



Précis Paper

The Development of the Remedy of Disgorgement in the USA

This is a fascinating insight into developments in contract law in the United States of America, and specifically the remedy of disgorgement.

Discussion Includes

- Factual background
- Overview of contractual remedies
- Elements of the disgorgement remedy
- The Supreme Court's consideration of disgorgement
- The efficient breach theory
- Predictions for future developments in contractual remedies

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The Development of the Remedy of Disgorgement in the USA

1. In this edition of BenchTV, Professor Caprice Roberts (Professor of Law, Savannah Law School, Georgia, USA) and Ian Benson (Solicitor, AR Conolly & Company) discuss the recent decision of the US Supreme Court in *Kansas v. Nebraska*, 136 S. Ct. 1042 (2015).

Factual Background

2. In *Kansas v. Nebraska*, 136 S. Ct. 1042 (2015), Kansas and Nebraska had come up with a long term water agreement about the allocation of water rights between them. When a dispute arose under the compact, a case was filed in the Supreme Court's original jurisdiction, and the case was allocated to a Special Master, who is someone who can assist the Court in dealing with a matter that may be complex and time consuming. The Special Master handles the details of the case, makes factual findings, listens to all of the evidence and makes conclusions of law, which receive some deference when the matter goes before the Court.
3. The dispute arose when Nebraska determined that it was going to use the water for better purposes than Kansas. Nebraska therefore took a number of steps that led to more water flowing to Nebraska than Kansas, in breach of the compact that had been signed.
4. The Supreme Court agreed with the Special Master's findings, that included that there had been a breach of compact by Nebraska, and that the breach of compact warranted multiple remedies, including compensatory damages of \$3.7 million, and a \$1.8 million partial disgorgement award. The partial disgorgement remedy was controversial in US law.

Contractual Remedies

5. A disgorgement remedy comes from the idea that a person cannot reap what another has sowed. According to the principle, if a defendant does wrongfully make a profit, they may be stripped of the profits, which may be handed over to the plaintiff. There are parallel remedies to disgorgement, including constructive trust (where the property is seized). Disgorgement has been used in some contexts in the US before now, including torts and fiduciary duties, but not in contracts.
6. The traditional remedies for breach of contract are the extraordinary remedy of specific performance, or the standard remedy of expectancy damages. Reliance damages may also be available in some circumstances, which may include out-of-pocket costs. Typically,

however, contract law has focused on compensating the plaintiff, rather than trying to undo the defendant's unjust enrichment

7. Disgorgement suggests an element of deterrence, which is not something with which contract law in the US has generally dealt. Moreover, ordinarily, there are no punitive damages for breach of contract in the US, however there is a question as to whether disgorgement starts to look like punishment.
8. There are a number of ways of rationalising the disgorgement remedy. One way is to say that the defendant's profit was wrongful and it was a profit that the other party should have made. However, in this case, even if the water had not been diverted to Nebraska, Kansas may not have made the same level of profit. Another element to consider is that Nebraska also used its own resources and efforts to make the profit, so it arguably should have been credited for that work.
9. The law of unjust enrichment would focus on the fact that the plaintiff had a substantive entitlement to what was promised (here, the water), and the defendant consciously took advantage of the relationship by taking without asking. The *Restatement (Third) of Restitution and Unjust Enrichment* § 39 (Am. Law Inst. 2011) focuses on this second element when dealing with disgorgement, by indicating that the parties should go back and renegotiate prior to breaching the contract. The three essential elements are that the breach (1) is profitable; (2) is deliberate; and (3) takes advantage of the fact that the plaintiff will be left inadequately protected by traditional remedies. Disgorgement may therefore be appropriate in circumstances where, if the plaintiff knew in advance that the breach was going to occur, it could have sought an injunction or specific performance to prevent the conduct
10. The *Restatement of Restitution* operationalised the disgorgement remedy by suggesting that there should be a narrow, but useable, remedy for plaintiffs, if they can prove opportunistic breach of contract. The term "opportunistic" is novel, and was picked up on by the dissenting judges in *Kansas v. Nebraska* to criticise the majority opinion.
11. The *Restatement* is a useful guide created by the American Law Institute, which is made up of leading lawyers, judges and law professors. The *Restatement* is not binding, however once cases rely upon the Restatement more and more, this makes it more persuasive.
12. The remedy of disgorgement has existed before, but was not part of the conventional canon of contractual remedies. The cases in which it has arisen have been somewhat unusual. For example, *Snepp v. United States*, 444 U.S. 507 (1980) dealt with a former intelligence official had signed an agreement requiring him to get pre-publication

clearance before publishing anything that had been classified, but who went ahead and published a book without prior approval. The Court used a constructive trust, operating similarly to disgorgement, to take all of the profits, recognising that the minor breach could cause major damage to the government, but not so much in terms of compensable damages. This case, as well as *Laurin v. DeCarolus Constr. Co., Inc.*, 372 Mass. 688, 363 N.E.2d 675 (1977), lay the groundwork for suggesting that in an appropriate case, the remedy of disgorgement may be appropriate.

The Supreme Court's Decision

13. Focusing on the second element of § 39, Nebraska argued before the Supreme Court that it was not engaging in deliberate behaviour. The Supreme Court found that this was too narrow an interpretation, especially given the equities and natural resources at play. The conduct of Nebraska was sufficient to trigger the disgorgement remedy, as it had knowingly taken advantage and gambled with Kansas' rights under the compact. The Supreme Court justified recourse to the remedy because of the natural resources and public rights at stake, however the rationale might flow on to private rights in future cases, thus requiring something less than knowing or deliberate conduct.
14. One other difficulty with the Supreme Court decision is that there should be two separate goals - either to compensate the plaintiff to make them whole, or strip the gain from the defendant. However the Supreme Court, by awarding both compensatory damages and disgorgement, failed to make this distinction.
15. In many cases, including private contract cases, the Supreme Court case would not be binding. However, the fact that the remedy is given such prominence may increase the attention given to it and may therefore be influential.
16. The source of the remedy is unclear, specifically whether it is an equitable or legal remedy. This has some significance in the US, as it may impact upon whether or not there is a right to a jury trial.

The Efficient Breach Theory

17. Efficient breach theory suggests that a breach of contract is a conscious choice to pay compensatory damages by a party who concludes that they would incur greater economic loss by performing under the contract. An efficient breach theorist may consider that we should encourage people to breach their contract, as it is economically efficient.

18. There is concern that there will be tension that arises in circumstances where opportunistic breach is trying to deter breach, and efficient breach is trying to encourage breach. Professor Roberts agreed that there is some tension here, however in many cases, efficient breach could still occur without being subject to disgorgement because the plaintiff would not be left inadequately protected, thus failing to satisfy the third element in § 39.

Future Developments in Contractual Remedies in the US

19. Outside of the law of disgorgement, Professor Roberts noted that there have been dramatic shifts in the law of injunctions. There are many tests and factors for injunctions in the US across different jurisdictions. However in the recent case of *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006), Justice Thomas set down a four-part test for the grant of an injunction, considering the following factors: (1) the irreparability of harm; (2) the inadequacy of legal remedies; (3) the balance of harm has to tip in the plaintiff's favour; and (4) the public interest.
20. However, some jurisdictions apply other tests, including a sliding scale test. In a sliding scale jurisdiction, in a case where there is a high showing of irreparable harm, it may be possible to have a lower showing of another factor. In other jurisdictions, different tests are applied depending on the type of injunction sought. The decision also leaves a question mark as to whether the court consider additional factors, such as the judicial administrability of the remedy.

BIOGRAPHY

Professor Caprice Roberts

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Caprice Roberts is a professor at Savannah Law School and teaches contracts, remedies, jurisprudence and federal courts. Her classroom experience also includes teaching at Florida State University College of Law, Washington & Lee University School of Law, and University of North Carolina School of Law. Roberts has held two federal judicial clerkships and represented clients in complex civil litigation cases in Washington D.C. She earned a J.D. from Washington & Lee University School of Law and a Bachelor's from Rhodes College.

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BIBLIOGRAPHY

Focus Case

Kansas v. Nebraska, 136 S. Ct. 1042 (2015)

Judgment Link

https://www.supremecourt.gov/opinions/14pdf/126orig_olq2.pdf

Resources

Restatement (Third) of Restitution and Unjust Enrichment § 39 (Am. Law Inst. 2011)

Cases

Snepp v. United States, 444 U.S. 507 (1980)

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