

Article

Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract

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Disgorgement Principle

INTRODUCTION

It is a principle of the law of restitution that one should not gain by one's own wrong;¹ it is a principle of the law of contracts that damages for breach should be based on the injured party's lost expectation.² In many cases, the principles are mutually consistent. If, on breach, the injured party's lost expectation equals or exceeds the gain by the party in breach, then damages based on expectation strip the party in breach of all gain, and make the injured party whole. But if the injured party's lost expectation is less than the gain realized by the party in breach, then damages based on expectation do not strip the party in breach of all gain. This situation brings the two principles into conflict. When faced with this dilemma, courts have declined to apply the principle of restitution, holding in effect that a "mere" breach of contract is not a "wrong," and allowing the party in breach to keep part of the gain.³

Commentators who consider a breach to be a "wrong," however, have argued that even if the gain realized by the party in breach exceeds the injured party's loss, the measure of damages should strip the party in breach of all gain.⁴ This Article examines this "disgorgement principle" and concludes, first, that it is not sound as a general proposition and, second, that there is nonetheless a case for its limited application.

Suppose that you and I have made a contract under which I am to sell you a widget for \$100, cash on delivery. At the time we made the contract, I valued the widget at \$90 and you valued it at \$110, so the contract seemed advantageous to both of us. But instead of delivering the widget to you, I found another buyer willing to pay \$125 and sold it to that buyer, realizing \$25 over our contract price. Since you still valued the widget at \$110, I offered you \$10 out of that \$25. Can you recover \$25 from me?⁵

Since, according to conventional wisdom, my "mere" breach of contract is not a "wrong," you can recover only \$10 and not \$25. The \$10 that I offered you would put you in as good a position as you would have been

1. RESTATEMENT OF RESTITUTION § 3 (1937) ("A person is not permitted to profit by his own wrong at the expense of another.").

2. See, e.g., U.C.C. § 1-106(1) (1978) (remedies "shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . .").

3. "The question is not one of making the defendant disgorge what he has saved by committing the wrong, but one of compensating the plaintiff." *Tito v. Waddell* (No. 2), [1977] 1 Ch. 106, 332. (Sir Robert Megarry, V.C.) Cases in which an injured party has sought disgorgement in preference to expectation are, however, rare.

4. See *infra* note 46.

5. We shall defer consideration of possible reasons why the other buyer valued the widget more highly than you did.

in had the contract been performed, since that amount, plus the \$100 you have not paid me, equals the value of the widget to you.⁶

Those who view my breach as a "wrong," however, would require me to disgorge all of the \$25, because it is the sum that I gained by my wrong. Although the disgorgement principle is based on avoiding unjust enrichment of the party in breach, the word "disgorgement" is preferable to "restitution" for two reasons. First, it may avoid confusion between the asserted right to recover under this controversial principle and well-established rights to restitution. For example, it distinguishes between your asserted right to my full \$25 gain under the disgorgement principle and your well-established right to restitution of the \$100 price if you had paid in advance.⁷ Second, it helps to make clear that the principle applies without regard to whether the injured party can be said to have "lost" something that the party in breach is being asked to "restore."⁸ For example, it makes it easier to see that under the disgorgement principle your asserted right to \$25 does not depend on the widget I sold having become "your" widget so that there was a loss on your part as well as a gain on mine.

Part I of this Article describes the causation problems associated with the disgorgement principle and argues that courts should limit recovery under the disgorgement principle by imposing a strict requirement of cause in fact. Part II discusses the past history and present recognition of the disgorgement principle and concludes that, while the principle is rec-

6. Your expectation damages do not take account of the possibility that you could have sold the widget to the second buyer for \$125. If they did, your expectation damages would be \$25 and would result in disgorgement.

7. You would probably not want to assert a restitutionary claim for only \$100 if you had a claim for \$110 based on the expectation principle. But if, for example, it turned out that you had misinterpreted our agreement and I was under no duty to deliver the widget to you, you would be glad to have a restitutionary claim for \$100.

8. In the typical case of restitution where a contract is involved, the plaintiff has "lost" something (e.g., performance or preparation for performance) and the defendant has benefited from that loss. *See* RESTATEMENT OF RESTITUTION § 128 comment f, at 531 (1937) ("an action not based upon loss is not restitutionary"). Even John Dawson, an advocate of the disgorgement principle, thought that the kind of recovery that is the subject of this Article "could not be explained as restitution under present-day tests; there would be a fatal break in the chain of causation, for the asset or conduct that was merely promised would not have come from the promisee." Dawson, *Restitution or Damages?*, 20 OHIO ST. L.J. 175, 187 (1959).

It is not, however, essential to a restitutionary claim that the plaintiff have suffered a loss. *See* RESTATEMENT (SECOND) OF RESTITUTION § 1 & comment g, at 16 (Tent. Draft No. 1, 1983) ("a loss suffered by the claimant and the infringement of an interest of his . . . [are] alternative constituents of a right to restitution"). Thus a principal is entitled to a bribe received by an agent even though it occasioned no loss to the principal. *See* RESTATEMENT OF RESTITUTION, § 128 comment f (1937); *see also* Federal Sugar Ref. Co. v. United States Sugar Equalization Bd., 268 F. 575, 582 (S.D.N.Y. 1920) ("The point is not whether a definite something was taken away from plaintiff and added to the treasury of defendant. The point is whether defendant unjustly enriched itself by doing a wrong to plaintiff in such manner and in such circumstances that in equity and good conscience defendant should not be permitted to retain that by which it has been enriched.").

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ognized in a few categories of contract disputes, it is undesirable to extend those categories. Part III analyzes one significant field of application—nonperformance of contracts for goods or services available on a market—and demonstrates that the disgorgement principle is not suitable as a general basis for recovery. Part IV considers the case for a limited extension of the disgorgement principle and suggests that courts apply the principle to situations involving what is termed “abuse of contract,” on the ground that the breach has subjected the injured party to a significant risk of undercompensation if recovery is limited to expectation.

I. A CASE FOR A STRICT REQUIREMENT OF CAUSE

When one speaks of “gain” in the context of the disgorgement principle, one means gain that is in some sense *caused by* the breach of contract. Thus if, in the case of the widget resold, I had two widgets and sold both of them to the other buyer for \$125 each, even the disgorgement principle would not give you a claim to more than \$25. Your claim to anything more than that would fail on the ground that my breach was not the cause of the additional gain.

Advocates of the disgorgement principle, however, treat questions of cause briefly if at all.⁹ Indeed, they often phrase the disgorgement principle in a way that obscures questions of cause. So, in the assertion “one should not gain *by* one’s own wrong,” the single word “by” must carry the burden of articulating that the gains referred to are gains that are caused by the wrong. Because it is not common to view the disgorgement principle through the optic of causation, this Article will consider three questions and one practical problem relating to cause that will arise in the later discussion.

A. *Question of Cause in Fact*

In discussions of disgorgement, the words “gain” and “profit” are sometimes used interchangeably. But if a strict test of cause in fact (“but-for” cause) is applied, and one asks to what extent the profit could have resulted had there been no breach of contract, it becomes evident that not all profit is gain.

Suppose that I had two identical widgets, either of which I could have delivered under our contract, and that I sold both to other buyers, one for \$125 and one for \$110. Even without a breach of our contract, I could have sold one of the widgets for \$125. I would therefore contend that my

9. The most extensive discussion of cause, including references to briefer treatments, fills only about a page near the end of Jones, *The Recovery of Benefits Gained from a Breach of Contract*, 99 LAW Q. REV. 443, 457-58 (1983).

breach of contract was not a cause in fact of my \$25 profit, since even without a breach I could still have sold one widget for \$125.

Now suppose that I did not have a second widget, but could have bought one on the market for \$110. I would still contend that even without a breach of our contract I could have sold one widget for \$125, by buying it on the market for \$110, so that my breach of contract was not a cause in fact of my \$25 profit. I would have to admit that my breach was the cause in fact of a \$10 gain, since the breach enabled me to avoid going into the market at \$110, but \$10 is what I have offered you under the expectation principle. In effect, my argument is that what I have gained by my breach is not my net profit from resale but my savings by not arranging a substitute transaction that would have avoided breach.

It may at first seem strained to argue that my breach of contract was not the cause of my net profit on the ground that I could have realized that gain by some other means.¹⁰ Yet courts have accepted just such arguments in analogous situations.

In *Dunkley Co. v. Central California Canneries*,¹¹ for example, the holder of a combination patent on a peach-peeling machine sought to recover profits from an infringer. The court denied recovery, explaining that, since the patent was limited to the specific combination, the defendant could have achieved the same result using unpatented machinery. Therefore the profits recoverable should be only those that the infringer "derived from the use of the invention, as compared with other means then open to the public and adequate to enable him to obtain an equally beneficial result."¹² There was no proof that the wrongdoer made any greater profit by infringing the patent than could have been made without infringement.

This argument has also been accepted where a person tortiously deprives the owner of goods that are later returned to the owner. In an English case, *Strand Electric & Engineering Co. v. Brisford Entertain-*

10. This is a variant of a problem that Hart and Honoré discuss in the category of alternative causes—for example, "A wrongly puts B's goods where they are destroyed by fire but, had he not done so, another fire would have destroyed them." As they point out, "we may save the test by refining the description of the event" and asking whether the result would have happened in the particular way in which it did. H.L.A. HART & A. HONORÉ, CAUSATION IN THE LAW 118-19 (1959). Though they conclude that the "normally accepted view is that in all such circumstances defendant's wrongful act has caused the harm," *id.* at 226, they concede that the answer is less clear if the question is one of the amount of compensation, *id.* at 226-28.

Most questions of cause are posed in connection with loss, not gain, and people do not usually intend to inflict loss. In the case of the widget resold, I am intent on realizing gain for me, not loss for you. The breach is not the cause in fact of my gain. Even if there had been no breach, I would have realized the gain in another way.

11. 7 F.2d 972 (2d Cir. 1925); *see also* Black v. Thorne, 111 U.S. 122 (1884) (patent damages only nominal when other common methods would produce same result as patented method).

12. 7 F.2d at 975.

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ments,¹³ a prospective buyer of a theater took possession of the theater and used some portable switchboards that the theater owner had rented from a switchboard-rental company. The court held that the rental company was entitled “to a reasonable hire,” even though this exceeded the rental company’s actual loss. Lord Denning reasoned:

If the wrongdoer had asked the owner for permission to use the goods, the owner would be entitled to ask for a reasonable remuneration as the price of his permission. The wrongdoer 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.¹⁴

Thus damages were based on the prospective buyer’s gain in terms of its savings. Actual profit was irrelevant and there was no “need to evaluate the actual benefit which resulted to the defendants by having the plaintiffs’ equipment at their disposal.”¹⁵ The wrongdoer’s gain was the sum that it would have cost to realize the same profit without the tort—the sum that the wrongdoer saved by not obtaining a substitute on the market.

Adherence to a strict requirement of cause in fact in these cases yields a measure of gain not in terms of profit but in terms of what the wrongdoer saved by not arranging some other means of accomplishing the same end—a measure of gain in terms of *saving of the cost of other means*. If this approach is sound when the wrong is an infringement of a patent or a commission of a tort, it merits consideration when the wrong is a “mere” breach of contract.

If I could have obtained a substitute widget, the approach leads to a measure of gain in terms of *saving of the cost of substitution*. But suppose

13. [1952] 2 Q.B. 246 (action in detinue).

14. *Id.* at 254. As long ago as 1892, William Keener argued that the measure of recovery for use of land should be “such a sum as the jury would have been authorized to give, had there been a contract between the plaintiff and the defendant that the latter should pay the reasonable value of his user.” Keener, *Waiver of Tort*, 6 HARV. L. REV. 223, 226 (1892). Palmer criticizes Keener’s reasoning as encouraging “the belief . . . that profits are never recoverable in quasi contract.” 1 G. PALMER, THE LAW OF RESTITUTION § 2.12, at 158–59 (1978). But in this Article the question is whether, and to what extent, profits *should* be recoverable for breach of contract.

15. [1952] 2 Q.B. at 256 (Romer, L.J.). The court also held that the trial judge erred in limiting recovery to the plaintiffs’ lost rentals, which would have been less than the reasonable hire because, among other things, only about 75% of plaintiffs’ switchboards were rented out at any time. This aspect of *Strand* was followed by Lord Denning in *Penarth Dock Eng’g Co. v. Pounds*, [1963] 1 Lloyd’s List L.R. 359, 362, in holding that when a buyer of a dock broke its contract with sellers to remove a pontoon from its berth within a reasonable time, the measure of damages was “not what the [sellers] have lost, but what benefit the [buyer] obtained by having the use of the berth,” and this is what, if “he had moved it elsewhere, he would have had to pay . . .” See also RESTATEMENT (SECOND) OF RESTITUTION § 45 comment c, at 145–46 (Tent. Draft No. 2, 1984) (“[E]ven an innocent converter, chargeable with the use value of property . . . cannot reduce his liability by showing that the claimant would not have availed himself of that value.”).

that the widget is unique, so that no substitute is available. I could still argue that I could have arranged to realize the gain by some means that would have avoided the wrong; for example, when the second buyer appeared on the scene, I could have negotiated with you a release from my obligation to deliver the widget, so that I could have sold it to the other buyer for \$125 without a breach of our contract. The gain that was caused by my breach is the sum that I would have had to pay you for that release, if we had fairly negotiated on the assumption that my only alternative to performing was to reach agreement and not to breach.¹⁶ The suggested approach then leads to a measure of gain in terms of *saving of the cost of modification*.

The reader who finds this measure contrived should recall that it is analogous to one of the measures for patent infringement. Case law and subsequent statutes have held the infringer liable to pay, as a minimum, "a reasonable royalty."¹⁷ As the court explained in the leading case of *Egry Register Co. v. Standard Register Co.*:¹⁸

To adopt a reasonable royalty as the measure of damages is to adopt . . . the fiction that a license was to be granted at the time of beginning the infringement, and then to determine what the license price should have been

In fixing a reasonable royalty, the primary inquiry . . . is what the parties would have agreed upon, if both were reasonably trying to reach an agreement.¹⁹

16. Discussions do not always make clear, however, whether what is referred to is a gain to the party in breach or a loss to the injured party. If no transaction costs are involved in the supposed negotiations, the sum that I would have to pay could be regarded as your loss as well as my gain.

17. As for case law, see *Dowagiac Mfg. Co. v. Minnesota Moline Plow Co.*, 235 U.S. 641, 648 (1915) ("[I]t was permissible to show the value [of what was taken] by proving what would have been a reasonable royalty"). The statutory provision for a reasonable royalty dates from 1922 and is now found at 35 U.S.C. § 284 (1982) (requiring court to award damages "in no event less than a reasonable royalty for the use made of the invention by the infringer" and allowing the court to "receive expert testimony as an aid to the determination . . . of what royalty would be reasonable under the circumstances").

The rule for patents has been extended to allow a reasonable royalty for the wrongful appropriation of a trade secret. See *University Computing Co. v. Lykes-Youngstown Corp.*, 504 F.2d 518, 535-36 (5th Cir. 1974) (because defendants "failed in their marketing efforts, no actual profits exist," and since plaintiff retained use of secret and "there has been no effective disclosure of the secret through publication the total value of the secret to the plaintiff is an inappropriate measure") (footnote omitted); cf. *Structural Dynamics Research Corp. v. Engineering Mechanics Research Corp.*, 401 F. Supp. 1102 (E.D. Mich. 1975), discussed *infra* text accompanying note 118.

18. 23 F.2d 438 (6th Cir. 1928) (device was part of a larger product).

19. *Id.* at 443. This language has often been repeated. See, e.g., *Vitro Corp. of Am. v. Hall Chem. Co.*, 292 F.2d 678, 682-83 (6th Cir. 1961); see also *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1121 (S.D.N.Y. 1970) (referring to what "a willing licensor and a willing licensee would have agreed upon in a supposititious negotiation"), *modified*, 446 F.2d 295 (2d Cir.), *cert. denied*, 404 U.S. 870 (1971). In *United States Frumentum Co. v. Lauhoff*, 216 F. 610, 616 (6th Cir. 1914), the court analogized the reasonable royalty rule to the rule under which

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If the use of a measure of gain in terms of *saving of the cost of modification* can be defended in the case of an infringement of a patent, then it should not be ruled out in the case of a breach of contract.²⁰ In sum, there is support for a strict requirement of cause in fact, leading to a general measure of gain, not in terms of profits but in terms of *saving of the cost of other means*. This measure might either be in terms of *saving of the cost of substitution* or in terms of *saving of the cost of modification*. The measure has advantages in dealing with the two remaining questions of causation.

B. Question of Joint Cause

The next question is how to treat *joint cause*. Assume that the arguments just made are rejected, and my breach of contract is regarded as the cause in fact of all of my \$25 profit, so that profit and not savings is the measure of my gain. Suppose that it was through my skill and industry that I located the other buyer who was willing to pay \$125. My skill and industry are now, together with my breach, joint causes of my \$25 profit.²¹ Or suppose that instead of reselling the widget to another buyer, I kept it and used it in my factory in a manufacturing process, making a \$25 profit and offering you \$10 under the expectation principle. My skill and industry and my capital investment in my factory are now joint causes of my \$25 profit. How is a court to respond to my argument that even if you are entitled to recover some of my profit under the disgorgement principle, you are not entitled to all of it and some apportionment is required?²²

It is well settled that a patent or copyright infringer is entitled to an apportionment that recognizes the infringer's contribution to any profit. As Chief Justice Hughes explained in *Sheldon v. Metro-Goldwyn Pic-*

persons "familiar with real estate estimate and testify to the real value or fair value of land which is without market value."

The reasonable royalty rule can be justified on the ground of loss to the patentee as well as on the ground, suggested here, of gain to the infringer. See *infra* text accompanying note 20. In *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 505 (1964), four members of the Supreme Court declared that the "reasonable royalty" provision in the patent statute would apply if the "amount constitutes 'damages' for the infringement," since the provision for recovery of profit had been deleted from the statute. However, in *Marvel Specialty Co. v. Bell Hosiery Mills*, 386 F.2d 287 (4th Cir. 1967), the court held that *Aro* did not prevent the patentee from recovering damages based on gross rather than net rentals, a conclusion that suggests gain in terms of savings.

20. There is, to be sure, the difference that in the patent infringement case what the infringer would have agreed to may be suggested by the cost of other available alternatives.

21. If I had paid a broker to use skill and industry to find the other buyer, the broker's fee would be subtracted in calculating my profit.

22. Your recovery of your loss under the expectation principle would, after all, be diminished to the extent that you contributed to that loss by failing to mitigate it. Why, then, should your recovery of my gain under the disgorgement principle not be diminished to the extent that I contributed to it?

tures Corp.,²³ an owner of a patent or copyright should recover “only that part of the profits found to be attributable to the use of the copyrighted [or patented] material as distinguished from what the infringer himself has supplied” In applying this principle where an infringer, in making a movie, had taken material from a copyrighted play, Hughes observed that what is required is not “mathematical exactness” but only a “reasonable approximation.”²⁴ By analogy, then, one who breaks a contract should be allowed the same right to apportionment.

*Olwell v. Nye & Nissen Co.*²⁵ illustrates the failure of courts to grapple with the issue of joint cause and to apportion damages appropriately. In *Olwell*, the seller of an egg-packing plant retained ownership of an egg-washing machine, which was to be stored on premises near the plant. At first, the buyer of the plant washed eggs by hand, but when World War II caused a labor shortage, the buyer wrongfully took the machine and for three years used it to wash eggs. Although the owner of the machine would not have used it during that time, the court granted restitution of the benefit to the user of the machine, which the court based on “savings in labor cost” of \$1.43 per hour—the cost to wash the eggs by hand over the three-year period. But by using this basis for “savings,” the court ignored the question of joint cause. The decision has been rightly criticized on the ground that “the saving of labor expenses . . . could be achieved only by use in that enterprise, which was the defendant’s contribution.”²⁶

The court would have avoided unjustly including the defendant’s contribution in the plaintiff’s recovery if, as suggested above, it had measured gain in terms of *saving of the cost of other means*. If the defendant could have rented another egg-washing machine, the defendant’s *saving of the cost of substitution* would be of fair rental value. An alternative would be *the cost of modification*, that is, the rental that in the court’s view the

23. 309 U.S. 390, 396 (1940) (applying apportionment principles developed in patent cases to copyright case).

24. *Id.* at 404. This principle of apportionment appears in the Copyright Act of 1976, which allows an infringer to reduce liability by proving “the elements of profit attributable to factors other than the copyrighted work.” 17 U.S.C. § 504(b) (1982).

25. 26 Wash. 2d 282, 173 P.2d 652 (1946). For a case using a similar measure, see *Ablah v. Eymann*, 188 Kan. 665, 365 P.2d 181 (1961) (gain resulting from conversion of accountant’s working papers was amount that converter saved by using them to prepare for tax audit).

26. 1 G. PALMER, *supra* note 14, § 2.12, at 160-61; *see also* Dawson, *Restitution Without Enrichment*, 61 B.U.L. REV. 563, 612 (1981), where Dawson observes that “there must have been some place where [egg-washing machines] had been bought and sold, perhaps even rented.” Dawson also argues that “the shifty phrase, ‘saving of expenditure,’ . . . should be shunned like contagious disease” since it “calls for a guess as to what would have been spent if [the assets] had not been taken or used.” *Id.* But this is an odd criticism, since the relevance of the cost of renting an egg-washing machine would seem to be to show what saving of expenditure resulted from the defendant’s not renting one elsewhere.

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parties would have agreed upon if they had reasonably tried to reach agreement at the time that the defendant's need for the machine arose.²⁷

C. *Question of Remote Cause*

The third question is what to do about *remote cause*. Assume again that the arguments made above are rejected, and that my breach of contract is regarded as the cause in fact of all of my \$25 profit. Suppose that after reselling the widget, I used that \$25 to buy stock, which soon rose in value to \$250, whereupon I sold it and used the proceeds to buy a piece of land, which soon rose in value to \$2,500, whereupon I sold it and used the proceeds to start my own business, which (since I have worked without salary) is now worth \$25,000. Are you entitled to \$25,000 under the disgorgement principle?

Consider an analogous claim to \$25,000 damages under the expectation principle, based on the following argument: Had I delivered the widget to you, you could have resold it yourself to the other buyer for \$125, and with the additional \$25 bought stock, which would have risen to \$250, enabling you to buy a piece of land which would have risen in value to \$2,500, enabling you to start a business which would now be worth \$25,000. Such a claim would surely fail, if not on the ground that you failed to mitigate your damages, then on the ground either that your lost gain of \$25,000 was not foreseeable or that it was not proved with sufficient certainty. Because your loss is hypothetical, it is particularly unlikely that you would recover anything more than \$25, if that.²⁸

But your claim to \$25,000 under the disgorgement principle is a claim to actual, not hypothetical, gain. One can trace the profit from the widget into the stock, into the land, and into the business. And when the profit from the widget has been traced into its product in the hands of the wrongdoer, a court need only impose a constructive trust in order to require the wrongdoer to disgorge that profit no matter how remote.²⁹ Once we admit that my breach of contract is the cause in fact of my \$25 profit, a difficulty arises of putting limits on the remoteness of cause under the

27. The facts of the case suggest that *the cost of modification* would have been considerably less than the saving in labor cost. The total saving in labor cost was \$1560, though the court allowed only \$900 because that was all that the complaint asked. After the machine's owner discovered the wrongful use, however, he offered to settle the dispute by selling the machine to the defendant for \$600. The parties failed to reach agreement when a counteroffer of \$50 was refused. 26 Wash. 2d at 284, 173 P.2d at 653.

28. You might not recover even \$25 if you could have covered for less than \$125, or if a profit of \$25 on resale was extraordinary.

29. Imposing a constructive trust on property because of a wrongful act has two consequences if the property is exchanged. One is to treat profit realized from a product of the property as causally connected with the wrongful act. The other is to give priority over other creditors in the product of the property.

disgorgement principle. The question of remote cause is avoided, however, if recovery is limited to gain in terms of *saving of the cost of other means*, because by their nature savings cannot be identified and traced into property as profits can.³⁰

D. *Problem of Proof*

In addition to these three questions relating to cause, there is a practical problem of *proof*. It is one thing for you to prove, under the expectation principle, how much loss (including loss of gain) was caused by my breach. The loss (including loss of gain) at issue is *your* loss, and evidence of it is likely to be easily accessible to you. It is another thing for you to prove, under the disgorgement principle, how much gain was caused by my breach. The gain at issue is *my* gain and evidence of it is not likely to be easily accessible to you. Even if a bill for accounting is available, the obstacles may be substantial.³¹ Practical problems also inhere in measuring gain in terms of *saving the cost of modification*. But these problems are less serious than those of proving profits.

E. *Summary*

A strict requirement of cause in fact would limit the extent of recovery under the disgorgement principle and make it easier to defend the principle. As has been pointed out, there are other advantages to a strict requirement that limits disgorgement to saving: First, it aids in grappling with the problem of joint cause that has been so troublesome in other fields. Second, it avoids the question of remote cause. And third, it avoids the problem of proving profits. For these reasons the following discussion of the disgorgement principle will give special attention to the possibility of limiting recovery to gain measured in terms of *saving of the cost of other means*.

30. Tracing requires the claimant to prove both "that the wrongdoer once had property legally or equitably belonging to him" and "that he still holds the property or property which is in whole or in part its product." RESTATEMENT OF RESTITUTION § 215 comment a, at 866 (1937). Tracing is therefore not possible in the case of a saving, since it is not property.

31. As one writer has put it, "this right to the account . . . is, save in the most simple of cases, of dubious value. . . . The inquiry necessary to make that calculation often renders nugatory the practical value of the remedy." P. FINN, FIDUCIARY OBLIGATIONS 120 (1977). For a similar conclusion, see GREAT BRITAIN LAW COMMISSION, BREACH OF CONFIDENCE 93 (Working Paper No. 58, 1974) ("In practice . . . an account of profits is not generally a very satisfactory remedy . . ."); see also D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 254 (1973) ("measurement of business profits from an active operation is at best a difficult matter These problems are so great that the accounting for profits may well be appropriately denied to avoid the delay, complexity, and perhaps injustice even where, in principle, the accounting might seem appropriate.").

II. THE DEVELOPMENT OF THE DISGORGEMENT PRINCIPLE

A. *Origins*

The preeminence of the expectation principle as a basis for awarding damages in breach of contract goes back to the sixteenth century. Details are obscure because damages were left largely to the discretion of the jury until well into the eighteenth century.³² In spite of the inscrutable nature of jury verdicts, however, we have some indications of how common law judges viewed the basis of damages for breach of contract.

Although "expectation" was not part of the sixteenth-century legal vocabulary, cases of the period recognize the principle that damages are to be based on loss in value to the plaintiff. For example, the wrong inherent in a failure to perform a promise to deliver barley was seen as "an act against my bargain and to my deceit, whereby I am put to loss."³³ In a later case, a buyer of barley was allowed an action on the case because, when the seller failed to deliver, the buyer had been "driven to buy barley for his business, being a brewer, at a much greater price."³⁴ Though plaintiffs continued to allege deceit, what they asked for was lost profit.³⁵

When these cases were decided, the rule was that if parties exchanged promises, their promises were independent.³⁶ If a breach occurred before either party had performed, the plaintiff's expectation was the full value of the defendant's performance, with no deduction for the plaintiff's cost of rendering the return performance because, in theory, the plaintiff still had to perform.

It was not until 1773 that the concept of the dependency of promises, or what we now call "constructive conditions"³⁷ of exchange, was fashioned in Lord Mansfield's opinion, *Kingston v. Preston*.³⁸ When promises came

32. S. MILSOM, *HISTORICAL FOUNDATIONS OF THE COMMON LAW* 332-39 (2d ed. 1981); A. SIMPSON, *A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT* 582-87 (1975); S. STOLJAR, *A HISTORY OF CONTRACT AT COMMON LAW* 39-44 (1975). Atiyah is in agreement in substance, though not in terminology. See *infra* note 38. Morton Horwitz is an exception. See Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 936-41 (1974), where he contends that the "first recognition of expectation damages appeared after 1790 in both England and America in cases involving speculation in stock." *Id.* at 937. This conclusion is vigorously disputed in Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533, 555-61 (1979). On the roles of judge and jury, see Washington, *Damages in Contract at Common Law* (pt. 2), 48 LAW Q. REV. 90 (1932).

33. *Orwell v. Mortoft*, Y.B. Mich. 20 Henry 7, f. 8, pl. 18 (1505) (Frowicke, C.J.C.). This case is described in A. SIMPSON, *supra* note 32, at 262-64, and is also relied on by Stoljar, see S. STOLJAR, *supra* note 32, at 39-42.

34. *Core's Case*, 73 Eng. Rep. 42, 47 (1537).

35. See S. MILSOM, *supra* note 32, at 335 (sixteenth-century allegation of "the loss of profit which the plaintiff would have made had the agreement been kept" is common).

36. For discussion of this period, see Francis, *The Structure of Judicial Administration and the Development of Contract Law in Seventeenth-Century England*, 83 COLUM. L. REV. 35 (1983).

37. Corbin, *Conditions in the Law of Contract*, 28 YALE L.J. 739, 743-44 (1919).

38. 98 Eng. Rep. 606 (1773), discussed in *Jones v. Barkley*, 2 Doug. 685, 689, 99 Eng. Rep. 434,

to be regarded as dependent, the defendant's breach excused the plaintiff from performing and the plaintiff's expectation measure was based on the value of the defendant's performance less the cost to the plaintiff of rendering the return performance.³⁹

The expectation measure was virtually unchallenged for four centuries.⁴⁰ Less than fifty years ago, Lon Fuller's and William Perdue's landmark study of damages disturbed this calm. Fuller and Purdue pointed out that damages based on expectation are in some instances too generous, and proposed damages determined by a reliance measure instead.⁴¹ Others have suggested that damages based on expectation may in some instances be too grudging a form of relief. These suggestions have taken two approaches.

The first approach retains the injured party's expectation as a goal but argues that conventional contract damages are inadequate to achieve that goal. These damages do not take account of the value that this particular plaintiff may place on performance nor of the plaintiff's transaction costs, such as those of bringing suit. Undercompensation will often result because the plaintiff will get far less than lost expectation.⁴² Thus "super-

436-37 (1781). Even before *Kingston v. Preston*, however, in a case where the seller had actually resold the goods to another buyer, Common Pleas upheld the verdict of a jury that had deducted the proceeds of the resale from the contract price when calculating the seller's damages. *Smee v. Huddleston* (1768), reprinted in J. SAYER, *THE LAW OF DAMAGES* 49 (Dublin 1792); see also P. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 210 (1979) ("[I]t may be that in practice the rules about independent covenants were made tolerable by the common sense of juries.").

39. When account was taken not only of the cost to the plaintiff of rendering the return performance but also of the possibility of mitigation by the plaintiff's disposing of that performance elsewhere—as where a seller can resell the goods on the market after the buyer's breach—the familiar damage rules based on market price evolved. Atiyah uses "expectation damages" in this narrow sense.

[I]n the sixteenth and seventeenth centuries . . . the damages [the plaintiff] was entitled to claim represented the *full value* of the defendant's promise Although it is possible to say that damages in such a case are given in compensation for the plaintiff's lost expectations (as Professor Simpson does) these are *not* expectation damages in the modern sense. In modern law, such damages are called expectation damages because the only ground upon which a plaintiff appears to be entitled to damages at all is that he has suffered a disappointment of his expectations. . . ."

P. ATIYAH, *supra* note 38, at 200 (emphasis in original). Atiyah's use of "expectation damages" in the narrow sense suits his thesis that reliance is the key element in imposing liability for breach of contract, but it is not in accord with the general usage of the term "expectation interest" in the United States, as reflected in *RESTATEMENT (SECOND) OF CONTRACTS* § 344(a) (1981).

40. *But see* *Flureau v. Thornhill*, 2 Black W. 1078, 96 Eng. Rep. 635 (C.P. 1776) (limiting recovery against seller who contracted to convey land but was unable in good faith to make title to expense incurred by purchaser in reliance on promise). In a disdainful reference to the expectation measure, De Grey, C.J., remarked that the purchaser was not "entitled to any damages for the fancied goodness of the bargain, which he supposes he has lost." 2 Black W. at 1078, 96 Eng. Rep. at 635. The lack of any further discussion of the measure of damages is consistent with the historical judicial disinclination to delve into any matter that has been relegated to juries for centuries.

41. See Fuller & Perdue, *The Reliance Interest in Contract Damages* (pts. 1 & 2), 46 *YALE L.J.* 52, 373 (1936-1937) (reliance interest is better gauge of remedy for contract breach than "all or nothing" recovery).

42. See Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 *COLUM. L. REV.* 554,

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compensatory” damages are necessary in order adequately to protect the plaintiff’s expectation.⁴³ Some even argue, in a quantum jump, for replacing any payment of damages with universal specific performance.⁴⁴

The second approach, measures damages not by the loss to the injured party but by the gain to the party in breach. In 1959, John Dawson proposed that

an alternative form of money judgment remedy . . . could be used wherever the delivery of a specific asset or a defined course of action (a “service”) had been promised and through breach and resale to another the promisor was enabled to secure a readily measured gain. It may well be that the obstacle is nothing more than that well-known ailment of lawyers, a hardening of the categories.⁴⁵

What precedent is there for this disgorgement principle? All its advocates rely, at least by way of analogy, on a few instances in which the principle has long been accepted. These instances fall into two categories: those involving fiduciaries, and those involving the liability of sellers of goods and land.⁴⁶ We turn first to the recognition of the disgorgement principle in cases within those two categories and then to the more general recognition of the principle.

557 (1977) (“The proof problems inherent in fully recovering idiosyncratic values within the context of operationally practical damage sanctions may prevent the non-breaching party from recovering his subjective expectations if recovery is limited to legally determined remedies.”); *see also* Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 363 (1978) (“Whenever a court calculates money damages, there is some risk that it will undercompensate the injured party.”).

43. On “super-compensatory” damages, *see* Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1444-45 (1980) (“To the extent that every prospective plaintiff is not fully compensated, even though ‘compensatory’ damages are awarded in every litigated case, contracts are underenforced.”); *see also* Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733, 760 (1982) (urging that “knowing breacher should be discouraged from future breaches by . . . either specific performance or the highest possible measure of expectation damages”); Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365 (1982) (advocating damages based on cost of completion).

44. Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 138 (1981) (advocating “general use of specific performance” in place of system that fails to count “unquantifiable emotional and other costs of nonperformance to the promisee”); Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 306 (1979) (if “law is committed to putting disappointed promisees in as good a position as they would have been had their promisors performed, specific performance should be available as a matter of course . . .”).

45. Dawson, *supra* note 8, at 186-87; *accord* 1 G. PALMER, *supra* note 14, § 4.9(c), at 446.

46. In addition to Dawson and Palmer, advocates of some form of the disgorgement principle include Daniel Friedmann, *see* Friedmann, *Restitution of Benefits Obtained Through the Appropriation of Property or the Commission of a Wrong*, 80 COLUM. L. REV. 504 (1980) (analogizing to property); Robert Goff and Gareth Jones, *see* R. GOFF & G. JONES, *THE LAW OF RESTITUTION* 490 (2d ed. 1978) (same); Duncan Kennedy, *see* Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1717, 1734 (1976) (analogizing to fiduciaries); J.C. Shepherd, *see* J. SHEPHERD, *THE LAW OF FIDUCIARIES* (1981) (same); and Roberto Unger, *see* Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 641 (1983) (same); *see also* Jones, *supra* note 9, at 459-60 (more limited proposal).

B. *Recognition in Particular Instances*1. *Fiduciaries*

Suppose that under our contract for a sale of a widget, I hold the widget for you as your "fiduciary," but I sell it to another buyer in breach of my fiduciary duty. Since my breach was a breach of a fiduciary duty and not a mere breach of contract, a court will apply the disgorgement principle.⁴⁷ The origins of this rule go back to the seventeenth century, when equitable interests were revived in the form of trusts. A trustee undertakes both a duty of care and a duty of loyalty. The duty of care requires care proportioned to the occasion.⁴⁸ The duty of loyalty is more demanding; it requires the trustee to subordinate selfish interest to the interest of the beneficiary in case of conflict.⁴⁹ In the situations that concern us, it includes a duty not to profit at the beneficiary's expense.

In 1726, the landmark English case of *Keech v. Sandford*⁵⁰ made it clear that the duty of loyalty would be strictly enforced where a trustee entered into a transaction with a third party. A trustee held a lease of the profits of a business for the benefit of an infant. When the trustee sought to renew the lease on behalf of the trust, the lessor refused to renew it but leased to the trustee personally. The court decreed that the trustee held the lease in trust for the infant and had to account for any profits. Lord Chancellor King observed that, though the trustee may have been innocent of any wrongful intent, "if a trustee, on the refusal to renew, might have a lease to himself, few trust-estates would be renewed to *cestui que use*."⁵¹

Today the rules developed for trustees have been extended, with suitable variations, to a wide variety of "fiduciaries."⁵² The term is relatively

47. RESTATEMENT OF RESTITUTION § 138 (1937); see also RESTATEMENT (SECOND) OF RESTITUTION, § 4 comment b (Tent. Draft No. 1, 1983) (restitution may provide greater recovery than would tort or other theories in cases of interference with duty owed).

48. Compare RESTATEMENT (SECOND) OF AGENCY § 379 (1958) (paid agent must "act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and . . . to exercise any special skill that he has"; gratuitous agent must "act with the care and skill which is required of persons not agents performing similar gratuitous undertakings for others") with RESTATEMENT (SECOND) OF TRUSTS § 174 (1959) (trustee must "exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property").

49. Compare RESTATEMENT (SECOND) OF AGENCY § 387 (1958) (duty "to act solely for the benefit of the principal in all matters connected with his agency") with RESTATEMENT (SECOND) OF TRUSTS § 170 (1959) (duty "to administer the trust solely in the interest of the beneficiary" and, in dealing on trustee's account, "to deal fairly [with the beneficiary] and to communicate to him all material facts . . .").

50. 25 Eng. Rep. 223 (1726).

51. *Id.* at 223.

52. According to Sealy, the term became established in English law reports in the middle of the last century, when it was used to describe "situations which fell short of the . . . strictly-defined trust." Sealy, *Fiduciary Relationships*, [1962] CAMBRIDGE L.J. 69, 71-72; see also P. FINN, *supra* note 31, at 1 ("The term itself is a relative latecomer to the vocabulary of English law."); R. GOFF & G. JONES, *supra* note 46, at 490 ("English judges have wisely never attempted to formulate a comprehensive definition of who is a fiduciary."). As used in the United States, the term includes trustees.

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recent and includes not only trustees but also agents, partners, joint adventurers, guardians, attorneys, and corporate officers and directors.⁵³ We may simply define a fiduciary as a person who undertakes to act so as to serve the interest of some other person in some particular matter or matters.⁵⁴ Not every duty owed by a “fiduciary” is a fiduciary duty; some duties owed by fiduciaries are simple contract duties.⁵⁵

To characterize an obligor as a “fiduciary” has distinctive consequences that are remedial as well as substantive. The distinctive substantive consequence is that the obligor is bound by a duty of loyalty; the distinctive remedial consequence is that the obligor who violates the duty of loyalty must disgorge the resulting gain. Thus in *Keech v. Sandford*, the trustee who had violated his duty of loyalty was required to give up the renewed lease and the profits from it. Under the expectation principle, the trustee would not have been liable because the beneficiary would have been no better off had the trustee observed his duty of loyalty. But under the disgorgement principle, the trustee was required to surrender his gain even though it had not come at the beneficiary’s expense.⁵⁶

The substantive duty of loyalty imposed on a fiduciary is similar to the duty of good faith imposed on a party to a contract. Both duties may require one to act against one’s selfish interest.⁵⁷ Although the contract duty of good faith is less exigent, it can be made more demanding by

53. Courts have sometimes found relationships to be of a fiduciary character even where the relationships do not fall into particular categories. See *Wheeler v. Waller*, 197 N.W. 2d 585, 587 (Iowa 1972) (duty of good faith “not limited to the familiar categories such as partnership, joint venture, and agency; it permeates the law wherever a relationship of trust and confidence exists”); see also *Broomfield v. Kosow*, 349 Mass. 749, 757, 212 N.E.2d 556, 561 (1965) (relationship of “trust and confidence” growing out of “close business relationship and business friendship” was fiduciary one).

54. See RESTATEMENT (SECOND) OF AGENCY § 13 comment a (1958); RESTATEMENT (SECOND) OF TRUSTS § 2 comment b (1959); Scott, *The Fiduciary Principle*, 37 CALIF. L. REV. 539 (1949).

55. For example, “the agent’s liability for profits made by his use of the principal’s assets does not include a liability for profits made by him during hours which he should have devoted to the principal’s service, unless he has thereby violated a fiduciary duty owed by him to the principal.” RESTATEMENT (SECOND) OF AGENCY, § 404 comment b (1958). See P. FINN, *supra* note 31, at 1 (“[I]t is pointless to describe a person . . . as being a fiduciary unless at the same time it is said for the purposes of which particular rules and principles that description is being used.”); see also *SEC v. Chenery Corp.*, 318 U.S. 80, 85–86 (1943) (Frankfurter, J., for the Court) (“[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?”).

56. This is implicit in the holding in *Keech v. Sandford*, though the court did not address the issue. See *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969) (corporate officers and directors may be required to disgorge gains in transactions in corporation’s stock resulting from use of inside information even though they cause corporation no injury).

57. For a simple example, consider the contract cases that impose a duty to cooperate with the other party even when selfish interest may dictate otherwise. *E.g.*, *Patterson v. Meyerhofer*, 204 N.Y. 96, 97 N.E. 472 (1912) (buyer bid against seller at auction where seller was expected to acquire property that he was to sell to buyer). For statements of the duty of good faith, see U.C.C. § 1–203 (1978); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

Steven Burton appears to regard a fiduciary’s duty of loyalty as a version of the duty of good faith. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 394–95 & n.109 (1980).

adding express provisions expanding its scope. In substance both duties find a place on the same spectrum.

The more significant distinction between fiduciary obligations and contractual ones is remedial—the disgorgement principle applies to breach of a fiduciary obligation while the expectation principle applies to a breach of contractual obligation.⁵⁸ So singular is this remedial consequence of a fiduciary obligation that one English judge made the disgorgement principle the hallmark of a fiduciary relationship: “What is a fiduciary relationship? It is one in respect of which if a wrong arise, the same remedy exists against the wrong-doer on behalf of the principal as would exist against a trustee on behalf of the *cestui que trust*.”⁵⁹

Acceptance of the disgorgement principle raised the question of causation, for a fiduciary could be asked to disgorge only those benefits that resulted from the breach of fiduciary duty. The question of causation was especially troublesome if a trustee mingled trust funds with personal funds in a trade or business. The early English cases had held that in such a case the beneficiary could claim only interest on the trust funds.⁶⁰ Although seventeenth-century judges did not express these holdings in terms of cause, they were in effect applying a strict requirement of cause in fact in determining the trustee’s gain. Absent a breach of trust, the trustee could have obtained the additional funds for the trade or business only by borrowing at interest. The trustee’s gain was therefore what the trustee saved by not having to borrow. And interest on the trust funds measured this gain in terms of *saving of the cost of substitution*.

Until *Docker v. Somes*,⁶¹ decided in 1834, the precedents had not gone beyond granting of interest as the measure of damages. In *Docker v. Somes*, Lord Brougham for the court gave a beneficiary a right to a share of the profits of the trade or business in even this troublesome situation. Winding up Somes’s shipping business, the trustees appointed under his will received money that they then used in their own business, charging themselves interest at five percent, which they claimed was a higher rate than they could have obtained elsewhere. The court held, however, that a trustee must account “for all the gain which he has made,”⁶² and the trustees should therefore be charged with the proportion of the profits from their business that “was properly attributable to the monies so to be

58. This distinction has occasionally been overlooked in analogizing from fiduciary to contractual relations. See Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1126–30 (1981) (discussing substantive but not remedial aspects of analogy).

59. *Ex parte Dale & Co.*, 11 Ch. D. 772, 778 (1879).

60. See, e.g., *Ratcliffe v. Graves*, 23 Eng. Rep. 409 (1683) (administratrix controlling intestate’s estate for use in trade must account for interest earned).

61. 39 Eng. Rep. 1095 (Ch. 1834).

62. *Id.* at 1098.

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considered as employed in their trades.”⁶³ Where it is easy to tell what the gains are, the trustee must account for the actual gains.

The reason which has induced Judges to be satisfied with allowing interest only I take to have been this: they could not easily sever the profits attributable to the trust money from those belonging to the whole capital stock; and the process became still more difficult, where a great proportion of the gains proceeded from skill or labour employed upon the capital. In cases of separate appropriation there was no such difficulty; as where land or stock had been bought and then sold again at a profit; and here, accordingly, there was no hesitation in at once making the trustee account for the whole gains he had made.⁶⁴

Gone was the strict requirement of cause in fact; little matter that the trustees saved no more than five percent by using the trust funds.⁶⁵ Little matter too that the skill, industry, and capital of the trustees may have been a joint cause of the profits that they were required to disgorge.

However appropriate such rules may be for fiduciary relations, they seem oversolicitous of your interests when applied to our contract for the sale of a widget. The rules that limit the discretion of the trustee are intended to protect both the beneficiary and the public in ways inappropriate to ordinary commercial dealings.⁶⁶

Consider, for example, the restraints on modification. A party to a contract needs only to observe good faith in negotiating a modification of the contractual relation, but a modification of a fiduciary relation is voidable unless it is on fair terms and agreed to by the beneficiary after full disclosure by the fiduciary.⁶⁷ Such restraints on modification, which serve to

63. *Id.* at 1095.

64. *Id.* at 1098–99. Lord Brougham noted that limiting recovery to interest ignored the hazards to which the trustee had exposed the funds. *Id.* at 1099.

65. On this last point the Chancellor made a small concession by distinguishing cases in which the gain was almost entirely from the trustee’s “skillful labour,” as in “the case of trust money laid out in purchasing a piece of steel or skein of silk, and these being worked up into goods of the finest fabric, Birmingham trinkets or Brussels lace, where the work exceeds by 10,000 times the material in value.” *Id.* at 1099.

66. See Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 816 (1983) (“Fiduciary relations present a problem because a fiduciary holds a delegated power that is susceptible to abuse.”); Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975) (“The need to control discretion has been a justification for the imposition of the harsh rule concerning fiduciaries since the beginning.”); see also J. SHEPHERD, *supra* note 46, at 83–88 (discussing theories that define fiduciary relationship in terms of fiduciary’s “power and discretion” over principal’s interests). Discretion is so integral to the fiduciary relation that it has been held that there is no trust relation if no discretion is accorded the person in charge of funds. *Cohen v. Hughes*, 38 N.Y.S.2d 874 (Sup. Ct. N.Y. Cty. 1942), *aff’d mem.*, 266 A.D. 658, 41 N.Y.S.2d 210, *aff’d mem.*, 291 N.Y. 698, 52 N.E.2d 591 (1943). But for a case upholding a trust under which the settlor gave the trustee little discretion, see *Farkas v. Williams*, 5 Ill. 2d 417, 125 N.E.2d 600 (1955).

67. For the contract rule, see RESTATEMENT (SECOND) OF CONTRACTS §§ 89, 205 (1981);

protect beneficiaries from abuse of discretion by fiduciaries, would inhibit ordinary commercial dealings. Consider, too, the restraints on commingling property. A party to a contract is free to commingle property, but the trustee is under a duty to keep the trust funds separate from the trustee's own funds.⁶⁸ The inconvenience of a requirement of segregation in connection with contracts makes the fiduciary analogy unattractive.⁶⁹

Furthermore, the law of fiduciary relations, unlike that of contractual relations, is distinctively concerned with deterrence and ethical standards.⁷⁰ While the American Bar Association's newly adopted Model Rules of Professional Conduct leave a lawyer free to advise a client to break a contract, they cast doubt on the propriety of a lawyer's advising a client to violate a fiduciary duty.⁷¹ While courts will not grant punitive damages for breach of contract, they may award them for the breach of a fiduciary obligation.⁷² And while courts in some instances will not impose criminal liability for breach of contract, they may impose it for breach of a fiduciary obligation.⁷³ But the main drawback of the fiduciary analogy is

U.C.C. § 2-209 comment 2 (1978). As for fiduciaries, RESTATEMENT (SECOND) OF CONTRACTS § 173 (1981) requires such disclosure as will give "all parties beneficially interested . . . full understanding of their legal rights and of all relevant facts that the fiduciary knows or should know."

68. P. FINN, *supra* note 31, at 103. Indeed, it is this very requirement that makes it possible to determine that a particular profit has resulted from the misappropriation of trust funds instead of the proper use of the trustee's own funds.

69. Finn points out that, in many types of commercial transactions, the inconvenience of the requirement that the trustee maintain a separate trust account "affords a significant policy reason against finding a trusteeship." P. FINN, *supra* note 31, at 100. Of course, not all fiduciary relations involve property, but the disgorgement principle does not apply to such relations. Cf. *In re Interstate Record Distrib.* 307 F. Supp. 1142, 1144 (S.D.N.Y.) (agent, as distinguished from trustee, was mere debtor), *aff'd*, 430 F.2d 1017 (2d Cir. 1970).

70. See *Berenson v. Nirenstein*, 326 Mass. 285, 288, 93 N.E.2d 610, 612 (1950) (fiduciary obligations rest "upon fundamental principles of business morality and honor which are of the highest public interest"); Friedmann, *supra* note 46, at 558 ("[L]ike punitive damages, deterrent restitution ought generally to be confined to exceptional circumstances involving breach of fiduciary duty or conduct that is morally reprehensible."); Weinrib, *supra* note 66, at 11 (fiduciary obligation is element of the common law for protection of business structures).

71. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 (1983) ("lawyer shall not counsel a client to engage . . . in conduct that the lawyer knows is criminal or fraudulent"). The comment says that if the client is a fiduciary, "the lawyer may be charged with special obligations in dealings with a beneficiary." The comment in the final draft was more specific and said: "[W]here the client is a fiduciary, and therefore charged with special obligations of honesty in dealings with a beneficiary, the lawyer's obligations to avoid assisting in fraudulent conduct is correlative." The result was presumably the same under the old Model Code. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102 (A)(7) (1981) (forbidding lawyer to "[c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent"). Under the old Model Code, this "illegal" conduct probably did not include breach of contract. Hazard, *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. MIAMI L. REV. 669, 674-75, 682 (1981).

72. See *Brown v. Coates*, 253 F.2d 36 (D.C. Cir. 1958); see also Sullivan, *Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207, 226-29 (1977) (discussing cases). The subject of punitive measures against trustees has come into prominence as a result of *In re Rothko*, 43 N.Y.2d 305, 372 N.E.2d 291, 401 N.Y.S.2d 449 (1977). See Wellman, *Punitive Surcharge Against Disloyal Fiduciaries—Is Rothko Right?* 77 MICH. L. REV. 95 (1978) (criticizing award of punitive damages against trustees for fiduciary breach).

73. Criminal liability has been imposed for private fiduciary breach under the federal mail fraud

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that it unrelentingly applies the disgorgement principle to reach a proportional share of all profits, with little regard to questions of cause in fact, joint cause, or remote cause.⁷⁴

Snepp v. United States,⁷⁵ in which the Supreme Court applied fiduciary law to a case involving a breach of contract, illustrates the shortcomings of the fiduciary analogy. Snepp had made an employment contract with the Central Intelligence Agency, including a commitment not to publish any information relating to the Agency without prepublication clearance. Had this been a mere breach of contract, the CIA would have been unable to show damages under the expectation principle with sufficient certainty.⁷⁶ The CIA, however, asserted that Snepp had broken a fiduciary duty, not merely a contractual duty, and sought to recover the profits from his book, which the CIA claimed Snepp had gained as a result of his breach. The Supreme Court agreed, characterizing Snepp's duty as fiduciary and concluding that Snepp should therefore be required "to disgorge the benefits of his faithlessness."⁷⁷ The Court failed, however, to address two questions of cause. First, was Snepp's breach of fiduciary duty the cause in fact of the profits from his book? If, as may well have been the case, the CIA could not properly have refused permission had Snepp sought it, Snepp could have made the same profits without breach; the essential causal link was not demonstrated. Second, to what extent were Snepp's own skill and industry the cause of his profits? With no attempt made to apportion the contributions of the breach and of Snepp's own

statute, which makes it a crime to use the mails or wires in furtherance of "any scheme or artifice to defraud." 18 U.S.C. § 1341 (1982). See Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 AM. CRIM. L. REV. 117 (1981).

74. The harsh rule of *Docker v. Somes* refuses to apportion profits even though they may have resulted in part from the fiduciary's skill, industry, or capital. Occasionally, however, where the fiduciary's contribution has been services of a kind that can be compensated by a sum of money, that sum has been subtracted from the beneficiary's claims. Thus a fiduciary who manages a business using misapplied funds as capital may be compensated by an allowance for the reasonable value of such services. *Greenan v. Ernst*, 408 Pa. 495, 184 A.2d 570 (1962); *Brooks v. Conston*, 364 Pa. 256, 72 A.2d 75 (1950). This solution will not often be useful in the kinds of cases I am discussing. It would be useful, however, in the case of the widget resold with the profit traced into a business.

75. 444 U.S. 507 (1980) (per curiam).

76. The district court found that the government's injury was "not quantifiable with any reasonable degree of certainty." *United States v. Snepp*, 456 F. Supp. 176, 181 (E.D. Va. 1978). The court of appeals indicated that punitive damages might be appropriate, *United States v. Snepp*, 595 F.2d 926, 936-38 (4th Cir. 1979), but was reversed on this point, 444 U.S. 507, 514-16 (1980) (per curiam).

77. 444 U.S. at 515. The Supreme Court assumed that the parties had the power to make the duty a fiduciary one by agreement, noting that in the opening sentence of his agreement with the CIA, in which Snepp recited "I am undertaking a position of trust in that Agency," he "explicitly recognized that he was entering a trust relationship." *Id.* at 510 & n.5.

It seems clearer that it is open to the parties to prevent a fiduciary relationship from arising. *E.g.*, *Midcon Oil & Gas and New British Dominion Oil Co.*, 1958 S.C.R. 314, 323 (Can.) ("[P]arties in terms provided that the relationship existing between them . . . was neither partnership nor that of principal and agent."); see also *Jirna Ltd. v. Mister Donut of Canada Ltd.*, 40 D.L.R.3d 303, 305 (Can. 1973) (court to rely on other parties' definition of their relationship).

efforts and talents, Snepp was denied any compensation whatsoever from his writing.⁷⁸

Partly to solve the problem of apportionment, advocates of the fiduciary analogy such as Roberto Unger point to the joint venture, a vaguely defined business association similar to a partnership but often less formal and narrower in purpose and scope.⁷⁹ As in a partnership, there is a feature of adventure in that its members share both profits and losses.⁸⁰ Furthermore, since Cardozo's landmark opinion in *Meinhard v. Salmon*, the strict rules applicable to fiduciaries clearly have extended to joint venturers, who "owe to one another, while the enterprise continues, the duty of the finest loyalty."⁸¹ One venturer must not derive a separate, personal profit from a transaction within the scope of the venture; the venturer who violates this duty is subject to disgorgement.

To view a contract as a joint venture, however, requires that one ignore the opposing nature of the parties' interests that is so characteristic of a contract. For example, in the contract for a sale of a widget, the seller takes the risk that the market in widgets will rise and the buyer takes the risk that it will fall. Rules developed for joint ventures also pose obvious problems when extended to contractual relationships. How does one determine each party's share of any gains resulting from a breach of contract: What are our respective shares in the \$25 profit on resale? Half and half? Or some other shares that would ultimately be determined by a court in its discretion? Another problem is how to implement the corollary burden of sharing losses: What happens if it turns out that it will cost me \$25 more than anticipated to produce or acquire the widget? Can I call upon you to pay some part of that increase? And if so, what part?⁸² The difficulties inherent in the fiduciary analogy have prompted most advocates of the disgorgement principle to seek other analogies.

2. Sellers

a. *Property as a Basis.* Under our contract for the sale of a widget, suppose that the widget has already become "your property," though I still have possession of it, when I sell it to the other buyer. You can re-

78. See 444 U.S. at 521 (Stevens, J., dissenting).

79. See Unger, *supra* note 46, at 642; see also I. MACNEIL, *THE NEW SOCIAL CONTRACT* 27-28 (1980) (image of joint venture evoked by references to "sharing . . . benefits and burdens"). A joint interest in property is usually required. See *Pfleider v. Smith*, 370 P.2d 17, 20 (Okla. 1962).

80. See *Rollins v. Rayhill*, 200 Okla. 192, 195-96, 191 P.2d 934, 937-38 (1948) (no joint venture because no right to share profits).

81. 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928).

82. See *Shrum v. Simpson*, 155 Ind. 160, 164, 57 N.E. 708, 709 (1900) (agricultural agreement involving sharing of farm products gave rise to relationship of agency and not of joint venture; declining to presume that parties intended to assume "intricate responsibilities of partners").

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cover the entire \$25 from me. Because the widget was “yours” at the time of my resale, a court will apply the disgorgement principle.

The result may accord with the widely held notion that if something is “your property,” your rights in it are entitled to a special measure of protection. But courts arrived at this result by a strikingly formalistic chain of reasoning. If you authorize me to sell “your” widget as your agent and I do so, the disgorgement principle applies, and I am liable to you for any proceeds beyond the \$100 price. If you do not authorize me to sell “your” widget but I sell it purporting to act as your agent, the disgorgement principle also applies; though I am liable to you for conversion of your property, you can ratify my wrongful act and recover from me in *assumpsit* for money had and received. The challenge is then to extend the disgorgement principle to the case where I do not even purport to act as your agent, for in that case, you cannot rectify my wrongful sale.

Two decades before *Keech v. Sandford*, *Lamine v. Dorrell*⁸³ invented the doctrine of waiver of tort and suit in *assumpsit*. The established law held that, for selling “your” widget without your authority, I was liable to you in tort for the conversion of your property; *Lamine v. Dorrell* added the proposition that even absent purported agency, you can “waive” the tort and sue in *assumpsit* for money had and received.⁸⁴ It was, of course, the baldest of fictions that permitted an owner whose goods had been wrongfully sold to “dispense with the wrong and suppose the sale made by his consent” when it was the wrong that made the other’s enrichment unjust. But by this fiction, the disgorgement principle could be extended to the case of a seller who, after goods had already become the property of the buyer, resold them to another buyer. Thus, if I resell “your” widget for \$125, I must disgorge my entire \$25 gain.

Today your recovery is thought of as restitutionary, grounded in my having enriched myself by committing a wrong against you.⁸⁵ In theory,

83. 92 Eng. Rep. 303 (1705).

84. As Justice Powell explained, “the plaintiff may dispense with the wrong, and suppose the sale made by his consent, and bring an action for the money they were sold for, as money received to his use.” *Id.* The decision has a suspect pedigree. Its antecedents were cases in which a plaintiff who was entitled to an office was allowed to recover in *assumpsit* the fees that the defendant had collected while usurping the office. In *Lamine v. Dorrell*, Chief Justice Holt remarked, “These actions have crept in by degrees,” though he could not distinguish them. *Id.* at 303–04.

In *Arris v. Stukely*, 86 Eng. Rep. 1060, 1060–62 (1677), the defendant argued that “*indebitatus assumpsit* will not lie . . . because there is no contract.” But the plaintiff replied that “though it is a tort yet an *indebitatus* will lie,” for because of the receipt of the profits, “the law creates a promise.” The Court of Exchequer agreed with the plaintiff and analogized to liability for rent received by one who pretends a title.

This was a questionable analogy, as is explained in R. GOFF & G. JONES, *supra* note 46, at 446. Therefore, in *Howard v. Wood*, 83 Eng. Rep. 540 (1656) (the only precedent cited in *Lamine v. Dorrell*), the Court of King’s Bench followed the Court of Exchequer only grudgingly.

85. See RESTATEMENT (SECOND) OF RESTITUTION § 4 (Tent. Draft No. 1, 1983) (“A person may be unjustly enriched by receiving a benefit from conduct in violation of a duty owed . . . by him

that recovery will be measured by the gain to me, even though it exceeds the loss to you. In practice, since courts measure the loss in a conversion action so generously,⁸⁶ my gain will only rarely exceed your loss.⁸⁷ In deciding these cases, courts have been oblivious to the question of cause in fact, just as they have been in cases involving fiduciaries.

What of the case in which, instead of selling "your" widget to another buyer, I keep it for my own use or consumption, having concluded that it is worth \$125 to me? At first, courts balked at such an extension of the doctrine of waiver of tort.⁸⁸ As Lord Mansfield expressed it, an action for money had and received to the plaintiff's use "will not lie . . . where no money was received."⁸⁹ Other courts stretched the rule to cover this situation, however, and allowed recovery of the value of the converted property by using yet another fiction, that the goods had been sold by their owner to the converter, and this is now the preferred view.⁹⁰ Thus if I keep "your" widget, the disgorgement principle applies; if the value of the widget is \$125, I am liable for the entire \$25. If there is a market for widgets, the value will be the market price, consistent with the fiction of a sale to the converter.⁹¹ This is the converter's gain in terms of *saving of the cost of substitution*. If there is no market for widgets, the value will be presumably the amount that a willing seller in the circumstances of the owner and a willing buyer in the circumstances of the converter would

. . . "); see also Corbin, *Waiver of Tort and Suit in Assumpsit*, 19 YALE L.J. 221, 246 (1910) ("In jurisdictions where the old forms of action have been totally abolished, there should be nothing whatever left of the whole doctrine excepting a few historical echoes.")

86. On the several possible measures of recovery for conversion, see D. DOBBS, *supra* note 31, § 5.14. In a jurisdiction that awards the most generous measure, i.e., the highest market price reached between the date of conversion and the date of the trial, a claim for restitution would be advantageous in amount only if the converter sold for more than the highest market price. But in a jurisdiction that follows the "New York rule" and awards the highest market price between the date the owner had notice of conversion and a reasonable time for replacement thereafter, a claim for restitution would also be advantageous in amount if the market was high when the converter sold and then fell before the owner had notice of conversion.

87. Plaintiffs who have relied on the doctrines of waiver or tort have usually done so in order to get the procedural advantages of an action sounding in contract rather than to get a more favorable measure of recovery. Nevertheless, in these conversion cases, the applicability of the disgorgement principle is firmly established. For a discussion of the procedural significance of the doctrine, including the effect on the statute of limitations, see Corbin, *supra* note 85, at 234-46.

88. This limitation is often called the rule of *Jones v. Hoar*, after *Jones v. Hoar*, 22 Mass. (5 Pick.) 285 (1827).

89. *Nightingal v. Devisme*, 98 Eng. Rep. 361, 363 (1770). On the present vitality of this view in England, see R. GOFF & G. JONES, *supra* note 46, at 470-71.

90. See *Conaway v. Pepper*, 30 Del. (7 Boyce) 511, 515, 108 A. 676, 678 (1919) ("[E]very reason for allowing a recovery in assumpsit . . . will apply with equal force, to a case for the recovery of the fair value of the property, upon a count for goods sold and delivered, where the property is not sold, but retained or consumed . . ."). See RESTATEMENT OF RESTITUTION § 128 comment h (1937); 1 G. PALMER, *supra* note 14, § 2.2, at 55.

91. See *Felder v. Reeth*, 34 F.2d 744, 747-48 (9th Cir. 1929) (use of market price less costs of transportation to determine value of property).

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have agreed on, again consistent with the fiction of a sale to the converter. This is the converter's gain in terms of *saving of the cost of modification*.

As has already been pointed out, a person who has tortiously deprived the owner of goods that have been returned later is under a duty to make restitution to the owner for the value of their use, with value determined in terms of the *saving of the cost of other means* in a similar fashion.⁹² Thus the disgorgement principle can be extended to use for a limited time, and applies in the situation in which I merely delay delivering "your" widget to you, as well as in situations in which I resell it to another or keep it for my own use or consumption.

Advocates of the disgorgement principle have urged that its applicability be extended by analogy beyond the conversion cases. Robert Goff and Gareth Jones, in their definitive treatment of the English law of restitution, remark that "[a]s yet the analogy of the cases on waiver of tort has not persuaded the courts to allow the plaintiff to waive a breach of contract and to reach the profits made from that breach." But they regard this restriction as "a product of history" that "can produce anomalous and unjust results" and add that "the recognition of a restitutionary right to recover profits which are the product of the breach would deter the cynical contract breaker."⁹³

92. *Fanson v. Linsley*, 20 Kan. 235 (1878); *Jansen v. Dolan*, 157 Mo. App. 32, 137 S.W. 27 (1911); cf. *Paar v. City of Prescott*, 59 Ariz. 497, 130 P.2d 40 (1942) (use of private water system consisting of thousands of feet of pipe). These cases implicitly reject the rule of *Jones v. Hoar*. Courts have traditionally been less willing to require restitution in cases involving the use of land. See 1 G. PALMER, *supra* note 14, § 2.5, at 74–80. The older view is stated in the RESTATEMENT OF RESTITUTION § 129 (1937).

93. R. GOFF & G. JONES, *supra* note 46, at 20, 371. For a fuller discussion of limited extension of the disgorgement principle, see Jones, *supra* note 9. Daniel Friedmann has argued that restitution should be allowed if the promisee is "entitled" to the promised performance "in such a way that if this performance is withheld, appropriated, or otherwise 'taken,' the promisee can be regarded as having been deprived of an interest that 'belonged' to him." See Friedmann, *supra* note 46, at 515. There are two flaws in this approach. First, it takes interests that are not commonly thought of as property or even as similar to property and characterizes them as property or "quasi-property" in order to reach a desired result. Second, the approach gives little guidance and leads to apparently inconsistent conclusions. Why is the concept of property being extended? And how far should we extend it? Furthermore, the attractiveness of this property analogy, like that of the fiduciary analogy, is diminished because of the measure of recovery generally allowed. At least in cases involving resale by a conscious wrongdoer, the measure of recovery is as generous as that available for breach of a fiduciary duty. See D. DOBBS, *supra* note 31, at 242–43; Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 CORNELL L. REV. 172, 219 (1983).

Friedmann himself admits that his approach "does not itself provide a means of determining whether a particular interest ought to be recognized as property" and that "any reasoning to the effect that an interest should be deemed property in order to prevent unjust enrichment would be circular." Friedmann, *supra*, at 557.

b. *Specific Relief as a Basis*

Suppose that the widget is "unique" or that for some other reason a court would grant you specific performance of the contract. In such instances, a court could apply the disgorgement principle and allow you to recover the entire \$25. How is recovery on this ground to be explained?

The earliest cases of disgorgement involve contracts for the sale of land, where specific performance was commonly available.⁹⁴ Because land is involved, recovery of the seller's profit might be based on the expectation principle on the ground that, had the seller performed and conveyed the land to the buyer, the second buyer would still have found and bought it at the higher price. The result, although consistent with the expectation principle, is grounded in the disgorgement principle. The traditional reasoning is that because of the right to specific performance, the buyer acquires an equitable interest in the land at the moment the contract is made, so that the seller holds the land as "trustee" for the buyer until title passes.⁹⁵ The disgorgement principle then applies as it does to any trustee.⁹⁶

This notion that the seller of land holds it as "trustee" for the buyer would, if taken literally, lead to extraordinary results by subjecting the seller to all of the restraints imposed on a trustee. For example, an attempt to modify the contract of sale would be scrutinized under the rules applicable to fiduciary relations.⁹⁷ Modern authority rejects the notion that the seller is "trustee" or, indeed, that there is any fiduciary relationship between the parties. And though the cases that require the seller to disgorge the gain commonly use trust terminology, they can be read as holding only that the court will impose a constructive trust on the proceeds of the sale, in aid of a buyer's right to restitution.⁹⁸ One consequence of imposing a constructive trust on the proceeds is to reject a strict

94. In this situation the disgorgement principle is well established (assuming that the second buyer is a good faith purchaser who can keep the land, so that the first buyer's only recourse is a damage action against the seller) even though the waiver of tort doctrine did not apply since land cannot be the subject of conversion. See RESTATEMENT (SECOND) OF TORTS § 222A (1965) (conversion defined as "an intentional exercise of dominion or control over a chattel").

95. See *Green v. Smith*, 26 Eng. Rep. 360 (1738) ("[T]he vendor of the estate is, from the time of his contract, considered as a trustee for the purchaser.") (emphasis in original); 1 J. STORY, EQUITY JURISPRUDENCE § 789 (2d ed. Boston 1839) (1st ed., Boston 1836).

96. See, e.g., *Timko v. Useful Homes Corp.*, 114 N.J. Eq. 433, 434, 168 A. 824, 824 (1933) (seller "held the lots in trust" for buyers); *Taylor v. Kelly*, 56 N.C. 240, 245 (1857) (seller "held the land as trustee" and "*cestui que use* may . . . have the price" on sale).

97. See *supra* text accompanying note 77.

98. RESTATEMENT (SECOND) OF TRUSTS, *supra* note 48, § 13 (1959); 1 A. SCOTT, LAW OF TRUSTS § 13, at 141 (3d ed. 1967) ("It is clear that . . . the vendor . . . is not in a fiduciary relation to the purchaser. The vendor in entering into further transactions with the purchaser is under no duty to make full disclosure to him."); see also D. WATERS, THE CONSTRUCTIVE TRUST 74-143 (1964) (vendor-purchaser relation in English law).

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requirement of cause in fact and give the buyer a right to the seller's profits. It has accordingly been held that if the proceeds are used to buy other land, the measure of disgorgement is the value of that other land.⁹⁹

The possibility of extending this basis for restitution has not gone unnoticed.¹⁰⁰ As a first step, the reasoning for requiring disgorgement in the sale of land cases could be extended to sale of goods cases where, because of uniqueness or for some other reason, the damage remedy is not regarded as adequate and specific performance is available to the buyer.¹⁰¹ This result, however, is less strongly reinforced by the expectation principle. In contrast to the sale of land cases, it is less likely, even in the case of unique goods, that, had the seller performed, the buyer would have been able to resell to the second buyer. In any case, it is doubtful whether such an extension would give you, as the buyer of my widget, a right to disgorgement in any case where you would not already have such a right based on conversion. In contrast to contracts for the sale of land, contracts for the sale of goods often do not specify the goods that are the subject of the contract. The fact that the widget is not yet identified will not deter a court from ordering specific performance, but it may prevent you from proving that the particular widget that I resold at a profit was the widget that was the subject of the contract.¹⁰² This difficulty vanishes once the widget has been identified, but then you acquire a right to disgorgement based on conversion.¹⁰³ Such a claim, however, is less certain than disgorgement based on specific performance, which still appears to assure to a buyer of goods the claim to profits that goes along with a constructive trust. The advantage to you is plain if you can trace the \$25 proceeds from the widget into the stock that I sold for \$250, into the land I sold for \$2,500, and into the business worth \$25,000.

Robert Sharpe and Stephen Waddams have proposed a more significant extension of the rule applicable to contracts for the sale of land.¹⁰⁴ Accord-

99. See *Colby v. Street*, 146 Minn. 290, 295-96, 178 N.W. 599, 602 (1920).

100. Dawson saw "no inherent reason why the technique of equity courts in land contract cases should not be more widely employed, not as a somewhat freakish by-product of a phantom 'trust,' but as an alternative form of money judgment remedy." Dawson, *supra* note 8, at 186.

101. 1 G. PALMER, *supra* note 14, § 4.9, at 443.

102. See U.C.C. § 2-716 comment 2 (1978) (specific performance not "limited to goods which are already specific or ascertained at the time of contracting"). If, for example, I have two widgets and I sell one for \$110 and the other for \$125 but deliver neither to you, you cannot show that my breach resulted in the sale at the higher price.

103. For a pre-Code case holding that in order for a buyer to recover from a third party in conversion, the buyer must have property in the goods, see *Procter & Gamble Co. v. Peters, White & Co.*, 233 N.Y. 97, 134 N.E. 849 (1922). U.C.C. § 2-722 (1978) now governs this situation. The availability of an action in conversion may account for the absence of sale of goods cases dealing with the right to disgorgement based on specific performance. This observation does not apply to contracts for the sale of land, however, since land cannot be the subject of conversion.

104. See Sharpe & Waddams, *Damages for Lost Opportunity to Bargain*, 2 OXFORD J. LEGAL STUD. 290 (1982); see also Kronman, *supra* note 42, at 379 (arguing that limiting the buyer to

ing to their argument, a party to a contract with a right to compel performance has an opportunity to bargain with the other party using that right as a bargaining tool. If the other party frustrates that right by breaking the contract, then that party should be liable for "damages for lost opportunity to bargain." In order to find liability, the court must construct a hypothetical bargain, one that the parties would have made had there been no breach.¹⁰⁶ This approach, of course, would lead to damages equal to gain in terms of *saving of the cost of modification*.

Sharpe and Waddams, however, fail to consider the possibility that a court might limit recovery to what the injured party might reasonably have obtained by negotiating a modification. They would allow damages equal to the full profit of the party in breach—even though the injured party could scarcely have succeeded in negotiating such a one-sided bargain—on the ground that the party in breach, "by his own misconduct, has prevented anyone from knowing how much in fact would have been paid for the right taken."¹⁰⁸

The case of the negative covenant illustrates the shortcomings of the Sharpe and Waddams model. Suppose that the seller of a business makes a valid covenant not to compete with the buyer and then breaks the covenant by operating a competing business. If the buyer claims damages under the expectation principle, the court will often receive evidence of the profits that the seller made from the competing business as evidence of the profits that the buyer lost as a result of the breach.¹⁰⁷ But a court will not assume that the buyer could have made the same sales that the seller did; the seller's profits are at most only evidence of the buyer's loss under the expectation principle.¹⁰⁸ The buyer would attempt to recover the seller's profits from the competing business under the disgorgement principle. Since the buyer would have been entitled to enjoin the seller from competing, disgorgement can be justified on the ground that the buyer is entitled to compensation in the amount of the profits for loss of an opportunity to

damages would permit "deliberate conversion of property rules to liability rules"); Schwartz, *supra* note 44, at 290 (specific performance should generally be available even where damages would be more efficient).

105. Cf. Note, *A Theory of Hypothetical Contract*, 94 YALE L.J. 415 (1984) (proposing hypothetical contract for certain cases of restitution).

106. See Sharpe & Waddams, *supra* note 104, at 296. The authors admit that "a critic might say . . . that the presumption is used as a fictitious justification for what should preferably be viewed as a restitutionary measure," but they defend the result "on a compensatory basis." *Id.* at 297.

107. Courts differ considerably in their treatment of this question of admissibility. Compare *Cincinnati Siemens-Lungren Co. v. Western Siemens-Lungren Gas Illuminating Co.*, 152 U.S. 200 (1894) (buyer's damages limited to seller's actual profits) with *Uinta Oil Ref. Co. v. Ledford*, 125 Colo. 429, 244 P.2d 881 (1952) (principal's sales can be used as estimate of agent's damages) and *Buxbaum v. G.H.P. Cigar Co.*, 188 Wis. 389, 206 N.W. 59 (1925) (if principal is in breach of exclusive agency agreement, agent may, where principal breaches, use principal's profits as evidence of agent's loss).

108. See *Vermont Elec. Supply Co. v. Andrus*, 135 Vt. 190, 373 A.2d 531 (1977).

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bargain, even though there is nothing comparable to land in which the buyer can be said to have an “equitable interest.”

A New York court held the buyer entitled to disgorgement in just such a case, *Y.J.D. Restaurant Supply Co. v. Dib*.¹⁰⁹ After selling his store to the plaintiff and covenanting not to compete within a five block radius, the defendant broke the covenant by opening a competing store that he then sold for \$250,000. The defendant admitted that after subtracting the costs of opening and running the business, he had realized a profit of \$35,000. The court held that the plaintiff was entitled to recover this entire sum, no doubt exceeding the amount that the plaintiff could have obtained by negotiating a modification, because “the defendant cannot sustain any gain by such willful misconduct on his part.”¹¹⁰ Other courts have used similar reasoning.¹¹¹

Use of the promisor’s profit to measure the promisor’s gain in these cases is easier to defend if one assumes that, had the promise been performed, the promisee would have made a similar profit. The expectation principle then reinforces the result. Although courts will not assume that the promisee’s loss equals the promisor’s gain when expectation damages are claimed, they may nevertheless assume a rough equivalence when measuring gain under the disgorgement principle.

Without such an assumption, a few courts have limited recovery to gain in terms of *saving of the cost of modification* as estimated by the court. In *Wrotham Park Estate Co. v. Parkside Homes*,¹¹² an English case, the defendants had constructed homes in violation of a restrictive covenant, but the plaintiffs could not prove that this had diminished the value of their property. The court concluded that it would not be just to leave the defendants “in undisturbed possession of the fruits of their wrongdoing”¹¹³ and that “a just substitute for a mandatory injunction would be such a sum of money as might reasonably have been demanded by the plaintiffs . . . as a quid pro quo for relaxing the covenant,”¹¹⁴ a sum that the court calculated on the assumption that the defendant would have paid five percent of the profit that it conceded it made from the development

109. 98 Misc. 2d 462, 413 N.Y.S.2d 835 (N.Y. Sup. Ct. 1979).

110. *Id.* at 465, 413 N.Y.S.2d at 837.

111. *See, e.g.*, *Deterding v. United States*, 69 F. Supp. 214 (Ct. Cl. 1947) (grantee of easement accountable for profits when it broke contract by claiming rights inconsistent with grantor’s exclusive right to oil and gas); *Automatic Laundry Serv. v. Demas*, 216 Md. 544, 141 A.2d 497 (1958) (son of owner of trailer park accountable for profits where he was “a knowing participant” in father’s breach); *Oscar Barnett Foundry Co. v. Crowe*, 80 N.J. Eq. 112, 86 A.2d 915 (1910) (inventor of patentable invention accountable for profits when it broke contract not to compete with exclusive licensee). Palmer urges a narrow reading of *Deterding* and *Oscar Barnett*. *See* 1 G. PALMER, *supra* note 14, § 4.9, at 446–48 & n.41.

112. [1974] 1 W.L.R. 798.

113. *Id.* at 812.

114. *Id.* at 815.

that violated the covenant.¹¹⁵ In *Arbutus Park Estates v. Fuller*,¹¹⁶ a Canadian case, the defendants had partially completed a garage in violation of a covenant requiring them to have plans approved by the plaintiff. The court allowed damages in the amount that the defendants had saved by not having an architect draw up plans, an amount estimated to be seven percent of the construction cost.¹¹⁷ There is also an American case, *Structural Dynamics Research Corp. v. Engineering Mechanics Research Corp.*,¹¹⁸ that gave limited recovery based on a reasonable royalty for breach of a contract not to disclose confidential information, even though the party in breach had not made a profit.

Equitable relief is more appealing than property as a basis for an extension of the disgorgement principle. Courts grant equitable relief only if damages would be inadequate to protect the injured party's expectation interest.¹¹⁹ The availability of equitable relief indicates that expectation damages pose a significant risk of undercompensation; a party who exposes the injured party to such a risk by breaking a contract, and who then puts equitable relief out of the other party's reach, arguably should be required to disgorge any gain resulting from the breach. Equitable relief is not, however, available in all situations where expectation damages pose a significant risk of undercompensating the plaintiff.¹²⁰ A party in breach who has exposed the injured party to a significant risk of undercompensation should be required to disgorge any gain resulting from the breach, even though there was no right to equitable relief. If disgorgement could be limited to gain in terms of *saving of the cost of modification*, the principle could more easily be extended to such cases of undercompensation.

115. *Id.* at 815-16. Though the court evidently regarded this sum as what the injured party lost, it is also equal to the "fruits" of the builder's wrongdoing if the negotiations are assumed to be without transaction costs. For a later case in which the court based damages on the assumption that an owner who built a £75,000 house in violation of a restrictive covenant would have been willing to pay £72,000 to acquire the right to do so, see *Bracewell v. Appleby*, [1974] 1 Ch. 408. The argument that damages should be based on what the party in breach would have been willing to pay was, however, rejected where no injunctive relief would have been granted in the *Ocean Island* case. *Tito v. Waddell* (No. 2), [1977] 1 Ch. 106, 335-36.

No American case appears to have taken this approach, but for a case granting the owner of land in a subdivision punitive damages in addition to an injunction where the subdivision developed violated restrictive covenants with respect to resubdivision and building, see *Eakman v. Robb*, 237 N.W.2d 423 (N.D. 1975), discussed *infra* text accompanying note 172.

116. 74 D.L.R.3d 257 (B.C. 1976).

117. *Id.* at 266.

118. 401 F. Supp. 1102 (E.D. Mich. 1975).

119. See RESTATEMENT (SECOND) OF CONTRACTS § 359 (1981); U.C.C. § 2-716 comment 2 (inability to cover is "strong evidence" that specific performance is appropriate). But see Schwartz, *supra* note 44, at 271 ("[T]he remedy of specific performance should be as routinely available as the damages remedy.").

120. See Kronman, *supra* note 42, at 365 (risk of undercompensation should not be placed on "someone who is, after all, an innocent victim of his breach").

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3. *More General Recognition*

The *Restatement (Second) of Restitution* appears at first to give general recognition to the disgorgement principle. A section styled "Benefit Acquired Through Wrongful Conduct" gives an injured party a right in some instances to require the party in breach to disgorge a benefit acquired as a result of a breach of contract: "A person may be unjustly enriched by receiving a benefit from conduct in violation of a duty owed either by him or by another."¹²¹ Although, read broadly, this language might apply to any benefit received as a result of a breach of contract, the commentary indicates that its scope is more limited. The only examples given in which the injured party might have such a claim are the two traditional ones in which the party in breach has committed a tort with respect to the injured party's property or has committed a breach of a fiduciary duty.¹²²

In no jurisdiction do courts generally apply the disgorgement principle. The decisions containing such statements are widely scattered, do not cite each other, and show no coherent pattern. Even advocates of the disgorgement principle concede that judicial recognition has been rare.¹²³ Those few cases containing broad endorsements of the principle can be explained on narrower grounds.¹²⁴

121. RESTATEMENT (SECOND) OF RESTITUTION § 4 (Tent. Draft No. 1, 1983). The comparable provision, § 3, of the RESTATEMENT (FIRST) OF RESTITUTION (1937) carried the narrower title "Tortious Acquisition of a Benefit." It stated the broad principle: "A person is not permitted to profit by his own wrong at the expense of another." But the commentary admitted that this "principle has not yet crystallized into a rule since . . . it is only in certain types of situations that restitution is permitted." *Id.* at § 3 comment a.

122. See RESTATEMENT (SECOND) OF RESTITUTION § 4 comment a (Tent. Draft No. 1, 1983).

123. See L. FULLER & M. EISENBERG, BASIC CONTRACT LAW 302 (4th ed. 1981); 1 G. PALMER, *supra* note 14, § 4.9, at 438; J. SHEPHERD, *supra* note 46, at 86; S. WADDAMS, THE LAW OF DAMAGES 552 (1983); Dawson, *supra* note 8, at 187.

124. *Gassner v. Lockett*, 101 So. 2d 33 (Fla. 1958), a case cited by advocates of the principle, involved an action by a purchaser of land against the vendor's estate after the vendor, a forgetful old man, had sold the land to a third person. The trial court based damages on the difference between the contract and the market price of the land. The Florida Supreme Court reversed, holding that under the minority rule followed in Florida, the purchaser would not be entitled to expectation damages since the forgetful vendor's breach was in good faith. The court held that the purchaser could recover the vendor's profit on his resale, an amount that was presumably no greater than expectation damages. The court explained that there was "no reason why the vendor should be allowed to benefit from such mistake" and that "[e]very rule of logic and justice would seem to indicate" that this purchaser should recover the profit. *Id.* at 34. The court cited no authority for this assertion, which has been cited as a general endorsement of the disgorgement principle. But the holding does not go beyond the well-established line of cases in other states that have held a vendor liable as constructive trustee in similar situations.

III. THE DISGORGEMENT PRINCIPLE AND MARKET DAMAGES

A. *When Market Damage Rules Result in Disgorgement*

Since contract law takes special notice when establishing damages of whether goods or services are available on a market, it is of interest to ask whether application of the disgorgement principle to contracts for these goods and services can be justified. If not, it would be difficult to recommend that the principle be generally applicable.

1. *Usual Effect of Market Damage Rules*

Only rarely have courts been faced with situations involving goods or services available on a market in which a breach results in a gain that exceeds liability under the expectation principle. Suppose that by the time for me to deliver the widget to you the market price for widgets rises to \$125, and I then sell the widget to the other buyer for that price. The \$25 damages that I will have to pay for your additional cost to replace the widget will eliminate my \$25 profit, leaving me with nothing.

If we assume a competitive market in which the price at which I sell is the same as the price at which you buy, there is a neat fit between the market damage rules on the one hand and both the expectation and disgorgement principles on the other. In practice, of course, a market will not always operate in such a way that your damages will completely eliminate my profit, even if you buy at the same time that I resell.

2. *Discrepancies in Application of Market Damage Rules*

The market damage rules are particularly likely to produce discrepancies if a shortage of supply disrupts the market. I may be fortunate enough to resell for an above-market price, say \$125, caused by the shortage, while you buy at market price, say \$124. Damages of \$24 will compensate you for your actual loss but will not entirely eliminate my profit of \$25. Or you may be fortunate enough to buy at a price below market, say \$124, while I resell at market price, say \$125. Damages of \$24 will again compensate you for your actual loss but will not entirely eliminate my profit of \$25.

In the first case, where I resell above market price, my breach of contract was not the cause in fact of the \$1 profit that I made by selling above the market price. Had I not broken our contract, I could have bought another widget on the market for \$124, just as you did, and sold it to my new buyer for \$125. In principle, at least, traditional market damage rules accord with this reasoning and base your damages on your \$24 loss, not my \$25 gain.

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In practice, however, courts have often applied traditional damage rules in such a way as to favor disgorgement. They have done this, first, by looking to market price rather than the buyer's actual cover price and, second, by looking to the seller's actual resale price as evidence of market price, thus stripping the party in breach of profit and depriving that party of recompense for the skill and industry to arrange a sale above the market.

If, for example, in applying the market damage rules to my breach of our contract, the court bases your damages on market price rather than your \$124 cover price and uses my resale price of \$125 as evidence of market price, you will recover \$25, not just your \$24 loss, stripping me of my \$1 profit.¹²⁵ In a few startling cases, courts have forced an employee to disgorge the additional compensation earned after quitting one job to take a higher paying one by holding that the new salary is evidence of the market price of the employee's services.¹²⁶ Courts do not, however, advance the notion of disgorgement as a justification in these cases.¹²⁷

Alternatively, when you buy at a below-market price, conventional wisdom—apart from the Uniform Commercial Code—says that market price nonetheless determines your damages. This measure of damages gives you the advantage resulting from the skill and industry it took you to buy at a price below the market. Thus if you buy a widget for only \$124 when the market price for which I sold it is \$125, you are entitled to \$25 damages. But the disgorgement principle is not needed to justify this result. If you bought for *more* than the market price—say for \$126—it would also be the market price of \$125 that determined your damages. It is only fair

125. Courts have used the seller's resale price as evidence of the market price somewhat more frequently in cases involving the sale of land than in cases involving the sale of goods. See *Mercer v. Lemmens*, 230 Cal. App. 2d 167, 173, 40 Cal. Rptr. 803, 807 (1964) ("difference between [plaintiff's] preemptive price and the market value of the property was properly awarded as damages"); accord *Murphy v. Lifschitz*, 183 Misc. 575, 577, 49 N.Y.S.2d 439, 441 (1944) (sale of goods case), *aff'd mem.*, 294 N.Y. 892, 63 N.E.2d 26 (1945). But see *Murarka v. Bachrack Bros.*, 215 F.2d 547, 555 (2d Cir. 1954) (citing *Murphy v. Lifschitz* for proposition that "the seller's resale price may be considered only in a situation where the buyer's loss of profits is too speculative and there is no other way of measuring damages").

126. *Roth v. Speck*, 126 A.2d 153 (D.C. 1956) (where "hairdresser of exceptional talent" broke employment contract, employer was allowed recovery based on value of employee's services as evidenced by \$100 per week received from new employer less his old salary); *Triangle Waist Co. v. Todd*, 223 N.Y. 27, 30-31, 119 N.E. 85, 86 (1918) (Cardozo, J., for the court) (although employer did not prove "by experts the sum that [designer's] services ought to command in the market. . . . [i]t did prove . . . the sum that they had in fact commanded" in subsequent employment). But cf. *William B. Tanner Co. v. WIOO, Inc.*, 528 F.2d 262 (3d Cir. 1975) (published prices at which radio station offered to sell advertising "spots" establish neither damages of plaintiff to whom station had promised a number of spots at those prices nor that plaintiff could have sold spots at those prices). Not even *Palmer* and *Friedmann* go so far as to urge disgorgement in this situation. See 1 G. PALMER, *supra* note 14, at 444-45; *Friedmann*, *supra* note 46, at 519-21. But if the employee's services are so unique or extraordinary as to merit injunctive relief, disgorgement could be justified.

127. For a rare exception, see *Murphy v. Lifschitz*, 183 Misc. 575, 577, 49 N.Y.S. 2d 439, 441 (1944), *aff'd mem.*, 294 N.Y. 892, 63 N.E.2d 26 (1945).

that if you take the risk of an unfavorable substitute purchase, you should also have the advantage of a favorable one.

Under the Code, an injured buyer "may 'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller."¹²⁸ A buyer who makes such a reasonable purchase can recover damages based on the difference between the contract price and the cover price, even if the cover price is higher than the market price. The Code does not make it clear whether the converse is true, that is, whether the buyer is limited to damages based on the difference between the contract price and the cover price if the cover price is lower than the market price. Because the Code relieves the buyer of the risk of a substitute purchase above the market price, it would be consistent with the expectation principle to deprive the buyer of the advantage of a substitute purchase below the market price.¹²⁹ I would then get to keep \$1 of the \$25 profit if you covered for \$24. The question has generated a considerable body of academic writing, most of which favors this result but ignores the disgorgement problem.¹³⁰

Neither of these two possibilities, however, is likely to produce a substantial discrepancy between the impacts of the expectation and the disgorgement principles. More interesting are those exceptional situations where the two principles produce substantially different results. We turn first to situations in which the market damage rules accord with the expectation principle and fall short of the disgorgement principle. We then turn to a few situations in which it has been argued that the market damage rules accord with the disgorgement principle and exceed expectation.

128. U.C.C. § 2-712(1) (1978).

129. See RESTATEMENT (SECOND) OF CONTRACTS § 347 comment e (1981) (if injured party "makes an especially favorable substitute transaction, so that he sustains a smaller loss than might have been expected, his damages are reduced by the loss avoided as a result of that transaction").

130. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 6-4 (2d ed. 1980); Childres, *Buyer's Remedies: The Danger of Section 2-713*, 72 NW. U.L. REV. 837, 843 (1978); Jackson, "Anticipatory Repudiation" and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance, 31 STAN. L. REV. 69, 112-14 (1978); Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 259-61 (1963). It has been suggested that allowing the buyer a larger recovery based on a higher market price rather than a lower cover price would give the buyer a "windfall." See G. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE § 10.02 (1981).

A similar controversy concerns the right of a seller, who on breach by the buyer has resold the goods at a price above the market price, to a greater recovery based on the difference between the contract price and the market price. Again the weight of academic authority would deny such recovery. RESTATEMENT (SECOND) OF CONTRACTS § 347 comment e (1981); J. WHITE & R. SUMMERS, *supra*, at § 7.7; Jackson, *supra*, at 112-14. *But see* Peters, *supra*, at 259-61.

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B. *When Market Damage Rules Fall Short of Disgorgement*

Although the market damage rules traditionally determine market price at the time for delivery of the goods, there are situations in which the seller resells either before or after the time for delivery. In one situation, the seller holds the goods until after the time for delivery and resells them on a market that has risen after that time. In another situation the seller resells the goods before the time for delivery in a market that has already risen and that falls by the time for delivery. In both, the disgorgement principle would give a larger but less justifiable recovery than the market damage rules.

To illustrate the first situation, suppose that instead of delivering the widget to you at the time for delivery, when the market price has risen to \$110, I hold the widget until the market price has risen to \$125 and sell it to another buyer at that price. You are then entitled to only \$10, not all of my \$25 profit. Had I not broken our contract, I could have bought another widget on the market for \$110, held it until the market rose to \$125, and sold it to another buyer for that amount. Therefore my profit of \$25 was not the result of my breach.¹³¹

Lack of causation, however, is not the conventional explanation. Rather, courts have applied the mitigation principle to deny an injured party damages that he could have avoided by taking appropriate steps to make a substitute purchase. The question is *when* was the buyer expected to purchase?

King's Bench in 1824 limited a buyer to damages based on the market price at the time for delivery, not enhanced by any subsequent rise in the market. The buyer's damages were based on "the difference between the contract price and the [market] price which the article bore at or about the time when, by the terms of the contract, it ought to have been delivered."¹³² American courts came to the same conclusion,¹³³ and this aspect of the mitigation principle was later given statutory form.¹³⁴

The purpose of the mitigation principle is to encourage you to take

131. If I did not break the contract but bought another widget at \$110, I would have to add \$10 of my own to the \$100 price you paid. Breach of the contract avoids my loss of the use of that \$10, in effect saving my interest on that amount. But since, upon breach, I am liable to you for \$10 damages, I lose the use of that amount or am liable for interest on it.

132. *Gainsford v. Carroll*, 107 Eng. Rep. 516, 516 (K.B. 1824); *accord* *Startup v. Cortazzi*, 2 C.M. & R. 165, 150 Eng. Rep. 71 (1835) (rejecting buyer's argument that *Gainsford v. Carroll* was distinguishable because buyer had advanced part of the price and thus was deprived of the use of the money).

133. See *Shepherd v. Hampton*, 16 U.S. (3 Wheat.) 200, 204 (1818) (Marshall, C.J., for the Court) (where seller broke contract for sale of cotton by failing to deliver, "the price of the article at the time it was to be delivered, is the measure of damages"); *Medema Homes, Inc. v. Lynn*, 647 P.2d 664 (Colo. 1982) (buyer of home not entitled to damages where market price at date for conveyance was same as contract price, though seller later sold home for higher price).

134. See *infra* note 175.

steps to minimize the loss resulting from my breach. But it does not follow from the mitigation principle that you should be denied a claim under the disgorgement principle if the market happens to rise after that time and if I happen to sell on the higher market. You would have a claim under the disgorgement principle based on my refusal to deliver, but you would still have an incentive to mitigate—that is, cover—whether or not the market rose. A higher market price would leave you with both a widget and the profit of my resale. Even if the market did not rise further, covering would leave you with a widget and your market damages.

It is the reciprocity principle, not the mitigation principle, on which the rejection of the disgorgement principle must rest in this situation. Under the reciprocity principle, a party to a contract should not be made to bear the risk of an adverse turn in the market without being allowed the reciprocal advantage of a favorable turn. A party to a contract is generally accorded such reciprocity in regard to market shifts. And it is implicit in the traditional rules of contract damages that a party who has broken the contract should not, merely because of breach, be denied such reciprocity.¹³⁵

We now turn to the second situation, in which the seller resells the goods before the time for delivery in a market that has already risen and that falls by the time of delivery. Suppose that the market price for widgets rises to \$125 before the time for delivery and I resell the widget for \$125 on the market, but the price falls to \$110 by the time for delivery, when you learn of my breach. I offer to pay you \$10 damages based on market price at the time for delivery. Can you require me to disgorge the entire \$25?

Under the market damage rules you cannot.¹³⁶ In some cases, this result accords with a strict requirement of cause in fact. This is so, however, only if I could have bought another widget on the market and delivered it

135. Admittedly the reciprocity principle is ignored when a fiduciary is required to disgorge the profit resulting from a rise in the market price of misappropriated property. The circumstances out of which fiduciary obligations arise and the law's solicitude for the beneficiaries of those obligations counsel against limiting the beneficiary to damages based on a substitute transaction in the marketplace. A similar point can be made when disgorgement is based on property or specific relief.

136. Prior to the Code, the result was the same even if you learned of my breach at the time of my resale. The Code changes this by allowing you to protect yourself from a further market rise by covering as soon as you learn of the breach. See U.C.C. § 2-712(1) (1978). Since you are protected if you cover, you are expected to cover, and the time that you learned of the breach is therefore the time for determining market price. See U.C.C. § 2-713(1) (1978). After that time, I have the risk of any further rise and the advantage of any decline in the market. Thus if you learned of my breach at the time of my resale, you could require me to pay damages of \$25 based on the market price at that time. Unaccountably, the Code does not make a similar change for a seller's damages. See J. WHITE & R. SUMMERS, *supra* note 130, at §§ 6-7, 7-7; Jackson, *supra* note 130, at 101-06; Peters, *supra* note 130, at 199, 258-59.

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in performance of the contract; that is, if you contracted merely to buy a widget rather than a specific widget.

There is, in any event, a more conventional explanation for the result. By limiting your recovery to \$10 if the market falls to \$110, the market damage rules reflect the reciprocity principle. If the market had continued to rise after my resale at \$125 and had stood at \$140 by the time for delivery, you could have recovered \$40 from me. And since I bear the risk that the market will continue to rise after my resale, I should have the advantage of a decline. The disgorgement principle, on the other hand, denies me this advantage by allowing you to recover \$25 if the market falls while not denying you the full \$40 if the market rises. This is a harsh result since you would be able to obtain a substitute widget on the market at \$110.

C. *When Market Damages Seem to Exceed Expectation: Tacit Approval?*

Although in the situations just discussed, the market damage rules fall short of disgorgement, in other situations those rules appear to exceed expectations. Some commentators argue that in these latter situations courts give tacit approval to the disgorgement principle.¹³⁷ These situations can, however, be explained on other grounds and therefore do not support the principle.

The most compelling situations suggesting tacit approval of disgorgement in connection with the market damage rules are those in which a seller fails to deliver goods following a rise in the market and the buyer behaves so as to appear to suffer less loss than market damages give.¹³⁸ In one situation the seller fails to deliver goods after a rise in the market, and the buyer might either wait until the market has fallen again before replacing the goods or not replace the goods at all. In a second situation, before the seller's failure to deliver, the buyer has made a contract with a sub-buyer for a price less than the market price at the time for delivery.

For an example of the first situation, suppose that you do not replace the widget when the market is \$125. Instead, you wait a month, the market drops to \$110, and you then purchase a widget at that price. I offer to

137. Thus Dawson suggests that "the factor of potential gain through breach has worked indirectly, in unacknowledged ways" and "has probably been a powerful factor in establishing the promisee's expectancy as the normal and accepted measure of damages for breach of contract." Dawson, *supra* note 8, at 187. See also Simon & Novak, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1402-03 (1979) (U.C.C. § 2-713 grants to buyer difference between market price and contract price but does not require that buyer use market).

138. A similar case can be made in connection with situations in which a buyer refuses to take delivery following a drop in the market.

pay \$10 damages, but the market damage rules plainly require me to pay you \$25, disgorging my entire gain. It might therefore seem that the disgorgement principle is at work.¹³⁹

There is, however, a different explanation. Under the reciprocity principle, if your damages—because of the mitigation principle—are not increased by a rise in the market after the date of delivery, they should not be decreased by a fall in the market during the same period.¹⁴⁰

Now suppose that instead of merely delaying replacement of the widget, you do not replace it at all. Can I keep the entire \$25 on the ground that you have suffered no loss? Since the market damage rules require me to pay you \$25 in damages, disgorging my entire gain, it might again seem that the disgorgement principle is at work.

Again, however, the result has a different explanation. It is but a short step from ignoring a buyer's later purchase when fixing damages under the market damage rules to ignoring a buyer's failure to make any purchase at all. If a later purchase by a buyer is of no significance in fixing damages, how can a buyer's failure to make such a purchase be significant? Thus a chain of reasoning that begins with the application of the mitigation principle to later purchases in a rising market leads to the conclusion that a buyer's right to damages under the market damage rules should not depend on whether the buyer ever makes a purchase of substitute goods.¹⁴¹ While the result may be disgorgement, the explanation does

139. See Simon & Novak, *supra* note 137, at 1395, 1420 ("Apart from the delay, such a buyer seems quite clearly to have suffered no loss other than the one measured by his actual replacement cost."); cf. Simon, *A Critique of the Treatment of Market Damages in the Restatement (Second) of Contracts*, 81 COLUM. L. REV. 80, 88 (1981) (same situation as text but buyer breaches).

140. This approach was adopted in both England and the United States. See Sale of Goods Act, 56 & 57 Vict. 30, ch. 71, § 51(3) (1893) (buyer's damages measured by "the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered"); UNIF. SALES ACT § 67(3) (1906) (buyer's damages measured by "the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered"). Both statutes establish a comparable rule for seller's damages. See Sale of Goods Act § 50(3) (1893); UNIF. SALES ACT § 64(3) (1906). In both statutes, damages were fixed according to the market price at the date originally agreed to for delivery, and if the buyer delayed in purchasing replacement goods, the advantage of any fall in the market price or the disadvantage of any rise was for the buyer's account. The incidental effect of the market damage rules in this situation may be to require the seller to disgorge the gain resulting from breach, but the explanation of the result lies not in the disgorgement principle but in the combined effect of the mitigation and the reciprocity principles.

141. This reasoning was even more compelling before the Uniform Commercial Code, when an actual substitute transaction, even one made promptly, was at most merely evidence of market price. The Code's introduction in U.C.C. § 2-706 and § 2-712 of seller's resale and buyer's cover prices as alternatives to market price in fixing damages seems to invite the argument that an injured party who has arranged no substitute transaction should recover no damages. But this argument would deny damages, for example, to an injured buyer who delayed too long before repurchasing or who repurchased something different and was therefore not entitled to relief under the cover section. See, e.g., *McGinnis v. Westworth Chevrolet Co.*, 295 Or. 494, 502, 668 P.2d 365, 370 (1983) (since rental of

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not lie in the disgorgement principle.¹⁴²

For an example of the second situation in which the buyer's behavior appears to result in less loss than market damages, suppose that, before my failure to deliver, you had already made a contract to resell the widget to a sub-buyer for \$110. By the time for delivery the market price rises to \$125, and I resell the widget for that amount. Are you entitled to only \$10, your lost profit on the resale, or to my entire profit of \$25? Under the prevailing view, the damage rules based on market price require me to pay you my entire \$25 profit.¹⁴³ Here too, it might seem that these rules are based on the disgorgement principle.

But again, there is a different rationale. Under the mitigation principle your damages are \$25. The justification is that you still must honor your resale contract. If you do not do so, you will not only lose your \$20 profit on the resale, but will also be liable for damages for breach of the resale contract, and your total damages will surely exceed the \$25 damages recoverable under the market damage rules.¹⁴⁴ Cases involving buyers'

car was not "cover" under contract to buy car, buyer's damages "must be computed through the 'market price' formula").

Even if it is shown that the buyer not only failed to cover but also no longer had any use for the goods, the result should be the same because, since there is a market, the buyer could ordinarily have sold the goods or assigned the right to them on the market. There are, however, extraordinary cases in which, though there is a market for the subject of the contract, the subject might not be marketable by the injured party. *See, e.g.,* *Ogden v. Marshall*, 8 N.Y. 340 (1853) (shipper allowed damages for carrier's failure to carry the shipper's corn following a rise in freight rates based on market for freight, even though shipper had not proved that he had corn to ship or that he could have disposed of his right at a profit).

142. In analyzing these problems it is easy to lose sight of the fact that the market damage rules focus on the market in which the injured party would arrange a substitute transaction to replace the one that has fallen through because of breach. Where the buyer is the injured party, this is the market in which the buyer would have covered by obtaining substitute goods and not the market in which the buyer might have resold the goods had they been delivered. *See* E. FARNSWORTH, *CONTRACTS* 864 (1982).

143. This was the view in many cases prior to the Code involving breach by the seller. *Coombs & Co. of Ogden v. Reed*, 5 Utah 2d 419, 303 P.2d 1097 (1956); *Brightwater Paper Co. v. Monadnock Paper Mills*, 161 F.2d 869 (1st Cir. 1947); *Iron Trade Prods. v. Wilkoff Co.*, 272 Pa. 172, 116 A. 150 (1922); *Tennessee Fertilizer Co. v. International Agricultural Corp.*, 146 Tenn. 451, 243 S.W. 81 (1922) (buyer resold only four-fifths of goods); *Clinton Oil & Mfg. Co. v. Carpenter*, 113 S.C. 10, 101 S.E. 47 (1919); *Floyd v. Mann*, 146 Mich. 356, 109 N.W. 679 (1906); *see* Farnsworth, *Legal Remedies for Breach of Contract*, 70 *COLUM. L. REV.* 1145, 1190 n.189 (1970); *Simon & Novak, supra* note 137, at 1395, 1405.

The leading case under the Code, however, involved a breach by the buyer. *See* *Nobs Chemical, U.S.A., v. Koppers Co.*, 616 F.2d 212, 215 (5th Cir. 1980) ("It is possible that the Code drafters intended . . . [U.C.C. § 2-708(a)] as a liquidated damage clause available to a plaintiff-seller regardless of his actual damages. . . . But, this construction is inconsistent with the code's basic philosophy . . ."); *see also* J. WHITE & R. SUMMERS, *supra* note 130, § 7-12, at 283 ("it is conceivable that [the drafters of the Code] regarded 2-708(1) as a liquidated damage clause available to the plaintiff irrespective of his actual damage," but the authors are "unpersuaded by the need to have a liquidated damage clause"). A few courts took this position prior to the Code where breach was by the seller. But these courts at least recognized the potential liability of the buyer under the resale contract. *See* *Texas Co. v. Pensacola Maritime Corp.*, 279 F. 19, 30 (5th Cir. 1922); *Kaye v. Eddystone Ammunition Corp.*, 250 F. 654, 655 (E.D. Pa. 1918).

144. Since the market in which you purchase has risen by \$25, the market in which your sub-

resale contracts are thus consistent with the expectation principle and offer scant support for the disgorgement principle.

D. *Some Conclusions as to the Disgorgement Principle*

This survey of the disgorgement principle in connection with contracts for goods or services available on a market suggests that the principle is neither justified nor needed. The principle is not justified because there is no compelling argument in its favor as long as the goods or services are available on a market. In addition, it violates the principle of reciprocity, which has its strongest appeal in just those cases. The principle is not needed because the market damages rules fall short of disgorgement in only a few situations.

1. *Some Different Assumptions*

These conclusions rest on the assumption that widgets are fungible and are readily bought and sold on a market. If the case for the disgorgement principle cannot be made on that assumption, its acceptability as a general principle is at best doubtful. Nevertheless, consider briefly two different assumptions.

First, make the assumption that each widget is unique. You would then have a right to specific performance of our contract and, if I frustrated

buyer purchases has probably experienced a similar rise, so that your total damages would be \$35. Suppose, however, that you reach a settlement with your sub-buyer that limits your liability for breach to, say, \$10, which makes a total loss to you of only \$20. The authority that exists appears to support recovery of \$25 rather than \$20. See *United States v. Burton Coal Co.*, 273 U.S. 337 (1927); *Ernesto Foglino & Co., v. Webster*, 244 N.Y. 516, 155 N.E. 878, 879 (1926); *Iron Trade Prods. Co. v. Wilkoff Co.*, 272 Pa. 172, 178, 116 A. 150, 152 (1922). But see *Nobs Chem. U.S.A. v. Koppers Co.*, 616 F.2d 212, 215 (5th Cir. 1980) (breach by buyer: "plaintiffs never acquired the goods from their . . . supplier"). But the explanation for this appears to be not the disgorgement principle but the desire to avoid complicating the dispute between us by introducing issues arising out of the separate transaction between you and your sub-buyer. See *Iron Trade Prods. Co. v. Wilkoff Co.*, 272 Pa. 172, 178, 116 A. 150, 152 (1922) (to consider resale contracts "would inject collateral issues"); *Rodoconachi v. Milburn Bros.*, 18 Q.B.D. 67, 77 (1886) ("the law does not take into account . . . anything that is accidental as between the plaintiff and the defendant"); cf. *Slater v. Hoyle & Smith, Ltd.*, [1920] 2 K.B. 11 (following reasoning in *Rodoconachi* where buyer accepted unmerchantable goods and delivered them to sub-buyer who had made complaints but not taken legal action). Cases involving buyers' resale contracts are thus consistent with the expectation principle and offer scant support for the disgorgement principle. See *Foss v. Heineman*, 144 Wis. 146, 128 N.W. 881 (1910) (where buyer contracted to resell to sub-buyer all the lumber it received from seller, buyer's recovery was limited to lost profit on resale contract resulting from seller's failure to deliver minimum amount promised).

The *Foss* court did lend some support to the disgorgement principle by suggesting that damages might be based on market price rather than on lost profit if the seller's breach was motivated by a desire to take advantage of the rising market. Disgorgement could also be achieved if the sub-buyer were subrogated to a claim by the buyer for damages based on market price, to the extent that the claim exceeded the buyer's lost profit. But see *Interpetrol Bermuda Ltd. v. Kaiser Aluminum Int'l*, 719 F.2d 992, 1000 (9th Cir. 1984) ("we see no reason to award the windfall of recovery against the supplier to the sub-buyer").

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that right by selling the widget to another buyer, the generous rule that is already law requires me to disgorge my entire profit. General application of the disgorgement principle would have no effect. Most actual situations, however, will fall between the extremes of fungibility and uniqueness.

Second, make the intermediate assumption that widgets—like tires or trucks—have significant differences, but that other widgets with generally similar characteristics are available on a market. You would not then be entitled to specific performance and could not, at least under present law, require me to disgorge my gain. Should you be given a claim to disgorgement? From both my point of view and yours, the situation is now different than it was when we assumed that widgets are fungible.

From my point of view, it is now less likely that the rules on market damages will operate to deprive me of any gain. Since widgets have significant differences, I may be able to find another buyer who will value *my* particular widget at \$125 on the date for delivery even though you can find a widget that will meet your needs on the market for \$110 on the same date. If I sell to the other buyer, I take no market risk, and your claim to disgorgement is therefore more compelling than it was when we assumed that widgets were fungible. When widgets are fungible, I can make a \$25 profit only by taking a market risk. And if I assumed such a market risk, the reciprocity principle argues against disgorgement. Now, although I can argue that at least some of my gain is the result of my skill and industry in finding the other buyer, that gain may also result in part from pure luck in finding the other buyer. Nevertheless, to allow your claim would deny me any compensation for my skill and industry.

From your point of view, the sum of money that you are entitled to as damages under the market damage rules will no longer enable you to buy a virtually indistinguishable widget. Is there a significant risk that you will be undercompensated? It is likely that you still have a variety of options. Perhaps you will choose to buy another widget that is, though not identical, an adequate substitute. Perhaps you will prefer to abandon the enterprise that involved the widget. The availability of these options tends to reduce the risk of undercompensation. Of course, if your damages do not wipe out my gain, you may argue that any risk of undercompensation leads to some unfairness in the result. To eliminate any such unfairness, courts would have to draw a line between the situation in which widgets are fungible and the situation in which widgets have significant differences but are not unique. The practical difficulties of such a solution make it an unattractive one. Under present law, you are entitled to disgorgement if you can show that the widget is unique, so that your only option was to abandon the enterprise that involved the widget, but this

does not require the court to make any distinction other than the traditional one used in deciding whether to grant specific performance.

If widgets are fungible, the disgorgement principle is undesirable. If widgets are unique, the disgorgement principle is unnecessary. And the practical difficulties of extending the disgorgement principle to situations in which widgets are neither fungible nor unique outweigh any arguable unfairness that results from the market damage rules.¹⁴⁵

2. *Economic Aspects*

Economic analysis posits that if there is a second buyer who values the widget more highly than you or I do, it is efficient for that buyer to acquire the widget.¹⁴⁶ One way to achieve this result is for me to sell the widget to the second buyer, paying you your damages and keeping the remaining profit from the resale. The prospect of keeping the remaining profit will encourage me to commit an efficient breach if such a buyer appears, and may even induce me to go in search of such a buyer. Because you are made whole for your loss, you are "indifferent" to the breach and hence will not be deterred from entering into contracts in the future.

It might seem, therefore, that application of the disgorgement principle would be economically inefficient. If I am required to disgorge all of the profit on resale, leaving me with nothing, I will no longer have an inducement to commit an efficient breach by selling the widget to the second buyer. If, however, we assume a world without transaction costs, even if I deliver the widget to you for the contract price, you will resell the widget to the second buyer. By hypothesis, it will cost you nothing to locate the

145. Another argument calls into question the view that it is immoral to retain gain acquired as a result of breach of contract. Requiring me to disgorge my full \$25 profit violates a basic principle of fairness that might be called the "evenhandedness principle." By and large, the market damage rules give similar treatment to sellers and other suppliers on the one hand and buyers and other recipients on the other. Suppose, then, that *you* broke your contract with me for the sale of a widget for \$100 by failing to perform when the market had dropped to \$90, and then waited until the market had fallen to \$75 before buying another widget. If you offered me the \$10 to which I am entitled under the market damage rules, could I insist instead that you disgorge your full \$25 profit? You might very well have bought a widget at \$75 even if we had never made a contract. Only rarely would it be possible to establish that the \$75 was part of the \$100 that you were to pay me.

It is therefore not surprising that all of the instances in which courts have required disgorgement of gains resulting from breach of contract have involved disgorgement by sellers and other suppliers. All of the suggestions for wider application of the disgorgement principle have also involved disgorgement by sellers and other suppliers. Such a limitation seems inevitable. A buyer is not a trustee. Because the law requires that a trustee keep trust funds separate from the trustee's own funds, a court can determine if those funds have been misused and, if so, can require disgorgement. But the law cannot require that, on making a contract, a buyer keep the price separate from the buyer's other funds in such a way as to enable a court to determine if those funds have been misused and, if so, to require disgorgement.

146. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 89-90 (2d ed. 1977) ("breach would be value-maximizing and should be encouraged").

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second buyer and to negotiate a resale of the widget. Economic efficiency will still be served since the second buyer would acquire the widget.¹⁴⁷

Thus in a world without transaction costs, the disgorgement principle is as consistent with economic efficiency as is the expectation principle.¹⁴⁸ But the question is which principle better serves economic efficiency in a world with transaction costs. The preferable rule of law then will be the one that enables us to reach a negotiated term with the least cost.

Under the expectation principle, I the seller get the entire advantage of the occurrence of the event (here, the appearance of the second buyer); you the buyer are paid damages intended to put you in the position in which you would have been had the event not occurred. Under the disgorgement principle, in contrast, you the buyer get the entire advantage of the occurrence of the event; I the seller am required to disgorge my gain and am left in the position in which I would have been had the event not occurred.¹⁴⁹

The premise of the traditional market damage rules is that it is best to begin negotiations with a rule based on the assumptions that sellers would prefer to bear the full impact of the event and buyers would prefer to avoid it. The buyer's expectation can be fully protected, with no significant risk of undercompensation, by a cover purchase on the market and a damage payment by the seller. Under the market damage rules, the buyer can pass along to the seller any costs of the buyer's cover transaction. The buyer who covers avoids the transaction costs of finding the second buyer and negotiating a sale or negotiating with the seller a modification of the contract. In these circumstances, especially if the buyer does not normally sell goods of the kind involved in the transaction with the seller, it is reasonable to assume that the buyer would have little interest in bargaining for any substantial part of the impact of the event in question.¹⁵⁰ On these assumptions, a rule based on the expectation principle best serves the interests of both buyer and seller by closely approximating the term that

147. Even if you could not learn the identity of the second buyer, it would be to our mutual advantage to negotiate a release to permit me to sell the widget to the second buyer at a profit, which you and I could divide. On the more limited assumption that negotiations involve transaction costs, it will cost us nothing to reach agreement on this.

148. The point can be put in more general terms: "All measures of damages are economically equivalent in the absence of transaction costs." Farber, *supra* note 43, at 1478.

149. If we were to bargain over the inclusion of a damage term based on one principle or the other, the resulting term would be reflected in the price. Thus I would have to charge a lower price to get the benefit of a term based on the expectation principle, and you would have to pay a higher price to get the benefit of a term based on the disgorgement principle. Of course we might negotiate a term that provided for an intermediate solution, depending on our respective preferences for either bearing or avoiding the impact of the event.

150. Since it is also possible that a second *seller* will appear, willing to take a low enough price for a widget to leave the *buyer* with a profit after the buyer pays the first seller expectation damages, the parties might decide that *each* should bear the full impact of a more advantageous bargain turning up.

would result if they were to negotiate one. The disgorgement principle serves the interest of neither.

IV. A PROPOSAL FOR LIMITED EXTENSION OF THE DISGORGEMENT PRINCIPLE

A. *The Argument for Extension*

An argument can nevertheless be made for extending the principle to a limited class of cases. Suppose that I contract to build a house for you according to your plans for \$150,000. I then find that by substituting cheaper materials I can do the job for \$25,000 less than if I follow the plans. I make the switch, but you do not discover this until the house is built and you have paid me the \$150,000. The price at which you can sell your house on the market is diminished by \$10,000, and it would now cost \$60,000 to replace the materials to conform to the plans, largely because of the cost of undoing and redoing the work.

It is unlikely that a court would award you damages in the amount of \$60,000, your cost of obtaining full performance ("cost to complete"), since the cost to complete will consist in large part of the expense of undoing my defective performance. A court will probably limit you to damages based on that cost and award you damages based on the diminution in the price at which you can sell your house on the market, that is, \$10,000.¹⁵¹ But can you require me to disgorge the \$25,000 that I have saved by switching material in breach of our contract? Of course, if the diminution in market price is \$30,000 rather than \$10,000, you will choose not to rely on the disgorgement principle, but to seek damages based on your \$30,000 loss under the expectation principle. If, however, the diminution in market price is only \$10,000 and you are unable to prove the actual \$30,000 diminution in value to you personally, you would prefer disgorgement of the \$25,000 rather than damages based on the expectation principle.

Here, as in the case of the widget resold, I have realized a gain that is

151. If a builder fails to complete performance or renders a useless performance, the usual measure of damages is the cost to complete. *See Henderson v. Oakes-Waterman Builders*, 44 Cal. App. 2d 615, 112 P.2d 662 (Cal. Dist. Ct. App. 1941) (untenantable and useless building built); *Miner v. Fidelity & Casualty Co.*, 265 Mich. 148, 251 N.W. 335 (1933) (garage built instead of barn). *But see* RESTATEMENT (SECOND) OF CONTRACTS § 348 comment c (1981) (where cost to remedy defects will be clearly disproportionate to probable loss in value to the injured party, damages will be based on diminution in market price to avoid giving the injured party "a substantial windfall"). *See also Grossman Holdings Ltd. v. Hourihan*, 414 So. 2d 1037 (Fla. 1983) (contractor built mirror image of planned house; owners entitled in damages only to difference between value of home as constructed and value of home as it should have been constructed); *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 129 N.E. 889 (1921) (although subcontractor, unknown to builder, used Cohoes and other pipe rather than Reading pipe in building house, court found defect "trivial" and ruled builder entitled to full payment).

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not offset by your expectation damages. But there is an important difference. There I left you with the performance that you were to render (\$100), which you could use to obtain a substitute on the market;¹⁵² here I claimed the right to retain your performance (\$150,000) and left you with my defective performance and no real prospect of recovering damages based on the actual loss to you personally.¹⁵³ My breach has subjected you to a significant risk of undercompensation.

1. *Cost to Complete and Other Indirect Solutions*

Courts sometimes have given the injured party damages in excess of the diminution in market value. They have done this in two ways.

One way is to reject diminution in market value as a basis for damages in favor of cost to complete.¹⁵⁴ In our example, this would give you \$60,000 rather than \$10,000, not only wiping out my gain of \$25,000 but leaving me with a loss of \$35,000. But as has been pointed out, this solution is not generally available in cases like the one under discussion.

The other way is to hold that there has been no substantial performance. Suppose, for example, that you have paid me only 80% of the price, retaining \$30,000 pending final inspection. If you discover before paying me the \$30,000 that I have switched the materials, I must show that my performance was substantial in order to recover on the contract. Under these circumstances, however, a court will find my performance not substantial, and I will have no right under the contract to any of the unpaid \$30,000.¹⁵⁵ A court may also conclude that I am not entitled to restitution, so that I will have no right to the \$30,000 on that ground either. My gain of \$25,000 will be wiped out and I will suffer a loss of \$5,000. This solution is severely limited, however, because it can be used only if the breach is discovered before all of the price has been paid.¹⁵⁶ Some writers

152. The choice is limited to a purchase "in substitution" if the buyer seeks recovery based on cover under U.C.C. § 2-712, but it is not so limited if the buyer is content with damages based on market price under U.C.C. § 2-713.

153. Because of transaction costs, you are not likely to be placated by the suggestion that your remedy is to sell the house that I have built, add your \$10,000 damages to the proceeds, and make new arrangements for another house according to your specifications.

154. *E.g.*, *Young v. Cumberland County Educ. Soc'y*, 183 Ky. 625, 210 S.W. 494 (1919) (builder used soft rather than hard brick on outside of school); *Turner v. Jackson*, 139 Or. 539, 11 P.2d 1048 (1932) (builder used inferior paint, fixtures, and other materials in construction of apartment house); accord *Harris, Ogus & Phillips, Contract Remedies and the Consumer Surplus*, 95 LAW Q. REV. 581, 589-94 (1979); *Muris, Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379, 379-80 (1983); *Yorio, supra* note 43, at 1424.

155. That the injured party has suffered no loss is irrelevant. See *Gillespie Tool Co. v. Wilson*, 123 Pa. 19, 16 A. 36 (1888).

156. In arriving at such indirect solutions, courts have frequently emphasized the "wilful" character of the breach. Thus it has been said that a party whose breach is "wilful" must pay damages based on cost to complete, while damages might otherwise be limited to diminution in market price. See *Muris, Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 571 (1981).

have argued from this that the prevention of gain is a factor in these cases and that such cases lend support to the disgorgement principle.¹⁵⁷

2. *A Direct Solution: Abuse of Contract*

If a case can be made for disgorgement in situations like the case of the switched materials, the question becomes: Can the wrong in these situations be defined with sufficient precision to yield a workable rule? We shall call that wrong "abuse of contract."¹⁵⁸ If I realize a gain as a result of my breach of contract, there has been an abuse of that contract if you, the injured party, are left with a defective performance and no opportunity to use your return performance to attempt to obtain a substitute.¹⁵⁹

Under this rule, my breach by switching materials amounts to an abuse of contract. You cannot use the money that you have paid me to attempt to obtain a substitute. Yet, in spite of the breach, I have the right to retain your performance. Disgorgement in this situation will deprive me of gain resulting from a breach that is likely to leave you inadequately compen-

Neither the RESTATEMENT OF CONTRACTS § 361(1) (1932) nor RESTATEMENT (SECOND) OF CONTRACTS § 348(2) (1981) mentions willfulness as a factor to be considered in deciding whether to award damages based on cost to complete. A breach motivated by a desire for gain seems plainly willful under any definition of the term. Corbin opposed the use of the concept. A. CORBIN, CONTRACTS § 1123, at 7 (1964) (use of term "indicates a childlike faith in the existence of a plain and obvious line between the good and the bad, between the unfortunate virtue and unforgivable sin").

157. See Dawson, *supra* note 8, at 188. Like others who have held this thesis, Dawson points to the case where a court must choose between cost to complete and diminution in market price as a prime example of "situations where actual or potential gain through breach may have influenced the working of the damage remedy." See also Friedmann, *supra* note 46, at 504, 523-24 ("concept of unjust enrichment . . . is implicit" in cases that have awarded cost to complete); Harris, Ogus & Phillips, *supra* note 154, at 593-94 (if diminution in market price is substantially less than cost to complete, "there may be a 'windfall' which must be 'awarded' to one party or the other"); Yorio, *supra* note 43, at 1393-94 (damages limited to diminution in market price may allow party "who deliberately reneged on his promise . . . to retain an unjust benefit from breach").

For cases in which damages appear to equal the builder's savings, see Healy v. Fallon, 69 Conn. 228, 37 A. 495 (1897) (owner allowed difference between cost of boards required by contract and that of boards used in gables and floors); Farrington v. Freeman, 251 Iowa 18, 99 N.W.2d 388 (1959) (owner allowed difference between cost of windows required by contract and that of windows installed). See Groves v. John Wunder Co., 205 Minn. 163, 165, 286 N.W. 235, 236 (1939), also discussed in note 168 *infra*, in which the court characterized the defendant's failure to have leased land in a graded condition as "wilful" and said that the trial court's decision to limit damages to the diminution in market price of the land "handsomely rewards bad faith and deliberate breach of contract." *Id.* at 165, 286 N.W. at 236. For a recent article in support of this approach, see Marshall, *supra* note 43.

158. This notion of abuse of contract differs from opportunism, which has been defined as "self-interest seeking with guile" and includes "bluffs, threats, and games of 'chicken' designed to exploit another party's presumed bargaining disadvantage." Goetz & Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 982 n.38 (1983) (quoting definitions of opportunism). "Wilful" behavior has been characterized as non-opportunistic where the breacher is prepared to pay damages "calculated by the loss to the non-breaching party." See Muris, *supra* note 156, at 571.

159. Cf. Jones, *supra* note 9, at 456 (restitutionary claim should lie only if "the defendant has saved himself expense by failing to perform a collateral term of a contract which he has substantially performed; conversely there should be no restitutionary claims if he fails to perform at all").

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sated. If you did not pay any of the price, however, there would be no abuse of contract, since you would be free to use that money to obtain a substitute from another contractor.¹⁶⁰ If you paid part of the price, you should be treated as if you had paid all of the price, but your right to disgorgement of my gain should be reduced by the amount unpaid.¹⁶¹

My breach by failure to deliver the widget to you, however, does not amount to abuse of contract. You are not left with my defective performance, and you can use the money that you would have paid to attempt to obtain a substitute widget. Even if my breach consisted of the delivery of a defective widget—one in which I had made a saving by a substitution of parts—it would not necessarily amount to an abuse of contract. You could reject the widget, or revoke your acceptance if you have accepted the widget, and then use the price that you would have paid to attempt to obtain a substitute widget.

A particularly important category for application of the notion of abuse of contract comprises cases in which, because of the passage of time, the promised performance is no longer possible. In these cases, as contrasted with the case of the switched materials, it would not help the injured party if courts were to be more generous in awarding cost to complete; there is no cost to complete since no amount of money can turn back the clock.¹⁶² Precedent for applying the disgorgement principle in these situations can be found in cases that required disgorgement by sellers who delayed the delivery of goods.¹⁶³

In most cases of abuse of contract, there is a significant risk of undercompensation. What if it is clear that expectation damages would fully compensate you for all your loss? If immediately after completion of the house you sold it, as you had always planned to do, and received a price diminished by only \$10,000 because of the substitution, disgorgement of the \$25,000 that I saved would go beyond compensating you for your \$10,000 loss. Nevertheless, the difficulty of identifying such cases for separate treatment argues against treating them differently. The Supreme

160. This assumes that my performance is not regarded as substantial and that I therefore cannot recover from you on the contract.

161. You would therefore have no right to disgorgement if the unpaid amount exceeded my gain. My gain would be measured in terms of *savings of the cost of substitution*, that is, the difference between the cost to me of using the cheaper materials and what it would have cost me to use the materials required by the contract. Since the purpose of disgorgement is to deprive me of the gain resulting from my breach, the difference would be measured at the time that my breach occurred—the time when I switched the materials. It would not, therefore, include the cost of replacing the cheaper materials with the proper ones.

162. There are other instances, not involving the passage of time, in which a defective performance is irremediable. *See, e.g., Moss v. Christchurch Rural Dist. Council*, [1925] 2 K.B. 750, 752 (“Suppose irreparable damage has been done to some historic building. No one would suggest that the mere cost of putting new bricks in place of the old . . . would fairly represent the actual loss.”).

163. *See supra* text accompanying note 92.

Court of New Zealand may have had this difficulty in mind in deciding *Samson & Samson Ltd. v. Proctor*.¹⁶⁴ A builder in constructing a home provided insufficient steel reinforcing. A few months after taking possession, however, the owner sold the home for a price undiminished by the defects. The court concluded that the proper measure of the owner's damages was the amount the builder saved by not carrying out his contract.¹⁶⁵

In the case of the switched materials, there is a strong moral argument for disgorgement. Most would agree that the fair thing for me, the builder, to do, once I become aware of the opportunity to use cheaper substitute materials, is to let you, the owner, know of this opportunity and seek your approval of the change, perhaps by a price concession. The unfairness in switching materials is that you have made no choice but have instead been left with a house constructed of cheaper materials. Damages based on diminution in market price will not pay for the replacement of the materials. They will at most enable you, if you sell the house and add the damages to the proceeds, to begin again to have a house built according to your specifications. Otherwise you are left with a house constructed with the switched materials. In either event, the risk of undercompensation is apparent. In the case of the widget resold, however, the market damage rules give you a sum that will enable you to purchase on the market a reasonable substitute of your choice. The point is not that my behavior in switching materials entitles you to damages sufficient to pay for the installation of the specified materials. It is rather that the unfairness of my leaving you with the switched materials and the resulting risk of undercompensation justifies disgorgement of any gain resulting from the switch.¹⁶⁶

3. *Economic Aspects*

In the case of the widget resold, my right to retain any profit remaining after compensating you for your disappointed expectation could be justified on the ground that it was best to begin negotiations with a rule based on the assumption that I would prefer to bear and you would prefer to avoid the full impact of the event in question—the appearance on the

164. [1975] 1 N.Z.L.R. 655 (N.Z.S.C.).

165. *Id.* at 656; *see also* *Joyner v. Weeks*, [1891] 2 Q.B. 31 (damages for lessee's failure to deliver subsequently altered premises in good repair is cost, at time lease ended, of putting premises into state of repair required by covenant).

166. The principle of evenhandedness discussed in note 145 poses no problem. In the case of the widget resold, the disgorgement principle cannot be effectively extended to require buyers to disgorge in situations analogous to those in which sellers would be required to disgorge. In the case of the switched materials, the breach is one that is characteristic of builders and not of owners; there is no analogous situation in which the issue of disgorgement can arise as to an owner.

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scene of a second buyer who was willing to pay enough for the widget to leave a profit after you have received your expectation damages.

But this is not so in the case of the switched materials. Here the event in question is my finding that by substituting cheaper materials, I can do the job for \$25,000 less, so that I will be left with a gain after I have paid you damages based on diminution in value. It is more reasonable to assume that you would prefer to bear the full impact of the switch, even though this would be reflected in a higher price. Since you would then be entitled to any saving made by my switching of materials, I would therefore be indifferent as to any such saving. Thus, if I found that I could save \$25,000 by substituting materials, it would not be in my interest simply to make the switch, for you would then be entitled to the entire saving. It would rather be in my interest to let you know of the possible saving—and negotiate a modification of our contract under which we would share in the saving. A rule based on the disgorgement principle will therefore come closer to the terms that would result if we were to negotiate them than will a rule based on the expectation principle.

B. *Possible Limits on Extension*

1. *Gain in Terms of Saving of the Cost of Modification*

In the examples of abuse of contract given so far, gain was measured in terms of *saving of the cost of substitution*. In the case of the materials switched, this was what I saved by not using the materials required by the contract. There are, however, cases of abuse of contract in which there is no gain in terms of *saving of the cost of substitution* though there is gain in terms of *saving of the cost of modification*. Can the concept of abuse of contract be extended to required disgorgement in these cases?

The leading examples involve restoration of property, usually land. Suppose that I lease land from you in order to extract minerals, promising to restore the land to its original condition by the end of the term. I fail to restore it and the cost to do so would be \$30,000. Restoring the land would, however, increase its price on the market by only \$10,000. I offer to pay you \$10,000 as damages, keeping the remaining \$20,000 for myself. Can I be required to disgorge any of the \$20,000? (A court would not grant you equitable relief by ordering me to restore the land in these circumstances, so that disgorgement would not be justified on the ground that such a right was frustrated.)

Courts that have been asked to determine the landowner's damages under the expectation principle in such cases have themselves left the landscape in a remarkably uneven condition. They have held sometimes that your lost expectation is no more than the \$10,000 diminution in mar-

ket price¹⁶⁷ and sometimes held that your lost expectation is the full \$30,000 cost to complete.¹⁶⁸

In order to see how the disgorgement principle might be applied in such situations, it is useful to ask why there is a discrepancy between the cost to complete and the diminution in market price. Why, when we made the contract, was either of us willing to make an agreement requiring me to do work that will now cost me more than the increase in the market price of your land?

One possible explanation is that when we made the contract, you overestimated the effect that restoration would have on the value of the land. You might have misjudged the market as of the time the contract was made, or you might have been correct in your assessment then, only to watch the market drop and thus reduce the effect of restoration. In either event, since your recovery under the expectation principle is based on your actual loss, my payment of \$10,000 is all that you are entitled to under the expectation principle. If this is the explanation, it is difficult to see why I should be required to disgorge any of the remaining \$20,000.

Another possible answer, however, is that the price was high because the special value to you of restoration is greater than the \$10,000 at which the market values it. In principle, you should then recover damages based upon your actual loss in special value under the expectation principle.¹⁶⁹ In practice, however, you may be unable to prove with sufficient certainty your loss of special value, so that if you are limited to expectation damages you will have to content yourself with the \$10,000 based on market price. Allowing you to recover more than \$10,000 under the disgorgement principle would then have a similar appeal to that in the case of the materials switched—it would deprive me of gain resulting from a breach that left you inadequately compensated.

A third possible explanation of the discrepancy is that I underestimated the cost of restoration, thinking that I could do it for only \$10,000 rather than \$30,000. I might have misjudged my costs at the time the contract

167. The leading American case is *Peevyhouse v. Garland Coal Mining Co.*, 382 P.2d 109 (Okla. 1962), *cert. denied*, 375 U.S. 906 (1963), in which restoring a farm after strip mining would have cost about \$29,000 and would have increased the market price of the farm by only \$300. *Accord* *Eastern S.S. Lines, Inc. v. United States*, 112 F. Supp. 167 (Ct. Cl. 1953) (restoration of ship); *City of Anderson v. Salling Concrete Corp.*, 411 N.E.2d 728 (Ind. Ct. App. 1980) (land fill not brought to level specified in lease). The leading English case, known as the *Ocean Island* case, is *Tito v. Waddell* (No. 2), [1977] 1 Ch. 106.

168. The leading case is *Groves v. John Wunder Co.*, 205 Minn. 163, 286 N.W. 235 (1939), in which restoring land after removal of gravel would have cost upwards of \$60,000 and would have increased the market price of the land by only \$12,160. *Accord* *American Standard, Inc. v. Schectman*, 80 A.D.2d 318, 439 N.Y.S.2d 529 (1981); *cf.* *Rock Island Improvement Co. v. Helmerich & Payne, Inc.*, 698 F.2d 1075 (10th Cir. 1983) (refusing to follow *Peevyhouse* because of enactment of Oklahoma Open Cut Land Reclamation Act).

169. *See* RESTATEMENT (SECOND) OF CONTRACTS § 347 comment b & illustration 1 (1981).

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was made, wrongly thinking that I could do the restoration for \$10,000.¹⁷⁰ Or I might have been correct in my assessment of cost at the time the contract was made, only to have a subsequent rise in prices push the cost of restoration up \$30,000.¹⁷¹ In either event, since your recovery under the expectation principle is based on your loss and not my cost, \$10,000 is all that you are entitled to under that principle. There are two reasons why it seems right in such circumstances to require me to disgorge at least some of the remaining \$20,000.

First, had I overestimated rather than underestimated my costs, I could have enforced against you what would then have been for me an advantageous contract. Second, had I realized before beginning performance that I had underestimated the cost of restoration and refused to begin performance, you would have been entitled under the expectation principle to damages based on another contractor's price. Since that contractor would not have underestimated the cost of restoration, the price would have been roughly \$30,000 higher than my price. I would then have been liable in damages based on that difference and you would have been more than compensated for any loss in special value.

Under the notion of abuse of contract I would have to disgorge my gain. But what is my gain in these circumstances? Here the answer is not as easy as it was in the case of the switched materials, where my saving resulted from the use of cheaper materials.¹⁷² Certainly my gain is not the full \$20,000. Had I, before any breach, recognized your right to performance and negotiated a settlement with you, relieving me of the duty of performance and avoiding a breach on my part, that settlement would have left you far short of \$20,000. It is both practical and fair to resolve this uncertainty in favor of the aggrieved party by requiring the party in breach to disgorge the gain in terms of *saving of the cost of modification*. I would be required to disgorge the sum that you could reasonably have charged for a modification of the contract relieving me of the duty of restoring the land.

Such authority as exists, however, is opposed to measuring gain in

170. This may have been the explanation in the *Peevyhouse* case. See L. FULLER & M. EISENBERG, *supra* note 123, at 196-97 (suggesting, based on court papers, that error as to amount of coal frustrated plan of restoration).

171. See *Eastern S.S. Lines*, 112 F. Supp. at 175.

172. It is also possible that all or part of the explanation of the discrepancy is similar to that in the case of the switched materials. It might, for example, have been possible to restore the land for only \$10,000 had normal steps been taken as the work progressed. But by cutting corners and failing to take such steps I saved, say, \$15,000, with the result that it will now cost \$30,000 to restore the land. In that rather unlikely event, the notion of abuse of contract would require me to disgorge \$15,000, my gain as measured by *saving in terms of the cost of substitution*. To the extent that this is only part of the explanation of the discrepancy, gain should be measured in this fashion.

terms of *saving of the cost of modification*. In the *Ocean Island Case*,¹⁷³ inhabitants of the Ocean Island in the South Pacific had granted the right to mine phosphate to the British Phosphate Commissioners, who promised to replant the land when they were done. When the Commissioners realized that this could be done only at enormous cost, they refused to fulfill their promise. The court, rejecting plaintiffs' suggestion that damages should be based upon what the British Phosphate Commissioners would have paid to be released from their obligation to replant, limited the landowners' recovery to damages based on the much smaller diminution in market price. The court reasoned that cases where the plaintiff initially had a right to specific performance did not apply because those cases merely allowed recovery for the loss that the plaintiff suffered by the defendant's failure to observe the obligation to obtain the plaintiff's consent. And since the court would not allow damages based on cost to complete, the landowners lost nothing by the Commissioner's failure to negotiate a release.

This may be an adequate basis for distinguishing *Wrotham Park*.¹⁷⁴ The reasoning in the *Ocean Island* case, however, focuses on the expectation principle—the landowners' loss—to the exclusion of the disgorgement principle—the Commissioners' gain. By failing either to perform or to negotiate a release, the Commissioners realized a gain in terms of *saving of the cost of modification*. If the disgorgement principle is to be coupled with a restrictive requirement of cause in fact, it is essential to assume that the hypothetical negotiations between the two parties are the only alternatives to performance and that breach with payment of expectation damages is not a possibility. Otherwise the disgorgement principle would have no significance, for there would never be any gain in terms of *saving of the cost of modification*.

Under the disgorgement principle, it would seem that the appropriate measure is the *saving of the cost of modification*.¹⁷⁵ Surely it is reasonable to suppose that when you made the contract you would have been willing to pay some price in order to be able to profit from the uncertain event in question. That event was my realization that I could refuse to perform my promise to regrade the land, pay you your damages (based on diminution in market price), and still be better off than if I had performed my promise. If that event occurred, you would want me to negotiate a modification

173. *Tito v. Waddell* (No. 2), [1977] 1 Ch. 106.

174. [1974] 1 W.L.R. 798 (discussed *supra* text accompanying notes 112–15).

175. Gain in terms of *saving of the cost of substitution* would still be the measure to the extent that the injured party's claim was based on a departure from the promised performance, as in the case of the switched materials. Gain in terms of *saving of the cost of modification* would be the measure of the extent that the injured party's claim was based on a refusal to perform, as in the case of the land unrestored.

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with you that would benefit us both and that would reflect any value to you personally. If I were deprived of the gain that would result from my failure to negotiate, I would have no incentive to act against your interests. You would have been willing to pay for a term that would have required disgorgement to that extent.¹⁷⁶ Note that there is both a lower and an upper boundary to the amount that a court could award. The amount could be no less than damages based on diminution in market price and no greater than damages based on cost to compete.

It can be objected that measuring gain in terms of *saving of the cost of modification* would be excessively burdensome. The expectation measure requires that a court look to the value that performance would have had to the injured party. The measure proposed here, however, would require that the court look also to the cost that performance would have imposed on the party in breach, an amount peculiarly within the knowledge of that party. Furthermore, in estimating the outcome of the course of negotiations between the parties, the court would have to assume that neither party could turn to anyone else. These burdens parallel the uncertainties that would arise if the parties were to attempt to settle the dispute without court intervention.

The proposed measure, nonetheless, is superior to the two other choices. One is to limit the disgorgement principle to situations in which gain can be measured in terms of *saving of the cost of substitution*, as in the case of the switched materials. The consequence of this would be a much more modest extension of the disgorgement principle, which would fail to cover an important instance of abuse of contract. Another is to require disgorgement of gain based on cost to complete, abandoning the strict requirement of cause in fact. The consequence of this approach would be a rule that would amount to the allowance of expectation damages based on cost to complete. Courts that disfavor this measure under the expectation principle would not favor it under the disgorgement principle.

2. *Significance of Unintentional Breach*

The concept of abuse of contract should not be limited to situations in which the breach is in some respect intentional. Although opinions in contract cases sometimes lay emphasis on the "willful" character of a breach, contract law generally treats unwilling breaches in the same way as knowing breaches committed to realize gain. Indeed, it would be hard to implement a distinction based on the character of the breach. Given the

176. For a suggestion that a court might divide the gain between the parties, without specifying very precisely the bases of the division, see Harris, Ogus & Phillips, *supra* note 154, at 593-94; Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49, 70.

eagerness of contracting parties to find possible legal justifications for non-performance where this is to their advantage, having to decide whether, and perhaps to what extent, a breach was committed knowingly would place a heavy burden on courts. Any extension of the disgorgement principle should be without regard to the character of the breach.

CONCLUSION

For roughly three centuries, courts have worked to implement two principles: the principle of the law of restitution that one should not gain by one's own wrong and the principle of the law of contracts that damages for breach should be based on the injured party's lost expectation. In many situations, the two principles appear to be in complete harmony; the traditional measure of damages based on the injured party's expectation strips the party in breach of the resulting gain. But in other situations, the traditional measure of damages does not accomplish this result, and the party in breach is left with at least some of the resulting gain.

In selected situations—notably those involving fiduciaries, sellers of goods who would be liable in conversion, and sellers of land—courts have gone beyond the traditional measure of expectation damages and required complete disgorgement. Courts have not, however, extended the disgorgement principle to contracts in general.

This Article has found the arguments in favor of such a general extension of the disgorgement principle unconvincing. In the important situation of goods or services available on a market, the disgorgement principle is undesirable because, among other reasons, it fails to take account of both the principle of reciprocity and the principle of evenhandedness.

There are, nonetheless, contract breaches to which the disgorgement principle ought to extend. These involve abuse of contract, the rendering of a defective performance that leaves the injured party with no opportunity to use that party's own return performance to obtain a reasonable substitute. In these situations, limiting the injured party to damages based on the expectation principle poses a significant risk of undercompensation. It is therefore appropriate to require the party in breach, who has placed the injured party in this position, to disgorge any gain resulting from the breach. A persuasive analogy can be found in cases that extend the disgorgement principle beyond promises to sell land to other promises that are enforceable in equity. Since the basis of equitable relief is generally the inadequacy of the damage remedy, these cases illustrate a general proposition that a party in breach should be required to disgorge any gain resulting from the breach when the breach has left the injured party with a significant risk of undercompensation. Extending the disgorgement principle to cases involving abuse of contract serves this end.

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If the disgorgement principle is extended to such cases, it is appropriate to measure gain not in terms of profit but in terms of *saving of the cost of other means*. Sometimes this will be *saving of the cost of substitution* and sometimes *saving of the cost of modification*. Again, a persuasive analogy can be found in cases that extend the disgorgement principle generally to promises that are enforceable in equity, since at least some of these cases have used saving as the measure of gain. Where courts have measured gain by profit rather than saving, they may be influenced by a suspicion that the lesser measure of saving would fall far short of the expectation damages that the injured party actually may have suffered as a result of the breach. Where there is no reason for such a suspicion, saving is a more suitable measure than is profit.

The proposal made here is more practical than the sweeping suggestion that the disgorgement principle be extended generally to all contracts. It would go far towards relieving the tension between the expectation and disgorgement principles.

