
CAUSATION IN DISGORGEMENT

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INTRODUCTION AND OVERVIEW

The *Restatement (Third) of Restitution and Unjust Enrichment* offers scant guidance on how to determine wealth legally attributable to a wrong for purposes of disgorgement. The black letter admits defeat, stating, “[T]he court may apply such tests of causation and remoteness, . . . may recognize such credits or deductions, and may assign such evidentiary burdens, as reason and fairness dictate, consistent with the object of restitution”¹ The comments warn against resort to mechanical rules,² including the familiar rule of but-for causation.³ They recommend merging the factual issue of causation with

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¹ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51(5) (2011). This is supplemented by a few rules of thumb: (a) liability includes “secondary enrichment” that is “not unduly remote”; (b) a wrongdoer is “accountable for profits and liable for losses”; (c) expenses are credited but not if they are in the form of services or incurred directly in the commission of the wrong; (d) the claimant has the initial burden of proving gains by a “reasonable approximation” while the residual burden of uncertainty is on the defendant. *Id.* I will have more to say about these in due course.

² *Id.* § 51 cmt. e (“While its purpose is easily stated and readily understandable, the application of the remedy involves well-known, seemingly intractable difficulties.”).

³ *Id.* § 51 cmt. f (“But causation in this sense gives only part of the answer. The conclusion that the defendant’s profit is property attributable to the defendant’s wrong depends equally on an implicit judgment that the claimant, rather than the wrongdoer, should . . . obtain the benefit of the favorable market conditions, acumen, or luck, as the case may be.”).

issues of policy and fairness into a holistic judgment about whether justice is served by allowing the claimant to recover wealth in the wrongdoer's hand.⁴

The recommended approach resembles an old approach to determining harm legally attributable to negligent conduct. The factual issue of causation and non-factual considerations of policy and fairness were merged into questions about whether the harm was proximately caused by the conduct or whether the conduct was a "substantial factor" in producing the harm.⁵ Most American tort theorists have come to reject a holistic approach that "fails to distinguish the empirical issues of causal contribution from the normative issue of the proper extent of legal responsibility for tortiously caused consequences."⁶ Adopting this position, the *Restatement (Third) of Torts: Liability for Physical and Emotional Harm* strongly endorses separating factual issues of causation from other considerations,⁷ which are addressed under the topic "scope of liability."⁸

⁴ *Id.* § 51 cmt. e ("The question whether specific elements of defendant's profit are properly attributable to the underlying wrong to the claimant is multifaceted Few of the questions are susceptible to resolution by rule, and the answers given will be visibly influenced by the court's view of the broader context: the degree of culpability on the one hand, the importance of the interest to be protected on the other, and the remedial alternatives available as a practical matter.").

⁵ This still is the approach taken under the approved jury instructions for negligence in California. See JUDICIAL COUNCIL OF CALIFORNIA CIVIL JURY INSTRUCTIONS no. 400 (2011) (stating the three elements of a negligence claim: the defendant was negligent, the plaintiff was harmed, and the defendant's "negligence was a substantial factor in causing [the] harm"); *id.* no. 430 ("A substantial factor in causing harm is a factor that a reasonable person would consider to have contributed to the harm. It must be more than a remote or trivial factor."). The rule of but-for causation appears as an alternative instruction that the directions describe as "subsumed" in the definition of substantial factor. *Id.* ("As phrased, this definition of 'substantial factor' subsumes the 'but-for' test of causation, that is, 'but-for' the defendant's conduct, the plaintiff's harm would not have occurred."). On the "uses and misuses of the substantial factor test," see David Robertson, *The Common Sense of Cause in Fact*, 75 TEX. L. REV. 1765, 1776 (1997). Robertson observes that in the most worrisome usage, "'substantial factor' describes an approach to the issue of legal [proximate] causation or ambit of duty, a matter that should be kept entirely distinct from the cause-in-fact issue." *Id.* Prior torts Restatements combine causation and scope under a requirement of legal cause and define negligence as the legal cause of a harm if it is "a substantial factor in bringing about the harm." RESTATEMENT (SECOND) OF TORTS §§ 430-431 (1965); RESTATEMENT OF TORTS: INTENTIONAL HARMS TO PERSONS, LAND AND CHATTELS §§ 430-431 (1934). The requirement of "but-for" causation is stated as generally necessary for negligence to be a substantial factor in bringing about harm. RESTATEMENT (SECOND) OF TORTS § 432(1). There is an exception for multiple sufficient causes. *Id.* § 432(2). The same rules appear in the *Restatement of Torts*. See RESTATEMENT OF TORTS: INTENTIONAL HARMS TO PERSONS, LAND AND CHATTELS §§ 430-432.

⁶ Richard W. Wright, *Once More into the Bramble Bush: Duty, Causal Contribution, and the Extent of Legal Responsibility*, 53 VAND. L. REV. 1071, 1073-74 (2001).

⁷ See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 26 (2010) ("Conduct is a factual cause of harm when the harm would not have occurred absent

This Article argues that the *Restatement (Third) of Restitution and Unjust Enrichment* is on the wrong track. Separating factual issues from other considerations makes it possible to provide a clearer and more coherent account of the law of disgorgement. It reveals that often the central problem in identifying wealth subject to disgorgement is choosing among possible counterfactuals.⁹ At bottom, this is a normative choice that is made based on considerations of policy and fairness. Once the choice is made, factual analysis often does the rest of the work in determining wealth subject to disgorgement. Part I makes the basic point. Part II expands on the point using the law of deceit to illustrate how the impermissibility of a counterfactual sometimes can be explained by the character of a right or wrong.

Isolating factual issues helps to clarify relevant considerations of policy and fairness in the attribution of wealth to a wrong. The major considerations relate to a riddle posed by the *Restatement (Third) of Restitution and Unjust Enrichment* when it admonishes (as it does repeatedly) that disgorgement is meant to deter but not to punish,¹⁰ as if these were distinct goals. Deterrence is one purpose of punishment.¹¹ The riddle serves to underscore the broad parameters of disgorgement. Because disgorgement is meant to deter,

the conduct.”). Comment a explains that the concept of “legal cause” used in prior torts Restatements was abandoned because “it has not been widely adopted in judicial and legal discourse . . . and because of the importance of distinguishing clearly between ‘factual cause’ and ‘proximate cause,’” which “is instead denominated ‘scope of liability.’” *Id.* § 26 cmt. a.

⁸ *Id.* § 29. A special note preceding section 29 explains, “Although the term ‘proximate cause’ has been in widespread use . . . the term is not generally employed in this Chapter because it is an especially poor one to describe the idea to which it is connected.” RESTATEMENT (THIRD) OF TORTS ch. 6, special note on proximate cause (2010).

⁹ See *infra* Part I.

¹⁰ See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. e (“The object of the disgorgement remedy – to remove the possibility of profit from conscious wrongdoing – is one of the cornerstones of the law of restitution and unjust enrichment.”); *id.* § 51 cmt. f (stating that any gain on investing embezzled funds should be disgorged if “there would be an incentive to embezzlement if the defendant were permitted to retain the profits”); *id.* (stating that profits are not disgorged if “liability for the profits so designated would be unacceptably punitive, being unnecessary to accomplish the objective of the disgorgement remedy”); *id.* § 51 cmt. h (“Denial of an otherwise appropriate deduction, by making the defendant liable in excess of net profit, results in a punitive sanction that the law of restitution normally attempts to avoid.”).

¹¹ The other textbook purposes are retribution, incapacitation, and rehabilitation. We can take incapacitation and rehabilitation off the table because these purposes are not served by damage awards. This leaves retribution and deterrence. Limiting damages to net profits predictably under-deters wrongdoing if a wrongdoer expects that there is a good chance he will not be made to disgorge his profits. Nevertheless, damages are limited to net profits even though this undercuts the stated goal of deterrence. One explanation is that what is permissible in the way of deterrence is constrained by what the instinct for retribution allows, which is a wrongdoer’s net profit.

damages are not limited to the price a wrongdoer probably would have paid had he bargained for the entitlement he used.¹² Because disgorgement is not meant to punish, no more than “the net profit attributable to the underlying wrong” is subject to disgorgement.¹³

The solution to this riddle begins with understanding that the wrong disgorgement rectifies is the wrongdoer’s use of the claimant’s entitlement without consent. It is not using the entitlement in combination with the wrongdoer’s own resources to produce wealth. Disgorgement deters – i.e., it encourages people to bargain for the entitlements they use – by making someone who consciously uses an entitlement without obtaining consent predictably pay more in damages than he would have paid by bargaining. Disgorgement can be described as punitive, for the damages exceed the likely harm to the claimant from the failure to bargain, which is the expected price of the entitlement. Two features of disgorgement make it a more attractive remedy than punitive damages. One is pragmatic. Determining punishment by the gain attributable to a wrong avoids the principal defect of punitive damages, which is the randomness in the amount of punitive awards.¹⁴ In addition, some believe the victim of a wrong has a stronger claim in justice to wealth in a wrongdoer’s hand that is attributable to a wrong against him than the victim has to wealth about which this cannot be said.

The measure of disgorgement presents no difficulty if a conventional counterfactual yields an identifiable increase in the wrongdoer’s wealth that is a reasonable multiple of a likely or fair price for the entitlement taken. One might say, with only a hint of irony, that such awards deter but do not punish. Difficulties arise when these conditions are not met. Factual uncertainty is an obvious source of difficulty. A less obvious difficulty arises when the factual inquiry yields too low an amount to deter adequately. I argue that courts sometimes fudge the factual issue to award more than the likely gain attributable to the wrong in order to deter. This is made possible by approaches that determine the wealth attributable to a wrong without resolving the counterfactual questions of how the wrongdoer would have acted differently and how a change of conduct would have affected his wealth. I develop these points in Parts III and IV, using *Sheldon v. Metro-Goldwyn Pictures Corp.*,¹⁵ a leading case on the measure of disgorgement in cases of copyright infringement. The *Restatement (Third) of Restitution and Unjust Enrichment* is less candid about this practice than it might be, perhaps because

¹² RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51(2) (“The value for restitution purposes of benefits obtained by the misconduct of the defendant, culpable or otherwise, is not less than their market value.”).

¹³ *Id.* § 51(4).

¹⁴ *Cf. Exxon Shipping Co. v. Baker*, 554 U.S. 471, 499 (2008) (limiting punitive damages to the amount of actual damages in maritime torts involving gross negligence and significant actual damages as a solution to “the stark unpredictability of punitive awards”).

¹⁵ 106 F.2d 45 (2d Cir. 1939), *aff’d*, 309 U.S. 390 (1940).

candor weakens the claim in justice for what is described falsely as disgorgement in such cases. Sometimes factual analysis is inconclusive for the opposite reason. The increase in a wrongdoer's wealth that is factually attributable to a wrong is more than deterrence justifies. Part V looks at a few such cases. They are atypical and involve what I describe as weak entitlements. Typically, a claimant is entitled to all of the immediate gain that is factually attributable to a wrong. Part VI argues that clarity on these points eliminates the need for a rule precluding recovery of remote gains.

I. CAUSATION AND OVER-DETERMINED OUTCOMES

The *Restatement (Third) of Restitution and Unjust Enrichment* states, "But neither the presence nor the absence of a causal link between the defendant's wrongdoing and the defendant's profit will be conclusive in all cases on the ultimate issue of unjust enrichment. Absence of but-for causation does not necessarily exonerate the wrongdoer . . ." ¹⁶ A reader may mistakenly equate causation with but-for causation. Such a reader will conclude that a claimant may reach wealth in a wrongdoer's hand without establishing that the wrong was a cause of the wrongdoer having the wealth. This Part explains why this conclusion is mistaken.¹⁷ While but-for causation is not a prerequisite to disgorgement (so the statement is technically correct), most of the cases in which damages are recovered in its absence are readily explained by special rules on causation that apply to over-determined outcomes.¹⁸

¹⁶ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. f.

¹⁷ Were it not for the language used in the *Restatement (Third) of Restitution and Unjust Enrichment*, I would have described this as the conventional wisdom, citing sources such as Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. Rev. 851, 857 (2011) ("A basic limit to a fiduciary's liability to disgorge ill-gotten gains is causal – the liability does not extend to assets acquired in a manner unrelated to the breach of duty.").

¹⁸ I use the term "over-determined outcomes" more broadly than is common to encompass problems dealt with by three types of rules. The text discusses two types – the rules on preempted causes and multiple sufficient causes. The function of the rule on multiple sufficient causes is to establish causation. The rule generally applies when there are concurring competing causes. The function of the rule on preempted causes is to negate causation. The rule generally applies to absolve an actor from causal responsibility for a harm the actor would have caused if some intervening factor had not caused the harm.

The third type of rule treats over-determined outcomes as problems of quantification or damages. The rules on quantification or damages monetize harm for which an actor is causally responsible. Sometimes damages will be reduced because of preempted cause. *Dillon v. Twin State Gas & Electric Co.*, 163 A. 111 (N.H. 1932), illustrates. A fourteen-year-old boy playing atop a bridge girder lost his balance. To keep from falling, he grabbed the defendant's negligently uninsulated wire and was instantly killed by the shock. Even had the wire been insulated, the boy probably would have fallen and would certainly have been killed by the fall. The death from the fall is a preempted cause. That the fall would have killed the boy does not absolve the defendant from causal responsibility for the death. But the prospect of the fall killing the boy bears on damages and the quantification of the

But-for causation is absent in some central cases of disgorgement. A fiduciary who makes an abnormal gain using misappropriated funds cannot retain the windfall even if he can prove he would have made the same investment using his own funds had he not used the claimant's funds.¹⁹ Typically, someone who uses property without bargaining for it cannot limit damages to the likely bargained-for price. This is true even if the wrongdoer had an offer in hand from the claimant at a favorable price.²⁰ Wrongdoers have been unsuccessful in arguing that the gain attributable to a wrong should be limited to the cheapest legal substitute available to them in other contexts.²¹ In *Snepp v. United States*,²² a CIA agent was made to disgorge royalties he made from a book he published without receiving required permission even though the government stipulated permission would have been granted had it been sought.²³

The *Restatement (Third) of Torts: Liability for Physical and Emotional Harm* provides two ways to explain these results in causal terms. The simpler and less satisfactory way is to disregard the potential competing cause on the ground that it is preempted by the wrong. The rule is that "[a]n act or omission cannot be a factual cause of an outcome that has already occurred."²⁴ Thus,

when one hunter negligently fires a rifle, killing a hiker, and, shortly thereafter, another hunter negligently fires, and the second shot would have been sufficient to cause the hiker's death, except that the death had already occurred[,] . . . [t]he first hunter's negligence is a cause of the hiker's death and preempts any causal role in the hiker's death of the second hunter's negligence.²⁵

Taking *Snepp* as an example, one could reason that (1) *Snepp* published the book without seeking CIA approval; (2) therefore approval by the CIA cannot be a cause of *Snepp*'s profits as it never happened; (3) therefore the prospect of

harm for which the defendant is liable. *Id.* at 115.

¹⁹ See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. e (explaining that but-for causation is not a necessary condition to treat a gain as attributable to a wrong and so subject to disgorgement).

²⁰ *Sheldon*, 106 F.2d at 48-50.

²¹ See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. c, illus. 7; RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. e, illus. 14 (Tentative Draft No. 7, 2010).

²² 444 U.S. 507 (1980).

²³ *Id.* at 515-16 (imposing a constructive trust on the agent's profits on a theory of breach of fiduciary duty); see also *Attorney General v. Blake*, [2001] 1 A.C. 268 (H.L.) 269 (appeal taken from Eng.) (requiring an author of a book published without security clearance to disgorge the profits on a theory of breach of contract).

²⁴ RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 26 cmt. k. (2010).

²⁵ *Id.*

approval cannot prevent attribution of the profits to Snepp's decision to publish the book without approval.

A rule disregarding preempted causes makes sense when the issue is the legal responsibility of the actor responsible for the preempted cause for the loss in question. The second shooter cannot be held legally responsible for negligently shooting someone who is already dead. But our question is different. We are asking whether the prospect that the second bullet would have killed the hiker bears on the legal liability of the first shooter. The *Restatement (Third) of Torts: Liability for Physical and Emotional Harm* acknowledges the possible relevance of a preempted cause to this issue when it explains that if the hiker had terminal cancer at the time of the accident, this might be relevant to the measure of damages.²⁶ Going back to *Snepp*, while it would be odd to say that the CIA's hypothetical approval of publication was a cause of the profits when publication was never approved, it is not clear why the prospect of approval does not bear on the determination of the gain attributable to Snepp's decision to publish without approval.

This brings me to a more satisfactory explanation.²⁷ The results can be explained using the alternative rule of causation that applies in cases involving

²⁶ *Id.* The *Restatement (Third) of Torts: Liability for Physical and Emotional Harm* punts on the problem of integrating the rule on preempted causes with the rule on multiple sufficient causes, which substitutes a test of sufficiency for a test of necessity. Comment h to section 27 may seem to resolve the conflict when it states, "This Section [referring to the rule on multiple sufficient causes] does not apply to tortious conduct that only could have caused harm at some time after the harm actually occurred." *Id.* § 27 cmt. h. But this is meant to negate only the possibility of invoking the rule in section 27 to hold the second shooter liable. It does not resolve the relevance of a preempted cause to the determination of the legal responsibility of the first shooter. Even on the issue of the legal responsibility of the second shooter, the reporters' note concedes, "The rule contained in this Section . . . and the rule of preempted conduct . . . create an anomaly, a discontinuity in the law that deserves mention, even if this Restatement does not contribute to its resolution." *Id.* § 27 reporters' note cmt. h. One of the reporters explains the decision to punt on the issue in Michael D. Green, *The Intersection of Factual Causation and Damages*, 55 DEPAUL L. REV. 671, 671-75 (2006).

²⁷ Many preempted causes are unlike competing sufficient causes in that they are imaginary – they never happened. Imaginary causes are easier to disregard. When a court is asked to disregard something that actually happened in answering the causal question, it runs into the working premise that

[t]he imagined counterfactual world must be the same as the actual world as shown by the evidence in the case in all respects save one: the defendant's wrongful conduct must be corrected to the extent necessary to make the conduct acceptable under plaintiff's theory of the case. This imagined correction of the defendant's conduct is the only allowable change, and this change must be done in an intellectually conservative way, employing as little creativity as possible.

David W. Robertson, *Metaphysical Truth vs. Workable Tort Law: Adverse Ambitions?*, 88 TEX. L. REV. 1053, 1061 (2010) (reviewing MICHAEL S. MOORE, *CAUSATION AND RESPONSIBILITY: AN ESSAY IN LAW, MORALS, AND METAPHYSICS* (2009)).

multiple sufficient causes.²⁸ The core cases covered by the alternative rule involve multiple wrongs against the claimant that operate concurrently to cause an indivisible loss. For example, two polluters concurrently and independently spill chemicals into a lake, each in a quantity sufficient to kill the claimant's fish. Neither spill is a but-for cause of the loss of the fish because the other spill was sufficient alone to kill the fish. Still, both polluters are held legally responsible for the loss of the fish.²⁹

Several reasons justify this result and the rule. If the competing causes all are wrongs against the claimant, then it seems perverse to allow each wrongdoer to evade legal responsibility for the loss by pointing to the other.³⁰ The rule is not limited to competing wrongs,³¹ indicating other reasons exist for the rule. Often it is not certain whether a competing cause would have been sufficient without the wrong. It is thought better to cast the loss on a wrongdoer whose wrong probably would have been a sufficient cause of the loss had the other possibly sufficient cause not been operating concurrently.³²

²⁸ See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 27. The expanded test is a translation of the "NESS test," which asks whether the conduct in question is a necessary element in a sufficient causal set. See Richard W. Wright, *Causation in Tort Law*, 73 CALIF. L. REV. 1735, 188-1803 (1985). Jane Stapleton argues that we would do better dispensing with the term causation and using the term involvement. Jane Stapleton, *Choosing What We Mean by "Causation" in the Law*, 73 MO. L. REV. 433, 444-46 (2008).

²⁹ RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 27 cmt. f, illus. 4.

³⁰ An argument for imposing liability on multiple wrongdoers where each is a sufficient cause of the harm is that while the wrong may not be a cause-in-fact of the harm to the claimant, the wrong impairs the ability of the claimant to recover from the other wrongdoer. See David W. Robertson, *Causation in the Restatement (Third) of Torts: Three Arguable Mistakes*, 44 WAKE FOREST L. REV. 1007, 1012-14 (2009) (discussing the remedial impairment rationale).

³¹ For example, when a man-made fire converges with a natural fire to destroy the claimant's property, the fire-maker may be held legally responsible for the claimant's loss even though the natural fire probably would have caused the same loss operating alone. RESTATEMENT (SECOND) OF TORTS § 432 cmt. d, illus. 4 (1965). The illustration is based on *Anderson v. Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, 179 N.W. 45 (Minn. 1920). Comment d to section 27 states that the rule in section 27 "applies . . . regardless of whether the competing cause involves tortious conduct or consists only of innocent conduct." RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 27 cmt. d. It is left to the law of damages to resolve the potential liability effects of a preempted cause that is not a wrong against the claimant. *Id.* ("When one of multiple sufficient causes is not tortious, the question of damages is a different matter from the causal question. The question of what (if any) damages should be awarded against these tortfeasors properly belongs to the law of damages and is not addressed in this Restatement."). For further reflections from a reporter on the problem, see Green, *supra* note 26, at 671-75.

³² Andrew Botterell and Christopher Essert argue this is the best way to account for the liability of concurrent wrongdoers. Andrew Botterell & Christopher Essert, *Normativity*,

Insofar as the law's goal is deterrence, it seems senseless to allow a wrongdoer to escape legal responsibility for a loss that would normally result from his wrongful conduct on the ground that another fortuitous event prevented the loss from occurring.³³ And denying a wrongdoer the opportunity to try to evade responsibility for a loss by establishing a competing sufficient cause simplifies litigation.³⁴

The reasons are strongest when the potentially competing cause never comes into play. Thus, they readily explain the intuition that "no defendant should escape liability for killing the decedent in a car accident merely because the decedent was on her way to catch a plane that was later blown up by a terrorist."³⁵ The hypothetical is an easy case because the competing cause is a wrong. But the result probably is the same if the plane is destroyed by an act of God. The other reasons explain why. Since the decedent never made it on the plane, we cannot be certain that he would have boarded the plane or that his presence on the plane would have made no difference to the outcome. If the goal is deterring careless driving, then it makes little sense to excuse the defendant from responsibility because of the fortuity (from the defendant's perspective) of the destruction of the plane. It simplifies litigation to foreclose liability-reducing, speculative, forward-looking, individualized arguments about things that never happened. It is so easy to dismiss imaginary competing causes that unconventional preempted causes are thought to present a difficulty only if the events actually occur, as in the hypothetical of the passenger who is killed on the way to catch a plane that crashed, killing all aboard, or in a case such as *Baker v. Willoughby*,³⁶ where the defendant negligently injured the claimant's leg and before the claim could be litigated the claimant lost his leg as a result of being shot by a robber.³⁷ Conventional preempted causes are dealt with by damages rules.

Turning back to the law of disgorgement, the take-away point is that the usual test of but-for causation gives way to an expanded test to treat conduct as a cause of an event despite an imagined (and sometimes a non-imagined) competing cause if reasons of policy or fairness justify disregarding the competing cause. In effect, the wrongdoer is denied the opportunity to argue the counterfactual involving the competing cause. Once the issue is

Fairness, and the Problem of Factual Uncertainty, 47 OSGOODE HALL L.J. 663, 663 (2009).

³³ *Basko v. Sterling Drug, Inc.*, 416 F.2d 417, 429 (2d Cir. 1969) ("[N]egligent conduct will be more effectively deterred by imposing liability than by giving the wrongdoer a windfall in cases where an all-sufficient innocent cause happens to concur with his wrong in producing the harm." (quoting 2 HARPER & JAMES, THE LAW OF TORTS § 20.2 (1956))).

³⁴ See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 27 cmt. d.

³⁵ DAN B. DOBBS, THE LAW OF TORTS § 177 (2000). Dobbs treats the problem as a question about whether the passenger's likely fate is a preexisting condition. *Id.*

³⁶ [1970] A.C. 467 (H.L.) 467 (appeal taken from Scot.).

³⁷ *Id.*

approached in this way, it is easy to explain most of the cases in which a claimant can reach a wrongdoer's wealth without establishing the wrong was a but-for cause of the wrongdoer's having the wealth. Typically, the competing cause is imaginary. Familiar reasons explain why the probable license price is disregarded in determining the gain attributable to taking or using property without a license. Measuring the gain by the probable license price takes the power to set price from the owner and gives it to a court. Other familiar reasons explain why a fiduciary who makes an abnormal gain using misappropriated funds is not allowed to keep the windfall even if he can prove he would have made the same investment with his own funds. Allowing a fiduciary to keep abnormal gains made by investing misappropriated funds so long as the fiduciary has other funds at his disposal that he could use to make the investment undercuts the deterrent effect of the disgorgement remedy unless we can be certain the fiduciary would have made good any losses with his own funds.

Sometimes the choice among possible counterfactuals will determine wealth subject to disgorgement. *Olwell v. Nye & Nissen Co.*³⁸ illustrates. The plaintiff bought an egg-washing machine from the defendant, taking title but never taking delivery. The defendant used the machine without permission. After learning of this use, the plaintiff offered to sell the machine back to the defendant for \$600, which was half the original price. The defendant offered \$50. The plaintiff rejected the offer and sued. The court awarded damages based on the defendant's estimated savings in not having to wash the eggs by hand, which was \$10 per week for 156 weeks, or \$1,560. Some argue that this measure of disgorgement cannot be right, for it is more than double the plaintiff's asking price.³⁹ Daniel Friedmann writes, "In essence, the question is one of causation."⁴⁰ That is incorrect; principles of causation do not dictate the choice among possible counterfactuals. In *Olwell*, the character of the wrong justifies denying the wrongdoer the counterfactual in which it accepts the claimant's offer. The counterfactual chosen by the court is appropriate because it is a plausible counterfactual and produces an award that is a fair multiple of the asking price.

Cases that visibly present an issue of over-determined loss are at the periphery of negligence law. Typically, the issue arises after a claimant tells a causal story that plausibly attributes a loss to the defendant's wrong. The

³⁸ 173 P.2d 652 (Wash. 1946).

³⁹ Daniel Friedmann, *Restitution for Wrongs: The Measure of Recovery*, 79 TEX. L. REV. 1879, 1894-95 (2001) (agreeing with 1 GEORGE E. PALMER, THE LAW OF RESTITUTION § 2.22 (1978)).

⁴⁰ *Id.* at 1894. For a similar argument that causal analysis would limit damages to the price the wrongdoer would have paid, see E. Allan Farnsworth, *Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract*, 94 YALE L.J. 1339, 1346 (1985). For a different critique of this argument, see Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559, 566-68 (2006).

defendant will then argue that some other factor was sufficient to cause the loss in the absence of his wrong. For example, in an inadequate warning/failure to read case, the plaintiff argues he was harmed because of the defendant's failure to warn, and the defendant responds that the plaintiff would have been harmed in any event because the plaintiff did not read the label.⁴¹ The expanded test of causation for over-determined losses merely tells courts that the likelihood (and sometimes even the certainty) of an alternative sufficient cause does not require rejecting a claim. The court may disregard the competing cause if it concludes that is warranted by reasons of policy or fairness.

Issues of over-determined gains are more central in the law of disgorgement. The proverb "success has many fathers, failure is an orphan" comes to mind. Typically, wrongfully exploited resources are not unique. Alternative sources of a resource will be available to the wrongdoer. And typically, a wrongdoer has alternative profitable uses for resources that he commits to the activity in which he uses the wrongfully exploited resource. These are not reasons to give up on causal analysis. Instead, they show the normative importance of deciding what is a permissible counterfactual. Once the appropriate counterfactual is chosen, often factual analysis does the rest of the work. *Olwell v. Nye & Nissen Co.* is one example. Another follows.

II. IMPERMISSIBLE COUNTERFACTUALS IN THE LAW OF DECEIT

A victim of deceit has the option to sue for disgorgement rather than compensation.⁴² In a typical case a defrauded seller of an asset seeks disgorgement of a wrongdoer's gain on reselling the fraudulently acquired asset. *Lawton v. Nyman*⁴³ illustrates. The plaintiffs had a 9.2% interest in a closely held family corporation that had fallen on hard times. They redeemed their shares for \$200 per share in May 1996 in a transaction tainted by fraud. The defendants, two brothers who controlled the company, misrepresented the opportunity to sell as "once-in-a-lifetime" and failed to disclose the existence of a potential buyer of the company who was willing to pay a significantly higher price. While this sale fell through the defendants hired a new manager who, aided by favorable market conditions, quickly turned the company's fortunes around. Defendants sold the company in June 1997 for around \$2,400

⁴¹ See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 27 cmt. h (2010), for a discussion of the problem.

⁴² *Restatement (Third) of Restitution and Unjust Enrichment* section 51, illustration 11 is similar to *Lawton v. Nyman (Lawton I)*, 327 F.3d 30 (1st Cir. 2003). *Janigan v. Taylor* is a leading and strong statement of the availability of disgorgement in the context of securities fraud. 344 F.2d 781, 786 (1st Cir. 1965). For later cases and context, see L.D. Lowenfels & A.R. Bloomberg, *Compenstory Damages in Rule 10b-5 Actions: Pragmatic Justice or Chaos*, 30 SETON HALL L. REV. 1083, 1098-1102 (2000); see also James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345 (2010).

⁴³ *Lawton I*, 327 F.3d 30; *Lawton v. Nyman (Lawton II)*, 357 F. Supp.2d 428 (D.R.I. 2005).

per share. It seems that that this price was unimaginable in May 1996 when the plaintiffs redeemed their shares and that a fair price at the time was \$303 per share.

The district court initially held that the plaintiffs were entitled to \$2,200 per share as damages both as compensation and disgorgement. As I will explain, this was correct on both points under traditional common-law rules. But the First Circuit disagreed. It reversed the verdict for the plaintiffs and remanded.⁴⁴ The court held that compensatory damages were limited to plaintiff's "out-of-pocket" loss of \$103 per share.⁴⁵ This represents the difference between the price paid for the stock and the fair price on the sale date. The court remanded so the district court could determine whether a greater amount could be recovered on the disgorgement claim. The First Circuit instructed that this amount turned on an "equitable judgment" based on the facts and circumstances,⁴⁶ including a factual determination of whether the claimants would have sold the shares and at what price had they not been misled.⁴⁷ On remand the district court reinstated its original damage award (\$2,200 per share) on the disgorgement claim, finding the plaintiffs would not have sold their shares in May 1996, because if the prospective buyer had been disclosed, plaintiffs would have demanded a premium that the defendants did not have the means to pay.⁴⁸

The First Circuit's opinion runs roughshod over traditional causal principles in the law of deceit. The errors begin with the decision to limit compensatory damages to \$103 per share. One gets the impression that the court did not perceive the \$2,200 as a loss in fact caused by the deception. This position is indefensible given the eventual finding that the plaintiffs would not have sold but-for the deception and the absence of evidence defendants would have managed the company differently had they not bought out the plaintiffs' minority interest. A more defensible basis for this part of the decision is that the \$2,200 loss is outside the scope of liability. Sometimes damages for common-law fraud are limited to a claimant's out-of-pocket loss on the date of the transaction. Typically the issue arises when an investor is deceived into making an investment that plummets in value for reasons unrelated to the deception. The issue then is whether the victim or the wrongdoer will bear a

⁴⁴ *Lawton I*, 327 F.3d at 30.

⁴⁵ *Id.* at 51.

⁴⁶ *Id.*

⁴⁷ *Id.* at 48 (citing authority for the proposition that gains-based damages would then be limited to the difference between the price they would have taken and the price they were paid).

⁴⁸ *Lawton II*, 357 F. Supp. 2d at 428. The district court recognized that the brothers would be entitled to retain some of the increase in share price if they could show it was attributable to their "extraordinary efforts" but found that the brothers failed to make this showing. I explore the arguments for a setoff on this basis in Parts III and IV.

fortuitous loss.⁴⁹ Under the traditional common-law rule, a wrongdoer generally bears the loss unless the cause is wholly unrelated to the deception.⁵⁰ The narrower rule on scope of liability applied by the First Circuit, limiting compensatory damages to the out-of-pocket loss, comes from the federal law of securities fraud and the law of negligent misrepresentation. *Lawton* is among a large handful of cases that apply the narrower rule on scope of liability to common-law deceit.⁵¹

⁴⁹ The First Circuit's opinion is unusual in applying the limitation on scope of liability to a deceived seller's claim seeking compensatory damages for being denied a fortuitous gain. This aspect of the opinion is of no practical significance, for the opinion allows a seller to recover this gain on a disgorgement claim if the seller can establish causation. The leading case, *Janigan v. Taylor*, 344 F.2d 781 (1st Cir. 1965), justifies the more generous rule on scope of liability on a disgorgement claim:

[T]here can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the profit by fraud, that the profit was the proximate cause of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit of windfalls than to let the fraudulent party keep them [I]t is simple equity that a wrongdoer should disgorge his fraudulent enrichment.

Id. at 786. The facts in *Janigan* are similar to those in *Lawton*. The defendant acquired ownership of a struggling company he managed by misleading the owners into believing the company's condition was worse than it actually was. He paid \$40,000 for ownership of the company. Two years later he sold the company for \$700,000. The court characterized this gain as "unforeseeable" and as a "windfall" because it was largely attributable to changes in the market that were unrelated to the deception. *Id.* at 785 ("Certainly it could not be claimed that the change [misrepresented] presaged the dramatic improvement that occurred subsequently in the company's affairs, or that the defendant could have any thought that it did.").

⁵⁰ Traditionally the out-of-pocket loss is a floor and not a ceiling on damages. See RESTATEMENT (SECOND) OF TORTS § 549(1) (1965) (giving the out-of-pocket loss under subsection (a) and providing in addition in subsection (b) "pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the misrepresentation"). *Marbury Management, Inc. v. Kohn* collects more than a score of common-law cases allowing a deceived purchaser of security to recover all losses incurred on the investment until the deception is discovered. 629 F.2d 705, 709-10 (2d Cir. 1980). The *Restatement (Second) of Torts* section 548A, illustration 2, is similar. Under a rarely applied exception to this rule, the defendant might avoid liability if the loss on the investment was immediate and due to events completely unrelated to the matters on which the defendant deceived the plaintiff. RESTATEMENT (SECOND) OF TORTS § 548A, illus. 1 (describing a situation in which the deceit was of a fact that actually came to pass before the loss was realized and the loss was for a completely unrelated reason).

⁵¹ *Spreitzer v. Hawkeye State Bank* is an important case because the court grounds a rule limiting the scope of liability to losses resulting from risks about which the claimant was misled on general tort principles of scope of liability. 779 N.W.2d 726, 741 (Iowa 2009) ("The scope of liability is limited to harms that result from the risks that made the actor's conduct tortious."). In *Reisman v. KPMG Peat Marwick LLP*, the court refused to limit damages for deceit to shield a defendant from losses that resulted from market shifts or other forces unrelated to the misrepresentation, applying the traditional common-law rule

Turning to the disgorgement claim, the First Circuit held the plaintiffs' right to recover \$2,200 per share as gains-based damages depended to some degree on their establishing they would not have sold at \$303 per share had they not been misled. This placed the burden of establishing reliance on the plaintiffs. Again this is unusual. Usually the burden of establishing reliance is not placed on a victim of deceit. Reliance is presumed if a misrepresentation is material. The classic English case on the issue states a presumption in near irrebuttable terms.⁵² Modern American cases tend to apply a rebuttable presumption.⁵³ The *Restatement (Second) of Torts* uses the language of "substantial factor"⁵⁴ and states that a substantial factor need not be "the predominant or decisive factor."⁵⁵

A rebuttable presumption resolves against the wrongdoer uncertainty about the causal impact of a misrepresentation on a claimant's decision. This should be uncontroversial. Generally, causal uncertainty is resolved against a wrongdoer when his conduct is "deemed wrongful precisely because it has a strong propensity to cause the type of harm that ensued."⁵⁶ Common-law

holding a deceiver liable for all losses that directly and naturally result from an investment made in reliance on a misrepresentation. 787 N.E.2d 1060, 1074 (Mass. 2003) ("Once liability is established, the [defendant] would be entitled to recover damages that 'flow naturally,' i.e. directly from the wrong, to wit, the misrepresentations that induced their acquisition and subsequent forced retention of . . . stock.").

⁵² See *Mathias v. Yetts*, (1882) 46 L.T. 497 (C.A.) at 502 (Eng.) ("The man who makes the material misstatement to induce the other to enter into the contract cannot be heard to say that he did not enter into it, to some extent, at all events, on the faith of the statement, unless he can prove one of two things: either in fact that the man did not rely upon it, and made inquiries and got information which showed that the misstatement was untrue, and still went on with the contract, that is one thing; or else that he said, expressly or impliedly, 'I do not care what your representations are; I shall not inquire about them. I shall enter into the contract taking the risk.'").

⁵³ *Engalla v. Permanente Med. Grp., Inc.*, 938 P.3d 903, 918-21 (Cal. 1997) (finding insufficient evidence to conclusively rebut the inference of the plaintiff's reliance on the defendant's misrepresentations).

⁵⁴ RESTATEMENT (SECOND) OF TORTS § 546 ("The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in the loss.").

⁵⁵ *Id.* § 546 cmt. b ("It is not, however, necessary that his reliance upon the truth of the fraudulent misrepresentation be the sole or even the predominant or decisive factor in influencing his conduct. It is not even necessary that he would not have acted . . . as he did unless he had relied on the misrepresentation."). *Nails v. S & R, Inc.* holds that there is sufficient evidence of reliance to sustain a jury verdict though the plaintiffs admitted in testimony that they did not know if they would have acted any differently had they not been misled. 639 A.2d 660, 669-70 (Md. 1994).

⁵⁶ *Liriano v. Hobart Corp.*, 170 F.3d 264, 271 (2d Cir. 1999). See *Zuchowicz v. United States*, 140 F.3d 381, 390-91 (2d Cir. 1998) ("Where such a strong causal link exists, it is up to the negligent party to bring in evidence denying *but for* cause and suggesting that in the

deceit clearly is within this principle, for the tort requires not only that the misrepresentation have a strong propensity to influence the decision in question but also that the wrongdoer know (or have reason to know) of this propensity and have made the misrepresentation with an intent to exploit it. A misrepresentation is actionable as deceit only if the misrepresentation is made “for the purpose of inducing another to act.”⁵⁷ And under the materiality requirement the maker of the misrepresentation must know or have reason to know “that its recipient regards or is likely to regard the matter as important in determining his choice of action.”⁵⁸

But this is not the most remarkable feature of the First Circuit’s opinion. Other cases have required that a fraud claimant establish the misrepresentation was a but-for cause of the decision leading to the loss in question, often by importing the requirement of “transaction causation” from federal securities law.⁵⁹ The court’s treatment of the casual issue as relevant to the disgorgement claim is unremarkable. Reliance is part of the claimant’s prima facie case. Without reliance there is no wrong to serve as a basis for disgorgement.

The most remarkable feature of the *Lawton* opinion is the counterfactual permitted by the First Circuit. Typically, in the law of deceit, the causal issue is whether the claimant would have made the choice he actually made had the wrongdoer not made the misrepresentation. To negate causation a wrongdoer will try to show that the claimant was unaware of the misrepresentation when he made the decision resulting in the loss or that other factors compelled the claimant to act as he did even had he not been misled.⁶⁰ The counterfactual in *Lawton* asks whether plaintiffs would have made an imaginary choice never presented to them. This is unusual. Courts have refused to permit this sort of counterfactual in cases involving misappropriation of property, even when

actual case the wrongful conduct had not been a substantial factor.”).

⁵⁷ RESTATEMENT (SECOND) OF TORTS § 525. The actor need not know that the information is false or misleading. It is enough that the actor have reason to know that it is false or misleading or that the actor is reckless with regards to the accuracy of the information. *See id.* § 526.

⁵⁸ *Id.* § 538(2)(b).

⁵⁹ *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 209 (2d Cir. 2000) (explaining that transaction causation means that the violations in question caused the appellant to engage in the transaction in question and analogizing the element to reliance); *Amusement Indus., Inc. v. Stern*, 693 F. Supp. 2d 327 (S.D.N.Y. 2010) (holding that the plaintiff sufficiently alleged transaction and loss causation elements where it alleged that the lead investors’ statement regarding their participation in the real estate transaction induced it to make the investment); *Laub v. Faessel*, 745 N.Y.S. 2d 534, 536 (N.Y. App. Div. 2002) (“To establish causation, plaintiff must show both that defendant’s misrepresentation induced plaintiff to engage in the transaction (transaction causation) and that the misrepresentations directly caused the loss about which plaintiff complains (loss causation).”).

⁶⁰ *DOBBS, supra* note 35, § 474, cites *Schaaf v. Highfield*, 896 P.2d 665 (Wash. 1995) (holding that the purchaser failed to show that he justifiably relied upon alleged an misrepresentation), to illustrate both points.

there was an offer from the claimant on the table to sell the property at a favorable price.⁶¹

I suspect that the First Circuit did not appreciate the novelty of the counterfactual it permitted because the out-of-pocket damage measure from the law of securities fraud supplied the counterfactual price. This unthinking supplanting of the long-standing rules on causation and scope of liability in the common law of deceit for rules developed in handling federal securities fraud claims is lamentable.⁶² Allowing this counterfactual alters the law of deceit by giving a wrongdoer the opportunity to limit damages by identifying a payment the wrongdoer could have made at the time of the transaction that the victim probably would have taken to enter into the transaction had he not been misled. This converts the argument for limiting damages to the victim's out-of-pocket loss from an argument about scope of liability to an argument about causation. This will tend to complicate litigation and shift fortuitous losses following transactions infected by deceit to the victims and fortuitous gains to wrongdoers. For those who believe deceit is a special wrong because it involves purposefully interfering with the victim's autonomy, this change in the law will seem deeply perverse, for it allows the wrongdoer to contest the victim's unimpaired choice.

⁶¹ See, e.g., *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d 45, 48 (2d Cir. 1939) (“[A]n infringer carries the burden of disentangling the contributions of the several factors which he has confused.”); *Olwell v. Nye & Nissen Co.*, 173 P.2d 652 (Wash. 1946) (“The very essence of the nature of property is the right to its exclusive use However plausible, the [defendant] cannot be heard to say that his wrongful invasion of the [plaintiff's] property right to exclusive use is not a loss compensable in law.”).

⁶² The out-of-pocket damage measure is used in federal securities fraud litigation as a by-product of the theory of fraud on the market. The theory of fraud on the market is designed to facilitate a class action in securities fraud litigation. It satisfies the element of reliance on a class basis by presuming that traders rely on the accuracy of the market price, which the misrepresentation distorts. *Basic Inc. v. Levinson*, 485 U.S. 224, 242 (1988) (“Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.”). The gist of the wrong in securities fraud is to knowingly disseminate false or misleading material information regarding a publicly-traded security. An actor may be liable even though he did not make the misrepresentation for the purpose of inducing people to buy or sell the security and even though he did not seek to gain by the misrepresentation. Justice White makes this point in his dissent in *Basic Inc.*, 485 U.S. at 260-61 (White, J., dissenting). The standard of materiality possibly is lower for securities fraud than it is for common-law deceit. See Marcel Kahan, *Games, Lies, and Securities Fraud*, 67 N.Y.U. L. REV. 750, 761-62 (1992) (“Material fact does not only encompass ‘hard’ historic information, but also includes opinions and beliefs, forecasts, estimates and predictions, and intentions. Thus, there mere fact that a misrepresentation concerned soft, forward-looking information will not take it out of the realm of misstatements of material fact.”).

III. CAUSATION WITHOUT COUNTERFACTUALS: A WRONGDOER'S OPPORTUNITY COST

American courts are split on the question of whether a copyright or trademark infringer is allowed to deduct fixed costs or overhead in determining profits subject to disgorgement.⁶³ The standard argument against the deduction is causal: “[c]osts that would be incurred anyway should not be subtracted, because by definition they cannot be avoided by curtailing the profit-making activity.”⁶⁴ The contrary argument is non-causal: the wrongdoer is entitled to keep a share of profits, the production of which required use of the wrongdoer's assets.⁶⁵ Both arguments get it backwards. Causal analysis favors a deduction for fixed costs, for they represent opportunity costs.⁶⁶ The

⁶³ The Second and Ninth Circuits allow a credit for overhead, applying what has been called the full absorption rule. *See* *Hamil America Inc. v. GFI*, 193 F.3d 92, 104-07 (2d Cir. 1999) (holding that a competing designer was not necessarily barred from deducting overhead expenses from its gross revenues for purpose of damages calculation but had to show a nexus between overhead expenses and production of infringing pattern, as well as means of fair allocation); *Kamar Int'l, Inc. v. Russ Berrie & Co.*, 752 F.2d 1326, 1332 (9th Cir. 1984) (holding that deduction from the infringer's profits for overhead should be allowed only when the infringer can demonstrate that overhead actually was of assistance in the production, distribution, or sale of the infringing product); *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d 45, 51 (2d Cir. 1939) (holding that motion picture producers and distributors could be credited only with such factors as they bought and paid for), *aff'd*, 309 U.S. 390 (1940). The Seventh Circuit does not, applying what has been called the incremental rule. *See* *Taylor v. Meirick*, 712 F.2d 1112, 1121 (7th Cir. 1983) (holding that loss of revenue is not, for purpose of determining a damage award, the same thing as loss of profits).

⁶⁴ *Meirick*, 712 F.2d at 1121. The *Restatement (Third) of Restitution and Unjust Enrichment* endorses this position and echoes this reason: “[T]he defendant will not be allowed to deduct expenses (such as ordinary overhead) that would have been incurred in any event, if the result would be that defendant's wrongful activities – by defraying a portion of overall expenses – yield an increased profit from defendant's operations as a whole.” RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. h (2011). The last bit might be read to leave the door open to accounting for overhead based on an opportunity cost.

⁶⁵ This is one reading of the argument in *Kamar International* that the incremental rule allows a copyright owner to “obtain by lawsuit net profits greater than he could have earned.” *Kamar Int'l, Inc.*, 752 F.2d at 1332. Steven E. Margolis translates the argument as thus: “In effect, absent allocation of the defendant's overheads, the copyright owner would be using the infringer's capacity rent free.” Stephen E. Margolis, *The Profits of Infringement: Richard Posner v. Learned Hand*, 22 BERKELEY TECH. L.J. 1521, 1537 (2007).

⁶⁶ The point is not original. *See* *Schnadig Corp. v. Gaines Mfg. Co.*, 620 F.2d 1166, 1171-76 (6th Cir. 1980) (holding that fixed expenses of a design patent infringer are as necessary to the infringing production as are the variable expenses and should be treated similarly); Margolis, *supra* note 65, at 1543-52 (arguing that a full absorption rule provides a defensible proxy for opportunity cost).

confusion on this point might be attributable to not being clear about the counterfactual. Indeed, in these cases causal analysis often proceeds informally without specifying possible counterfactuals.

*Sheldon v. Metro-Goldwyn Pictures Corp.*⁶⁷ illustrates. The defendants (MGM and related entities) produced, distributed, and exhibited a film, *Letty Lynton*, that lifted substantial bits from the plaintiffs' play, which was based upon a famous nineteenth century trial.⁶⁸ MGM produced over forty films in the year in question. Profits attributable to the film were measured by taking MGM's gross receipts from distributing and exhibiting the film and subtracting its direct costs. Some direct costs were estimated. For example, MGM did not account for distribution costs by film, so it was allowed to deduct a fraction of its total distribution costs.⁶⁹ The plaintiffs did not challenge this allowance. They did challenge giving the studio a credit for "'overhead' . . . on the theory that the defendants did not show that it had been increased by the production of the infringing picture."⁷⁰ The Second Circuit disagreed and deducted a share of overhead.⁷¹

In principle, determining the amount of MGM's wealth that is causally attributable to lifting bits of the plaintiffs' play in producing *Letty Lynton* requires comparing MGM's actual financial position with the position MGM would have been in had it not produced and distributed the film with the lifted bits.⁷² This turns on a counterfactual question never asked by the Second Circuit. A likely possibility is that MGM would have produced another film. If you accept this hypothesis, then profits attributable to the infringing conduct would be measured by the difference between the money MGM made on *Letty Lynton* and the money MGM probably would have made on another film. If courts took this approach, then the plaintiffs might be required to show that

⁶⁷ 106 F.2d 45 (2d Cir. 1939), *aff'd*, 309 U.S. 390 (1940).

⁶⁸ MGM had negotiated a contract to acquire the film rights of the play for \$30,000, but the contract fell through when the censors refused to pass the play. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 26 F. Supp. 134, 137 (S.D.N.Y. 1938). MGM purchased the film rights to a novel based upon on the same events for \$3,500. *Id.*

⁶⁹ These included advertising and publicity costs, as well as "the cost of carriage," presumably referring to shipping costs. *Sheldon*, 106 F.2d at 51-52. Two possible approaches were considered – dividing by the total number of pictures distributed during the year in question and apportioning based on the infringing film's share of total gross receipts for the year. *Id.* The Second Circuit held that either was fine as there was no reason in theory to prefer one over the other. *Id.*

⁷⁰ *Id.* at 54.

⁷¹ Curiously, the *Restatement (Third) of Restitution and Unjust Enrichment* endorses the handling of overhead in *Sheldon* though this contradicts its general position on overhead. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 illus. 14 (2011) (emphasizing that the risk of uncertainty is assigned to the wrongdoer).

⁷² *Cf. id.* § 51 cmt. e ("The profit for which the wrongdoer is liable by the rule of § 51(4) is the net increase in the assets of the wrongdoer, to the extent that this increase is attributable to the underlying wrong.").

Letty Lynton was more profitable than the average MGM film. But this is not the approach taken. Under both the Copyright and Trademark Acts, to make out a prima facie case for disgorgement, a plaintiff need only establish gross revenues or proceeds from sales from the activity using the infringing material. The defendant has the burden of establishing the cost of the activity.⁷³

This approach to determining the profit attributable to copyright and trademark infringement eliminates the need to determine the counterfactual of how the infringer would have acted differently had it not committed the infringing act and the effect of the change in conduct on its wealth. Later I will argue that this informal approach to causal analysis may be attractive in cases like *Sheldon* for the cynical reason that it enables a court to award an amount greater than the gain plausibly attributable to the wrong. But the informal approach has a non-cynical justification. There are a range of possible counterfactuals in *Sheldon*. One of these – in which MGM acquires the film rights to the play – is rejected out of hand as impermissible. Others include the following: (1) MGM uses the resources it commits to *Letty Lynton* to produce and distribute a different film; (2) MGM produces and distributes *Letty Lynton* without the lifted bits; and (3) MGM begins production of *Letty Lynton* and abandons the project when it turns out to be not worth pursuing without the lifted bits. The determination of the likely alternative and MGM's resulting wealth are highly fact-intensive and speculative. Requiring this determination would increase litigation costs and might make results more uncertain.

The informal approach taken to causal analysis is a likely source of the erroneous view that causal principles justify denying an infringer credit for overhead or fixed costs on the reasoning that these costs would have been incurred anyway. The disregard of overhead or fixed cost requires a non-causal justification. This error may feed into a view that a conscious wrongdoer rarely is entitled to a credit or offset for opportunity costs. The *Restatement (Third) of Restitution and Unjust Enrichment* rejects out-of-hand a claim by a conscious wrongdoer seeking a credit for the value of his labor or the use of his assets. It characterizes the claim as “in effect a restitutionary set-off or counterclaim” that seeks to “recover (through a credit against liability) the value to the claimant of benefits conferred without request.”⁷⁴ The

⁷³ 15 U.S.C. § 1117(a) (2006) (“In assessing profits the plaintiff shall be required to prove defendant’s sales only; defendant must prove all elements of cost or deduction claimed.”); 17 U.S.C. § 504(b) (2006) (“In establishing the infringer’s profits, the copyright owner is required to present proof only of the infringer’s gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.”).

⁷⁴ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. h. This is a peculiar way to frame the normative issue. For there to be a free-standing right to restitution based on providing a benefit that cannot be returned in kind, it generally is required that the benefit be of incontrovertible value to the recipient. The standard of incontrovertible benefit makes sense in this context, for the high standard dramatically reduces litigation costs and uncertainty by eliminating claims that do not come close to

wrongdoer's claim seems a bit less presumptuous if it is understood to bear on the causal issue. A wrongdoer who is seeking a credit or offset for opportunity costs is arguing that part of the wealth the claimant is seeking to capture is not attributable to his wrong against the claimant.

The upshot is that if you believe disgorgement generally is limited to the gain attributable to a wrong, then you ought to give a wrongdoer credit for overhead, fixed costs, and opportunity costs more generally if their value can be determined with a fair degree of certainty.⁷⁵ *Sheldon* is authority for this.⁷⁶ The *Restatement (Third) of Restitution and Unjust Enrichment* endorses this result, explaining that an allocation of fixed costs was "routinely made in other contexts (for example, in determining Studio's contractual obligations to persons entitled to share in net profits of particular films)."⁷⁷ The ability to

satisfying the standard. Rules that define the specific components of damages affect litigation costs and uncertainty in a much less dramatic way. Litigation already is up and going, so the rules generally affect cost and uncertainty at a narrower margin. A per se rule denying credit for a category of items (such as non-cash costs or opportunity costs) reduces litigation costs and uncertainty with respect to items clearly in the excluded category. But it increases uncertainty and may increase litigation costs on items at the boundary of the category. The value of the per se rule is further reduced by loosely defined exceptions to the rule. And there are exceptions. The *Restatement (Third) of Restitution and Unjust Enrichment* makes an exception to avoid forfeiture. See *id.* § 51 illus. 22 (describing a situation in which, by fraudulent misrepresentation, A induces B to sell a chain of retail stores at a grossly inadequate price, but not accounting for opportunity costs would leave A with no compensation for significant time and labor increasing the value of the chain).

⁷⁵ Margolis draws some other conclusions. A credit should be given for fixed costs only if the wrongdoer is operating at capacity. Also, the resources in question must have "assisted in the production" of the film, for only then is there an opportunity cost. Margolis, *supra* note 65, at 1560-62.

⁷⁶ *Janigan v. Taylor*, 344 F.2d 781 (1st Cir. 1965), is authority for backing out some opportunity costs in the context of cases discussed in Part II. The defendant acquired the plaintiffs' stock in a company for approximately \$40,000 after misleading the plaintiffs about the company's condition. Two years later he sold the stock for \$700,000. The court held that the plaintiffs were entitled to recover the defendant's entire gain on the transaction, even though much of the increase in price was for reasons unrelated to matters on which defendant misled the plaintiffs. The defendant, however, was allowed to subtract a bonus to which he would have been entitled "had there been no misrepresentation and no sale." *Id.* at 787.

⁷⁷ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 illus. 14. Learned Hand's opinion in *Sheldon* suggests that he took the accounting treatment of items as a baseline. Thus, he rejects MGM's argument seeking a credit for overhead for the cost of failed projects ("continuities") from earlier years, explaining that he might have decided otherwise "[h]ad this been an annual depreciation credit," and so expressed more like a current expense. 106 F.2d at 53. On the other hand, he treated the cost of ventures scrapped in the current year as part of overhead, rejecting the plaintiffs' argument that they should not have to bear the cost of failed ventures, explaining the failures were part of MGM's capacity and that "[s]ince therefore the plaintiffs profited by the fact that the defendants had developed this capacity, they must be content to take the breakage, so to say,

piggyback on the accounting measure of profit reduces the cost of the exercise by providing premade data and heuristics for analyzing the data. It may also reduce the variance in the answer.

Some defensive claims based on opportunity costs can still be rejected out-of-hand for essentially administrative reasons. A knowing trespasser who cuts, hauls, and mills timber to sell the lumber must disgorge the entire sale proceeds with no credit for his labor or the use of his assets.⁷⁸ His opportunity costs can be disregarded because we expect (or at least hope) people who turn to thievery do not have legitimate opportunities to make money. And the honest value of a thief's time is likely to be highly speculative.

IV. WHITHER APPORTIONMENT BY DESERT?

Apportionment is treated as separate from and posterior to causal analysis.⁷⁹ The court first determines the wealth in a wrongdoer's hand causally attributable to a wrong. Then the court decides how to apportion this wealth between the parties. *Sheldon* illustrates. The court determined MGM's accounting profit on the film. Then it awarded the claimants one-fifth of this amount as the "best estimate" of the share of the profits attributable to the lifted material, striving to "make an award which by no possibility shall be too small . . . [and] which will favor the plaintiffs in every reasonable chance of error."⁸⁰ The working premise is that apportionment divides wealth whose production required the combination of the claimant's entitlement and the wrongdoer's resources "in accordance with their relative contribution."⁸¹ The corollary is that apportionment allows a wrongdoer to retain wealth he would not have had but for the wrong in order to repay his contribution in producing the wealth.

I will argue in this Part that this understanding of how apportionment is used in *Sheldon* misses the point entirely. Apportionment camouflages the fact that the damage award significantly exceeds the likely gain to MGM causally attributable to the wrong. A related point is that in cases like *Sheldon*, causal analysis should set a floor on disgorgement. Generally a wrongdoer is entitled to retain no share of wealth causally attributable to a wrong based on his

which was its inevitable incident." *Id.* at 54.

⁷⁸ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 illus. 17 ("To allow a credit for the value of [the thief's] services or expenses would to that extent impose a forced exchange, requiring [the victim] not only to pay for logging services for which he did not contract but acquire them from a thief.").

⁷⁹ The *Restatement (Third) of Restitution and Unjust Enrichment* calls this allocation. It separates the "threshold" question of determining the portion of the wrongdoer's profit attributable to the activity using the claimant's entitlement, deducting the accounting cost, from "a further problem of apportionment that ordinary accounting practice has no call to address." *Id.* § 51 cmt. g.

⁸⁰ *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d 45, 51 (2d Cir. 1939).

⁸¹ Friedmann, *supra* note 39, at 1925.

contribution in producing the wealth. Counterexamples are discussed in the next Part.

The facts in *Edwards v. Lee's Administrator*⁸² serve to illustrate the problem and to define some key terms. Edwards found the entrance to the "Great Onyx Cave" on his land. Encouraged by the success of nearby "Mammoth Cave," he developed the cave as a popular tourist attraction. One-third of the cave, including some of the most spectacular features, were under Lee's land. The court awarded Lee one-third of Edwards' net profits from exhibiting the cave, allowing Edwards to subtract his cash expense but not the value of his personal services.⁸³

To determine Edwards' income from the cave causally attributable to the wrong requires estimating the additional money Edwards made by exhibiting Lee's part of the cave.⁸⁴ This requires estimating the effect a smaller attraction would have on the number of visitors and the ticket price to determine the reduction in gross income from the smaller attraction. Edwards' expenses would be recalculated to subtract expenses he would have saved not exhibiting Lee's part of the cave.

Assume this is done so that the profits made by Edwards' exhibiting Lee's part of the cave are isolated. The argument for what I call "apportionment by desert" is that Edwards is entitled to retain part of this amount because it was produced by his effort and by using his resources. Edwards may claim he is entitled to a share of the profits attributable to showing Lee's part of the cave because this required use of his land, because he risked his labor and capital, and because he contributed the idea of developing the cave as an attraction.

The fact that Lee's part of the cave was economically worthless without access from Edwards' land makes the claim for apportionment by desert based on Edwards' contribution of his land particularly compelling. To clarify the nature of the claim, it is useful to change the facts a bit. Imagine the land with the entrance is owned by Boone, who hires Edwards to survey the land. Edwards discovers the cave, realizes its potential value, and purchases the land from Boone without disclosing the cave. This is a breach of fiduciary duty. Edwards develops the cave as a tourist attraction. Boone and Lee sue Edwards seeking a share of the profits. As between Boone and Lee, Boone is entitled to any profits he can show would have been made by exhibiting his part of the cave alone. Edwards' wrong against Boone deprived Boone of the opportunity to make this profit. Lee is entitled to none of these profits because they could have been made without exhibiting his part of the cave. As for the remaining profit attributable to exhibiting Lee's part of the cave, there is no obvious basis for apportioning this between Boone and Lee. This profit is a gain from trade that required exhibiting their parts together. Neither could make the profit

⁸² 96 S.W.2d 1028 (Ky. Ct. App. 1936).

⁸³ *Id.* at 1033.

⁸⁴ This assumes Edwards' part of the cave could have been profitably exhibited by itself.

alone.⁸⁵ This gain must be apportioned between Boone and Lee. This is apportionment by desert.

Drop Boone from the tale. Edwards finds the cave on his own land. Does he have a claim similar to Boone's for a share of the gain from trade? The case for apportionment by desert largely hinges on the answer to this question. I think it is no in this case. There is no obvious basis for apportioning gains from trade. In stylized bargaining games people tend to divide gains from trade evenly and to treat a demand for a disproportionate share as offensive.⁸⁶ But Edwards cheated, trying to capture the entire gain for himself (and more if Lee is harmed by Edwards' activity) and denying Lee an opportunity to bargain. As far as fairness is concerned, I think Edwards forfeited his right to a fair division. As for instrumental concerns, the purpose of disgorgement is to deter Edwards from taking what he should have bought. If the expected or fair division of the gain from trade is even, then giving Edwards none of the gain imposes a modest one-to-one penalty multiplier.

The same may be said for the arguments that Edwards deserves a share of the profit attributable to exhibiting Lee's part of the cave as a reward for risk taking or as compensation for contributing the idea of developing the cave as an attraction. If Edwards had bargained with Lee, then he probably would have been able to negotiate a better than even split of the gain from trade because of these contributions. But they are difficult to price. Edwards cheated, denying Lee an opportunity to decide for himself how much of the gain from trade he was willing to relinquish in order to make the trade. Denying Edwards a share of the gain from trade based on these contributions increases the penalty multiplier slightly, again taking the expected or fair division of the gain as the baseline.

This brings me back to *Sheldon*. The informal approach to causal analysis in the case has already been noted. No attempt was made to determine what MGM would have done had it not produced *Letty Lynton* with the lifted bits and the resulting effect on its wealth. There is a cynical explanation for why this approach seems attractive. It is that a less informal approach to the causal issue yields an amount that is too low a multiple of the license price to adequately deter MGM from doing what it did. This suggests that the need to apportion by desert arises only because causal analysis is truncated in a way that allows the claimant to reach wealth not causally attributable to the wrong.

⁸⁵ If Boone's part of the cave could not be profitably exhibited without Lee's part, then the entire profit is a gain from trade.

⁸⁶ Ernst Fehr & Klaus M. Schmidt, *The Economics of Fairness, Reciprocity and Altruism – Experimental Evidence and New Theories*, in 1 HANDBOOK OF THE ECONOMICS OF GIVING, ALTRUISM AND RECIPROCITY 615, 622 (Serge-Christophe Kolm & Jean Mercier Ythier eds., 2006) (“A robust result in the ultimatum game, across hundreds of experiments, is that the vast majority of the offers to the responder are between 40 and 50 percent of the available surplus. Moreover, proposals offering the responder less than 20 percent of the surplus are rejected with probability 0.4 to 0.6. In addition, the probability of rejection is decreasing in the size of the offer.”).

A close reading of Learned Hand's opinion in *Sheldon* supports this reading of the case. Hand was adamant that in apportionment MGM was entitled to no credit for its "standing and reputation in the industry" and that MGM "can be credited only with such factors as they bought and paid for."⁸⁷ MGM's reputation looms large in causal analysis. There was unchallenged testimony that many exhibitors and filmgoers chose a film based largely on MGM's reputation and the identity of the leading players. The likely inference is that whatever MGM would have done had it not produced *Letty Lynton* with the lifted bits it would probably have made approximately the same profit. Excluding this contribution for purposes of both causal analysis and apportionment yields an estimate of the gain resulting from using the lifted bits that is predictably larger than the likely actual gain.

Several points follow. In cases like *Sheldon* and *Edwards*, a court should never award an amount of damages that is less than the best estimate of a wrongdoer's wealth causally attributable to the wrong.⁸⁸ A claimant should recover any "gain from trade," meaning wealth which requires combined use of the claimant's entitlement and the wrongdoer's resources. If this estimate is an amount that is too little to deter – i.e., not much more than the amount the wrongdoer probably would have paid for the entitlement – then *Sheldon* is authority that a court may award a greater amount. *Sheldon* shows how to do this while maintaining the pretense that disgorgement reaches only a wrongdoer's wealth attributable to wrong. Start with a gross measure of the wealth attributable to the wrong; subtract only hard or easily measured opportunity costs in producing the wealth; disregard other opportunity costs; and take a generous fraction of the resulting number. Whatever the resulting amount, it will serve to deter so long as it is a reasonable multiple of the likely price of purchasing the entitlement. The damage award in *Sheldon* was roughly four times the likely purchase price.⁸⁹

V. BEYOND CAUSATION: WEAK ENTITLEMENTS

For most of the cases discussed up to this point, causal analysis generally determines a wrongdoer's wealth subject to disgorgement if an appropriate counterfactual can be chosen. I now turn to cases involving conscious wrongs in which disgorgement is denied or the measure of disgorgement clearly is less than wealth causally attributable to the wrong. I argue the common feature of these cases is the weakness of the entitlement taken.

⁸⁷ *Id.* at 50-51.

⁸⁸ *Cf.* Eisenberg, *supra* note 40, at 599 (framing the question as whether full disgorgement "would leave the promisee with an undue windfall" and arguing that "[i]n most cases, the answer to this question would be no").

⁸⁹ The court awarded 20% of \$587,000 in net profits. This yielded a damage award of approximately \$118,000. The negotiated price for the motion picture rights of the play was \$30,000. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 397 (1940).

That causal analysis only takes one so far is unsurprising. In negligence law, one of the benefits of separating the issues of causation and scope of liability is that it discourages masking non-causal considerations in causal language. Causal clarity pushes non-causal considerations out in the open. It does not vanquish them. In negligence law, separating causation and scope of liability has strengthened the case for a general default principle on scope of liability. This is the risk rule. Generally, harm in negligence law is considered to be within the scope of liability if the risk of such harm is among the risks that made the actor's conduct unreasonable.⁹⁰ The structure and coherence of negligence law makes it possible to postulate such a principle. Its desirability is debated.⁹¹

The structure of the law of disgorgement makes it unlikely that we can formulate a useful general principle on the scope of liability for ill-gotten gains. Disgorgement is a remedy for a large class of wrongs that protect diverse types of financial and proprietary interests and involve diverse types of misconduct, including dishonesty, disloyalty, and misappropriation of property. My general point in this Part is modest: sometimes the nature of the entitlement taken justifies allowing a wrongdoer to keep all or part of the gain causally attributable to the wrong. This qualifies the claim in Part IV that typically a claimant is entitled to all of a wrongdoer's wealth causally attributable to a wrong against him.

The unusual character of the wrong in *Storage Technology Corp. v. Cisco Systems, Inc.*⁹² makes the case an apt illustration of the general point. In early 1980, NuSpeed, a start-up company, "raided" Storage for employees. It hired twenty-seven of Storage's current and past employees. The people raided did important work on a NuSpeed project that soon caught Cisco's eye. In late 1980, Cisco acquired NuSpeed, paying with Cisco stock worth \$450 million. Storage sued NuSpeed claiming NuSpeed committed various torts in the employee raid, including interference with contract and complicity in breach of fiduciary duty. In particular, Storage presented evidence that a key manager recruited other employees to move with him while he was still working for

⁹⁰ RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL AND EMOTIONAL HARM § 29 (2010).

⁹¹ See, e.g., John C.P. Goldberg & Benjamin C. Zipursky, *Intervening Wrongdoing in Tort: The Restatement (Third)'s Unfortunate Embrace of Negligent Enabling*, 44 WAKE FOREST L. REV. 1211 (2009) (criticizing replacement of traditional rules on superseding cause with risk rule). Bob Scott and George Triantis have made a similar point regarding the systematization of contract law in the late nineteenth and early twentieth centuries. They argue that the importation of the compensation principle into contract law from tort law had the effect of undercutting a heterogeneous set of rules that served important purposes other than compensation. Robert E. Scott & George G. Triantis, *Embedded Options and the Case Against Compensation in Contract Law*, 104 COLUM. L. REV. 1428, 1437-47 (2004) (discussing the history of contract law's incorporation of the compensation principle).

⁹² 395 F.3d 921 (8th Cir. 2005).

Storage. This is clearly a breach of fiduciary duty. Storage also presented evidence that NuSpeed was complicit in the wrong. This was for naught. The district court granted NuSpeed's motion for summary judgment and the Eighth Circuit affirmed.⁹³

Storage told a plausible causal story. The people who jumped ship comprised five of NuSpeed's fifteen key employees and one-third of its workforce.⁹⁴ Quite possibly without these people NuSpeed could not have brought to fruition the project that induced Cisco to pay the price it did. Nevertheless the court found the evidence of causation insufficient, imposing a dauntingly high standard that required Storage to provide a coherent basis for determining how much of the gain was attributable to the stolen workforce.⁹⁵ The *Restatement (Third) of Restitution and Unjust Enrichment* recommends a more lenient standard of proof, stating that "the claimant's burden of proof . . . is ordinarily met as soon as the claimant presents a coherent theory of recovery in unjust enrichment" and that "a claimant who is prepared to show a causal connection between defendant's wrongdoing and a measurable increase in the defendant's net assets will satisfy the burden of proof as ordinarily understood."⁹⁶ Under this standard there appears to be sufficient evidence of causation to survive a motion for summary judgment.

The case shows that the lenient standard of proof cannot be applied across the board. The lenient standard is drawn from cases involving the misappropriation of capital or property. There was no allegation that NuSpeed's golden project used any of Storage's intellectual property, other than whatever proprietary rights Storage may have had in the identities and salaries of the employees who jumped ship to work on the project. A damage measure designed to deter misappropriation of capital or property should not apply to what is in effect theft of employees because of the employees' liberty interests.⁹⁷ The general principle favoring free movement of labor justifies denying an employer whose employees are lured away in a wrongful manner the legal right to recover wealth produced by the employees in their new jobs. Causal uncertainty reinforces this conclusion, but I do not think it essential. The result should not have been different if the employees who jumped ship started their own company.

⁹³ *Id.* at 922.

⁹⁴ *Id.* at 926.

⁹⁵ *Id.* at 928-29.

⁹⁶ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. i (2011).

⁹⁷ Storage's disgorgement claim would have been stronger if the employees who jumped ship had violated fixed term employment agreements. It would have been even stronger if the employees had violated clear and enforceable covenants not to compete. These facts would have strengthened the disgorgement claim because the employees would have bargained away their freedom to move.

My second example is more controversial. Recent American cases reject gains-based damages for violation of a restrictive covenant⁹⁸ and nuisance.⁹⁹ English law allows what might be described as gains-based damages in cases of violation of a restrictive covenant, but they limit damages to a “reasonable fee” for the infringement, which generally has been a small fraction of the gain made possible by violating the covenant.¹⁰⁰ The damage award is in lieu of ordering the defendant to remove the infringing structure. Academics have criticized low damage awards in this situation.¹⁰¹

The courts may be right. A restrictive covenant does not endow the owner of the dominant estate with a general right to control use of the servient estate. A covenant is a limited entitlement that is meant to enhance the value of the dominant estate in specific ways.¹⁰² Because of this, it might be considered opportunistic, bad faith, an abuse of rights, or even a violation of public policy for the owner of the dominant estate to hold out for an amount much greater than the entitlement is worth to him knowing he has the owner of the servient estate over the barrel.¹⁰³ A fractional damage award replicates a fair price for the entitlement.

⁹⁸ *Jantzen Beach Ass’n v. Jantzen Dynamic Corp.*, 115 P.3d 943 (Or. Ct. App. 2005). The defendant built a big-box store violating a restrictive covenant that prohibited any structure obstructing the visibility of the plaintiff’s property from a highway. *Id.* at 944. It appears the big-box store increased the value of the plaintiff’s land. *Id.* at 945 n.3.

⁹⁹ *Marmo v. Tyson Fresh Meats, Inc.*, 457 F.3d 748 (8th Cir. 2006) (applying Nebraska law). The plaintiffs alleged that the defendant saved \$70 million by not installing appropriate pollution control equipment at wastewater lagoons at the defendant’s beef processing plant, causing a nuisance through emissions of hydrogen sulfide gas. *Id.* at 754. The court of appeals held an unjust enrichment claim was unavailable under Nebraska law. *Id.* at 764.

¹⁰⁰ *Amec Devs. Ltd. v. Jury’s Hotel Mgmt. Ltd.*, [2001] EGLR 81 (U.K.) (explaining that the defendant built a hotel too close to the property line and that the plaintiff argued the resulting profit was £1.5 million while the defendant argued it was £.14 million and setting damages at £.375 million); *Wrotham Park Estate Co. v. Parkside Homes Ltd.*, [1974] 1 WLR 798 (U.K.) (finding that the defendant built houses in violation of restrictive covenant and awarding 5% of the expected gain as damages).

¹⁰¹ Friedmann, *supra* note 39, at 1900-01; Katy E. Barnett, *Accounting for Profit for Breach of Contract: A Theoretical and Practical Justification* 179-180 (Sept. 2010) (unpublished Ph.D. thesis, Melbourne Law School) (on file with author).

¹⁰² RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.10 (2000) (permitting a holder only “to use the servient estate in a manner that is reasonably necessary for the convenient enjoyment of the servitude” and precluding causing “unreasonable damage to the servient estate” or interference with its enjoyment).

¹⁰³ *Id.* § 7.10 cmt. a (explaining that “permitting the enforcement of servitudes after they have lost their utility reduces land values and turns the law into an instrument of extortion” and that it is inappropriate for a holder to “exact an unreasonably high price for release of an encumbrance that otherwise has no value and interferes with the ability of the servient owner to use his or her property”).

A counter-argument is that much or all of the gain should be disgorged to encourage the owner of the servient estate to bargain for the entitlement.¹⁰⁴ There are two responses. First, if this is the goal, and if the owner of the dominant estate is expected to demand no more than a fair price, then damages need only be set at a reasonable multiple of the predicted fair price to encourage bargaining. This encourages bargaining and does not deter the owner from changing the use of the servient estate in the way that violates the entitlement. The second point is more complicated. The owner of the servient estate cannot assume the owner of the dominant estate will bargain fairly. The legal protections against extortion in this situation are fairly weak. There is a concern that setting the penalty too high may leave the owner of the servient estate in an overly vulnerable position, particularly if he has reason to fear being held up by the owner of the dominant estate.

If the last point seems far-fetched, then consider one more case involving a weak entitlement. The case is *Peters Corp. v. New Mexico Banquet Investors Corp.*¹⁰⁵ Defendants held a controlling interest in an American bank in which the plaintiffs (Peters Corp.) had a minority interest. The American bank had an option to purchase a Mexican bank. Under the option's terms, if the American bank chose not to exercise the option, then Peters Corp. had the power to do so only if it could acquire all the shares in a short period. The defendants directed the American bank to pass on the option without disclosing this to Peters Corp. This made it possible for a holding company that the defendants controlled to purchase the Mexican bank. The defendants had complicated reasons for pursuing this interested transaction without disclosure, which resulted in a breach of fiduciary duty. They knew Peters Corp. had neither the votes to alter their decision to have the bank pass on the option nor the capital to buy the bank itself. But they feared Peters Corp. would try to prevent their holding company from acquiring the Mexican bank out of anger at losing out on the opportunity.

Once the scheme was discovered, Peters Corp. sued for fraud and breach of fiduciary duty, seeking disgorgement of defendants' gain from the acquisition of Mexican bank.¹⁰⁶ If the decision to have the American bank not exercise the option had been a wrong, then Peters Corp. would be entitled to a share of the profit as compensation or as disgorgement. But the court held the decision was legitimate.¹⁰⁷ If Peters Corp. had been able to exercise the residual option, then they would be entitled to recover the entire profit as compensation or disgorgement. But the court found Peters Corp. did not have the financial resources to exercise the residual option.¹⁰⁸

¹⁰⁴ Barnett, *supra* note 101, at 163-64.

¹⁰⁵ 188 P.3d 1185 (N.M. 2008).

¹⁰⁶ *Id.* at 1190.

¹⁰⁷ *Id.* at 1194-97.

¹⁰⁸ *Id.*

Peters Corp. came up with a new causal theory on appeal that was tailored to the wrong they were able to establish and their weak position on the facts. The theory was that Peters Corp. would have brought a lawsuit challenging the acquisition by the holding company, which would have prevented the holding company from completing the acquisition even though the suit would ultimately turn out to be meritless.¹⁰⁹ The New Mexico Supreme Court did not address this theory in affirming a judgment for the defendants, holding it should have been raised in the trial court.¹¹⁰ Had the theory been raised in a timely fashion it should not have changed the result. The entitlement that was taken was the right to the information that the bank passed on the option. While the claimants might have acted on this information to prevent the holding company from buying the bank, this would have been an illegitimate response. The purposes of the duty to disclose do not include enabling a minority of shareholders in a corporation to pursue a meritless lawsuit to prevent the majority from pursuing opportunities properly foregone by the corporation.

VI. BEYOND CAUSATION: REMOTENESS

The *Restatement (Third) of Restitution and Unjust Enrichment* has a black letter rule excluding as damages “unduly remote” profits derived from a wrong, even if the profits are “identifiable and measurable.”¹¹¹ Respected authorities agree. Graham Virgo endorses a rule limiting damages to benefits that “arose directly from the commission of the wrong.”¹¹² James Edelman endorses a rule limiting damages to foreseeable gains.¹¹³

This enthusiasm for a rule of remoteness is curious. Criteria of “remoteness” and “proximity” were tried in negligence law and found wanting.

¹⁰⁹ *Id.* at 1195-96.

¹¹⁰ *Id.*

¹¹¹ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51(5)(a) (2011); *see also id.* § 53(3) (“A conscious wrongdoer or a defaulting fiduciary is liable for proceeds or consequential gains that are not unduly remote.”).

¹¹² Graham Virgo, *Restitutionary Remedies for Wrongs: Causation and Remoteness*, in JUSTIFYING PRIVATE LAW REMEDIES 301, 306 (Charles EF Rickett ed., 2008).

¹¹³ JAMES EDELMAN, GAIN-BASED DAMAGES: CONTRACT, TORT, EQUITY AND INTELLECTUAL PROPERTY 108 (2002). Edelman proposes borrowing the test of foreseeability from negligence law. This is a mistake. The foreseeability of a harm is relevant to the determination of whether the harm is within the scope of liability for negligent conduct because if a harm is unforeseeable, the risk of such harm cannot be among the risks that made the conduct unreasonable. It is possible to construct an analogous argument that is pitched in terms of the goals of disgorgement. The argument is that the goal of disgorgement, which is to deter a wrongdoer from taking what he ought to buy, is achieved by stripping away the expected or foreseeable profit from the wrong. Stripping away unexpected or unforeseeable gains is unnecessary. This is not a strong argument for it presupposes that a wrongdoer has a better claim than does the claimant to what is by definition a windfall gain.

The terms evoke a muddle of physical considerations (the closeness of action and outcome in time and space), psychological considerations (the actor's state of mind regarding the outcome), and normative considerations (the bearing of the outcome on normative evaluation of the action). The *Restatement (Third)* acknowledges this problem in its comments. They observe that a profit may be characterized as remote for various reasons, including causal uncertainty, the wrongdoer's desert, immeasurability of a gain, and incentive effects.¹¹⁴ The *Restatement (Third)* defends the use of remoteness as an excluding criteria "because it summarizes in intuitive fashion a variety of concerns that are potentially relevant to the ultimate issue of unjust enrichment."¹¹⁵

If available, a causal explanation is preferable to remoteness because the causal explanation is clearer. Causal analysis explains why, if Leonardo had painted the Mona Lisa on stolen canvas using stolen paint, the value attributable to his craft and genius is not subject to disgorgement. Had Leonardo not stolen the canvas and paint, he likely would have produced the Mona Lisa anyway.

Sometimes gains are characterized as remote because causal analysis yields too much in the way of deterrence. Consider an illustration in the *Restatement (Third)*.¹¹⁶ Company trespasses on Owner's land to acquire geological information. Using this information Company acquires mineral rights in the area worth \$5 million. The mineral rights are not acquired from Owner. Company probably could have acquired the right to conduct the test on the claimant's land for \$50. The *Restatement (Third)* concludes, "Given the multifarious causes of Company's profits from the mineral rights, and the disproportion between the injury to Owner and the consequential gains, a court is likely to find that the greater part of Company's profits are too remote from the trespass to be properly subject to disgorgement."¹¹⁷ The language of remoteness obfuscates the basis for the result. The purpose of disgorgement is to deter Company from conducting the test without bargaining for the right. It is not to punish Company for learning what it did by conducting the test or for exploiting the information. The goal of deterrence is adequately served by awarding a reasonable multiple of \$50. The result should be the same, even if it is clear that the information acquired by conducting the test was worth \$5 million to Company.

Sometimes the language of remoteness may seem to summarize aptly a tangle of reasons that justify denying a claim for profits. For example, in *Edwards*, Lee recovered only a share of Edwards' profit from exhibiting the cave.¹¹⁸ He recovered no share of Edwards' profit from a hotel serving tourists

¹¹⁴ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. e (2011).

¹¹⁵ *Id.* § 51 cmt. f.

¹¹⁶ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 53 illus. 11.

¹¹⁷ *Id.*

¹¹⁸ *Edwards v. Lee's Adm'r*, 96 S.W.2d 1028, 1033 (Ky. Ct. App. 1936).

who came to see the attraction.¹¹⁹ In copyright and trademark infringement cases, courts generally limit recovery to the profits earned from the infringing activity itself. Claimants have had little success reaching profits in other parts of the wrongdoer's business on the theory that the infringing activity boosted profits in the other parts. *Burns v. Imagine Films Entertainment, Inc.*¹²⁰ illustrates. This was a claim that the film *Backdraft* infringed on a copyrighted screenplay.¹²¹ In addition to seeking a share of the profits made by the film, claimants sought a share of the profits from a theme park attraction based on the film.¹²² There was no claim that the attraction used infringing material. The claim to a share of the profits from the theme park attraction was denied.¹²³

Causal uncertainty goes a long way toward explaining these results. In both cases, defendant made a significant investment in the secondary activity, entailing a large opportunity cost, and it is uncertain to what extent the connection to the primary infringing activity added to the profit on the investment. Cutting off claims based on such gains simplifies litigation and makes damages more certain. And there is an argument that the secondary gains are outside the scope of the right that is infringed. In *Burns*, the claim to a share of the profit from the theme park attraction would have been stronger if the attraction had used infringing material.

Part IV suggested another, more cynical explanation for these results. I argued that courts sometimes fudge the causal analysis in determining the gain attributable to a wrong because the likely gain from use of an entitlement is too close to the likely price for the entitlement to deter the defendant from taking the entitlement without bargaining. Courts measure the gain attributable to the wrong by starting with the gross wealth produced by the infringing activity, subtracting only hard costs, ignoring most opportunity costs, and taking a generous fraction of the resulting number. If applying this technique to the primary infringing activity yields an amount that is a reasonable multiple of the likely price of the entitlement, then there is no reason to extend the exercise to a defendant's other activities, even if those activities profited from the infringing activity. The extension unnecessarily complicates the exercise and probably makes results more uncertain. If I am right about the last point, then the law could be made clearer and more coherent by adopting a rule that causal

¹¹⁹ *Id.* at 1033 (affirming the chancellor's exclusion of "profits received by the appellants from the operation of their hotel"). For a discussion of why this point received little attention in the literature, see Friedmann, *supra* note 39, at 1919.

¹²⁰ No. 92-CV-2438, 2001 WL 34059379 (W.D.N.Y. Aug. 23, 2001).

¹²¹ *Id.* at *1.

¹²² *Id.* at *4.

¹²³ *Id.* ("[A]lthough the theme park may have reaped some 'marginal benefit' from infringing elements in the film *Backdraft*, the percentage of such profits attributable to Plaintiffs is 'too speculative and the relationship between such profits and infringement is too attenuated' to justify an award of indirect damages from theme park profits.").

uncertainty regarding gain attributable to a wrong is resolved against a claimant once the measure of gains-based damages is a reasonable multiple of the likely or fair price for the entitlement taken by a wrongdoer.

CONCLUSION

The major contribution of this Article is the insight that causal analysis can do a great deal of work in determining wealth in a wrongdoer's hand subject to disgorgement once the appropriate counterfactual is chosen. Non-causal considerations of fairness and policy determine permissible counterfactuals. I used the law of deceit to illustrate the importance of clarity about permissible counterfactuals. A contentious point is my claim that causal analysis is fudged in some cases because it generates a measure of damages that is too low to deter the wrong. Candor on this point would make the law clearer and more coherent while weakening the claim in justice for damage awards that exceed the likely gain causally attributable to the wrong. I think this price is worth paying. Causal clarity makes it possible to identify reasons why causal analysis is inconclusive and it brings into view a normative benchmark to determine disgorgement damages when causal analysis is inconclusive. Causal analysis is inconclusive when the appropriate counterfactual is contestable, when factual analysis yields an uncertain answer, and when factual analysis yields a measure of damages that seems too low or too high. The purpose of disgorgement – to deter but not to punish – supplies a normative benchmark for all of these situations. This benchmark is a reasonable or fair price for the entitlement taken by the wrongdoer. Disgorgement damages should be set at a multiple of this price in an amount that is sufficient to deter persons such as the defendant from taking such an entitlement without bargaining for it.