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CONTRACT AS PROPERTY: TRIANGLES AND TRAGIC CHOICES

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ABSTRACT. *According to the "Inadequacy Thesis", the law's refusal to extend the tort of conversion to interferences with contractual rights is evidence of systemic ossification and proof of its failure to protect the most valuable asset class in the modern economy. Whilst it is true that, like chattels, the benefit of contractual rights can be usurped by third parties, transforming such rights into objects of property is the wrong solution to the problem. This article departs from previous analyses by stressing that the analogue of acts of interference with contractual rights is not the conversion of a chattel but a "triangle dispute". The problem raised by triangle disputes is not how to reach the primary wrongdoer, but how to allocate the loss between the innocent parties. Invoking the concept of "property" cannot solve this problem. Its efficient solution is to be found in better contracts, not more property.*

KEYWORDS: *property rights, property theory, law and economics, private law, contract law.*

I. INTRODUCTION

Although the family home remains the most valuable asset that many of us will ever own, it is trite to observe that intangible assets constitute the dominant share of wealth in modern economies. As Rudden remarked: "Nowadays the great wealth lies in stocks, shares, bonds and the like, and is not just movable but mobile, crossing oceans at the touch of a key-pad in the search for a fiscal Utopia."[1] What unifies the assets mentioned by Rudden is not merely their intangibility, but their status as contractual rights. A bond is a promise to repay a loan at a particular time at a particular rate of interest. Depending on its class, a company share is a promise to allow the shareholder to vote at meetings and to be paid declared dividends

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1 B. Rudden, "Things as Thing and Things as Wealth" (1994) 14 O.J.L.S. 81, 82. See also M. Bridge et al., *The Law of Personal Property*, 2nd ed. (London 2018), [1-031].

and a proportionate share of surplus capital on winding up.[2] To this list of valuable contractual rights we could add exclusive licences to intellectual property, bank money, futures contracts, options and other "synthetics" that can be traded on financial markets.[3] Trends in modern commercial life have certainly vindicated Roscoe Pound's statement that "[w]ealth in a commercial age, is made up largely of promises".[4]

The central role played by contractual rights in modern commerce has led to calls for the assimilation of contract and property. Some have argued that the tradability of many contractual rights, initially made possible by assignments in equity, has largely eliminated the divide between property and contract.[5] Others have argued that a limited merger of the rules of property and contract is necessary to ensure that valuable contractual rights receive adequate legal protection from those who would misappropriate their value.[6] Scholars in this camp argue that because contractual rights are, no less than chattels, vulnerable to misappropriation by third parties, the common law should include them within the ambit of the property torts lest it fail to safeguard the principal repository of wealth in most modern economies. Unsurprisingly, the most forceful proponent of this view has described the result in *OBG v Allan*,[7] in which a majority of the House of Lords confined conversion to acts of interference with chattels, as a "landmark of reactionism"[8] which has made the tort a "commercial anachronism".[9] The purpose of this article is to examine this influential argument, which will be called the "Inadequacy Thesis", and to assess both the accuracy of its diagnosis of the ills afflicting modern property law and the viability of its prescribed treatment.

Section II of the article commences by discussing the nature of contractual rights and the difficulties inherent in treating purely jural concepts, such as rights, as objects of property capable of being converted. Whilst these conceptual difficulties do not prevent third parties from intermeddling with the fact of contractual performance, most instances of third-party interference with contractual performance are adequately covered by existing tortious liability, a conclusion that is not challenged by the fate of the

[2] J.G. MacIntosh and C.C. Nicholls, *Securities Law* (Toronto 2002), 9–11. The description of a share as a mere "personal right" against the company is sometimes disputed. See P.L. Davies and S. Worthington, *Principles of Modern Company Law*, 10th ed. (London 2016), 787–90.
[3] See generally MacIntosh and Nicholls, *Securities Law*, 18–22.
[4] R. Pound, *An Introduction to the Philosophy of Law* (New Haven 1922), 236.
[5] See particularly S. Worthington, "The Disappearing Divide between Property and Obligation: The Impact of Aligning Legal Analysis and Commercial Expectation" (2006) 42 Texas International Law Journal 917, 920; S. Worthington, *Equity*, 2nd ed. (Oxford 2006), 58–67. See also P.G. Turner, "Proprietary Modes of Protecting Contractual Rights" [2012] L.M.C.LQ. 555.
[6] This argument is made most compellingly in S. Green and J. Randall, *The Tort of Conversion* (Oxford 2009), 131–39.
[7] *OBG v Allan* [2007] UKHL 21, [2008] 1 A.C. 1 (hereafter, *OBG*).
[8] S. Green, "*OGB v Allan* [2007]", in S. Douglas, R. Hickey and E. Waring (eds.), *Landmark Cases in Property Law* (Oxford 2015), 111, 124.
[9] Ibid., at 111.

insolvent company in *OBG*. Although it is possible to conceive of circumstances in which a third-party may deprive a promisee of the value of her contractual rights, a promisee can only be protected against this risk at the cost of recognising liability for pure economic loss.

Section III of the article argues that the basic flaw in the Inadequacy Thesis is its reliance on a false analogy between the conversion of a chattel and an act of third-party interference with a contractual right. The important contribution made by this article is to demonstrate that the true analogue of the latter problem is not a plain vanilla case of conversion, but a more complex "triangle dispute", such as that between an owner and a good-faith purchaser of stolen goods. Consequently, the real question for the law is how to allocate loss between two innocent parties whose interests have been affected by the conduct of a rogue from whom recovery is impossible. Contrary to the thrust of the Inadequacy Thesis, this is not a question that can be answered by invoking the law of personal property.

How, then, should the law answer this question of loss allocation? The argument advanced in Part IV of the article is that efficiency provides the most defensible basis on which to discriminate between the claims of two prima facie innocent parties whose interests have been affected by a judgment proof rogue. Consistently with Calabresi's analysis of accident law, liability for the loss should be allocated in the way that minimises the sum of the cost of third-party interference with contractual rights and the cost of avoiding it. Crucially, and unlike in archetypal triangle disputes, promisors and promisees are not strangers. Consequently, the first-best way of implementing Calabresi's model is to allow the parties to allocate liability for the loss *ex ante* by the terms of their contract. However, when transaction costs prohibit bargains between the parties, the law should devise default rules that incentivise them to invest in cost-justified precautions. In short, the answer to the problem identified by advocates of the Inadequacy Thesis is not more property rights, but better contracts.

II. Is The Common Law Inadequate?

A. Can Contractual Rights be Converted?

The basic claim made by proponents of the Inadequacy Thesis is that contractual rights should be protected by the tort of conversion. A necessary presupposition of this argument is that a contractual right is in fact a "thing" capable of being converted.

David Hume famously remarked that, "the principal disturbance in society arises from those goods, which we call external, and from their looseness and easy transition from one person to another".[10] Tangible

[10] D. Hume, *A Treatise of Human Nature* (first published 1739, D.F. Norton and M.J. Norton (eds.), Oxford 2000), [3.2.2.9].

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things are the objects of *in rem* rights of exclusion actionable in conversion because they are, by virtue of their existence in the world, vulnerable to non-consensual transfer. To borrow Penner's explanation: "[t]he reason why a right to a material object would seem to entail something like a right in rem is simply that a material object, existing as it does in the world, is … in principle accessible by anyone and subject to the depredations of anyone."[11]

Whilst contractual rights amount to "property" in the broad sense that they are economically valuable assets, many of which can be assigned,[12] it does not follow that, like tangible things, they are therefore capable of being converted. This argument has been made by Douglas in an important article on the nature and scope of conversion.[13] His argument is that unlike chattels, which exist independently of any legal system, *rights* to contractual performance are artefacts of a particular legal system. Consequently, whilst the question of whether an owner has been deprived of his chattel by a thief is simply one of fact, the question of whether a promisee has been deprived of his *right* to performance is one of law, the answer to which depends on the rules of the legal system in which it is constituted and recognised. He explains that "a contractual right … is a purely legal construct. It is something which depends upon a legal system for its existence. As such, it is for the legal system to determine when such a right comes into existence and …when the holder of such a right is deprived of it".[14]

Although subject to important exceptions such as frustration[15] and termination for breach[16] or repudiation,[17] the general position at common law, which will be referred to as the "Basic Rule", is that contractual duties can only be discharged by performance rendered by the promisor to the promisee.[18] Consequently, it is generally impossible for third parties to

[11] J.E. Penner, "The 'Bundle of Rights' Picture of Property" (1996) 43 U.C.L.A. Law Rev. 711, 727.
[12] On the "propertiness" of assignable contractual rights see, for instance, the comments in *Zhu v Treasure of New South Wales* (2004) 218 C.L.R. 530, at [130] (the Court). This expansive view of property has an ancient pedigree. In Roman law, the category of "things" always included debts and other purely personal rights. See B. Nicholas, *An Introduction to Roman Law* (Oxford 1976), 98–100; A. Pretto-Sakmann, *Boundaries of Personal Property Law: Shares and Sub-shares* (Oxford 2005), 88. The persistence of this view in modern English law is evidenced by the inclusion of *choses in action* in leading works on personal property law. See e.g. Bridge et al., *Law of Personal Property*, [1-031]; M.G. Bridge, *Personal Property Law*, 4th ed. (Oxford 2015), 4–9.
[13] S. Douglas, "The Scope of Conversion: Property and Contract" (2011) 74 M.L.R. 329. See especially at 340–41.
[14] Ibid., at 340.
[15] *Taylor v Caldwell* (1863) 122 E.R. 309, 312 (Blackburn J.).
[16] Although not all breaches of contract. See *Tramways Advertising Pty Ltd. v Luna Park (NSW) Ltd.* (1938) 38 SR (NSW) 632, 641–42 (Jordan C.J.); *Hongkong Fir Shipping Co. Ltd. v Kawasaki Kisen Kaisha Ltd.* [1926] 2 Q.B. 26, 71–72 (Diplock L.J.). See generally G.H. Treitel, *The Law of Contract*, 15th ed. (by E. Peel, London 2020), [18–053].
[17] *Hochster v De la Tour* (1853) 118 E.R. 922, 926 (Lord Campbell C.J.). See generally Treitel, *Law of Contract*, [17–089], [18–030].
[18] Douglas, "Scope", 340.

"steal" or "convert" a promisee's right to performance because the promisor's duty to perform remains intact.

Douglas's point can be illustrated with the following example. A is an egg wholesaler who, in consideration of £1,000, agrees to sell B, an egg retailer, 1,000 eggs deliverable by a certain date. The contract provides that B need only pay on receipt of the eggs, but that title to the eggs is not to pass to B until A has been paid in full. C is a rival retailer who is aware of A's contract with B but, due to supply constraints, wishes to acquire the eggs for himself. Using his skills of impersonation, C dupes A into delivering the 1,000 eggs to himself instead of to B. In this example, C has plainly interfered with the *fact* of A's contractual performance. However, due to the operation of the Basic Rule, C's conduct has not discharged A of his *duty* to B, meaning that B's correlative *right* to performance survives.[19] It thus seems impossible to say that C has "converted" B's *right* to performance against A.

A potential response to this argument is to point out that liability in the property torts requires only interference with, and not deprivation of, an owner's right. If, for instance, A touches B's chattel or trespasses onto his land, A will have committed an actionable wrong against B even though he has not deprived B of his right to the land or chattels. This objection, however, misses the point. As Douglas explains: "When we talk of the conversion of a chattel … it is not the right, but the thing to which the right relates – the chattel – which the defendant deprives the claimant of."[20] For the purposes of an analogy with conversion, the contractual right takes the place of the chattel as the "thing" or object to which the property right relates.[21] Douglas's point is simply that extinguishment of the contractual right is the only *jural* event that is analogous to an act of physical interference with a chattel. If the jural structure of a purely jural object remains unaltered by the actions of a third party, then it seems impossible to say that it has been converted.

The proceeding argument can be summarised as follows. Scarce, tangible resources are the objects of *in rem* rights of non-interference because their physical existence in the world makes them vulnerable to the depredations of others. The corollary of this observation is that resources that are not vulnerable to third-party interference need not be objects of such duties. Because, as Douglas observes, "[t]he legal nature of a contractual right makes it generally impossible for the holder of such a right to be deprived of it",[22] the attempt to transform contractual rights into objects of property for the purposes of an action in conversion seems redundant.

[19] For the seminal discussion of jural correlativity see W.N. Hohfeld, "Some Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1913) 23 Y.L.J., 16, 30–59.

[20] Douglas, "Scope", 341. If it were otherwise, the former right-holder would have no standing to sue.

[21] In other words, a purely jural thing is the *object* of another purely jural thing.

[22] Douglas, "Scope", 340.

B. Loss Caused by Interference with Contractual Performance

Douglas's analysis of the nature of contractual rights suggests that the Inadequacy Thesis fails at the first hurdle. Why extend the ambit of conversion to a species of "thing" that is, by its very nature, incapable of being converted?

One answer is that, whilst Douglas's analysis vindicates the traditional view that one "owns" property and is "owed" obligations,[23] it does not prove that the law adequately protects holders of valuable contractual rights. More particularly, it does not address the fact that a third party can cause a promisee real loss, even where the latter's contractual right survives. This can be demonstrated by altering the egg merchant example.

Recall that A was fraudulently induced into delivering eggs to C, a roguish third party, instead of B, his promisee. Because A's duty to B remains undischarged, we cannot say that C has converted B's rights. C's duplicity thus appears to be a problem for A, who must bear the costs of performing again, but not for B, who can either insist on performance or sue A for breach of contract. Imagine, however, that before being able to correct his embarrassing error, A became bankrupt. That B's rights remain enforceable against A's personal representatives does not alter the fact that C's interference with A's *performance* of his contractual duties to B has caused B loss. Assuming that there is no change in the market price of eggs, the quantum of this loss will equal the cost of organising substitute performance less whatever meagre sum B recovers from A's trustee in bankruptcy.

We thus have a situation in which C has caused B loss but, following Douglas's analysis, B has no action in conversion against C because his right to contractual performance remains enforceable against A's trustee in bankruptcy. Does this example demonstrate a lacuna in the law? The answer to this question is "no", because the law already affords B a means of redress against C. Because C has induced A to breach his contract with B, C will be liable to B in the tort of inducing contract.[24] Moreover, because C's impersonation of A amounts to an actionable deceit, C will also be liable to B for intentionally causing loss by unlawful means.[25]

As both courts and commentators have observed,[26] the tort of inducing breach of contract blurs the boundaries between property and obligation.

[23] Nicholas, *Introduction to Roman Law*, 99; R.M. Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 L.Q.R. 433, 433. As Gretton has noted, it is extremely odd to speak of "owning" contractual rights. G.L. Gretton, "Owning Rights and Things" (1997) 8 Stellenbosch Law Review 176, 177.

[24] *OBG* [2007] UKHL 21, at [3]–[5], [39]–[44] (Lord Hoffmann).

[25] Ibid., at [6]–[8], [45]–[64] (Lord Hoffmann).

[26] Ibid., at [32] (Lord Hoffmann). See also *Attorney General (NSW) v Perpetual Trust Co. (Ltd.)* (1952) 85 C.L.R. 237, 296–97; Turner, "Proprietary Modes", 553–54, 567–68. The inclusion of the term "limited" indicates that the tort does not completely "propertise" the contractual right in the sense of making the correlative, and potentially positive, duty exigible against the world-at-large. Such an outcome would

Nevertheless, the limited *in rem* effect created by the tort is perfectly compatible with the argument advanced above, which is simply that extending the tort of conversion is unnecessary because the law already recognises an action that enables a promisee to recover loss inflicted by a stranger in these circumstances.

Moreover, the quasi-proprietary status bestowed on contractual rights by the inducing tort does not provide a conceptual stepping stone for those who seek to extend conversion to contractual rights. This is so for two reasons. First, consistently with Douglas's argument, liability for inducing breach of contract does not presuppose that the promisee has been deprived of her right to performance by the actions of the inducer. This is illustrated by the *locus classicus*, *Lumley v Gye*.[27] That the promisee, Benjamin Lumley of Her Majesty's Theatre, had an action against the inducer, Frederick Gye of Covent Garden Theatre, did not prevent him from successfully enjoining the promisor, Madame Wagner, from breaking her contract with him by singing at Covent Garden.[28] Secondly, the liability of a converter of chattels is famously strict.[29] By contrast, a plaintiff suing for inducing breach of contract must prove that the inducer intended to procure a breach of contract.[30] The wrong of inducing breach of contract lies not in the inducer's interference with the promisee's right as a "thing", but in his intention to induce the promisor to commit a breach of duty.[31] Conceptually, then, the tort's nearest relation is not conversion or trespass, but personal liability in equity for knowingly receiving property transferred in breach of trust.[32]

C. OBG v Allan

1. The Facts

What happens, however, if a promisee suffers loss at the hands of a third party but has no claim in the economic torts because the facts disclose neither a breach of contract nor an intention to cause loss by unlawful means? Does this demonstrate a lacuna in the legal protection afforded to promisees? Just such a circumstance appeared to arise in the (in)famous decision of the House of Lords in *OBG*.

be anathema to the common law principle that duties *in rem* are almost always negative in character. On this point see Douglas, "Scope", 342–43; A. Honoré, "Rights of Exclusion and Immunities against Divesting" (1960) 34 Tulane Law Review 453, 458; B. McFarlane, "The *Numerus Clausus* Principle and Covenants Relating to Land" in Bright (ed.), *Modern Studies in Property Law*, vol. 6 (Oxford 2011), 311, 325–26.

27 *Lumley v Gye* (1853) 11 E.R. 749.

28 *Lumley v Wagner* (1852) 42 E.R. 687. The real benefit of the tort is that it presents the promisee with another defendant should the promisor be judgment proof. This much is suggested by Crompton J. in *Lumley v Gye* (1853) 11 E.R. 749, 755.

29 *Fowler v Hollins* (1872) LR 7 Q.B. 616, 639 (Cleasby B.).

30 *OBG* [2007] UKHL 21, at [99] (Lord Hoffmann).

31 For a similar, though not identical, observation see Douglas, "Scope", 348–49.

32 *Barnes v Addy* (1874) LR 9 Ch App 244.

OBG Ltd ("OBG"), a civil engineering firm, was plunged into a financial crisis when its largest client, North West Water Ltd ("NWW"), refused to pay outstanding invoices following a dispute about the quality of OBG's work. As part of a rescue attempt, OBG sought assistance from a creditor who purported to receive an assignment of an "all-moneys" debenture previously granted to OBG's bankers. Although no money was due under the debenture, the creditor received advice that debts owed to it by OBG could be secured by the otherwise moribund instrument. In purported exercise of its powers under the debenture, the creditor appointed the respondents as administrative receivers. Amongst other acts, the receivers compromised outstanding contractual obligations owed to OBG by its clients, including NWW, for what appeared to be a fraction of their true value.[33]

Unfortunately, the advice on which the creditor acted was wrong. The debenture remained lifeless, making the purported appointment of the respondents invalid and rendering their every dealing with OBG's assets ultra vires. OBG subsequently appointed a liquidator who brought proceedings against the respondents claiming, inter alia, that the settlement with NWW amounted to a conversion of OBG's contractual rights. Whilst the respondents admitted that they were strictly liable for interference with OBG's chattels,[34] they denied liability for conversion of OBG's contractual rights on the simple ground that conversion is confined to wrongful interferences with chattels.[35] By a bare majority of three to two, the House of Lords agreed.

Of the majority, Lord Hoffmann and Lord Brown each offered substantive arguments against extending the ambit of the tort to intangible assets. Lord Hoffmann was concerned about making receivers, appointed in good faith, strictly liable for pure economic loss.[36] Lord Brown argued that it was undesirable to extend tortious liability to assets which, so he argued, had no determinable value at the date of their seizure.[37] These arguments were, however, subsidiary to the majority's primary ground for denying the liquidator's claim, which was that any decision to expand the scope of conversion to include intangible assets, such as contractual rights, must be made by Parliament.[38]

The minority of Lord Nicholls and Baroness Hale were not persuaded of the need for judicial reticence, arguing that confining conversion to acts of interference with tangible assets is to draw a distinction without a

[33] The receivers compromised OBG's rights against NWW for £400,000. The trial judge assessed the true value of those rights at £1,400,000. *OBG* [2007] UKHL 21, at [211] (Lord Nicholls).
[34] Ibid., at [81] (Lord Hoffmann).
[35] Ibid.
[36] Ibid., at [99].
[37] Ibid., at [321]. It is difficult to see the force in this argument. Plainly, OBG's contractual rights had some value, otherwise NWW would not have paid £400,000 to compromise them. For the same criticism see Green, "*OGB v Allan* [2007]", 119.
[38] *OBG* [2007] UKHL 21, at [100] (Lord Hoffmann), [271] (Lord Walker), [321] (Lord Brown).

difference.[39] Each noted that, because one who converts a cheque is liable to pay damages equal to its face value and not the value of the paper on which it is printed, it is clear that the tort already protects contractual rights. The only barrier to recognition of OBG's claim is the mystical significance that the law appears to attach to certain scraps of paper.[40]

2. Does OBG *Reveal a Lacuna in the Law?*

Because the receivers' conduct was not unlawful, was not intended to cause loss and did not result in a breach of contract, OBG could not avail itself of the economic torts.[41] Its only chance of being made whole thus depended on its novel conversion argument. The rejection of this argument is, according to supporters of the Inadequacy Thesis, irrefutable evidence of an ossified legal system whose preoccupation with traditional forms of property has resulted in the systemic under-protection of the most valuable asset-class in most modern economies.[42]

If the receivers compromised OBG's contractual rights for a fraction of their true value, then it is undeniable that the company's unsecured creditors suffered a real loss. However, the existence of this loss does not prove that the law failed to protect the insolvent company's contractual rights from the actions of the receivers.

Green has observed of *OBG* that "[s]ince settled debts no longer exist as items of property, the receivers, in acting as they did, deprived the rightful owners substantially of the value of those assets".[43] Whilst this is undoubtedly true, the real question is why OBG's debtors were discharged of their duties to OBG given that, by paying the invalidly appointed receivers, they appeared to render performance to the wrong party.[44] To again illustrate with the example of the credulous egg merchant, the outcome in *OBG* appears to be the equivalent of holding that A's mistaken act of delivering the eggs to C effected a good discharge of his contractual duty to B. What explains this apparent departure from the Basic Rule?

The answer is that *OBG* involved no such departure. What is insufficiently emphasised about *OBG* is the way in which two crucial decisions transformed an unremarkable corporate insolvency into what Green regards as a missed opportunity to drag property law kicking and screaming into the twenty-first century.[45] The first was the creditor's decision to appoint liquidators pursuant to powers nominally acquired as the assignee of a

39 Ibid., at [221] (Lord Nicholls), [311] (Baroness Hale).
40 Ibid., at [232] (Lord Nicholls), [310] (Baroness Hale).
41 Ibid., at [86] (Lord Hoffmann). See also Green, "*OBG v Allan* [2007]", 112.
42 See Green and Randall, *Tort of Conversion*, 137; P.-W. Lee, "Inducing Breach of Contract, Conversion and Contract as Property" (2009) 29 O.J.L.S. 511, 529.
43 S. Green, "To Have and to Hold – Conversion and Intangible Property Cases" (2008) 71 M.L.R. 114, 118.
44 See also S. Douglas, "Converting Contractual Rights" [2008] L.M.C.L.Q 129, 134.
45 Green, "*OGB v Allan* [2007]", 111, 124.

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debenture. But for this intervention, OBG would have skipped receivership and proceeded directly to an orderly insolvency.[46] The second was the liquidator's decision to concur in the void settlement that the receivers reached with NWW. Because the liquidator had power to dispose of the company's assets, his concurrence in the otherwise void settlement meant that the debtors in fact rendered performance to the correct party. Had it not been for the liquidator's intervention, NWW's contractual obligations would have remained undischarged, rendering the claim in conversion redundant.[47]

Put briefly, the outcome in *OBG* simply does not reveal the lacuna in legal protection of contractual rights claimed by its critics. This is because, contrary to Green's view,[48] ultimate legal responsibility for the fate suffered by OBG's unsecured creditors lay with the properly appointed liquidator, and not the alleged tortfeasors. If it is true that the liquidator ratified a compromise that grossly undervalued OBG's contractual rights,[49] the appropriate response is not to upend the law of property, but to allow OBG's creditors an action against the liquidator.[50]

3. Explaining the Face Value Rule

Before concluding the discussion of *OBG*, a final argument must be confronted. As noted above, the minority in *OBG* made much of the "face value" rule, according to which damages for the conversion of a negotiable instrument are equal to its face value, and not the value of the paper on which it is printed.[51] Their purpose in doing this was not so much to argue that the tort of conversion ought to apply to contractual rights, as to point out that it already does.[52] According to Lord Nicholls, acceptance of OBG's claim only required the law to "discard the fictional significance of a piece of paper".[53] This, however, betrays a misunderstanding of the face value rule.

Contrary to Lord Nicholls's statement, the requirement of a document is not "hocus pocus", but a necessary consequence of the law's decision to completely subsume a promise to pay within a physical document which,

[46] The trial judge found that OBG was inevitably headed for insolvent liquidation. *OBG* [2007] UKHL 21, at [107] (Lord Hoffmann).

[47] See also Douglas, "Scope", fn. 57; D. Sheehan, *The Principles of Personal Property Law*, 2nd ed. (Oxford 2017), 188. Goymour also notes that the receivers had no power to compromise OBG's rights against its debtors but argues that re-opening the negotiations would put OBG at a practical disadvantage. A. Goymour, "Conversion of Contractual Rights" in S. Bright (ed.), *Modern Studies in Property Law*, vol. 6 (Oxford 2011), 333, 347. It is not clear, however, if or why this is true.

[48] Green, "To Have and to Hold", 118.

[49] About which there is some dispute. See *OBG* [2007] UKHL 21, at [322] (Lord Brown).

[50] As a practical matter, suing liquidators is extremely difficult because of the discretion that courts afford to such office-holders. See J.M. Wood, "Insolvency Office Holder Discretion and Judicial Intervention in Commercial Decisions" (2020) 6 Journal of Business Law 451.

[51] *Morison v London County and Westminster Bank Ltd.* [1914] 3 K.B. 356, 370 (Phillimore L.J.).

[52] *OBG* [2007] UKHL 21, at [228] (Lord Nicholls).

[53] Ibid., at [232].

like chattel money, is fully negotiable.[54] Merging a promise to pay within a chattel such that the promise obeys the rules of chattel money has several advantages. It obviates the need to deal *in specie* because it allows debt instruments to circulate like cash.[55] It enables the benefit of a contractual right to pass by manual delivery which, prior to statutory assignment,[56] overcame the common law's prohibition on the assignment of contractual rights.[57] And even since the advent of statutory assignment, drawing a cheque is a more convenient payment method than executing an instrument of assignment in favour of the payee and giving notice to the assignor's debtor.[58]

However, one cannot enjoy the benefits of negotiability without also bearing its infirmities. Imagine that A pays B by a bearer cheque that is subsequently stolen by C, who uses it to purchase goods from D, a "holder in due course".[59] When D presents the cheque for payment and the drawee debits A's account, the bill will be "discharged",[60] extinguishing B's contractual rights against A. That B can sue C for the face value of the cheque, and not its value as a scrap of paper, is not a fiction but recognition of the reality that C has, by his actions, deprived B of her contractual rights against A.[61] In this important respect, a bearer cheque with a face value £50 is no less vulnerable to acts of third-party interference than a £50 note.[62] Contrary to the minority position, the difference between negotiable and non-negotiable instruments is not that the former are printed on magic paper whilst the latter are not. It is instead that, unless a document is negotiable, interference with it will not alter the rights evidenced by it.[63] Consequently, as Douglas also notes,[64] no analogy can be drawn between acts of interference with chattels and attempted acts of interference with contractual rights that are evidenced by non-negotiable instruments.

[54] *Miller v Race* (1758) 97 E.R. 398, 401 (Lord Mansfield). For discussion, see D. Fox, "Bona Fide Purchase and the Currency of Money" (1996) 55 C.L.J. 547.

[55] This is illustrated by the origins of cheques which, in England, can be traced to the seventeenth-century commercial practice of negotiating deposit certificates issued by London goldsmiths as an alternative to withdrawing metallic coin and paying *in specie*. See J.M. Holden, *The History of Negotiable Instruments in English Law* (London 1955), 206–07.

[56] Law of Property Act 1925, s. 136.

[57] Bridge, *Personal Property Law*, 233; M. Smith and N. Leslie, *The Law of Assignment: The Creation and Transfer of Choses in Action* (Oxford 2013), 198, 214.

[58] See generally R.M. Goode and E. McKendrick, *Goode on Commercial Law*, 4th ed. (London 2010), 566–68.

[59] Bills of Exchange Act 1882, s. 29(1).

[60] Ibid., s. 59(1).

[61] For an excellent discussion of this point see Douglas, "Converting Contractual Rights", 131–32.

[62] Their susceptibility to theft is one reason why bearer instruments are rarely issued. The US federal government, for instance, ceased to issue bearer bonds because so many were being stolen in transit between holders. See P.F. Coogan, "Article 9 – An Agenda for the Next Decade" (1977) 87 Y.L.J. 1012, 1037. The modern hostility to all species of bearer instruments is reflected in the prohibition on the issuance of bearer shares. See Companies Act 2006, s. 779(4).

[63] See also Sheehan, *Principles of Personal Property Law*, 187.

[64] Douglas, "Converting Contractual Rights", 132, 134.

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D. The Problem of Pure Economic Loss

If the foregoing analysis is correct, it is neither true to say that "the tort of conversion has already jumped the gap between tangibles and intangibles",[65] nor that it ought to. However, merely demonstrating that *OBG* does not reveal a lacuna in the legal protection of contractual rights does not prove the broader point that the law is adequate.

Take the following example. B, a large football club, signs A, a star football player, on a multimillion-pound, multi-year contract. To celebrate, A goes out to a bar where he is assaulted by C. A's injuries are sufficiently serious that he will miss the entire season.[66] C's actions have plainly diminished the value of B's rights against A. However, because C neither caused A to breach his contract with B, nor intended to cause B loss, B has no claim in inducing breach of contract or the unlawful means tort, and thus no means of recovering from C.[67]

Is the absence of a claim proof of the Inadequacy Thesis, and can we envisage a way in which B can recover from C? According to what Douglas has described as the "reification" theory of contractual rights, the answer may be "yes". Douglas explains that:

> Under this analysis of contractual rights, which is sometimes called "reification" by its advocates, it is possible to view the financial value of the right as something distinct from the right itself; it may be seen as the "thing" to which the right relates. The importance of this for present purposes is that it allows us to say that there is something which a defendant can deprive the claimant of.[68]

Because it "propertises" the value of a contractual right, the reification theory is a variation on the theme proposed by advocates of the Inadequacy Thesis. On this view, C will be liable to B because he has breached the *in rem* duty not to interfere with the value of B's contractual rights against A. Likewise, the receivers in *OBG* would be liable to the insolvent company for diminishing the value of its contractual rights against its customers. Whilst this expansive notion of "contract as property" captures third-party conduct that eludes the economic torts, "reification", and all cognate theories, suffers from three problems, each more serious than the last.

The first is that, as Douglas has demonstrated,[69] there is no authority for an *in rem* right to the value of a contractual right. An exclusive licencee of

65 *OBG* [2007] UKHL 21, at [228].
66 Assume that the contract between A and B contains no contingency for injuries.
67 See *Attorney General (NSW) v Perpetual Trust* (1952) 85 C.L.R. 237, 294 (Kitto J.).
68 Douglas, "Scope", 342, footnotes omitted.
69 Ibid., at 344–46.

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an intellectual property right cannot bring an action against a third party who, by infringing the underlying intellectual property right, diminishes the value of his contractual rights against the licensor.[70] The second problem is that the judicial creation of any such novel property right or "fancy"[71] is forbidden by the *numerus clausus* principle, according to which there is a fixed or "closed list" of property rights recognised at common law.[72] Finally, irrespective of whether it is created by a court or Parliament, the creation of an *in rem* right to the value of an *in personam* contractual right would undermine the fundamental principle that third parties are not liable for causing pure economic loss, whether maliciously or otherwise.[73] As established in *Allen v Flood*[74] and affirmed in *OBG*,[75] a plaintiff can only recover pure economic loss from a third party who intentionally induced a breach of contract or inflicted loss by unlawful means.

The law's general prohibition on claims for pure economic loss not only reflects the concern that allowing such claims would create "liability in an indeterminate amount for an indeterminate time to an indeterminate class".[76] It also reflects the fact that allowing individuals the liberty to inflict pure economic loss on each other is the *sine qua non* of competition, without which there could be no efficient markets through which to allocate scarce resources.[77] This imperative was expressly recognised by Lord Nicholls, who remarked that "[c]ompetition between businesses regularly involves each business taking steps to promote itself at the expense of the other … Far from prohibiting such conduct; the common law seeks to encourage and protect it".[78] To recognise any free-standing right to the *value* of a contractual right, in whatever theoretical form, would be to overthrow this fundamental principle by a side-wind.[79]

[70] See *RCA Corpn v Pollard* [1983] Ch 135, 153 (Oliver L.J.); *Isaac Oren v Red Box Toy Factory Ltd.* [1999] FSR 785, 798, at [33] (Jacob J.). Each of these cases was referred to with approval by Lord Hoffmann in *OBG* [2007] UKHL 21, at [52]–[54].

[71] A term popularised by the discussion in B. Rudden, "Economic Theory v Property Law: The *Numerus Clausus* Problem" in J. Eekelaar and J. Bell (eds.), *Oxford Essays in Jurisprudence: Third Series* (Oxford 1987), 239.

[72] *Keppell v Bailey* (1834) 47 E.R. 106, 114 (Lord Brougham L.C.); *Hill v Tupper* (1863) 159 E.R. 51, 53 (Pollock C.B.), 53 (Martin B.).

[73] See *Allen v Flood* [1897] A.C. 1, 92, 94 (Lord Watson); *Bradford Corpn v Pickles* [1895] A.C. 587, 594 (Lord Halsbury L.C.); *OBG* [2007] UKHL 21, at [142] (Lord Nicholls).

[74] *Allen v Flood* [1897] A.C. 1, 96 (Lord Watson).

[75] *OBG* [2007] UKHL 21, at [13]–[14] (Lord Hoffmann), [142], [145] (Lord Nicholls).

[76] *Ultramares Corp v Touche* 174 NE 441, 444 (1931) (Cardozo C.J.). The prohibition is "general" and not "absolute" because it is possible, in truly exceptional cases, for a plaintiff to recover pure economic loss in negligence. As the cases on negligent misstatement demonstrate, this is usually only possible where the defendant has assumed responsibility for a plaintiff, who has in turn relied on him to exercise due care and skill. See for example, *Henderson v Merrett Syndicates Ltd.* [1995] 2 A.C. 145, 180–81 (Lord Goff); *White v Jones* [1995] 2 A.C. 207, 275 (Lord Browne-Wilkinson).

[77] See generally P.A. Samuelson and W.D. Nordhaus, *Economics*, international ed., 19th ed. (New York 2010), 160–61.

[78] *OBG* [2007] UKHL 21, at [142].

[79] A point equally appreciated by Lord Hoffmann. Ibid., at [99].

III. Triangle Disputes and Tragic Choices

A. False Analogies

Despite the criticisms made above, the basic truth underpinning the Inadequacy Thesis is that contractual rights can be vulnerable to acts of third-party interference. For instance, if a rogue agent acting outside his actual, but within his ostensible, authority makes a withdrawal from his principal's bank account, the bank will receive a good *pro tanto* discharge of its duties to the principal as its customer. Nothing in the foregoing denies that, in a colloquial sense, the agent has "stolen" or "converted" his principal's rights against the bank. However, what is denied is that invoking the tort of conversion can solve the problem faced by the contracting parties. To the contrary, it is argued that viewing the problem through the prism of conversion diverts attention from the very real problem that the law must solve in these circumstances; *viz.* how best to allocate the loss between the innocent promisor and promisee.

Invoking conversion is misleading because, unlike a simple conversion of chattels, attempts by third parties to usurp a promisee's right to contractual performance invariably involve three protagonists: an innocent promisee, an innocent promisor and a wrongdoer. The appropriate analogue of the latter problem is thus not a dispute between an owner and a thief, but that between an owner and a good-faith purchaser who has purchased the former's goods from a thief. Like the problem of the good-faith purchaser, acts of third-party interference with contractual rights create one of the "eternal triangles of the law".[80]

In a legal Utopia in which rogues were identifiable and solvent, and legal proceedings cheaply and expeditiously resolved, triangle disputes would cause the law little anxiety.[81] In the case of stolen goods, for instance, either the owner would forfeit the goods to the purchaser and sue the thief in conversion, or the purchaser would forfeit the goods to the owner and sue the thief for breach of his implied warranty to pass good title.[82] In the real world, however, the rogue often cannot be identified or is not worth suing. Consequently, the real significance of the law's solution to any triangle dispute is not that it determines which of the two innocent parties must endure the tedium of suing the rogue, but who must bear the loss that cannot be recovered from him.[83]

80 See M. Mautner, "The Eternal Triangles of the Law: Toward a Theory of Priorities in Conflicts Involving Remote Parties" (1991) 90 Michigan Law Review 95, 95.

81 For similar observations, see ibid., at 96; R.A. Epstein, "Inducement of Breach of Contract as a Problem of Ostensible Ownership" (1987) 16 J.L.S. 1, 8.

82 Sale of Goods Act 1979, s. 12(1).

83 See also Mautner, "Eternal Triangles", 108.

B. Bank Money and Triangle Disputes

A particularly good example of a contractual triangle dispute is that caused by a rogue who attempts to steal bank money. The term "bank money" is, of course, something of a misnomer. The relationship between a bank and its customer is fundamentally contractual,[84] and "bank money" is a chose in action; a debt owed by the bank to its customer equal to the sum deposited and payable on demand.[85] If, at the instigation of a rogue, a bank processes an unauthorised transaction on its customer's account, the question that the law must answer is whether the payment constitutes a good *pro tanto* discharge of the debt that it owes its customer. Because financial fraud forms the core business of many organised crime syndicates, attempts to steal bank money are, unlike the peculiar dispute in *OBG*, a problem of great practical concern.[86]

As is true of all triangle disputes, the problem caused by the fraudulent targeting of bank accounts is not legal inadequacy in the sense that the rogue falls into some interstice between forms of action and cannot be sued. If, for instance, a rogue agent is acting within his ostensible authority, the bank will be entitled to debit the principal's account,[87] leaving the principal to sue the agent for breach of the contract of agency. If, on the other hand, the agent was acting outside both his actual and ostensible authority, the bank will not be entitled to debit the principal's account but can recover the sum from the agent either as compensatory damages for deceit or, by "waiving the tort", as money had and received.[88] Whichever way the court answers the mandate question, the rogue will be liable for his misdeeds. The problem is instead that an infinity of claims is of no assistance against a rogue who either cannot be found or is so impecunious as to be judgment proof. Consequently, the resolution of the jural question of whether the bank discharged the debt to its customer amounts to the following: which of the two nominally innocent parties should bear the loss caused by the absence of the true wrongdoer? No appeal to the tort of conversion can assist in answering this question.

[84] *Joachimson v Swiss Bank Corporation* [1921] 3 K.B. 110, 127 (Atkin L.J.).

[85] That is, the bank does not become bailee or trustee of the customer's money. See *Foley v Hill* (1848) 9 E.R. 1002, 1005–06 (Lord Cottenham L.C.).

[86] In 2019, it was reported that £2 million was "stolen" from British bank accounts every day. Many of the criminal gangs perpetrating this financial fraud did so using the relatively low-tech means of "card skimming". See S. Feay, "'Fraud: How They Steal Your Bank Account': The Low-tech and Effective Ways to Get Your Bank Details", *The Financial Times*, available at https://www.ft.com/content/cadf5258-44c1-11e9-a965-23d669740bfb (accessed 22 October 2022).

[87] This is not because the bank is acting within mandate *per se*, but because the principal will be estopped from denying that it is. On the relationship between ostensible authority and estoppel see *Freeman & Lockyer v Buckhurst Park Properties (Managal) Ltd.* [1964] 2 Q.B. 480, 503 (Dipock L.J.).

[88] For discussion of "waiver of tort" see A. Burrows, *The Law of Restitution*, 3rd ed. (Oxford 2011), 642–43. For an excellent overview of the parties' means of redress, see A. Goymour and S. Watterson, "Testing the Boundaries of Conversion: Account-holders, Intangible Property and Economic Harm" [2012] L.M.C.L.Q. 204, 218–25.

C. The Symmetry of the Parties

Whilst the apparent moral symmetry of the true parties to a triangle dispute seems to make this "an impossibly difficult question",[89] the law must answer it if the dispute is to be resolved. Who, then, should draw the short straw?

One possibility, suggested by the symmetry of the parties, is to pick at random. According to one principle of decision-theory, a decision maker should aim to "minimize the sum of the costs of making decisions and the costs of error".[90] Because all decisions about liability in a generic triangle dispute are equally unfortunate, none can be considered erroneous. Consequently, the only imperative is to minimise the cost of decisions. In resolving such disputes, the law should thus refrain from expending resources in "choosing" a winner and should instead arbitrarily "pick" one.[91]

Whilst this proposal appears radical, picking strategies are used to resolve other disputes where the merits of the parties appear equal. Take the maxim *in pari delicto potior est conditio possidentis*.[92] Where both parties to a dispute over the ownership of a chattel are tainted by illegality, the law is content to allow the possessor to prevail, not because he is worthier, but because the alternative is no better. So long as no decision is superior to any other, the decision maker is not justified in incurring costs in altering the *status quo ante*.

Just as there is nothing to choose between parties *in pari delicto* because they are equally bad, there is nothing to choose between innocent parties to a triangle dispute because they are equally good. The rules "favour the promisor" and "favour the promisee" are thus equally satisfactory. The only imperative is to make a choice between the alternatives and, to avoid creating prospective uncertainty, stick with it.

Picking rules are both cheap to apply and have the welcome effect of "sanitising" decisions that require discrimination between equals.[93] Despite these virtues, many will chafe at the idea of harnessing randomness to resolve a question of just distribution.[94] Whilst one might sympathise with this intuition, those who hold this view must find a satisfactory way

[89] B. McFarlane, *The Structure of Property Law* (Oxford 2008), 189.
[90] C.R. Sunstein and E. Ullmann-Margalit, "Second-order Decisions" in C.R. Sunstein (ed.), *Behavioural Law and Economics* (New York 2000), 187, 190.
[91] Ibid., at 189–90, 201. Archetypal examples of "picking-type" decision procedures include coin tosses and lotteries.
[92] *As between two wrongdoers, possession decides*. See e.g. *Taylor v Chester* (1869) L.R. 4 Q.B. 309.
[93] For discussion, see P. Stone, *The Luck of the Draw* (New York 2011), 35–37, 146; L.A. Kornhauser and L.G. Sager, "Just Lotteries" (1988) Rationality and Society 483, 499, 502; G. Calabresi and P. Bobbitt, *Tragic Choices: The Conflict Society Confronts in the Allocation of Tragically Scarce Resources* (New York 1978), 41.
[94] As Elster has noted, our "addiction to reason" leads us to reject picking rules, even when they are a desirable way of allocating benefits or burdens. J. Elster, *Solomonic Judgements: Studies in the Limitations of Rationality* (Cambridge 1989), 116–17.

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of breaking the symmetry of the parties to a generic triangle dispute.[95] The problem here is not that arriving at a more just outcome requires a more costly decision process. If a fairer outcome can be reached, then incurring additional decision costs may be justified. It is instead that it is difficult to conceive of decision criteria that a court would find acceptable.

The essential difficulty is that triangle disputes raise questions of just distribution that fit awkwardly, if at all, into the familiar private law paradigm of corrective justice in which reasons for liability are correlatively structured.[96] One need not be a corrective justice evangelist to appreciate that its inherently bilateral structure spares courts from the embarrassment of deciding questions of liability by appeal to unipolar considerations. For instance, whilst a defendant's deep pockets might be a reason to subject her to a higher marginal tax rate,[97] its irrelevance to her bilateral relationship with the plaintiff means that it is an incoherent basis on which to make her liable to the plaintiff as a matter of corrective justice.[98] However, because the innocent parties to a triangle dispute cannot be considered as the "doer" and "sufferer" of the same wrong,[99] some non-correlatively structured basis for liability must be found. What might this be?

A utilitarian, for instance, might solve the problem by assigning liability in the way that minimises the net loss of social utility. If one accepts the law of diminishing marginal returns, a utilitarian decision rule could be to "allocate liability to the richer of the two parties".[100] Someone who sought to allocate liability on the ground of relative "need" may arrive at the same conclusion. Putting aside objections to the philosophical rigour of interpersonal comparisons of welfare[101] and the equivocal nature of "need",[102] the fatal objection to any such rule is that it would be far too controversial for a court to apply.[103]

[95] Not all such disputes are "generic", of course. For instance, the law does not regard the parties as equal where a buyer has left the vendor in possession of the goods or a document of title thereto. See Sale of Goods Act 1979, s. 24.

[96] E.J. Weinrib, *The Idea of Private Law*, revised ed. (Oxford 2012), 120–22; E.J. Weinrib, *Corrective Justice* (Oxford 2012), 10.

[97] A controversial topic on which no view is taken here. Compare e.g. W.J. Blum and H. Kalven Jr, "The Uneasy Case for Progressive Taxation" (1952) 19 The University of Chicago Law Review 417, with L. Murphy and T. Nagel, *The Myth of Ownership* (New York 2002), ch. 6.

[98] Weinrib, *Idea of Private Law*, 35.

[99] For the same observation, see A. Nair and I. Samet, "What Can 'Equity's Darling' Tell Us about Equity?" in D. Klimchuk, I. Samet and H.E. Smith (eds.), *Philosophical Foundations of the Law of Equity* (Oxford 2020), 264, 268.

[100] On which see T. Nagel, *Equality and Partiality* (New York 1981), 61.

[101] See famously L. Robbins, "Interpersonal Comparisons of Utility: A Comment" (1938) 48 The Economic Journal 635.

[102] E.g. "need" might dictate distribution, not to the poorest, but to those who would benefit most. See Elster, *Solomonic Judgements*, 74.

[103] As several scholars have argued, judges never justify their decisions by reference to "comprehensive theories" of the right and the good, be that utilitarianism, Kantianism or anything else. See C.R. Sunstein, "Incompletely Theorized Agreements" (1995) 108 H.LR. 1733, 1735–36. For a recent discussion of the same idea, see S.A. Smith, "Intermediate and Comprehensive Justifications for Rules" in S. Degeling, M. Crawford and N. Tiverios (eds.), *Justifying Private Rights* (Oxford 2020), 63, 70.

The criterion of "desert" fares little better. Unlike need, desert is generally conceived of as an entitlement justified by something that one has done or achieved.[104] The winner of the 100-metre sprint "deserves" her gold medal because she crossed the finish line first. Whilst desert works well in some applications,[105] it is difficult to conceive of what a party might relevantly have done to warrant favourable treatment in a triangle dispute. Whilst we might say that the party who took reasonable precautions is *deserving* of preferential treatment, this is simply to clothe the least-cost-avoider principle in the language of non-consequentialist morality.[106]

D. The "Calabresian" Turn

Does the foregoing discussion lead inexorably to the conclusion that the law should resolve triangle disputes by some version of a coin flip? The answer is "no". Whilst the virtues of a coin flip are not to be underestimated, a better way of breaking the symmetry between the innocent parties is to allocate liability on the grounds of relative cost.

Unlike flipping a coin or any other arbitrary "picking" rule, a decision rule that turns on relative cost pursues a socially worthwhile end, viz. efficiency, and does so without committing any obvious moral *faux pas*.[107] Indeed, as noted above, it is entirely possible that considerations of efficiency and desert will pull in the same direction.[108] In any case, the modest claim being advanced here is not that efficiency is the premier value.[109] It is instead that, where questions of just distribution are too difficult or controversial for a court to decide, it is desirable, *ceteris paribus*, to employ rules that minimise the cost of the dispute.

If the foregoing is true, how should disputes between innocent promisees and promisors be resolved? In light of Mautner's suggestion that triangle disputes should be viewed as examples of the accidents that form the core of tort law,[110] their efficient resolution is best achieved by following

104 J. Feinberg, *Doing & Deserving* (Princeton 1970), 48.

105 Perhaps the most famous example is Locke's labour-desert theory or property. See J. Locke, *Two Treatises of Government and A Letter Concerning Toleration* (first published 1689, Ian Shapiro (ed.), New Haven 2003), [27].

106 For essentially this point, see H. Demsetz, "When Does the Rule of Liability Matter?" (1972) 13 J.L.S. 13, 28.

107 For an argument that wealth-maximisation is an inherently desirable goal, see R.A. Posner, "Utilitarianism, Economics and Legal Theory" (1979) 8 J.L.S. 103. Posner is particularly concerned to establish the superiority of wealth maximation, as measured in dollars, over the utilitarian concern for utility maximisation. See especially at 120–23.

108 Mautner, for instance, has argued that the cheapest cost-avoider can also be regarded, in moral terms, as the more blameworthy party. Mautner, "Eternal Triangles", 128.

109 The literature on this point is enormous and cannot be discussed here. Seminal contributions include R. Dworkin, "Is Wealth a Value?" (1980) 9 J.L.S. 191, D.B. Johnson, "Wealth *Is* Value" (1986) 15 J.L.S. 263 and those contained in *Symposium on Efficiency as a Legal Concern* (1980) 8 Hofstra Law Review 485, *et seq*.

110 Mautner, "Eternal Triangles", 102.

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Calabresi's rule that liability should be allocated so as to "reduce the sum of the costs of accidents and the costs of avoiding accidents".[111]

Because the Calabresian framework is based on a global assessment of cost, it nominally requires two enquiries.[112] *Ex ante*, the law should minimise the cost of prophylaxis by identifying the party who can avoid the accident at least cost. *Ex post*, after attempts at prevention have failed, the imperative is to minimise the net sunk cost of the accident.[113] This second imperative may favour imposing the loss on the party who, though she may not have "caused" the accident in the conventional sense, is the superior loss spreader or has the deepest pockets.[114]

That cost is a defensible basis on which to discriminate between the parties to a triangle dispute does not mean that it is perfect. Calabresi's solution not only requires the legal architect to answer difficult empirical questions about least cost-avoiders and best loss-spreaders, it also requires her to solve a complex optimisation problem where the party who is best able to spread the costs of an accident is not also the least cost-avoider.[115] In these cases, it must be decided whether the benefits of loss distribution following an accident justify increasing the costs of avoiding accidents in the first place.

IV. Implementing Efficiency: Less Property, More Contract

If a rogue dupes a promisor into rendering performance to someone other than the promisee, and the law determines that the promisor's performance constitutes an effective discharge of the duty he owed the promisee, then one might say that the third party has converted the promisees's right to performance. This invocation of property is, however, purely conclusory. By contrast, Calabresi's framework, though imperfect, has the virtue of providing the law with a principled basis for resolving questions of liability. How, then, should the law apply it? The key to answering this question lies in the privity between the parties to contractual triangle disputes.

[111] G. Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* (New Haven 1970), 26. For Calabresi, efficiency tied with "justice" as one of the two principal goals of accident law: at 24. Discussion of Calabresi's justice goal is beyond the scope of this article.

[112] In fact, Calabresi's scheme involves three subgoals. In addition to minimising the costs of accidents and the costs of preventing them, the third relevant goal is minimising the cost of administering the system. In Calabresi's terms, these are the primary, secondary and tertiary subgoals of accident law. Ibid., at 28–29. See also Mautner, "Eternal Triangles", 102. Discussion of the "tertiary" subgoal is not necessary given the thesis of this article.

[113] Mautner, "Eternal Triangles", 101–02.

[114] This is not only because assigning liability on this basis minimises economic dislocation by dispersing the costs of accidents. It is also because, due to the diminishing marginal utility of money, spreading the loss or imposing it upon the wealthier of the two parties minimises the loss of total utility caused by an accident. See Calabresi, *Costs of Accidents*, 39–41; G. Calabresi, "Some Thoughts on Risk Distribution and the Law of Torts" (1960) 70 Y.L.J. 499, 517–19.

[115] Calabresi, *Costs of Accidents*, 29.

A. The Significance of Privity

Mautner describes the paradigmatic triangle dispute as one in which, "parties *not in contractual privity themselves* assert simultaneous claims of rights over the same asset whose concurrent discharge is legally impossible".[116] A crucial point, and one that is completely overlooked in the "contract as property" literature, is that triangle disputes involving contractual rights diverge from the paradigm case of the good-faith purchaser of stolen goods because, unlike an owner and purchaser, promisors and promisees are not strangers.

In principle, then, the law can implement the Calabresian solution by doing nothing. This is because, as the "strong version" of Coase's theorem tells us,[117] in a world of full information and costless bargaining, the parties will reach the efficient outcome themselves. Returning to the example of bank money, imagine that it costs a customer £10 to avoid losses caused by the misuse of a lost bankcard, but that it costs the bank £20 to avoid the same loss. If, under the default rule, the bank were liable for these losses, then it would be willing to pay, and the customer willing to accept, some amount between £10.01 and £19.99 to transfer liability to the customer. If the roles were reversed and the customer were liable, the outcome would be the same because the bank would demand £20.01 for the reversal of the default rule, and no rational customer would pay a bank £20.01 to assume liability for a risk that, to her, costs £10 to avoid.

Whilst, *ex post*, each party will disclaim liability for all losses, *ex ante*, rational parties will agree to an efficient contract.[118] Any arbitrary allocation of initial entitlements will do because, as the example above demonstrates, any misallocation will be corrected by transactions between the affected parties.[119]

B. Are Contracts Efficient?

The Coasean thought experiment demonstrates why the solution to acts of third-party interference with contractual rights is not to treat contractual rights as property, but to create the conditions that allow the contracting parties to draft more complete contracts. The obvious question is: do parties create tolerably efficient contracts in the real world? There are good reasons to believe that they do. Once again, bank money provides an illuminating example.

[116] Mautner, "Eternal Triangles", 95, emphasis added.

[117] R.H. Coase, "The Problem of Social Cost" (1960) 3 J.L.E. 1, 9–10.

[118] I. Ayers and R. Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989) 130 Y.L.J. 130, fn. 18.

[119] See also Calabresi, *Costs of Accidents*, 135; G. Calabresi and A.D. Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85 H.L.R. 1089, 1118. Although Coase never used the language of "least" or "cheapest cost-avoider", as the example above demonstrates, this person will always bear liability in the Coasean universe of zero information and transaction costs.

When a third party induces a bank to process an unauthorised transaction on the customer's account, the jural question is whether the bank's actions constitute a good discharge of the debt that it owes its customer. As should be obvious from the foregoing discussion, the general answer to this question is "no".[120] As is true of other contractual relationships, that between a bank and its customer follows the Basic Rule, according to which a promisee's rights can only be discharged by performance rendered to the promisee herself. This is demonstrated by *Rogers v Kelly*,[121] in which money deposited by the plaintiff was mistakenly paid by his bankers to the defendant. The plaintiff's claim in money had and received failed because, in restitutionary terms, the defendant was not enriched at his expense. The enrichment was instead at the expense of the bank, which paid the defendant with its own money and, in the absence of authorisation, had no right to debit the plaintiff's account. Although a transfer of value occurred, the plaintiff's "bank money" remained intact. As Lord Ellenborough explained: "The plaintiff's claim is on the bankers, and they [the bankers] must seek their remedy against the defendant the best way they can. The plaintiff's money must still be considered as in the hands of the bankers. *His account with them is the same as if this mistake had not been committed*."[122]

In these circumstances, a customer is entitled to have his account re-credited, and the bank must attempt to recover its losses from the mistaken payee.[123] Whilst this outcome will certainly be welcomed by the customer, the relevant question is: is it efficient?

Any assessment of the efficiency of contracts between banks and their customers should commence by noting that, whatever default rule is applied, the bank is unlikely to bear the cost of financial fraud in the long term. Whilst the Basic Rule initially places liability on the bank, this arrangement simply transforms the costs of fraud into another operational expense which, in a (reasonably) competitive market,[124] banks will pass on to their customers.[125] In functional terms, the Basic Rule

[120] For an excellent summary of the general position and its exceptions see Goymour and Watterson, "Testing the Boundaries", 207–12. Other regulatory exceptions are discussed below.

[121] *Rogers v Kelly* (1809) 170 E.R. 1102.

[122] Ibid., at 1102, emphasis added.

[123] This also applies when the bank makes a transfer at the instigation of a rogue, such as a forger of cheques. See the comments of Lord Scarman in *Tai Hing Ltd. v Lieu Chong Hing Bank* [1986] 1 A.C. 80, 106 (P.C.).

[124] This is because, in a perfectly competitive market, price will equal cost. Consequently, higher costs of production must be passed on to consumers, leading to lower production at higher prices. In monopolistic and oligopolistic markets, price does not equal cost. Monopolists and oligopolists can thus absorb the increased costs without the need to raise prices which, assuming that demand is reasonably elastic, would reduce demand for their goods or services. For discussion of this point see Calabresi, "Risk Distribution", 511–12.

[125] This is a manifestation of the general rule that changes in liability seldom redistribute income where the affected parties are in an actual or potential contractual relationship. See A.M. Polinsky, *An Introduction to Law and Economics* (New York 2011), 156–57. Changes in legal liability may, however, price some products, and thus some consumers, out of the market. See J.M. Buchanan, "In Defense of Caveat Emptor" (1970) 38 University of Chicago Law Review 64, 67–68.

makes banks insurers for their customers who pay what are effectively premiums in the form of slightly higher fees. That the choice of liability will not alter the distribution of income does not, however, mean that there are no benefits, assessed in terms of minimising the *ex post* costs of financial fraud, of imposing the loss on the bank in the first instance. In particular, there are two benefits of a default rule that makes a bank the de facto compulsory insurer of its customers.

First, as is true of an insurance company, a bank is an effective loss spreader and, *ceteris paribus*, it is better to distribute the inevitable cost of fraud amongst a bank's many customers than it is to concentrate it on a single, unfortunate victim.[126] Secondly, whilst the amount that the average customer will pay in higher bank fees will equal her expected losses from financial fraud in the long term,[127] most bank customers are likely to be risk averse and thus would prefer to make many small payments to the bank in the form of higher fees than to suffer one very large loss should they fall victim to fraud.[128] Whilst, under a regime of self-insurance, customers could theoretically purchase insurance against financial fraud, the Basic Rule obviates the need for them to do so. If the law wishes to avoid these costs, it is better to have a few large financial institutions bear the initial loss than to have millions of individual customers organise their own insurance.

C. Solving Moral Hazard with Contracts

So far as *ex post* efficiency is concerned, the Basic Rule appears desirable. However, a global assessment of cost requires one to minimise the sum of the costs of accidents *and* of avoiding them. This imperative is simple to satisfy either where there is no obvious least cost-avoider, or where the least cost-avoider is also the best loss spreader. However, if the former is not also the latter, a problem arises because parties' knowledge of *ex post* liability will alter their *ex ante* behaviour. As a system of de facto insurance, the Basic Rule suffers from a problem that plagues all arrangements in which one party undertakes to indemnify the other: the inefficient behavioural changes that economists refer to as "moral hazard".[129]

In the absence of insurance, a rational maximiser subject to a particular risk would invest in precautions up to the point at which the cost of risk-elimination equalled the expected cost of the risk. So, for instance,

[126] This is sometimes referred to as "enterprise liability", the virtue of which is the broad loss distribution made possible by passing on losses to an enterprise's customers and/or factors of production. See Calabresi, *Costs of Accidents*, 53.

[127] Assuming that the bank has sufficient customers to enable the law of large numbers to transform uncertainty into risk.

[128] Someone is "risk averse" if, when faced with a choice between the certainty of a £50 loss or the 50 per cent chance of £100 loss, she chooses the former, even though the expected value of each choice is identical. See S. Shavell, *Foundations of Economic Analysis of Law* (Cambridge, MA 2004), 258.

[129] See generally S. Shavell, *Economic Analysis of Accident Law* (Cambridge, MA 2009), 194–96.

he would spend £4.99, but not £5.01, to eliminate a risk with an expected value of £5.00. However, this calculation ceases to hold when insurance is introduced. Because an insured party will bear none of the loss should the risk materialise, he has no incentive to invest so much as a penny to prevent it. Insurance thus deters the taking of cost-justified precautions and encourages inefficient risk-taking behaviour because the insured party captures all the benefits of the risky behaviour but bears none of its costs, which are imposed on other policy holders.

One might think that because banks will pass on higher *ex ante* costs to their customers, the moral hazard would be solved by the threat of increased bank fees. Unfortunately, as with insurance more generally, an externality problem remains because of the necessity of pooling people with disparate risk profiles. A risk-prone member of an insurance pool internalises all the benefit of his risky behaviour. However, because his premium is calculated on the average level of risk in his pool, he pays only a fraction of its cost, the balance being borne by the more prudent members. Consequently, although risky behaviour raises premiums for everyone, including the member in question, it is still rewarded.[130] If it were possible to categorise each member of an insurance pool according to his appetite for risk and charge premiums accordingly, there would be no externality problem. However, just as no insurance company can individuate every policy holder based on his appetite for risk, no bank can tailor its fees according to the carelessness of individual customers.

The problem of moral hazard is not confined to attempts to optimise *ex ante* and *ex post* costs when those goals are in tension. It also afflicts attempts to minimise *ex ante* costs where the efficient solution to accident prevention is for both parties to take precautions.[131] Take the following example. Imagine that it costs a bank £110 per annum, per customer to prevent sophisticated cyberattacks on its online banking facilities. Imagine also that it would cost an individual customer £200 to avoid the same loss. Because the bank is the least cost-avoider, a contract between a bank and its customer that allocated liability for such losses to the bank is prima facie efficient. However, imagine further that, if customers spent £10 per annum on purchasing updates to their antivirus software, the bank's cost of precautions could be reduced to £90. This is a more efficient solution because the total costs of precautions required to eliminate the risk would be £100, not £110. Unfortunately, as we know from the foregoing discussion, the efficient joint-care solution will not occur because, where the customer is indemnified against losses caused by cyberattack by the

[130] M.V. Pauly, "The Economics of Moral Hazard" (1968) 58 The American Economic Review 531, 534.

[131] On "joint-care" cases see Shavell, *Economic Analysis of Accident Law*, 9–12, 17–18; S.G. Gilles, "Negligence, Strict Liability, and the Cheapest Cost-avoider" (1992) 78 Virginia Law Review 1291, 1308–09.

terms of her contract with the bank, she has no incentive to take any precautions at all.

Precisely this problem afflicts disputes between owners and good-faith purchasers of stolen goods. The efficient prevention of the dispute requires both the owner to make some efforts to safeguard his property and the purchaser to make some effort to assess the quality of her vendor's title. Because the parties are strangers and cannot bargain prior to the dispute, the law relies on the categorical title rules of property law that favour either the owner or the purchaser.[132] The problem with these all-or-nothing rules is that they cannot simultaneously incentivise each party to invest optimally in precautions.[133] If the owner invariably succeeds, he will fail to take efficient precautions against theft. If the purchaser invariably succeeds, she will not invest optimally in investigating her vendor's title. Whilst a requirement of good faith on the part of the purchaser may ameliorate the problem, there is no reason to believe that the good-faith standard is also the optimal standard. This is why recent economic analyses of the good-faith purchaser problem have advocated replacing the all-or-nothing title rules of property law with a negligence standard.[134]

When the parties are in a contractual privity, these problems of moral hazard can be largely overcome, and without resorting to the law of negligence. In the example given above, that the bank was both the best loss spreader and the least cost-avoider made it the obvious candidate for liability. Nevertheless, a moral hazard remained because fixing the bank with liability destroyed the incentives required to sustain the more efficient joint-care model, under which precautions taken by both contractual parties reduced the net cost of avoidance by £10 per annum. Crucially, a sufficiently detailed contract would eliminate this stubborn moral hazard. This is because the bank's promise to bear the costs of a cyberattack would be made conditional on the customer updating her antivirus software, employing and safeguarding a sufficiently robust online banking password, and so on. Conditional terms such as these allow the parties to minimise the net costs of precaution, and without sacrificing loss spreading and other *ex post* goals.

Whilst a complete contract, enforceable at zero cost, would eliminate all moral hazard, a frictionless world is not required for parties to substantially

132 A third option is to sell the asset and divide the proceeds of sale between the owner and purchaser. With the apparent exception of Mongolian tribal law, no legal system employs the Solomonic solution. See S. Levmore, "Variety and Uniformity in the Treatment of the Good Faith Purchaser" (1987) 16 J.L.S 43, 62–65.

133 Hence why this problem is said to give rise to a "double moral hazard". See A. Schwartz and R.E. Scott, "Rethinking the Laws of Good Faith Purchase" (2011) 111 Columbia Law Review 1332, 1347.

134 See ibid., at 1339–40; Y.-C. Chang, "247 Jurisdictions in the World Get the Good-faith Purchase Problem Wrong: A New Economic Framework" (NYU Law & Economics Research Paper Series Working Paper No, 19-25), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208458 (accessed 26 October 2022).

ameliorate the problem. Insurance companies, for instance, routinely employ simple contractual mechanisms to prevent the most egregious acts of carelessness on the part of the insured.[135] The most straightforward is the requirement that an insured pay an excess or "deductible" when making a claim, the effect which is to make the insured responsible for some part of the total loss. Likewise, the common strategy of insuring an asset for some fraction of its total value, known as "coinsurance", ameliorates moral hazard by incentivising the insured to take those precautions whose cost is less than the expected value of the damage to the uninsured portion of the asset. Insurance companies also offer inducements to encourage efficient *ex ante* conduct. For instance, many insurance companies will offer reduced premiums on home and contents policies to those who install security devices in their homes, and on health and life insurance policies to those who do not smoke or drink to excess. If the reduction in the premium exceeds the cost of the precaution, such terms are advantageous to both the insured, who will enjoy a reduced premium, and to the lower-risk members of his insurance pool who, as explained above, would otherwise subsidise his risky behaviour.[136] Whilst such contractual measures do not make the bargain optimally efficient, they do much to correct the misaligned incentives that arise when one party undertakes to indemnify another.

That we are doomed to inhabit a world of "second best" is only an objection to the strong version of the Coase theorem, according to which the law is *indifferent* to the content of default rules because the parties can always bargain around them. It is not an objection to the main thesis of this article, which is that the problem of third-party interference with contractual rights raises a problem of loss allocation that is best solved by improving the contract between the affected parties. If the parties suffer from insurmountable information or transaction costs, it is for the law to assist them by creating efficient default rules where they are either known or can be reasonably guessed at.[137]

Some might regard the possibility of the state supplying efficient terms as hardly less fantastical than the avowedly hypothetical conditions of the Coase theorem. Yet the reality is that the law has already gone some way to creating default contractual terms that approximate the efficient solution to the problem of financial fraud. Take, for instance, the Payment Services Regulations 2017 (UK) ("*PSR*"). In conformity with the Basic Rule, the *PSR* obliges a bank[138] to re-credit its customer's[139] account if the bank

[135] See generally R.B. Cooter Jr and T. Ulen, *Law and Economics*, international ed., 6th ed. (Harlow 2014), 48.
[136] See Shavell, *Economic Analysis of Accident Law*, 195.
[137] This was Coase's central, but much misunderstood, message. Coase, "Problem of Social Cost", 15–16, 19.
[138] Described as a "payment service provider".
[139] Described as the "payer".

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processes a "payment transaction" that is not authorised by the customer.[140] By imposing liability on the bank, this baseline rule secures the *ex post* benefits of loss spreading by dividing the loss amongst the bank's many customers. Significantly, the *PSR* also creates a series of exceptions that shift liability for certain losses from the bank to the customer. For instance, the customer will be liable for a maximum of £35 if the unauthorised transaction arose from the use of a lost or stolen "payment instrument".[141] The customer will be liable for *all* losses if she has acted fraudulently or has, "with intent or gross negligence", failed to use the payment instrument in accordance with its terms and conditions, to notify its issuer without "undue delay" if it has been lost or stolen, or to take all reasonable steps to safeguard her personalised security credentials.[142] By transferring liability for these losses to customers, these provisions incentivise customers to exercise basic prudence and thus mitigate the worst of the moral hazard created by the application of the Basic Rule, or some version of it.

In Australia, similar efficiency-promoting provisions can be found in the "*ePayments code*" ("*Code*"),[143] a voluntary code of conduct covering electronic payments that is administered by the Australian Securities and Investments Commission, and to which most major banks and financial institutions subscribe.[144] As with the *PSR*, the *Code* preserves a version of the Basic Rule by providing that a customer "is not liable for loss arising from an unauthorised transaction where it is clear that [the customer] has not contributed to the loss",[145] and specifies when she will be taken to have so contributed.[146] The *Code* also lists other circumstances in which the customer will be liable for unauthorised transactions on her account. Significantly, and consistently with the *PSR*, those circumstances include, inter alia, customer fraud and the failure to satisfy "pass code security requirements,"[147] leaving a card in an Automatic Teller Machine,[148] or unreasonably delaying reporting the misuse, loss or theft of a "device" to its issuer.[149]

140 *PSR*, s. 76(1)(b)
141 Ibid., s. 77(1). Section 2 defines a "payment instrument" as any "personalised device" or "personalised set of procedures" used to initiate a payment order.
142 Ibid., s. 77(3).
143 Australian Securities and Investment Commission, *ePayments Code*, available at https://asic.gov.au/regulatory-resources/financial-services/epayments-code/ (last accessed 28 October 2022).
144 For a list of current subscribers see https://asic.gov.au/for-consumers/banking/epayments-code-subscribers/ (last accessed October 2022). The *Code* takes effect as a term of the standard from contract between the bank, or other financial institution, and its customer.
145 *Code*, cl. 10.3.
146 Ibid., cl. 11.8
147 Ibid., cl. 11.2(a). This includes, inter alia, disclosing "pass codes" to family and friends. See cl. 12.2(a). "Pass codes" include internet banking passwords, personal identification numbers (PINs) and one-time codes generated by tokens.
148 Ibid., cl. 11.4.
149 Ibid., cl. 11.5. A "device" includes anything from an ATM card to a "contactless device", such as a mobile telephone.

As is true of the insurance contracts discussed above, the liability-shifting provisions in these regulatory codes allow for the creation of a contract between a bank and its customer that preserves the loss-spreading benefits of the Basic Rule whilst avoiding the worst of the moral hazard created by it. This is not to say that they perfectly replicate the frictionless universe, or even that this is their primary objective. Like every legislative or regulatory instrument, the *PSR* and the *Code* are the product of lobby-group pressure and political expediency.[150] The important point is that they demonstrate that, even in our non-Coasean world of expensive information and costly bargains, the solution to the problem caused by acts of third-party interference with contractual rights is not more property rights, but better contracts.

V. Conclusion

Proponents of the Inadequacy Thesis are correct to point out that, like chattels, contractual rights can be vulnerable to the depredations of third parties. Whilst the ability of third parties to damage the interests of promisees is not doubted, to search for a solution in personal property law is to pursue a conceptual dead end. Acts of third-party interference with contracts are not analogous to simple cases of conversion, but to more complex triangle disputes. The problem at the heart of all triangle disputes is not a gap in the law, but how to allocate loss between two prima facie innocent parties, neither of whom can recover from the true wrongdoer. When applied to the resolution of triangle disputes, the term "property" simply becomes, as Cohen famously observed, one of the "magic 'solving words' of traditional jurisprudence" which "add[s] precisely as much to our knowledge as Moliere's physician's discovery that opium puts men to sleep because it contains a dormitive principle".[151]

Putting aside the Realists' extreme scepticism of legal concepts,[152] Cohen's observation captures the flaw at the heart of the Inadequacy Thesis. To say, for instance, that a rogue "stole" or "converted" a customer's contractual rights against the bank is simply to state the conclusion that the loss allocation exercise between the bank and its customer has been resolved in favour of the former. What it cannot explain is why the customer drew the short straw. If the law is to at least approximate the efficient resolution of such disputes, it needs better contracts, not more property.

[150] For customer-sided criticisms, see A.L. Tyree, *Banking Law in Australia*, 9th ed. (Chatswood 2017), 379–80. On the other hand, one wonders why £35 was selected as the cap for customer liability under *PSR*, s. 77(1), particularly when the predecessor regulations imposed a maximum liability of £50. See Payment Services Regulations 2009, s. 62(1).

[151] F.S. Cohen, "Transcendental Nonsense and the Functional Approach" (1935) 35 Columbia Law Review 809, 820.

[152] Ibid., at 821.

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