RESTITUTIONARY DAMAGES FOR BREACH OF CONTRACT: *BANK OF AMERICA CANADA v. MUTUAL TRUST CO.*

1. Introduction

The orthodox response to a breach of contract is compensation. The defendant must, through the monetary proxy of damages, place the plaintiff in the position that she would have enjoyed if the contract had been properly performed.[1] The value of that remedy is calculated exclusively by reference to the plaintiff's loss. The corollary is also true. The common law traditionally refused to award gain-based relief. The plaintiff was not entitled to strip the defendant of a benefit that he acquired through breach.[2] In 2000, however, the House of Lords released a remarkable judgment that, for the first time ever, expressly imposed a gain-based, or "restitutionary", remedy for breach of contract. *Attorney General v. Blake*[3] involved a convicted double agent who escaped prison, fled to the Soviet Union, and subsequently sold his memoirs to an English publisher in exchange for the promise of £150,000 in advances.

Although George Blake's actions did not constitute a breach of confidence or a breach of fiduciary duty, they did violate a lifelong contractual obligation of non-disclosure that he assumed when he joined the British Secret Service in 1944. Faced with the prospect of allowing a traitor to profit from his own wrong, the House of Lords ordered Blake's publisher to pay the outstanding advances to the Attorney General. Lord Nicholls, who wrote the lead judgment, stressed that such relief was anomalous and insisted that it was available "only in exceptional circumstances"[4] (which he did not fully elaborate upon).

Attorney General v. Blake was the subject of a comment that appeared in this journal.[5] It raised a number of questions, including

1. *Asamera Oil Corp. v. Sea Oil & General Corp.*, [1979] 1 S.C.R. 633 at p. 645, 89 D.L.R. (3d) 1 at p. 8, application to vary granted [1979] 1 S.C.R. 677, 97 D.L.R. (3d) 300 *sub nom. Baud Corp., N.V. v. Brook*; *Robinson v. Harman* (1848), 1 Ex. 850 at p. 855, 154 E.R. 363 at p. 365.
2. *Tito v. Waddell*, [1977] Ch. 106 at p. 332.
3. [2001] 1 A.C. 268.
4. *Ibid.*, at p. 285.
5. M. McInnes, "Gain-Based Relief for Breach of Contract: *Attorney General v. Blake*" (2001), 35 C.B.L.J. 72. See also M. McInnes, "Disgorgement for Breach of Contract: The Search for a Principled Relationship" in E.J.H. Schrage, ed., *Unjust Enrichment and the Law of Contract* (London, Kluwer Law Int'l., 2001), p. 225.

the extent to which the House of Lords' decision, despite its conservative tone, would encourage other courts to award gain-based relief. Elsewhere in the Commonwealth, the answer was surprisingly swift and positive, if not entirely convincing.[6] In this country, the response has been more muted. No Canadian case has discussed *Blake*. Intriguingly, however, the Supreme Court of Canada recently said that gain-based relief is indeed available for breach of contract.[7] In the circumstances, however, the precise effect of that proposition is unclear.

2. *Bank of America Canada v. Mutual Trust Co.*

For present purposes, the facts of *Bank of America Canada v. Mutual Trust Co.* can be simplified. A company called Reemark intended to build a condominium complex. It arranged long-term financing, in the form of a mortgage for $36.5 million, through Mutual Trust Co. (MT). It also arranged short-term financing, in the form of a construction loan for $33 million, through Bank of America Canada (BAC). That loan carried compound interest. The two transactions were then consolidated such that MT was obliged to advance money under the mortgage directly to BAC in discharge of Reemark's construction loan. MT subsequently breached that agreement by refusing payment. BAC was entitled to the outstanding amount, but a difficult question arose as to whether it was entitled to claim damages representing compound interest as well. The Ontario Court of Appeal, reversing the trial judge, answered in the negative.[8] The availability of interest is governed by the Courts of Justice Act.[9] Section 128(1) allows a court to award simple interest, but s. 128(4)(a) expressly prohibits compound interest (or "interest . . . on interest"). Moreover, while s. 128(4)(g) allows interest to be "payable by a right other than under this section", Goudge J.A. noted that a non-statutory right to compound interest was historically limited, for the most part, to cases involving equitable fraud or fiduciary gains. The facts did not support either of those possibilities.

6. *Esso Petroleum Co. Ltd. v. Niad Ltd.*, [2001] E.W.J. No. 5715, online: QL (EWJ) (Ch. D.); cf. *Hospitality Group Pty. Ltd. v. Australian Rugby Union Ltd.*, [2001] F.C.A. 1040 (August 3, 2001) (Aust. F.C.).
7. *Bank of America Canada v. Mutual Trust Co.* (2002), 211 D.L.R. (4th) 385 (S.C.C.).
8. (2000), 184 D.L.R. (4th) 1, 130 O.A.C. 149 (C.A.), revg 18 R.P.R. (3d) 213 (Gen. Div.).
9. R.S.O. 1990, c. C-43.

As a matter of authority, the Court of Appeal was correct. The common law's traditional approach to interest was notoriously restrictive. Although a loss representing compound interest is often a foreseeable consequence of a breach of contract, the courts historically refused to impose relief out of deference to precedent[10] and Parliament. Most significantly, since the legislature had chosen generally to restrict the plaintiff to simple interest, it was thought inappropriate for judges to award anything more.[11] On further appeal to the Supreme Court of Canada, however, Justice Major boldly broke with the past and created a new right to recover compound interest as contractual damages.[12] It appears that such relief is available subject only to the usual rules of remoteness.[13]

Justice Major relied primarily on a compensatory analysis. If MT paid as promised, BAC would have enjoyed both the receipt of money *and* the ability to lend those funds to another borrower on a compound basis. Moreover, given the circumstances, both of those losses were within the parties' contemplation at the time of the contract. Interestingly, however, Major J. also drew motivation for his decision from "restitutionary" principles. Both parties were financial lenders. Consequently, the breach not only deprived BAC of income, it also supplied MT with funds with which it supported loans to its own customers. The award of compound interest therefore had the salutary side-effect of stripping MT of the profit that it improperly earned.

3. The Meaning of Restitution

There is much to be said for the decision to award contractual damages representing compound interest. The traditional rule refused, for largely antiquated reasons,[14] to compensate the plaintiff

10. *Page v. Newman* (1829), 9 B. & C. 378, 109 E.R. 140.
11. *London, Chatham & Dover Railway Co. v. South Eastern Railway Co.*, [1893] A.C. 429 (H.L.); *President of India v. La Pintada Cia Navigacion SA (No. 2)*, [1985] 1 A.C. 104 (H.L.).
12. The Supreme Court of Canada's decision on the issue of compound interest is discussed in M. McInnes, "Breach of Contract and Compound Interest" (2002), 118 L.Q.R. (forthcoming). The High Court of Australia had reached a similar conclusion in *Hungerfords v. Walker* (1989), 171 C.L.R. 125.
13. *Hadley v. Baxendale* (1854), 9 Exch. 341, 156 E.R. 145. Cf. *Wadsworth v. Lydall*, [1981] 1 W.L.R. 598 (C.A.); *Atlantic Salvage Ltd. v. Halifax (City)* (1978), 30 N.S.R. (2d) 512, 94 D.L.R. (3d) 513 (C.A.) (limiting damages for compound interest to positive expenditures falling within the second, but not the first, branch of *Hadley v. Baxendale*).
14. Leaving aside the issue of legislative intervention, the traditional rule was built upon the condemnation of usury and the supposed difficulty of calculation: *Costello v. Calgary (City)* (1997), 209 A.R. 1, 152 D.L.R. (4th) 453 (C.A.), leave to appeal to

fully. However, the Supreme Court of Canada's comments regarding "restitution" may create problems. Justice Major began with the following proposition:

> Contract damages are determined in one of two ways. Expectation damages, the usual measure of contract damages, focus on the value which the plaintiff would have received if the contract had been performed. Restitution damages, which are infrequently employed, focus on the advantage gained by the defendant as a result of his or her breach of contract.[15]

That statement seems to mirror *Blake* by suggesting that the law may respond to a breach of contract by compelling the defendant to give up an ill-gotten gain. There is, however, room for doubt.

That uncertainty arises because "restitution" is an ambiguous term. Narrowly defined, it refers to the remedy invariably awarded in response to the three-part cause of action in unjust enrichment. The defendant was enriched; the plaintiff suffered a corresponding deprivation; and there is an absence of juristic reason for the enrichment.[16] Restitution simply reverses the transfer of wealth that occurred between the parties. The defendant gives back what he acquired from the plaintiff. The plaintiff gets back what she lost to the defendant. And no more. In particular, restitution does not encompass gains that the defendant obtained from a third party.[17] Although the precise reasons for that limitation are complex, they reflect the fact that the action is strict. Liability generally is triggered not by the defendant's breach of duty, but rather, as in the paradigm case of a mistaken payment, by the plaintiff's impaired intention.[18] And, in the absence of wrongdoing, there is no warrant for looking beyond the impugned transfer itself.[19]

The second definition of "restitution" is much broader. It encompasses not only the remedy triggered by the action in unjust

S.C.C. refused 154 D.L.R. (4th) ix, 168 W.A.C. 398*n*. Today, of course, both of those concerns have been overcome and compound interest is the commercial norm.

15. *Supra*, footnote 7, at para. 25. That statement clearly was not intended to be exhaustive. While loss-based relief usually takes the form of expectation damages, the plaintiff occasionally is awarded reliance damages instead. Moreover, contractual damages are not restricted to repairing the plaintiff's loss or reversing the defendant's gain. Nominal damages symbolically vindicate the violation of a right and punitive damages punish the defendant's outrageous conduct.
16. *Pettkus v. Becker*, [1980] 2 S.C.R. 834, 117 D.L.R. (3d) 257.
17. *Air Canada v. British Columbia* (1989), 59 D.L.R. (4th) 161 at p. 194, [1989] 1 S.C.R. 1161 at p. 1203.
18. *Air Canada v. Ontario (Liquor Control Board)* (1997), 148 D.L.R. (4th) 193, [1997] 2 S.C.R. 581.
19. M. McInnes, "The Measure of Restitution" (2002), 52 U.T.L.J. 163.

enrichment, but also gain-based responses that are exceptionally available in cases of wrongdoing. A breach of fiduciary duty, for example, allows the plaintiff to remedially choose between reparation of her own loss (compensation) and divestment of the defendant's gain ("restitution").[20] Two points are significant. First, that sort of "restitution" does not presume proof of the constituent elements of the action in unjust enrichment. It responds directly to the wrong. Second, the operative remedy may affect *all* of the defendant's ill-gotten gains, including those acquired from a third party. Consequently, it is inappropriate to speak of "restitution". Treated as a term of art, that word means "to give *back*". In a case of wrongdoing, however, the plaintiff may be awarded something that she never previously held. It is therefore preferable to speak of "disgorgement", which means "to give *up*". *Attorney General v. Blake* is illustrative. The Crown received from the spy a sum to which it had no prior connection.[21]

The distinction between restitution and disgorgement is critical to an understanding of *Bank of America Canada*. In discussing "restitution damages", Justice Major was particularly impressed by the fact that the breach allowed the defendant to acquire a benefit that was "exactly the same as the detriment to the plaintiff". It was a "zero-sum outcome" in the sense that the "defendant's gain [was] the plaintiff's loss".[22]

At first glance, it might appear that Major J. was referring to a restitutionary remedy in the narrow sense.[23] After all, the cause of

20. *Boardman v. Phipps*, [1967] 2 A.C. 46 (H.L.).
21. Interestingly, Lord Nicholls preferred to "avoid the unhappy expression 'restitutionary damages' ", possibly because of its ambiguous nature: *supra*, footnote 3, at p. 284.
22. *Supra*, footnote 7, at para. 32. See also para. 61 ("The respondent's gains have come at the appellant's expense.").
23. The interpretive exercise is complicated by Major J.'s reference to Professor Waddams' discussion of gain-based remedies: *ibid.*, at paras. 30-31, citing *The Law of Damages*, 3d ed. (Aurora, Ont., Canada Law Book Inc., 1997), pp. 473-76. That discussion addresses a variety of claims that may arise in a contractual context. Some involve restitution under an action in unjust enrichment. Others involve disgorgement for some form of wrongdoing, such as breach of contract or breach of fiduciary duty. Interestingly, Professor Waddams often rejects the need to isolate a single theory of liability. "[C]oncepts of wrongdoing, compensation, expectation, unjust enrichment, property, and public policy", while "incommensurable and not all pointing in the same direction", may be "simultaneously in play": "Breach of Contract and the Concept of Wrongdoing" (2000), 12 Supreme Court L.R. 1 at p. 13. Similarly, in *Bank of America Canada*, compound interest was awarded because it "yields a satisfactory result with respect to both expectation damages and restitution damages": *ibid*, at para. 61.

action in unjust enrichment, which invariably triggers true restitution, is premised upon proof of an enrichment to the defendant and a corresponding deprivation to the plaintiff. In contrast, the cause of action in breach of contract, which exceptionally supports "restitutionary damages" (or, more accurately, disgorgement), is actionable *per se*. It does not require proof of either the defendant's gain or the plaintiff's loss, let alone a correspondence between the two. The unjust enrichment analysis nevertheless must be rejected. In the Supreme Court of Canada, BAC framed its claim in contract. And for good reason. It would have been hard pressed to satisfy the requirements of unjust enrichment. That action is aimed at reversing an unjustified transfer of wealth. The defendant must have subtracted from the plaintiff.[24] MT did not, however, receive anything from BAC. It merely agreed to redirect money initially intended for Reemark to BAC instead.

An attempt might be made to save the possibility of a claim in unjust enrichment by relying on the notion of "interceptive subtraction". As suggested in the last paragraph, the right to restitution usually arises in response to a direct transfer of wealth from the plaintiff to the defendant. Exceptionally, however, a corresponding gain and loss may exist because the defendant acquired from a third party a benefit that otherwise would have accrued to the plaintiff.[25] On that basis, it might be argued that while MT did not directly subtract the principal sum from BAC, it did, because of its breach, usurp BAC's ability to invest that money and thereby earn compound interest. That analysis must be rejected. Although a full explanation lies beyond the scope of this comment,[26] the notion of interceptive subtraction is, as a matter of precedent and principle, properly confined to situations in which the defendant obtained a benefit that the third party was *legally obligated* to confer upon the

24. *Peel (Regional Municipality) v. Canada*, [1992] 3 S.C.R. 762 at p. 788, 98 D.L.R. (4th) 140 at p. 154 ("[F]or recovery to lie, something must have been given, whether goods, services or money. The thing which is given must have been received and retained by the defendant.")

25. *Air Canada v. British Columbia*, *supra*, footnote 17, at p. 194; *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805 at p. 824, 152 D.L.R. (4th) 411 at pp. 424-25.

26. G. Jones, ed., *Goff & Jones: The Law of Restitution*, 5th ed. (London, Sweet & Maxwell, 1998), p. 38; G. Virgo, *The Principles of the Law of Restitution* (Oxford, Oxford University Press, 1999), pp. 109-13; R.B. Grantham and C.E.F. Rickett, *Enrichment and Restitution in New Zealand* (Oxford, Hart Publishing, 2000), p. 20.

plaintiff.[27] In the absence of such an obligation, the plaintiff is not connected to the defendant's enrichment in a way that warrants restitution.[28] That nexus was, of course, missing in *Bank of America Canada*. The borrowers from whom MT collected compound interest did not owe anything to BAC.

For the preceding reasons, Justice Major's observations regarding the parties' corresponding gain and loss do not pertain to the action in unjust enrichment. The phrase "restitution damages" refers not to "restitution" in the narrow sense, but rather to disgorgement. The issue was not whether the plaintiff conferred a reversible benefit upon the defendant, but rather whether MT was required to give up a gain acquired through breach. In that respect, the Supreme Court of Canada, like the House of Lords in *Blake*, started from the premise that disgorgement is exceptional. Major J. was particularly concerned that the availability of such relief might discourage efficient breach of contract. If the defendant can break a promise, fully compensate the plaintiff, and still be left with a profit, so much the better. In economic terms, a resource has thereby moved to a higher use. The wrongdoer should not be compelled to divest that surplus enrichment. The analysis is different, however, if the defendant's gain is mirrored by the plaintiff's loss. *Bank of America Canada* is illustrative. The breach did not allow MT to uniquely realize a benefit that was beyond BAC's reach. To the contrary, it merely allowed the defendant to exploit a profitable opportunity that otherwise would have accrued to BAC. The economic outcome

27. A broader notion of interceptive subtraction appears in Justice La Forest's controversial judgment in *Lac Minerals v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574 at p. 669-70, 61 D.L.R. (4th) 14 at p. 45. Relief was allowed because the defendant purchased a property that the vendor, as a matter of fact, though not legal necessity, probably would have sold to the plaintiff. However, even that test could not be satisfied on the facts of *Bank of America Canada*. MT almost certainly did not receive compound interest from the very same people to whom BAC would have granted loans if the contract had not been breached.

28. In other circumstances, however, it may be appropriate to award compound interest to reflect the defendant's investment profit. Consider a case of mistaken payment. After receiving money from the plaintiff, the defendant lends it to a third party at commercial rates. Although the income earned on that loan does not represent an interceptive subtraction (because the third party did not owe a legal obligation to the plaintiff), it may be subject to liability. The plaintiff can prove that it provided the defendant with two benefits: money *and* the ability to exploit that money. Consequently, there may be a sufficient connection between the plaintiff's loss and the defendant's income: *Air Canada v. Ontario (Liquor Control Board)*, *supra*, footnote 18, at p. 614; *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.*, [1996] A.C. 669 (H.L.) *per* Lord Goff and Lord Woolf; R. Chambers, "Restitution, Trusts and Compound Interest" (1996), 20 U. Melbourne L.R. 1192.

therefore would have been the same in any event. The only question was whether that enrichment should be re-allocated from the wrongdoer to the innocent party. The court understandably thought it should.

Nevertheless, the test of economic efficiency is problematic. First, while it provided additional incentive to award compound interest, it is, at a fundamental level, redundant. It indicates that "restitution damages" are available *only if* a breach was *not efficient*. Accordingly, MT could have retained its profit if that benefit would not otherwise have accrued to BAC. Disgorgement was only available in *Bank of America Canada* because the defendant's gain was, in fact, a function of the plaintiff's loss. And therein lies the problem. BAC's loss, by itself, was capable of supporting the same quantum of relief. Justice Major's compensatory analysis forcefully established that proposition. As a result, the "restitution" principle appears limited to cases in which it is unnecessary. It can catch only those wrongful gains that are mirrored by compensable losses.

Furthermore, it would be undesirable if economic efficiency invariably precluded disgorgement. There may be cases in which the defendant should be required to give up a gain that exceeds the plaintiff's loss. *Blake* once again is illustrative. The traitor's breach did not inflict a compensable injury upon the Crown. By the time of publication, the Berlin Wall had fallen and everything in Blake's manuscript was common knowledge. Nevertheless, the court understandably felt compelled to award disgorgement, rather than merely nominal damages. The same may be true in less dramatic, but more common, situations. A company promises to incur certain expenses (*e.g.* by acquiring firefighting equipment) in order to safeguard a client. Fortuitously, the contract runs its course without incident even though the company chose at the outset to skimp on performance and pocket the saved expense as additional profit. On one view, at least, the client has lost nothing. While the company was scandalously unprepared, the equipment was never actually required.[29] The breach was efficient. Nevertheless, there should be some way of discouraging life-endangering wrongs of that sort.[30]

29. *City of New Orleans v. Firemen's Charitable Assoc.* (1891), 9 So. 486 (S.C. La.).

30. One possibility is to compel the defendant to disgorge the additional profit that it reaped as a result of its breach. In *Blake*, Lord Nicholls suggested that the same result could be reached on compensatory principles by simply expanding the concept of a compensable loss. Even though it was never actually imperilled, the client in the preceding hypothetical did not receive that for which it paid. In other words, it suffered a loss: *supra*, footnote 3, at pp. 285-86.

4. Conclusion

Bank of America Canada v. Mutual Trust is doubly significant. It creates a new right to receive contractual relief representing compound interest, despite the existence of a statutory provision that denies recovery of compound interest in most cases. And, more generally, it recognizes that damages exceptionally may be oriented toward the defendant's gain, rather than the plaintiff's loss. As in *Attorney General v. Blake*, the Supreme Court of Canada's initial comments on the latter possibility are controversial. A great deal of work remains to be done. The important point for now, however, is simply that the remedial option exists.

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