HOT TOPICS IN LITIGATION:

RESTITUTION/UNJUST ENRICHMENT

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Member, Pattern Jury Charge Committee (Family Law), State Bar of Texas (1987-2000)

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President, Texas Academy of Family Law Specialists (1990-91)

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---*A Guide to Proceedings Under the Texas Parent Notification Statute and Rules,* SOUTH TEXAS LAW REVIEW (2000) (co-authored)

---*Obligations of the Trial Lawyer Under Texas Law Toward the Client Relating to an Appeal,* 41 SOUTH TEXAS LAW REVIEW 111 (1999)

---*Asserting Claims for Intentionally or Recklessly Causing Severe Emotional Distress, in Connection With a Divorce*, 25 ST. MARY'S L.J. 1253 (1994), republished in the AMERICAN JOURNAL OF FAMILY LAW (Fall 1994) and Texas Family Law Service *NewsAlert* (Oct. & Dec., 1994 and Feb., 1995)

---Chapter 21 on *Business Interests* in Bancroft-Whitney's TEXAS FAMILY LAW SERVICE (Speer's 6th ed.)

---*Characterization of Marital Property*, 39 BAY. L. REV. 909 (1988) (co-authored)

---*Fitting a Round Peg Into A Square Hole: Section 3.63, Texas Family Code, and the Marriage That Crosses States Lines*, 13 ST. MARY'S L.J. 477 (1982)

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SBOT's Marriage Dissolution Course: Property Problems Created by Crossing State Lines (1982); Child Snatching and Interfering with Possess'n: Remedies (1986); Family Law and the Family Business: Proprietorships, Partnerships and Corporations (1987); Appellate Practice (Family Law) (1990); Discovery in Custody and Property Cases (1991); Discovery (1993); Identifying and Dealing With Illegal, Unethical and Harassing Practices (1994); Gender Issues in the Everyday Practice of Family Law (1995); Dialogue on Common Evidence Problems (1995); Handling the Divorce Involving Trusts or Family Limited Partnerships (1998); The Expert Witness Manual (1999); Focus on Experts: Close-up Interviews on Procedure, Mental Health and Financial Experts (2000); Activities in the Trial Court During Appeal and After Remand (2002)

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SBOT's Advanced Civil Appellate Practice Course: Handling the Appeal from a Bench Trial in a Civil Case (1989); Appeal of Non-Jury Trials (1990); Successful Challenges to Legal/Factual Sufficiency (1991); In the Sup. Ct.: Reversing the Court of Appeals (1992); Brief Writing: Creatively Crafting for the Reader (1993); Interlocutory and Accelerated Appeals (1994); Non-Jury Appeals (1995); Technology and the Courtroom of the Future (1996); Are Non-Jury Trials Ever "Appealing"? (1998); Enforcing the Judgment, Including While on Appeal (1998); Judges vs. Juries: A Debate (2000); Appellate Squares (2000); Texas Supreme Court Trends (2002); New Appellate Rules and New Trial Rules (2003); Supreme Court Trends (2004); Recent Developments in the *Daubert* Swamp (2005)

Various CLE Providers: SBOT Advanced Civil Trial Course: Judgment Enforcement, Turnover and Contempt (1990-1991), Offering and Excluding Evidence (1995), New Appellate Rules (1997), The Communications Revolution: Portability, The Internet and the Practice of Law (1998), Daubert With Emphasis on Commercial Litigation, Damages, and the NonScientific Expert (2000), Rules/Legislation Preview (State Perspective) (2002); College of Advanced Judicial Studies: Evidentiary Issues (2001);

El Paso Family Law Bar Ass'n: Foreign Law and Foreign Evidence (2001); American Institute of Certified Public Accounts: Admissibility of Lay and Expert Testimony; General Acceptance Versus Daubert (2002); Texas and Louisiana Associations of Defense Counsel: Use of Fact Witnesses, Lay Opinion, and Expert Testimony; When and How to Raise a Daubert Challenge (2002)

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Restitution/Unjust Enrichment

by
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I. SCOPE OF ARTICLE. This article discusses the doctrines of restitution and unjust enrichment. The article covers the Restatement (Third) of Restitution and Unjust Enrichment as well as the Texas cause of action known as "money had and received," and the principle of disgorgement applied in *Burrow v. Arce.*

II. THE VIEW FROM 10,000 FEET. After more than a century of expansion, tort law is now in retreat, in Texas and across America. In Texas, advertising and news reports have made high damage awards unpopular. Attacks by politicians on plaintiffs' lawyers, legislatively-imposed limitations on damages, harder proof requirements and an elevated burden of persuasion for exemplary damages, the evisceration of class actions, are all indications of this trend.

The focus of those who would like to recover lost opportunities to seek legal redress, or to continue to expand opportunities to seek legal redress, will now shift from traditional tort remedies to other avenues that have fewer impediments. One area of the law that could lend itself to such efforts is the law of unjust enrichment and restitution.

The law of restitution and unjust enrichment has ancient roots, but has only recently begun to be articulated as a cohesive set of principles. There is much ignorance, confusion, and disagreement, about the law of unjust enrichment and restitution. The American Law Institute's [ALI] Restatement of Restitution, published in 1937, was the first effort in America to recognize a body of law on the subject. The ALI's Restatement (Second) was started and then abandoned. A law professor is now laboriously developing a Restatement (Third) of Restitution and Unjust Enrichment ["Restatement (Third)"]. Some scholars are skeptical that such a body of law exists. The small number of scholars who are interested in the subject offer differing rationales that could serve as unifying principles for such a body of law. The courts of different states are at different stages of development in recognizing the threads which could be used to weave the tapestry of this body of law. Conditions such as these create an environment where creative and determined lawyers can find new ways for their clients to recovery money through the legal system and to right wrongs that can no longer be as effectively addressed through traditional tort remedies.

Both contract and tort law are founded on two principles: fault and reparation. In both contract and tort law, liability is founded on wrongful behavior, i.e., breach of a duty. In both contract and tort law, recovery is based on restoring the injured party to its pre-injury condition. In both instances, recovery (i.e., damages) is measured by the loss suffered by the victim. Tort law also allows the jury, in certain instances, to award an extra recovery as punishment for the wrongdoer and disincentive to others.

In unjust enrichment, fault is still usually required. This is the "unjust" component of unjust enrichment. But recovery is not limited to the victim's loss. Recovery is sometimes allowed even when the plaintiff has suffered no measurable damages. In such situations, recovery is measured by the gain to the wrongdoer. This is the "enrichment" part of unjust enrichment.

"Disgorgement" is an example. In Texas, a breach of fiduciary duty can be remedied by reducing or denying

the fiduciary's compensation, or by forcing the fiduciary to disgorge earnings or profits. Across the nation, disgorgement is not limited to breach of fiduciary duty. The current draft of the Restatement (Third) of Restitution and Unjust Enrichment permits disgorgement of profits for "opportunistic" breach of contract, i.e., a deliberate breach of contract in situations where the gain to the wrongdoer exceeds the damages to the innocent contracting party. The new Restatement permits disgorgement for a "profitable tort,", i.e., the commission of a tort for the purpose of securing gains that exceeds the harm to the tort victim. Such disgorgement does not constitute exemplary damages, and thus is not subject to limitations on exemplary damages.

Imagine an unjust enrichment suit against a cigarette manufacturer where the measure of recovery is not actual plus exemplary damages, but rather a disgorgement of profits derived from the conscious sale of what the plaintiff claims the company knew to be an addictive and injurious product. Imagine an unjust enrichment lawsuit against a drug manufacturer based on allegations of selling a drug that the company knew would cause harm to a certain percent of its customers. Imagine a suit against a car manufacturer who failed to recall automobiles with a defective component, based on the determination that the cost of recall would exceed the damages they would have to pay to the small percentage of people who might be injured because of the defect. Disgorgement could be a powerful tool to support a recovery beyond the limits of traditional compensatory and exemplary damages.

The law of unjust enrichment and restitution contains "limiting principles" that guard against overuse of the doctrine. The requirement of fault, however defined, is such a limitation. Also, unjust enrichment and restitution do not apply to a situation governed by an enforceable contract. However, the requirement of damages suffered by the claimant is not such a limiting principle. Another limiting principle is the view that the degree of unjustness, and the resulting extent of disgorgement, must be determined by a judge and not a jury. This is a procedural limitation, but one that would tend to reduce the recovery from what a jury might be expected to award.

The power of these concepts, largely untried in litigation, makes unjust enrichment and restitution an important new area where the forces of expansion may clash with the forces of restraint over the scope of legal liability.

III. ROOTS. The roots of the concept of unjust enrichment and restitution trace back to Lord Mansfield's opinion in *Moses v. Macfarlin*, 2 Burr. 1005, 1012, 97 Eng. Rep. 676, 680-81 (K.B. 1760), involving a mistaken transfer of money from the plaintiff to the defendant. Lord Mansfield wrote that "the gist of this kind of action is, that the defendant, upon the circumstance of the case, is obliged by the ties of natural justice and equity to refund the money." The cause of action referred to by Lord Mansfield was "money had and received to the plaintiff's use." *Id.* 2 Burr. At 1001, 97 Eng. Rep. At 680. The remedy became known as "restitution," whereby the court restores to the plaintiff the money that the defendant received but should not keep. The claim sounded under the doctrine of assumpsit, or promise, and was viewed as a quasi-contractual (i.e. implied promise) obligation to return money paid in error. *Amoco Prod. Co. v. Smith*, 946 S.W.2d 162, 164 (Tex. App.– El Paso 1997, no writ).

In subsequent years, the conception of unjust enrichment and restitution migrated from "money had and received" to other areas of the law, including contract and tort.

IV. FIRST RESTATEMENT. In 1937, the American Law Institute (ALI) published the first Restatement of Restitution. The book gathered together cases reflecting recognized legal and equitable claims which the

Restatement said exemplified the principle that "[a] person who has been unjustly enriched at the expense of another is required to make restitution to the other." This Restatement invigorated the discussion between law professors, but has not left much of an impression in case law. The law professor writing the new Restatement on the subject identified the most significant innovation of the first Restatement as "its unified treatment of law and equity, presenting quasi-contract and constructive trust as alternative responses to the problem of unjust enrichment." Kull, Andrew, 25 OXFORD JOURNAL OF LEGAL STUDIES 297 (2005).

V. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT. The ALI is currently in the process of issuing a new Restatement on the subject of Restitution and Unjust Enrichment. Professor Andrew Kull is writing the Restatement (Third). The book is being written in stages. Professor Kull releases a "Tentative Draft," receives comment, and then releases a revised draft, called a "Discussion Draft." Much of the book is still at the Tentative Draft stage. Nothing in the Restatement (Third) has been considered at an ALI annual meeting. The current draft is basically the work of one person, with input from a group of advisors consisting of appellate judges, trial judges and law professors. You can purchase the work in parts from the ALI. *See* <http://www.ali.org/ali/Restit.htm. The work is also available on Westlaw at "REST 3d RESTI".

Professor Kull has carried forward the fundamental principle from the First Restatement: "A person who is unjustly enriched at the expense of another is liable in restitution to the other." Restatement (Third) § 1 (Discussion Draft, 2000). Professor Kull says that "[t]he law of restitution is the law of unjust enrichment." *Id*. § 1. Comment 6.

Professor Kull tackles a description of unjust enrichment in Comments to Section 1 of the Restatement (Third). He calls unjust enrichment "unjustified enrichment." Unjustified enrichment, he says, is "enrichment that lacks an adequate legal basis: it results from a transfer that the law treats as ineffective to work a conclusive alteration in ownership rights." *Id.* Unjustified enrichment means "the transfer of a benefit without adequate legal ground." *Id.*

Professor Kull identifies three principal divisions of liability in restitution: (1) where the plaintiff may negate a transfer based upon mistake, fraud, duress, undue influence; (2) transfer by a person lacking capacity or authority; and (3) transfers made under legal compulsion later invalidated. *Id.* Professor Kull also recognizes restitution as a remedy for breach of contractual and tort duties are covered below.

VI. ANOTHER APPROACH. A clear approach to restitution and unjust enrichment is provided by Washington & Lee law professor Doug Rendelman in *When is Enrichment Unjust? Restitution Visits an Onyx Bathroom*, 36 LOYOLA OF LOS ANGELES L. REV. 991 (2003). Professor Rendelman divides restitution into two branches: restitution for breach, and freestanding restitution. *Id*. at 993.

In restitution for breach, liability is premised on breach of contract or tort, and restitution is an alternative remedy to compensatory damages. In freestanding restitution, based on unjust enrichment without a breach of contract or tort, the claimant recovers restitution or nothing. *Id*. at 993.

Freestanding restitution can be based on mistake, or on circumstances that negate consent, like duress, undue influence or lack of capacity. *Id.* at 993. Freestanding restitution also includes the recovery of consideration the claimant transferred pursuant to a contract, which fails, due to the statute of frauds, or direct inability to perform. *Id*. at 993-94. Freestanding restitution is also recognized in some cases for a benefit conferred without mistake and without a contract or gift. *Id.* at 994.

Professor Rendelman goes on to differentiate analysts into those who support "broad restitution" and those who support "narrow restitution." Broad restitution is free-ranging, and does not require the case to fit specified fact patterns. In this view, restitution has been described as "an indefinable idea in the same way that justice is indefinable." Professor George E. Palmer, THE LAW OF RESTITUTION § 1.1, at 5 (1978). Professor Palmer expansively noted: "The idea of unjust enrichment permeates almost the whole of restitution and occasionally is called upon to explain the relief given when anything more precise defies formulation." *Id.*, § 1.7, at 44, cited in Rendelman, at 995. Rendelman also quotes Professor Dan Dobbs, who said that "[u]njust enrichment cannot be precisely defined, and for that very reason has the potential for resolving new problems in striking ways." Dan B. Dobbs, DOBBS LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION § 4.1(2), at 557 (2d ed. 1993), quoted in Rendelman, at 995. In contrast, Professor John Dawson criticized restitution based on unjust enrichment as being susceptible to abuse. Professor Dawson believed that embracing unjust enrichment, without requiring recognized rules, would "carry us so far that we would quickly lose our way." JOHN P. DAWSON, UNJUST ENRICHMENT 150-51 (1951), cited in Rendelman, at 997. Professor Dawson envisaged claims based on identifiable fact patterns used as the basis for restitution, although these fact patterns would and should differ from those required to support recovery in contract and tort.

VII. MONEY HAD AND RECEIVED. As noted above, one historical root of unjust enrichment and restitution was a cause of action, arising in assumpsit, for a mistaken transfer of money by the plaintiff to the defendant, called "money had and received." The claim was conceived as an implied promise to return what was mistakenly received. The cause of action did not require proof of fault, or even knowledge by the defendant of the mistaken conception behind the transfer. A similar remedy existed in equity courts, i.e., the imposition of a constructive trust. This dual nature of mistaken transfers, implied contract and constructive trust, pervades modern discussion of restitution and unjust enrichment.

In Texas, all that must be proved for money had and received is that "the defendant holds money which in equity and good conscience belongs to [the plaintiff]." *Staats v. Miller*, 243 S.W.2d 686, 687 (Tex. 1951). The remedy also exists in Texas for money not only money paid by mistake, but also money paid by fraud, or duress, or undue advantage, or as consideration for an act that the defendant was unable to perform. *HECI Exploration Co. v. Neal*, 982 SW2d 881, 891 (Tex. 1998); *Merryfield v. Willson*, 14 Tex. 224 (1855), cited in *Friberg-Cooper Water Supply Corp. v. Elledge*, 2006 WL 1716103, n. 34 (Tex. App.– Fort Worth 2006, pet. filed). Regardless of the trigger, the remedy is the same: restitution of the money paid.

VIII. UNJUST ENRICHMENT AND CONTRACTS. The proposed Restatement (Third) suggests that restitution is not available when a suit for breach of contract is available. Restatement (Third), § 2(4) and Comment at 21 (Discussion Draft, 2000). However, the proposed Restatement (Third) does recognize a recovery based on unjust enrichment when the defendant has committed an "opportunistic breach" of contract. A breach of contract is "opportunistic" when the breach is deliberate and results in gains to the defendant greater than the defendant would have realized from performance of the contract. Restatement (Third) § 39. (Tentative Draft No. 4, 2005). The plaintiff can recover the profit realized by the defendant as a result of the breach. *Id.* at § 39(1).

Section 39 of the proposed Restatement (Third) does not reflect a new cause of action, because liability rests on a breach of contract. However, Section 39 provides a new measure of damages because in contract law damages are designed to "put the aggrieved party in the same position he or she would occupy if the other party had fully performed." *O'Farrill Avila v. Gonzalez*, 974 S.W.2d 237, 247 (Tex. App.– San Antonio 1998, no pet.). This might require restitution of money paid by the plaintiff, or of money expended by the

plaintiff in reliance upon the contract, or the defendant's payment of the money required by the plaintiff to obtain substitute performance of the contract terms. *Id.* at 247. Section 39, in contrast, measures its recovery by the benefit the defendant received by breaching the contract.

Fixing the recovery based on the profit gained from the breach is a species of "disgorgement," a concept finding expression in unjust enrichment theory applied to torts. The purpose of disgorgement in this context is to protect promisees whose contractual position is vulnerable to abuse because the gain to the breaching promisor exceeds the damages of the promisee.

It should be noted that, in a market-dominated transaction, the profits arising from opportunistic breach will equal the cost to the plaintiff of obtaining substitute performance in the marketplace, so that disgorgement of profits offers nothing beyond ordinary contract damages.

IX. UNJUST ENRICHMENT AND TORTS. The focus of tort law is to permit someone whose rights have been wrongfully injured to receive compensation for the harm. Additionally, tort law serves as a deterrence against such wrongful behavior.

Where the gain to a tortfeasor exceeds the damages to the victim, the disincentive of having to pay actual damages may not stop the tortfeasor from committing a "profitable tort." The fear of exemplary damages might be enough disincentive, but the recovery of exemplary damages is burdened by uncertainty and limitations. By allowing the victim to recover the tortfeasor's gain from committing a "profitable tort" a complete disincentive is achieved. Restatement (Third) §§ 40, 42.

X. DISGORGEMENT. When the recovery under unjust enrichment theory is a surrender of the profits resulting from the wrongdoing, the remedy is called "disgorgement." Disgorgement can be premised on breach of duty in contract or tort. The function of disgorgement as a recovery is "the reinforcement of an entitlement that would be inadequately protected if liability for interference were limited to provable damages." Proposed Restatement (Third), ch. 5, Introductory Note, Section 39, Comment b (Tentative Draft No. 4).

The concept of disgorgement was prominently featured in *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999). The allegation was that plaintiffs' lawyers breached their fiduciary duties to certain clients in setting personal injury claims. The issue for the Supreme Court was whether an attorney who breaches his fiduciary duty to a client can be forced to forfeit some or all of his fee. *Id.* at 232. In his opinion for a unanimous Court, Justice Hecht examined the "jurisprudential underpinnings of the equitable remedy of forfeiture." *Id.*at 237. Justice Hecht cited the Restatement (Second) of Trustees, the Restatement (Second) of Agency, and the Restatement (Third) of the Law Governing Lawyers, all of which recognized fee forfeiture for breach of duty of loyalty owed to the beneficiary, the principal, or the client. *Id*. at 237. Justice Hecht noted that "the historical origins of the remedy of forfeiture of an agent's compensation are obscure...." *Id.* at 237. Justice Hecht suggested that fee forfeiture could be justified both in principle and based on pragmatics. The principle was that liability could be premised on a breach of the duty of loyalty. *Id.* at 238. This liability could be imposed even without damages to the principal. *Id*. This is because the main purpose of fee forfeiture is not to compensate for damage caused, but rather to "protect relationships of trust by discouraging the agent's disloyalty." *Id.* This then is the pragmatic justification–that stripping an agent of the fruit of disloyalty removes the incentive for being disloyal. *Id.* Applied to attorneys in particular, "[a]n attorney's compensation is for loyalty as well as services, and his failure to provide either impairs his right to compensation." *Id.* at 240. Noting that fee forfeiture might have a punitive effect, Justice Hecht noted

that punishment is not the "focus of the remedy." *Id.* The central purpose of the remedy is to create a disincentive for disloyalty. *Id.* This is why actual damages are not required to trigger fee forfeiture. *Id.* However, the equitable nature of the remedy requires that the degree of forfeiture fit the circumstances. *Id.* at 241. Justice Hecht noted that "[a]s a general rule, a jury 'does not determine the expediency, necessity, or propriety of equitable relief.'" *Id.* at 245. Only a judge is suited to consider the adequacy of other remedies, the public interest in protecting the integrity of the attorney-client relationship, and the weighing of "all other relevant considerations." *Id.* at 245. The jury still decides contested fact issues that must be resolved before equitable relief may be determined. *Id.* Justice Hecht analogizes to declaratory judgment actions, where the jury decides what constitutes a reasonable fee, but a judge decides how much of that fee is to be paid by the opposing party, based on what is "equitable and just."

Although Justice Hecht did not base his analysis on principles of unjust enrichment (other than that connection with an analogy to constructive trusts), the hallmarks of unjust enrichment are stamped all over the Opinion in *Burrow v. Arce*. The trigger for liability is a breach of the duty of loyalty (not a traditional tort standard), and the recovery is based not on damages to the client but rather on the gain or profit to the lawyer.

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