgorgement for Wrongs” (1999) 62 MLR 218; E.J. Weinrib, “Restitutionary Damages as Corrective Justice” 1 Theoretical Inquiries in Law 1 (2000); H Dagan, “Restitutionary Damages for Breach of Contract: An Exercise in Private Law Theory” [2000] 1 Theoretical Inquiries in Law 115.

<sup>62</sup> The compensation approach is generally based on the idea of loss of the “opportunity to bargain”: see Sharpe & Waddams, *ibid.* Licence fee damages or “reasonable hire” would be an appropriate measure of compensation if instead of having broken a duty not to use the claimant’s property, the defendant had broken a duty to use-the-property-and-pay-for-it by using it without tendering payment. Clearly there is no such duty: see further Jaffey, above n3, 139.

<sup>63</sup> The compensation approach is taken by e.g. Millet LJ in *Jaggard v Sawyer* [1995] 2 All ER 189, Lloyd LJ in *Ministry of Defence v Ashman*, Romer LJ in *Strand Electric and Engineering v Brisford Entertainments* [1952] 2 QB 246. A “restitutionary” approach is taken by e.g. Hoffmann LJ in *Ashman*, Lord Denning in *Strand Electric* and Dillon LJ in *Surrey CC v Bredero* [1993] 3 All ER 705. The assimilation of disgorgement and the licence fee measure in *Blake* and *Hendrix* is clearly incompatible with the compensation approach.

owner's right to the "use-value" of the property. The owner's right to the use-value is a right to a share of the profits made from an enterprise that exploits the property, reflecting the extent to which the profits are attributable to the use of the property. This is quite different from disgorgement.<sup>64</sup> The approach does not provide a complete answer, however, because there is room for argument whether in a particular case an owner's rights include the right to use-value. Take the case of ownership of intellectual property. The very purpose of intellectual property is to secure to the owner of the intellectual property a share of the pecuniary benefits to be made from its exploitation. It seems clear that he must have a right to the use-value. Compare the case of *Stoke City Council v Wass*.<sup>65</sup> Here the claimant council had what was referred to as a "market right", which gave it the exclusive right to license markets in the city precincts. It was held that the defendant, who had held an unauthorised market in contravention of the council's market right, could be enjoined and was liable to pay compensation for any disturbance, but was not liable to pay a licence fee. This is understandable on the basis that the rationale of the council's market right was not to give it a right to the use-value of the city precincts for holding markets – i.e., to raise money – but to enable it to regulate the use of the city precincts for the general benefit of the public.<sup>66</sup> With respect to the ownership of land, generally one would think that ownership encompasses a right to all aspects of the value of the land, but one can conceive of forms of ownership that are limited to conferring a right of occupation, say, and so would not encompass a right to the use-value.<sup>67</sup>

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<sup>64</sup> Disgorgement is not in its nature limited to wrongs involving the use of property or other profitable activities; and the unauthorised use of property such as to generate a claim for "licence fee damages" does not arise from a wrongful act, as such, at all: see further Jaffey, *ibid*, 137-8.

<sup>65</sup> [1988] 3 ALL ER 394.

<sup>66</sup> See Nicholls LJ at 404. This is not to say of course that there should not be disgorgement of the profits of breach, which would make the issue of licence fee damages redundant for most purposes.

<sup>67</sup> e.g. long term council housing.

Similarly, compare two cases on restrictive covenants. In *Surrey County Council v Bredero*,<sup>68</sup> it was said that the purpose of imposing the covenant “was that [the covenantor] would have to apply for and pay for a relaxation if he wanted to build anything more”. The purpose of the covenant was in effect to create what amounted to a form of licensable property that could be subsequently exploited to raise money. By contrast, in *Wrotham Park Estates v Parkside Homes*<sup>69</sup> it was said that the covenant “is not an asset which [the covenantee] ever contemplated he would have the opportunity or the desire to turn to account.” The purpose was to preserve indefinitely the conditions of the existing housing. The implication is that in the former case the licence fee damages should have been available, but not in the latter case. These cases illustrate the distinction, but they do not support the argument, since the decisions were the other way round, for reasons that are not clear.<sup>70</sup>

If this argument is right, one can infer that in contract cases licence fee damages should be available in respect of a contractual provision that was designed to create a power to license some act of the other party, to be exercised to secure further payments, which might be described as a form of licensable property. This is not generally the purpose of a contract, but it is arguable that it was the case in *Hendrix*. As mentioned above, it may well be that the prohibition on licensing the records was designed to enable the claimant subsequently to waive the constraint in return for the payment of licence fees. On the argument above, this would justify a claim for licence fee damages. On the other hand, it may have been the case that the purpose of the provision was simply to ensure that the records in question did not see the light of day

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<sup>68</sup> [1993] 3 All ER 705, 709.

<sup>69</sup> [1974] 2 All ER 321, 341.

<sup>70</sup> See for example Treitel, above n23, 929-30.

at all, in order to avoid damage to the reputation of Hendrix's later records, and this would imply that there should be no claim for licence fee damages.<sup>71</sup>

One might ask why a defendant who has wrongfully breached the contract should be able to keep all his profits in one type of case but not the other. This is a reasonable question, but it pertains to disgorgement, not licence fee damages. As argued above, in *Hendrix* the defendant did indeed act wrongfully and should have been subject to disgorgement for that reason. If disgorgement had been ordered, the availability of licence fee damages would have been immaterial. Leaving aside disgorgement, the availability of licence fee damages cannot be understood to be a matter of the applicability of the principle that a wrongdoer should not be allowed to retain his profits. Indeed if the court considers that the defendant has acted wrongfully, requiring him to pay over merely a small proportion of his profits is a perverse and inadequate response.

## **Summary**

Disgorgement is based on the principle that a wrongdoer should not profit from his wrongdoing. It justifies removing the whole measure of profit. In contract, the reason why disgorgement should not be generally available is that it is generally not wrongful to fail to perform or to avoid performing a contract. It is wrongful only where the defendant knows or ought to know that the claimant has become dependent on the defendant for performance because it is impossible for him to obtain the contractual benefit from elsewhere, which means that damages will not be an adequate remedy. In such cases it is justified to order specific enforcement, where it is possible, and otherwise disgorgement. Thus where disgorgement is ordered because

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<sup>71</sup> See at para 14.



damages are inadequate this is not because disgorgement serves as a proxy measure of compensation, or is some way a substitute for compensation; it is because the inadequacy of damages indicates that the defendant acted wrongfully by not performing the contract in those circumstances.

On this basis, the cases where disgorgement is likely to be appropriate include the following: where the contract requires the defendant to exercise judgement as to how to promote the claimant's interest in some matter for which he is given responsibility (i.e., a fiduciary contract); where the claimant has had to adapt his business to use the particular product supplied by the defendant; where the contract imposes a negative constraint; where the contract was for the provision of a benefit to a third party that can no longer be provided by the defendant or anyone else; where the purpose of the contract is to reduce the risk of harm to the claimant. These are all exceptional cases: there is no justification for disgorgement in standard contract cases concerning ordinary goods or services.

“Licence fee damages” are distinct from disgorgement and are not based on the principle that a wrongdoer should not profit through his wrongdoing. They are appropriate in respect of an activity of the defendant where the claimant has a right to some share of the profits made from the activity. Thus if the defendant has made a profit through using the claimant's property in his business, and the claimant's ownership entails a right to the use-value of the property, the claimant is entitled to a proportion of the defendant's profits, reflecting the degree to which the profits are attributable to the use of the property. In contract, licence fee damages are appropriate where the contract was intended to create a licensing power, amounting to a sort of licensable property, by prohibiting the defendant from conducting a profitable activity

with a view to empowering the claimant subsequently to waive the prohibition for a fee.