DOES THE DEAD CONTRACT RULE RESTITUTION FROM ITS GRAVE?

DANIEL FRIEDMANN[*]

INTRODUCTION

The purpose of this Article is to examine some aspects of the remedy of rescission and, in particular, the extent to which the terms of the extinguished contract remain relevant for ordering the parties' rights. At the outset, it is important to clarify a fundamental distinction between contracts rescinded on the ground of a "defect in the will" of one or both parties and contracts rescinded on the ground of their breach.

The term "defect in the will" is used as a general concept embracing a large group of conceivable defects in the formation of a contract – notably fraud, misrepresentation, mistake, duress, and undue influence.[1] Their common feature is that they undermine the very foundation of the contract, so that the terms of the contract do not represent the "free will" of the party involved.[2] The contract can be avoided ab initio by the induced party.[3] Consequently, the terms of the rescinded contract impose no limitation on the rights of a party who did not really agree to be bound by such a contract. Thus, suppose that because of *D*'s fraud, *P* agrees to perform certain work for *D* at a cost of

[*] Professor (Emeritus), Faculty of Law, Tel Aviv University; Member, Israel Academy of Sciences and Humanities; Member, International Academy of Comparative Law; Minister of Justice, Israel, 2007-2009.

[1] *See, e.g.*, Nili Cohen, *Good Faith in Bargaining and Principles in Contract Law*, 9 TEL AVIV UNIV. STUD. L. 249, 250 (1989). A contract may also be voided for other defects in formation, such as illegality or failure to meet the requirement of a writing. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 36 cmt. c (1981).

[2] *See* Cohen, *supra* note 1, at 251, 301.

[3] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 167 illus. 1; *id.* § 175.

$5000. Having performed about half of the work, *P* discovers *D*'s fraud and rescinds the contract. *P* is entitled to restitution for the value of the work done (in quantum meruit), an amount not limited by the terms of the contract, since – ex hypothesis – *P* never really agreed to it.[4] It is thus conceivable that, for part performance, *P* may recover an amount exceeding that stipulated in the contract for full performance.[5]

Rescission for material breach differs from rescission ab initio. In the case of rescission for breach, it is assumed that the contract was voluntarily made and that both parties agreed to its terms.[6] It has been suggested that this type of rescission merely "truncates" the contract and does not avoid it ab initio.[7] Put another way, the effect of rescission for breach is not retroactive but merely prospective.[8] Consequently, under English law, causes of action arising prior to rescission of the contract remain in force so that even the party in breach can sue for rights that accrued before the contract was terminated.[9] It is, however, doubtful whether this description of the merely prospective effect of rescission for breach clarifies the situation, and it has been rightly pointed out that such descriptions "are of limited value."[10] For our purposes, it suffices that many legal systems allow restitution upon rescission of a contract for its breach.[11] Yet, the status of such a contract remains complex and seems to defy

[4] The position of the party responsible for the fraud is less happy. If in the above example *D* performed the work and *D* was the fraudulent party, *D*'s claim for quantum meruit for the value of the work done, if allowed, will be limited to the proportionate part of the amount stipulated in the contract. *See generally* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38 (2011).

[5] *See, e.g.*, Chilingrian v. Kloian, No. 229186, 2003 Mich. App. LEXIS 1240, at *1, *20 (Mich. Ct. App. May 22, 2003); Taylor & Jennings, Inc. v. Bellino Bros. Constr. Co., 483 N.Y.S.2d 813, 815 (N.Y. App. Div. 1984). This result may ensue even if *D*'s fraud did not relate to elements bearing upon the cost of the work or its value, but to other elements relating to the contract. *See* RESTATEMENT (SECOND) OF CONTRACTS § 376.

[6] *See* Cohen, *supra* note 1, at 251.

[7] Brian Coote, *The Effect of Discharge by Breach on Exception Clauses*, 28 CAMBRIDGE L.J. 221, 226 (1970); Marion Hetherington, *Contract Damages for Loss of Bargain Following Termination: The Causation Problem*, 6 UNIV. N.S.W. L.J. 211, 211 (1983).

[8] *See* G.H. TREITEL, REMEDIES FOR BREACH OF CONTRACT 382-85 (1988); Coote, *supra* note 7, at 227.

[9] *See* J. BEATSON, ANSON'S LAW OF CONTRACT 581-82 (28th ed. 2002); Coote, *supra* note 7, at 226; Steven Lurie, *Towards a Unified Theory of Breach: Tracing the History of the Rule that Rescission Ab Initio Is Not a Remedy for Breach of Contract*, 19 J. CONTRACT L. 250, 250 (2003).

[10] TREITEL, *supra* note 8, at 383.

[11] BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, REICHSGESETZBLATT [RGBL.] 195, as amended, § 346 (Ger.), *available at* http://dejure.org/gesetze/BGB/346.html; STEPHAN LORENZ & THOMAS RIEHM, LEHRBUCH ZUM NEUEN SCHULDRECHT 216-23 (2002); TREITEL, *supra* note 8, at 382-92. The position of English law on the subject is complex, but it recognizes the right of restitution in a great

any simplified formula. For some purposes its consequences are similar to a contract voided ab initio, but for other purposes its terms continue to affect the rights of the parties.[12]

Let us return to the above example and assume that there has been no defect in the formation of the contract, but after *P* has done about fifty percent of the work, *P* rescinds the contract due to *D*'s material breach. Arguably this situation differs from that which arises in cases of rescission on the ground of defect in the will at the stage of the contract formation. This indeed is the position adopted by Professor Andrew Kull, who argues that the breaching defendant ought not to be treated as if he obtained the plaintiff's performance by fraud.[13] In line with this position, the *Restatement (Third) of Restitution and Unjust Enrichment* allows an injured party who rescinds a contract to recover the value of his performance but caps the recovery at the contract rate.[14] This view enjoys considerable academic support,[15] and the German Bürgerliches Gesetzbuch (Civil Code) adopts a similar position.[16]

This, however, has not been the traditional approach. In much of American case law, once the contract has been rescinded on the ground of its breach, *P*'s claim for quantum meruit is not to be limited by the amount stipulated in *P*'s contract with *D*,[17] and *P* conceivably may recover an amount exceeding that

variety of situations, so that even the party in breach is entitled to recover payments made by him to the other party in cases of total failure of consideration. LORD GOFF & GARETH JONES, THE LAW OF RESTITUTION 495-96 (7th ed. 2007). Restitution is, however, excluded if the failure of consideration is merely partial. *Id.* at 495-96, 546-47.

[12] The *Restatement (Third) of Restitution and Unjust Enrichment* uses the same term, "rescission," to describe both of these forms of ending a contract. *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 13, 37 (2011). Arguably, it is preferable to use different terms to distinguish between them, so that "rescission" describes the first category, in which the contract is extinguished on the ground of "defect in the will," while "termination," for example, describes a contract ended on the ground of its breach. Since the *Restatement (Third)*, however, uses the term "rescission" in both contexts, I shall follow its terminology.

[13] *See* Andrew Kull, *Disgorgement for Breach, the "Restitution Interest," and the Restatement of Contracts*, 79 TEX. L. REV. 2021, 2041 (2001); Andrew Kull, *Restitution as a Remedy for Breach of Contract*, 67 S. CAL. L. REV. 1465, 1466 (1994) [hereinafter Kull, *Restitution as a Remedy*].

[14] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38 cmt. c, illus. 9.

[15] *See, e.g.*, GOFF & JONES, *supra* note 11, at 518; DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 647-52 (3d ed. 2002); Mark P. Gergen, *Restitution as a Bridge over Troubled Contractual Waters*, 71 FORDHAM L. REV. 709, 730-41 (2002); Kull, *Restitution as a Remedy*, *supra* note 13, at 1466.

[16] BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, REICHSGESETZBLATT [RGBL.] 195, as amended, § 346 (Ger.), *available at* http://dejure.org/gesetze/BGB/346.html; *see also* LORENZ & RIEHM, *supra* note 11, at 219.

[17] *See* 1 GEORGE E. PALMER, THE LAW OF RESTITUTION 389-93 (1978). Perhaps the best-known decision, because of the rather extreme result, is *Boomer v. Muir*, 24 P.2d 570, 574

agreed upon for full performance. The same position has been adopted by the *Restatement (Second) of Contracts*,[18] subject to the qualification that if the injured party has already fully performed his part, his claim is subject to the "full performance" doctrine and is therefore limited to the amount contractually agreed upon.[19]

This Article is concerned with the incongruity on this point between the *Restatement (Second) of Contracts* and the new *Restatement (Third) of Restitution and Unjust Enrichment*. This Article is based on the following premises:

1. The issue cannot be resolved by examining the theoretical basis of restitution, namely whether restitution upon rescission of a contract is a contractual remedy or a remedy best allocated to the field of unjust enrichment.

2. Both the *Restatement (Second) of Contracts* and the *Restatement (Third) of Restitution and Unjust Enrichment* adopt the position that in determining the parties' rights and obligations upon rescission of the contract, the contractual allocation of the risk should be taken into account in some instances, while in other instances it is to be disregarded.[20] The *Restatement (Third) of Restitution and Unjust Enrichment*, however, prefers a somewhat broader application of the contractual risk allocation than that adopted by the *Restatement (Second) of Contracts*. Arguably, then, the difference between the two is a matter of degree.

3. In view of the developments in this area and other practical considerations, it seems almost impossible to offer solutions that will be consistent with each other in all the various situations in which the issue may arise. Some inconsistencies seem almost inherent, giving credence to Holmes's aphorism that "[t]he life of the law has not been logic – it has been experience."[21]

(Cal. Ct. App. 1933). English, Canadian, and Australian decisions generally adopt a similar approach. *See* PETER D. MADDAUGH & JOHN D. MCCAMUS, THE LAW OF RESTITUTION 591-96 (2d ed. 2004). For a recent Australian example, see *Sopov v Kane Constrs. Pty. Ltd.* (2009) 257 ALR 182 (Austl.).

[18] *See* RESTATEMENT (SECOND) OF CONTRACTS § 373 cmt. d, illus. 12 (1981).

[19] *See id.* § 373 cmt. b, illus. 5; PALMER, *supra* note 17, at 378-89. The full performance doctrine has been also adopted in England and Canada. *See* MADDAUGH & MCCAMUS, *supra* note 17, at 591-95.

[20] *Compare* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38 cmt. c (2011), *and* RESTATEMENT (SECOND) OF CONTRACTS § 261, *with* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 34 cmt. c, illus. 9.

[21] OLIVER WENDELL HOLMES, THE COMMON LAW 1 (1909).

I shall now examine a number of typical situations in which the question arises – that is, whether or not a party recovering on a quantum meruit basis should be limited to the amount stipulated in the contract.

I. PERFORMANCE THAT HAS NOT YET BEEN RENDERED

The general rule is that rescission releases both parties from what has been termed their unperformed "primary" contractual obligations.[22] Thus, if the buyer (*B*) agrees to buy property from the vendor (*V*) and the agreement is rescinded, *B* is relieved from his obligation to pay the price (*B*'s primary obligation) and *V* is relieved from his obligation to transfer the property (*V*'s primary obligation). This rule applies irrespective of whether the contract has been rescinded due to a "defect in the will" of one of the parties (such as fraud or duress) or due to a "fundamental" breach. Moreover, the rule is equally applicable to the injured party, the party in breach, and the party responsible for the defect in the other party's will.[23]

This, however, is not the end of the matter since the innocent party is entitled to damages – the breaching party's "secondary" obligation.[24] In the following examples, assume that *V* is the breaching party and *B* is the innocent party:

(1) The price stipulated in the contract was $1000 and the value of the promised property was $1200. The contract was therefore profitable from *B*'s point of view, as *B* expected to gain $200 from its performance, while from *V*'s point of view, it was a losing contract.

(2) The same price as in illustration (1), except that the value of the property was only $800, so that it was a losing contract from *B*'s point of view and a profitable contract from *V*'s point of view.

In illustration (1), if the contract is rescinded on account of its breach, *B* is entitled to damages in the amount of $200.[25] Hence, despite the rescission of

[22] The term "primary obligation" and the distinction between primary and secondary obligations has been developed by Lord Diplock. *See* Photo Prod. Ltd. v. Securicor Transport Ltd., [1980] A.C. 827 (H.L.) at 848-49 (Eng.). The primary obligation relates to the performance due under the contract. The secondary obligation is the obligation to pay damages for breach of the primary obligation. *Id.* at 849. In case of rescission for fundamental breach, the parties are released from their primary obligations. But the terms of the contract remain relevant for the calculation of damages. Furthermore, other contractual provisions relating to secondary obligations (such as those imposing liquidated damages as well as exemption clauses) remain in force. *Id.* at 849-50.

[23] *See id.* at 849-50.

[24] *Id.* at 849.

[25] *Cf.* RESTATEMENT (SECOND) OF CONTRACTS § 344 cmt. a, illus. 1 (1981). If the contract was rescinded on the ground of defect in its formation (e.g., misrepresentation), *B* is not entitled under contract theory to expectation (performance) damages because, ex hypothesis, the contract was not voluntarily made and therefore *B* is not entitled to derive the benefit that the contract was supposed to grant him. *B* may, however, have a cause of

the contract, the contractual allocation of the risk is maintained by virtue of *B*'s claim for damages. In illustration (2), however, the rescission of the contract determines the rights of the parties. *B* has no right to damages since he suffered no loss.[26] In fact, by virtue of the rescission, *B* was able to avoid the loss he would have suffered had the contract been performed. The rescission deprived *V* of the profit he stood to gain under the contract, while the contractual risk allocation was disregarded for the purpose of ordering the parties' rights.

It is thus possible to generalize that, in this category, the contractual allocation of the risk is maintained when it operates in favor of the innocent party but is disregarded when it would have operated in favor of the party in breach.

II. THE INNOCENT PARTY PAID MONEY BEFORE THE RESCISSION

The same approach regarding the allocation of risk applies when the innocent party pays for the property but the breaching party fails to transfer, as demonstrated by the following illustration:

> (3) The same facts as in illustration (1), except that *B* paid the price of $1000 in advance, and *V* subsequently failed to transfer the property. Upon rescission of the contract, *B* is entitled to damages in the amount of $1200.[27]

It is also possible to offer an alternative calculation under which *B* may recover $1000 in restitution and an additional $200 in damages, leading to the same total recovery of $1200. Under the traditional American rule, this alternative calculation is disallowed on the ground that the plaintiff may not recover both in restitution and on performance-based (that is, expectation) damages.[28] The theory is that since restitution takes the parties back to their

action for damages against the other party for causing the defect in *B*'s will. This cause of action is usually grounded in tort. The measure of recovery depends on the nature of the other party's conduct (e.g., was the conduct fraudulent or merely negligent misrepresentation). In principle, recovery should be based on reliance damages, though in the context of misrepresentation it was often termed an "out of pocket measure." DAN B. DOBBS, LAW OF REMEDIES § 9:2(1) (2d ed. 1993). Developments in torts, however, have greatly expanded the rights of the defrauded party, so that recovery in tort may grant him more than that to which under contract theory he is entitled. *See id.* § 9:2; W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 767-78 (5th ed. 1984). A similar approach may apply to other instances in which the formation of a contract was tainted by an intentional tort such as duress. *See* JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 9.8 (6th ed. 2009). A discussion of this point is not within the scope of the present Article.

[26] *See* 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 66:47 (4th ed. 1993).

[27] *See id.* § 64:5.

[28] *See, e.g.*, Hemminger v. W. Assur. Co., 54 N.W. 949, 950 (Mich. 1893); PERILLO, *supra* note 25, § 16.17.

pre-contract position, restitution is therefore incompatible with expectation damages, which look at the situation the party would have been in had the contract been performed.[29]

Under Uniform Commercial Code section 2-711, however, the buyer may recover in both restitution and expectation damages.[30] I find the U.C.C. approach preferable. There is no reason to require election between restitution and damages.[31] The U.C.C. approach merely requires the flexibility of viewing the contract as rescinded to restore that which was given under the contract, while recognizing that the contract's terms continue to operate for the purpose of damages. It is not very different from the flexibility required to conclude that the contract is rescinded for the purpose of absolving the parties from their duties to perform their primary obligations, while the contract's terms continue to govern the calculation of expectation damages.

Now consider the scenario of a losing contract for *B* that is rescinded on the ground of *V*'s breach:

> (4) The same facts as in Illustration (2), except that *B* paid the price of $1000 in advance. In this case, *B* is entitled to restitution of the amount paid, even though the property depreciated in value and is now worth only $800.[32]

The fact that *B* would have lost $200 had *V* transferred the property has no effect on *B*'s right to recover the $1000 in restitution. This means that *V* cannot deduct his potential profits on the breached contract from his liability in restitution.[33] Moreover, *B* is obviously not entitled to damages (even if it is assumed the damages can be added to restitution) since *B* suffered no loss.[34] This illustration demonstrates how, in a losing contract, restitution enables the injured party to escape the contractual allocation of the risk and avoid the loss that he would have suffered had the contract been performed.

Hence, this category follows the same approach as that found in Part I, under which the contractual allocation of the risk is maintained (via the remedy of damages) when it operates in favor of the injured party; but it is disregarded (by virtue of restitution) when it would have operated in favor of the party in breach.

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[29] *See* RESTATEMENT (SECOND) OF CONTRACTS § 373 cmt. a; *id.* § 378 cmt. d.

[30] U.C.C. § 2-711 (2005); *see also* PERILLO, *supra* note 25, § 16.17; Richard R.W. Brooks & Alexander Stremitzer, *Remedies on and off Contract*, 120 YALE L.J. 690, 701 n.28 (2011).

[31] But, of course, care must be taken to prevent duplication of payments, since restitution often reduces the loss for which damages are awarded. *See* PALMER, *supra* note 17, at 435.

[32] This result is also supported and explained by Brooks & Stremitzer, *supra* note 30, at 718.

[33] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 37 cmt. b, illus. 2 (2011).

[34] *See supra* note 26.

III. THE INNOCENT PARTY TRANSFERRED GOODS BEFORE THE BREACH

This category deviates from the approach reflected in Parts I and II, though a similar result is sometimes reached. Let us examine the following illustrations:

> (5) *V* agreed to sell goods to *B* for $1000. *V* transferred to *B* the goods, which lost part of their value and are subsequently worth only $800. *B* failed to pay.

This case is governed by the full performance doctrine: When a party has fully performed his portion of a contract and the performance due by the non-performing party is the payment of a definite sum of money, the performing party has no right to restitution.[35] Consequently, *V* is not entitled to restitution. The contractual allocation of the risk, however, is maintained, since *V* can claim the price *B* agreed upon, $1000, which exceeds the value of the goods at the time of *B*'s breach, thereby granting *V* the contractual gain.

> (6) *V* agreed to sell goods to *B* for $1000. *V* transferred to *B* the goods, which increased in value and are subsequently worth $1200. *B* failed to pay.

From *V*'s point of view, this is a losing contract. But because this case is also governed by the full performance doctrine, restitution is not available to *V*. *V* is therefore unable to escape the contractual allocation of the risk. He can only recover the contractual price of $1000 and will therefore suffer the loss imposed upon him by the terms of the contract.[36]

Hence, the full performance doctrine creates an exception to the rule reflected in illustrations (2) and (4), under which rescission and restitution enable the injured party to escape the consequences of a losing contract. The full performance doctrine applies also to "divisible" contracts that provide for payment of an agreed sum of money for the performance of a specific part of the contract, with such payment constituting full consideration for the part performed.[37]

The full performance doctrine does not apply, at least in some states, when consideration is in the form of services to be rendered.[38] Also, by its own terms, the doctrine does not apply to part performance of an entire contract. The following illustration between a seller of grain (*S*) and a purchaser (*P*) reflects the problem that may arise:

> (7) *S* undertook to supply 20 tons of Quality *X* grain and 20 tons of Quality *Y* grain for $10,000. After *S* supplied the 20 tons of Quality *X* grain, *P* repudiated the contract. In the meantime, the price of both

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[35] *See supra* note 19 and accompanying text.

[36] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 37 cmt. b, illus. 4.

[37] RESTATEMENT (SECOND) OF CONTRACTS § 373 cmt. c (1981).

[38] *See* PALMER, *supra* note 17, at 501.

qualities of grain greatly increased. The contract is therefore a losing contract from *S*'s point of view.

If *S* were entitled to restitution in specie, *S* would be able to avoid the contractual risk allocation and escape the loss he is sure to suffer if the contract is performed in full.[39] This is always the result of restitution in specie when it is allowed.[40]

Restitution in specie is generally denied to a seller of goods who transfers title on credit.[41] But this rule does not necessarily apply to cases of non-divisible contracts in which the seller has only partly performed. In these cases, restitution of the value of the part supplied on credit is likely to be available, and some decisions allow recovery in restitution based on the market value of the goods supplied, even though the market price is higher than the contract rate.[42] Under this approach, the seller can presumably recover for his part performance an amount exceeding the contract price. This result is in line with section 373(1) of the *Restatement (Second) of Contracts* but not with section 38(2)(b) of the *Restatement (Third) of Restitution and Unjust Enrichment*, which provides that the price of the part performance is to be "determined by reference to the parties' agreement."[43] It is, of course, difficult to find out the exact contractual rate of the part performance when the contract provides for a lump sum payment for different performances or for an equal

[39] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 54 cmt. c.

[40] A number of rules limit such a result in cases of breach. An important example is that of an executed conveyance of real property. The denial of restitution in this type of situation, however, is subject to a narrow exception. Where the exception applies, the injured party will be able to escape the consequences of a losing contract. Thus, comment e to section 37 of the *Restatement (Third) of Restitution and Unjust Enrichment* refers to the general rule under which an attempt to rescind an executed conveyance of real property is usually bound to fail. *Id.* § 37 cmt. e. An exception to this rule, however, is reflected in illustration 17 to section 37: "Mother conveys Blackacre to Son and Daughter-in-Law, in exchange for the couple's promise to allow her to reside on the property for the rest of her life and to provide for her support." After several years, relations between the parties deteriorate and Son and Daughter-in-Law evict Mother. Mother is entitled to rescission and to reacquiring the title to Blackacre. If the value of Blackacre is greater than the value of the consideration promised by Son and Daughter-in-Law, restitution will allow Mother to avoid the contractual risk allocation and to escape the consequences of a losing contract. *Id.* § 37 cmt. e. Avoidance of the contractual risk allocation is always the result of restitution in specie in losing contracts.

[41] *See* PALMER, *supra* note 17, at 499-500.

[42] *Id.* at 394-95 & nn.18-19 (citing Smith v. Keith & Perry Coal Co., 36 Mo. App. 567 (1889), and Wellston Coal Co. v. Franklin Paper Co., 48 N.E. 888 (Ohio 1897), as decisions allowing the credit-transferring seller to recover in restitution the market value of the goods transferred). This also seems the dominant trend in other jurisdictions. *See* MADDAUGH & MCCAMUS, *supra* note 17, at 591-96.

[43] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38(2)(b).

payment rate for performances that differ in value.[44] It is clear, however, that under section 38 of the *Restatement (Third) of Restitution and Unjust Enrichment*, the seller is not entitled to an amount exceeding the whole contractual price for his part performance and is likely to receive substantially less than this amount.

IV. THE INNOCENT PARTY HAS PARTLY PERFORMED A CONTRACT OF SERVICES BEFORE RESCISSION

In this category, the different approaches of the *Restatement (Third) of Restitution and Unjust Enrichment* and the *Restatement (Second) of Contracts* lead to drastic differences. A typical feature of this category is that restitution in specie is impossible.[45] Hence, in this category, restitution will always be in the form of payment for what was rendered. Another feature of this category is the difficulty in appraising the value of part performance.[46] Consequently, the difference between the contractual price and the value of the performance as determined by the court is, on occasion, so large that the award may seem harsh to the defendant. Thus, in the well-known case of *Boomer v. Muir*,[47] the injured party recovered more than $257,000 in restitution for part performance and would have only been entitled to an additional sum of $20,000 had he completed performance.[48] In another case, a lawyer recovered $13,000 in restitution for part performance, more than twice the contractual price of $5000 for full performance.[49]

These huge discrepancies between the contractual price and the recovery in restitution for part performance leave a certain feeling of uneasiness. It also seems paradoxical that a party who has partly performed can recover more than he would have recovered had he fully performed. Indeed, this possibility points to an incongruity between the full performance doctrine and the right of an injured party to recover in restitution in excess of the contract price for part performance.

The *Restatement (Third) of Restitution and Unjust Enrichment* remedies this incongruity by providing that, in the case of part performance, the injured party can recover an amount "not exceeding the price of such performance as determined by reference to the parties' agreement."[50] The measure of recovery under the *Restatement (Third)* cannot be determined simply by looking at the terms of the contract, if the performance to be rendered consisted of different units of work and services and the contract did not provide for a specific

[44] *See id.* § 38 cmt. c, illus. 12-15.

[45] *See id.* § 37 cmt. a.

[46] *See id.* § 38 cmt. c.

[47] 24 P.2d 570 (Cal. Ct. App. 1933).

[48] *Id.* at 578.

[49] *In re* Montgomery's Estate, 6 N.E.2d 40, 41 (N.Y. 1936).

[50] RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38(2)(b).

amount to be paid for each unit of work and service.[51] Evidence will be needed in order to indicate the ratio between the value of that which was performed and that which was required under the contract.[52] In any event, recovery for part performance cannot exceed the contractual price for full performance.

Thus, in this category of part performance of a contract to supply work or services, the *Restatement (Second) of Contracts* allows the innocent party to disregard the contractual risk allocation, while the *Restatement (Third) of Restitution and Unjust Enrichment* allows the party in breach to take advantage of the contractual risk allocation (limiting recovery to the amount stipulated in the contract) despite the fact that his breach prevented performance according to the terms of the contract.

V. THE BURDEN OF PROOF

The gap between section 38 of the *Restatement (Third) of Restitution and Unjust Enrichment* and section 373 of the *Restatement (Second) of Contracts* is somewhat narrowed by the shift of the burden of proof adopted by the *Restatement (Third) of Restitution and Unjust Enrichment*. Where the injured party proves the value of his performance, in accordance with section 38(2)(b) of the *Restatement (Third)*, the onus shifts to the defendant to show that such value exceeds the contractual price for such performance.[53] If the defendant is unable to do so, the injured party's recovery will equal that which would have been allowed under section 373 of the *Restatement (Second) of Contracts* – namely, the full value of his performance unaffected by the terms stipulated in the contract. This is clearly demonstrated by the following illustration based, with some variations, on illustration 1 to section 38 of the *Restatement (Third) of Restitution and Unjust Enrichment*:[54]

> (8) Lawyer (*L*) undertakes to write a treatise that Publisher (*W*) promises to publish and pay *L* fifteen percent of gross sales. On receipt of the completed manuscript, *W* wrongly repudiates the contract, concluding that demand for the book is likely to be modest and investment in its publication may not be profitable. *L* invested 3000 hours in preparing the manuscript. *L* normally charges $200 per hour and thus invested $600,000 of his time. The court finds that *W* would have been willing to pay $150,000 for the manuscript at the time the contract was made. *W* tries to prove that gross sales of the book would not have exceeded $500,000 and that *L* would

[51] *See id.* § 38 cmt. c.

[52] *See, e.g., id.* § 38 cmt. c, illus. 13.

[53] This is not expressly stated in section 38(2)(b), though it is stated in section 38(2)(a) in the context of reliance damages. But it is clear from the comments and illustrations that the onus shifts to the defendant. *See id.* § 38 cmt. b, illus. 1.

[54] The illustration is based on *Chodos v. West Publishing Co.*, 292 F.3d 992 (9th Cir. 2002).

consequently be entitled to only $75,000 in royalties, but the court considers the evidence on this point to be too speculative.

L can recover the $600,000 as reliance damages, assuming he had sufficient alternative work to occupy his investment of 3000 hours in the manuscript.[55] Alternatively, for purposes of restitution, the $600,000 arguably represents either the value of the manuscript or the value of the work done in performance of the contract.[56] Consequently, the $150,000 that *W* would have paid for the manuscript at the time the contract was made, but to which *L* never agreed, is not decisive for *L*'s recovery on a quantum meruit basis.[57] In any event, *L* can recover the value of his performance unlimited by the terms of the contract. This result occurs both under the *Restatement (Second) of Contracts* and the *Restatement (Third) of Restitution and Unjust Enrichment*. The reason for the congruity in the result despite the fundamental difference in their approach, as already pointed out, is that the *Restatement (Third)* imposes upon the defendant the onus of proving the contractual rate for the work done.[58] This evidentiary requirement mitigates the substantive rule that limits restitution in the case of rescinded contracts to the contractual rate.[59]

CONCLUSION

As discussed above, rescission of a contract on the grounds of a fundamental breach creates a situation in which the rescinded contract is sometimes treated

[55] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38 cmt. b, illus. 1.

[56] The difference between a claim in restitution and a claim for reliance damages is that the latter requires *L* to show that he had sufficient alternative work that could have occupied the 3000 hours. There is no need to prove this element for the purpose of restitution. In the context of restitution, however, the question arises whether the value of *L*'s work as a writer is $200 an hour. Obviously the amount he charges for legal services is not necessarily the amount he could charge as an author.

[57] Compare *Planche v. Colburn*, (1831) 131 Eng. Rep. 305 (C.P.); 8 Bing. 14, in which the plaintiff undertook to write a book requested by the defendant. After the plaintiff wrote part of the book and was willing to complete it, the defendant repudiated the contract. The plaintiff, who had not yet submitted the complete manuscript, recovered in quantum meruit for the work he had done. *Id.* at 306; 8 Bing. 16. The questions of whether the defendant benefited from the plaintiff's work and how this benefit was to be valued gave rise to disagreement. For the view that it is unrealistic to consider the defendant as having received a benefit and that the award should therefore be considered damages, see ANDREW BURROWS, THE LAW OF RESTITUTION 17 (2d ed. 2002), and also see JACK BEATSON, THE USE AND ABUSE OF UNJUST ENRICHMENT 31-44 (1991). *But see* GOFF & JONES, *supra* note 11, at 515.

[58] *See supra* note 53 and accompanying text.

[59] Another point in connection with this illustration is that although *L* has completed the manuscript, the full performance doctrine does not apply for the simple reason that *W* did not owe a definite sum of money, but an amount contingent upon the extent of the sales of the book. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §37 cmt. a.

as having come to an end; yet for other purposes, its terms continue to affect the parties' rights. The present Article has been devoted to examining the extent to which the contractual allocation of risk remains relevant in determining a party's rights once the contract has been terminated.

It is universally agreed that when a contract would be profitable from the injured, non-breaching party's point of view, rescission of the contract does not deprive this party of the benefit of the contractual allocation of the risk.[60] This result is normally achieved via the remedy of performance-based (or expectation) damages.[61]

The situation is more complex when the contract is a losing contract from the injured party's point of view, and no general formula provides a uniform and consistent answer to whether the injured party can escape the contractual allocation of risk through rescission. In some instances the non-breaching party is able to do so, while in other instances he will suffer the consequences of the disadvantageous contract despite its rescission, and the breaching party will enjoy the advantages that were granted to him under the terms of the rescinded contract.[62] In this category the approaches of the *Restatement (Third) of Restitution and Unjust Enrichment* and the *Restatement (Second) of Contracts* diverge, although in numerous instances the same result is reached under both Restatements.[63]

The positions can be summarized as follows:

1. Under both Restatements an innocent party can, by rescinding a contract, escape the disadvantageous contractual risk allocation with regard to the executory part of the contract – that is, performances that were due after the contract was rescinded.[64]

2. Under both Restatements the opposite result occurs when the full performance doctrine applies. Consequently, if the innocent party fully performs his part of the contract and the other party's obligation that remains due is the payment of a definite sum of money, the rights of the parties will be determined in accordance with the terms of the contract.[65] The innocent party will be unable to escape the contractual allocation of risk that turns against him, while the party in breach will enjoy the benefit that the contract was expected to grant him.

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[60] *See supra* Part I.

[61] *See supra* Part I (showing this result in illustration 1).

[62] *See supra* Parts II-IV.

[63] *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 373 (1981), *with* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38(2)(b).

[64] *See supra* Part I (discussing illustration 2 and showing how a party can escape the contractual allocation of risk through rescission).

[65] *See supra* Part III.

3. It is also generally agreed that where the innocent party is entitled to restitution in specie, he can escape the contractual risk allocation and avoid the loss that the losing contract would have imposed upon him.[66] The most conspicuous example relates to restitution of money paid by the injured party prior to rescission, which technically is not restitution in specie (as the defendant is not required to restore the same coins he received) but is akin to it. By recovering the amount paid, the innocent party can escape an adverse contractual risk allocation and avoid the consequences of a losing contract.[67] Thus, restitution in specie (as well as restitution of the sum of money or a similar quantity of any other fungible) operates in much the same manner as rescission operates with regard to executory performance. Both enable the injured party to escape the loss that he would have suffered had the losing contract been performed.

4. The *Restatement (Third) of Restitution and Unjust Enrichment* and the *Restatement (Second) of Contracts* diverge on the important issue of restitution in value of part performance not recoverable in specie, rendered by the innocent party prior to rescission. Under the *Restatement (Third) of Restitution and Unjust Enrichment*, the valuation is to be made in accordance with the contractual rate.[68] The contractual allocation of risk is maintained with regard to the part performed. Consequently, the innocent, non-breaching party is unable to escape the consequences of a losing contract with regard to this part of the performance. The *Restatement (Third) of Restitution and Unjust Enrichment*'s approach is consistent with the full performance doctrine.[69] It is, however, inconsistent with the rule regarding release from future obligations and with the rule regarding restitution of money paid and restitution in specie, when it is available.[70]

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[66] *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 37 cmt. e, illus. 17; *supra* Part III.

[67] *See supra* Part II.

[68] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38(2)(b).

[69] *Compare id.*, *with* RESTATEMENT (SECOND) OF CONTRACTS § 373 cmt. b, illus. 5 (1981).

[70] Douglas Laycock has pointed out that the provisions of the *Restatement (Third) of Restitution and Unjust Enrichment* are consistent in the sense that both sections 37 and 38 of the *Restatement (Third)*

> treat the contract price as binding. . . . When plaintiff rescinds a losing contract, it is defendant who wants to override the contract price and revalue his promised performance. When plaintiff with a losing contract seeks damages based on the value of performance, it is plaintiff who wants to override the contract price and revalue her

5. Under the *Restatement (Second) of Contracts*, valuation of part performance is based on market value and is independent of the contractual rate (the contractual price may serve as evidence of the market value but is not conclusive).[71] This approach enables the innocent party to escape the consequences of a losing contract and, in extreme situations, to recover for part performance an amount exceeding the contractual price for the whole performance.[72] Such a result may seem harsh on the party in breach. This approach is consistent with the rule regarding release from future obligations and restitution both of money paid and in specie, but it is inconsistent with the full performance doctrine. This inconsistency is most striking when recovery for part performance greatly exceeds the contractual price of full performance.[73]

6. The actual results under the two Restatements converge in cases in which the contractual price cannot be ascertained since it is dependent on contingencies (for example, a promise to pay a percentage of future income that, because of the breach, will not materialize).[74]

A possible compromise between the two approaches is to allow recovery of the value of the injured party's part performance, unlimited by the contractual price but subject to the general defense against claims in restitution embodied in section 62 of the *Restatement (Third) of Restitution and Unjust Enrichment*. Under this approach, where the appraisal of the value of the performance rendered under the contract greatly exceeds the contractual price and the

performance. Neither side is allowed to do that.

Douglas Laycock, *Restoring Restitution to the Canon*, 110 MICH. L. REV. 929, 944 (2012). This analysis reflects the situation with regard to the part that has been performed. Under the *Restatement (Third) of Restitution and Unjust Enrichment*, the innocent party cannot claim for part performance an amount that exceeds the contractual rate. With regard to part performance, the contractual price remains binding, and he will have to suffer the loss that the losing contract imposes on him. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 38(2)(b). Similarly, the party in breach who failed to perform is bound to restore the payment he received under the contract even if this payment, which constitutes the contractual price, exceeds the value of the performance due from the party in breach. Yet the innocent party can disregard the contractual price in a losing contract (and hence avoid the contractual allocation of the risk) with regard to the part that has not yet been performed. *See supra* Part I.

[71] *See* RESTATEMENT (SECOND) OF CONTRACTS § 373 cmt. d, illus. 12.

[72] *See, e.g.*, *In re* Montgomery's Estate, 6 N.E.2d 40, 41 (N.Y. 1936).

[73] *See supra* Part IV.

[74] *See supra* Part V (discussing the burden of proof and instances when the two Restatements converge in result).

resulting award becomes too harsh on the breaching defendant, the court may reduce the award as justice requires.[75] Thus, for example, if the value of the part performance rendered under the terminated contract is appraised at $2500 while its contractual price is only $1000, the court may limit recovery to an amount between these two figures and grant an award of $1500. This solution does not provide a strict rule but rather endows the court with broad discretion, a possibility that is not unknown to American law.[76] Yet it has the advantage of narrowing the gap between the two Restatements.

[75] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 62 cmt. c.

[76] Compare the famous section 90(1) of the *Restatement (Second) of Contracts*, which provides that the remedy granted under this section "may be limited as justice requires."