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CALCULATING JUDGMENT INTEREST AFTER *BANK OF AMERICA CANADA V. MUTUAL TRUST CO.*: DIFFICULTIES COMPOUNDED

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Abstract

Until recently, compound judgment interest was only available in rare circumstances, namely where courts exercised their equitable jurisdiction. Simple interest was the ordinary measure awarded by the courts. However, in Bank of America Canada v. Mutual Trust Co. the Supreme Court of Canada stunned Canada's legal theorists and practitioners by holding that compound judgment interest could be awarded at common law. It was the firm belief of Major J. that such relief was necessary to protect the full time value of money owed to judgment creditors.

This paper considers the hidden implications of the decision. Attention is given to the Supreme Court of Canada's ambiguous use of restitution principles in awarding compound interest. The context of the case suggests that the Court was possibly referring to disgorgement, a type of restitution. However, neither the terminology used, nor the circumstances of the case clarify whether this was the Court's true intention. Additionally, Major J. decided to limit the use of restitution principles in cases of contract breach (where it traditionally was unavailable) to those involving inefficient breaches. The uncertainly with regard to the extent of this limit is examined. Finally, consideration is given to the possibility of contract rights attaining the status of property rights through the Court's apparent use of disgorgement principles.

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I. Introduction

In Bank of America Canada v. Mutual Trust Co.,[1] the Supreme Court of Canada made two surprising decisions. First, it held that there is a common law power to award compound rates on pre-judgment and post-judgment interest. Second, the Court may have decided that restitution principles are applicable in a claim for damages for breach of contract.

The facts in Bank of America are as follows:

In 1987 Reemark Sterling I Ltd. ("Reemark") decided to develop condominium units. The respondent Mutual Trust Company ("Mutual Trust") negotiated with Reemark to create a Takeout Mortgage Commitment Agreement ("TOC") on December 1, 1987. According to the terms of the TOC, Mutual Trust agreed to provide mortgage financing to investors who wished to purchase the Reemark condominiums. On the sale of a unit, the purchase funds were to be sent directly from Mutual Trust to Reemark. Mutual Trust was to collect payments from the investors with interest compounded semi-annually. On December 1, 1988, Bank of America Canada ("Bank of America") agreed to finance the cost of Reemark's development and entered a loan agreement with Reemark. The interest on this loan was compounded monthly at Bank of America's prime lending rate plus one percent. On December 16, 1988, Bank of America, Mutual Trust and Reemark executed an assignment of the TOC. The terms of the assignment incorporated the loan agreement dated December 1, 1988, and directed Mutual Trust to pay Bank of America directly, following the sale of a Reemark condominium unit.

On July 31, 1991, Mutual Trust breached the TOC. Negotiations ensued between the three parties and on December 18, 1991, an amended TOC was created ("ATOC"). Mutual Trust subsequently breached the ATOC as well. Bank of America then appointed a receiver and had the development sold for $22,500,000. However, Remark still owed Bank of America for the difference of the $33,000,000 that was originally advanced to Reemark under the loan agreement. As a result, Bank of America pursued the deficiency and claimed damages for breach of contract under the TOC, the assigned TOC and the ATOC. At trial, damages were awarded with compound interest at the prescribed rate in the loan agreement. The Ontario Court of Appeal upheld the measure of dam-

[1] 2002 CarswellOnt 1114 [*Bank of America*].

ages but substituted an award of simple interest. The Supreme Court of Canada restored the trial award of compound interest.

Traditionally, compound interest on judgment awards was only granted where a court exercised its equitable jurisdiction in cases involving breach of trust, breach of fiduciary duty, fraud, and expropriation. The object of awarding compound interest in these circumstances was to compensate the plaintiff in full. Speaking for the Supreme Court of Canada, Major J. held that the need to compensate fully for the time value of judgment awards should not be restricted to the traditional categories; Major J. decided to make what he described as an incremental change to the common law by creating a common law power to award compound interest on judgment awards. It is now no longer necessary to invoke a court's equitable jurisdiction in order to obtain compound interest on a judgment award.

In changing the common law, Major J. relied on compensatory principles as well as principles of restitution. The use of restitution principles was unnecessary. Compensatory principles alone could have obtained the same result. The following will demonstrate that Major J. was in fact using restitution principles in the sense of "disgorgement of profits" in order to make his change to the common law appear less drastic.

Disgorgement, a type of restitutionary remedy, has traditionally been available in cases involving a plaintiff's proprietary interests. Implicit in Major J.'s judgment is his reliance on the availability of disgorgement of profits where the proprietary interests of a plaintiff are involved. The proprietary interest at issue in *Bank of America* was the debt owed by Mutual Trust to Bank of America. Specific performance is available as a matter of course in actions to recover a debt and the availability of specific performance is akin to a proprietary interest. Major J. effectively disguised the disgorgement of profits in an action involving proprietary interests by awarding compound interest. Since disgorgement of profits has been available for actions for breach of contract involving proprietary interests, and there was a proprietary interest at issue in *Bank of America,* Major J's decision to award compound interest at common law as a disgorgement of profits seems less drastic in nature. His award of compound interest can be said to have disgorged any profit made by Mutual Trust by retaining the funds owed to Bank of America.

In implicitly utilizing restitution principles in an action for breach of contract, Major J. seems to have realised that he might appear to be simultaneously making restitution generally available in actions for breach of contract. This was not his intention; he merely wanted to use disgorgement principles as a vehicle to ease the transition to allowing compound interest at common law. He was concerned, and rightly so, that by making restitution readily available in actions for breach of contract, he could eliminate the distinction between contract rights and property rights. To protect that distinction, Major J. placed a limit on the availability of restitution in contract by limiting it to cases involving non-efficient breaches. In so doing, he made the availability of restitution possibly redundant,[2] as compensatory principles alone would suffice in cases where there is no efficient breach. This redundancy supports the view that Major J.'s use of restitution principles was premised solely on the desire to make the change to the common law appear incremental.

However, Major J.'s decision to restrict restitution to cases involving non-efficient breach may not be interpreted so narrowly by judges in future cases. In fact, in *Bank of America* the Court applied restitution principles in a factual situation that involved an efficient breach. Since Mutual Trust's breach did not fall within the traditional categories wherein compound interest was regularly awarded, Mutual Trust may have relied on the existing law, prior to *Bank of America,* as authority limiting it to the payment of simple interest on any judgment award obtained by Bank of America. In addition, the Supreme Court stated that efficient breach *should* not be discouraged, not that it *must* not be discouraged. Hence, it is plausible that judges will interpret *Bank of America* as simply setting out a general principle that ordinarily restricts restitution to cases of inefficient breach, thereby making restitution available in claims for damages for breach of contract in some instances where an efficient breach is present. This would be an extraordinary change, as restitution in the sense of unjust enrichment has not previously been available in claims for damages for breach of contract. Further, the Supreme Court's use of the term "restitution" is ambiguous. The facts and the nature of the cause of action suggest that "disgorgement" was the intended meaning. This is so not only because of the Court's implicit reliance on the proprietary interest at issue, but also due to the fact that

[2] McInnes, i*nfra* note 112 at 132.

the claim was for breach of contract. This ambiguity could result in additional confusion when *Bank of America* is applied to future cases.

To date, courts have fortunately been applying the *Bank of America* decision based on its compensatory principles alone. However, the ambiguities in the case leave open the possibility for future decisions to allow claims for restitution for simple breach of contract actions. This would be unfortunate as the distinction between contract rights and property rights would thereby be diminished, especially if the term "restitution" is used in the sense of disgorgement of profits. Allowing disgorgement for a simple breach of contract, where the expectation measure is the traditional measure of damages, could have the effect of making such a claim specifically enforceable. Efficient breaches would no longer be possible. Breaching parties would always be forced to return gains made by a breach, even where the plaintiff was already fully compensated. This would have a punitive effect on breaching parties, as non-breaching parties would be able to extort from them the anticipated cost of performance, as opposed to its value, upon breach. In other words, a non-breaching party would be able to obtain more than full compensation for the effects of a breach.

The possible consequences of his decision reveal that Major J. was making more than a mere "incremental change" to the common law. It is true that the main purpose of expectation damages is to compensate a plaintiff in full, and in that sense he was correct to endorse the doctrine of efficient breach. However, an ancillary character of the expectation damages rule is that it prevents profit from breach. The same result could have been achieved by compensatory principles alone, and the Court could have avoided the ambiguities flowing from its use of restitutionary principles. It is indeed true that by using compensatory principles alone it would no longer be open for the Court to rely on disgorgement principles as a method to change the common law incrementally. This may, however, have been the sort of change which is best left provincial legislatures. The provinces had enacted legislation that set out a rule which generally allowed simple interest on judgment awards. The resulting compensation for plaintiffs may have been less than perfect using simple interest, but at least the law was certain. Often all that can be achieved by lawmakers is an imperfect but predictable rule. The proper role of a court is not to attempt to legislate a more perfect rule; rather, this demands proper legislative reform.

II. Availability of Compound Rates for Pre-Judgment and Post-Judgment Interest

In *Bank of America*, the Supreme Court of Canada broke from the traditional view that compound interest is unavailable on pre-judgment and post-judgment interest. In this case, the Court examined the circumstances under which judgment interest is available pursuant to the Ontario *Courts of Justice Act*.[3] While s. 128(1) permits awarding pre-judgment interest, s. 128(4)(b) indicates that "interest shall not be awarded under subsection (1) on interest accruing under this section." Prior to *Bank of America*, it was commonly thought that such wording precluded awards of compound interest on judgments. The *CJA* also provides for post-judgment interest in s. 129(1), which states that "money owing under an order, including costs to be assessed or costs fixed by the Court, bears interest at the post-judgment interest rate, calculated from the date of the order." With regard to post-judgment interest, there is no provision analogous to s. 128(4)(b).

At the trial level of *Bank of America*, Justice Farley relied on s. 130 of the *CJA* in granting compound interest for the pre-judgment and post-judgment periods.[4] In awarding interest on judgments, a court is given considerable discretion by s. 130(1), which reads:

> The Court may, where it considers it just to do so, in respect of the whole or any part of the amount on which interest is payable under section 128 or 129,
>
> (a) disallow interest under either section;
>
> (b) allow interest at a rate higher or lower than that provided in either section;
>
> (c) allow interest for a period other than that provided in either section.

In exercising its discretion under s. 130(1), a court may examine a host of factors set out in s. 130(2), including any considerations that it deems relevant.[5]

[3] R.S.O. 1990, c. C-43.

[4] [1998] O.J. No. 1525 (QL).

[5] *Courts of Justice Act*, supra note 3, s.130(g).

The Court of Appeal agreed with the trial judgment but reversed Justice Farley's decision to award compound interest.[6] Justice Goudge held that s. 130 did not allow for the awarding of compound interest.[7] He felt that compound interest could only be awarded using the Court's equitable jurisdiction, as such jurisdiction was the sort of "right" contemplated by s. 128(4)(g) and s. 129(5).[8] Dealing with pre-judgment interest, s. 128(4)(g) states that "interest shall not be awarded under subsection (1), where interest is payable by a right other than under this section." With regard to post-judgment interest, s. 129(5) reads "interest shall not be awarded under this section where interest is payable by a right other than under this section."[9] Justice Goudge's decision was consistent with the law as it stood to that point. In considering the Supreme Court's reasoning in awarding compound interest at common law it is helpful to understand the circumstances in which compound interest was traditionally available. Once the common law as it traditionally stood is examined, it becomes apparent why Justice Major thought that it was too restrictive.

1. Traditional Grounds for Granting Compound Interest on Judgment Awards

Traditionally, compound interest was only available in cases involving breaches of fiduciary duty, fraud, and expropriation. In *Harrison v. Mathieson*,[10] it was held that compound interest could be awarded when a fiduciary or trustee who had a duty to invest entrusted monies breached a fiduciary obligation. Meredith C.J.O. held that it was:

> proper to take the account with annual rests, for the reason that… it was the duty of the trustee to have invested the money which he misapplied; and, if he had done so, the investment would have produced five per cent compound interest.[11]

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[6] [2000] O.J. No. 704 (QL).

[7] *Ibid*. at para 55.

[8] *Ibid*. at para 49.

[9] *Courts of Justice Act, supra* note 3.

[10] (1916), 30 D.L.R. 150 (Ont. S.C.A.D.).

[11] *Ibid*. at 158.

This line of reasoning was endorsed in *Wallersteiner v. Moir,*[12] which involved a company director who misused company funds for his own benefit in his fiduciary capacity. Buckley L.J. held that " it is well established in equity that a trustee who in breach of trust misapplies trust funds will be liable not only to replace the misapplied principal fund but to do so with interest from the date of the misapplication."[13] The rationale for such a holding was that such a trustee is presumed to have retained the trust funds and to have used them for his own purposes.[14] Buckley L.J. went on to say "where a trustee has retained trust money in his own hands, he will be accountable for the profit which he has made or which he is assumed to have made from the use of the money."[15]

A defaulting trustee will be accountable for simple interest only, but where a trustee uses trust funds in trade he may be charged compound interest. Buckley L.J. indicates that the justification for charging compound interest in such instances "lies in the fact that profits earned in trade would likely be used as working capital for earning further profits."[16] It was further posited that in commercial transactions involving misappropriated trust funds, a court should presume that the transaction was profitable for the trustee absent evidence to the contrary.[17] Hence, there is no need to prove any actual profit being made where trust funds are inappropriately used in commercial transactions by the trustee; profit will be imputed. In *Wallersteiner*, the director was presumed to have made a profit when he used company funds in commercial transactions and was ordered to pay compound interest.

Denning M.R., as he then was, agreed with Buckley L.J. that compound interest should have been awarded in the circumstances. Denning M.R. stated that it is to be presumed that:

> the company (had it not been deprived of the money) would have made the most beneficial use open to it… . Alternatively, it should be presumed that the wrongdoer made the most beneficial use of it. But, whichever it is, in order to give adequate compensation, the

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[12] [1975] 1 All E.R. 849 (C.A.) [*Wallersteiner*].

[13] *Ibid*. at 863.

[14] *Ibid*.

[15] *Ibid*.

[16] *Ibid*. Buckley L.J. also held that this presumption applied to agents who retained monies of their principals.

[17] *Ibid*. at 864.

> money should be replaced with interest yearly rests, i.e. compound interest.[18]

In addition to positing a presumption that a trustee makes a profit from the use of misappropriated trust funds, Denning M.R. makes it clear that the awarding of compound interest is based on compensatory principles. This is evidenced by the passage above wherein Denning M.R. states to "give adequate compensation," and by his statement that a "mere replacement of money – years later – is by no means adequate compensation, especially in days of inflation."[19] Since inflation is an ongoing process, it would be reasonable to argue that compound interest will always be necessary to compensate in such situations. This logic seems to be inherent in Justice Major's decision.

The principles enunciated in *Wallersteiner* have been followed in Ontario on numerous occasions. *Brock v. Cole*[20] was the first case expressly to follow *Wallersteiner.* The plaintiff in *Brock* advanced $20,000 on February 11, 1974 to his solicitors. The solicitors were supposed to use the money to enable their company to purchase land appraised at $40,000 as mortgagors, and were to deliver a first mortgage to the plaintiff as mortgagee. The mortgage was to be for a term of three months, with interest accruing at eighteen percent. As of August 1974, the plaintiff had yet to hear from his solicitors regarding the transaction. In October 1974, the plaintiff received a firm trust cheque for $3,095 for interest on his outstanding funds. Later in the same month he finally received a second mortgage, instead of a first as was initially agreed, on a property that was bought for only $16,000. The property was eventually sold, but the plaintiff never received more than the $3,095 firm trust cheque.

Thorson J.A. held that the plaintiff was entitled to compound interest on $20,000 at ten percent per annum from May 11, 1974 onwards. In coming to its decision, the Court of Appeal considered s. 36(5) of the *Judicature Act*.[21] Paragraphs 36(5)(b) and s. 36(5)(f) of the *Judicature Act* are identical to paragraphs 128(4)(b) and s. 128(4)(g) of the *Courts of Justice Act*. Thorson J.A. held that s. 36(5)(f) constitutes a statutory recognition that rights to interest on judgment claims that are found out-

[18] *Wallersteiner, supra* note 12 at 856.

[19] *Wallersteiner, supra* note 12 at 856.

[20] (1983), 142 D.L.R. (3d) 461 (C.A.) [*Brock*].

[21] R.S.O. 1980, c. 223.

side the general provisions of s. 36 of the *Judicature Act* continue to exist.[22] Further, it was noted that nothing in s. 36 demonstrates a legislative intent to abrogate the authority of a court, applying well-recognized principles of equity, to award compound interest in cases in which it is just and proper to do so.[23] Compound interest is available in cases where trustees fail to invest entrusted money as instructed, and thereby earn compound interest, and also in cases where money is wrongfully detained when it ought to have been paid.[24]

There was some discussion in *Brock* that the wording "payable by a right other than under this section" precluded the equitable application of compound interest. It was suggested that equitable remedies do not constitute "rights," as courts always have discretion to refrain from applying equitable remedies.[25] Thorson J.A. felt that such an interpretation would place too narrow a meaning on the word "right", "if on the facts before the Court no reasons or ground has been advanced upon which the Court, acting judicially, could properly refuse such an order."[26]

The Court went on to adopt the reasoning of Buckley L.J. and Denning M.R. in *Wallersteiner*, and held that the defendant could be presumed to have earned compound interest in using the plaintiff's funds in the course of its real estate ventures. Similar to Denning M.R. in *Wallersteiner,* Thorson J.A. emphasized that the plaintiff would not be adequately compensated by an award of simple interest.[27] Hence, the plaintiff was entitled to compounded judgment interest from May 11, 1974 onwards.

The *Brock* decision was followed in *Claiborne Industries Ltd. v. National Bank of Canada*,[28] and most recently in *Confederation Life Insurance Co. v. Shepherd, McKenzie, Plaxton, Little & Jenkins*.[29] *Claiborne* was an action brought for breach of trust, and for conspiracy. In awarding compound interest, the Court adopted the principles set out in *Brock* indicating that:

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[22] *Brock, supra* note 20 at 466.

[23] *Brock, supra* note 20 at 467.

[24] *Brock, supra* note 20 at 467.

[25] Iaccobucci J. notes, in *Air Canada v. LCBO*, [1997] 2 S.C.R. 581 at para. 86, that the awarding of compound interest is discretionary.

[26] *Brock, supra* note 20 at 466.

[27] *Brock, supra* note 20 at 469.

[28] 1989 CarswellOnt 1425 (C.A.) [*Claiborne*].

[29] (1996) 88 O.A.C. 398 (Ont. C.A.) [*Confederation*].

> a right other than under this section' [in s.36(5)(f) of the *Judicature Act*] included the general jurisdiction of the Court to award compound interest where there is a wrongful detention of money which ought to have been paid. This is on the theory that it is reasonable to assume that the wrongdoer made the most beneficial use of the money and is accountable for the profits. A reasonable use of money implies compounding interest at some appropriate interval.[30]

In *Confederation*, the Ontario Court of Appeal agreed with the principles put forth in *Brock,* but distinguished it on the facts.

Compound interest is regularly awarded in equity with respect to cases dealing with expropriation. In *British Pacific Properties Ltd. v. British Columbia (Minister of Highways & Public Works)*,[31] the Supreme Court of Canada upheld a compound interest award made by an arbitrator. The case revolved around a narrow interpretation of s. 3 of the Federal *Interest Act*,[32] which purported to fix interest rates at five percent "whenever any interest is payable by agreement or parties or by law, and no rate is fixed by such an agreement or by law." Laskin C.J.C. held that an award of interest at a specified rate made by arbitrators in fixing compensation for expropriated land pursuant to a statutory authority is payable by law and escapes the limitations of s. 3 of the *Interest Act*.[33]

Similar to instances of breach of trust or fiduciary duties, the purpose of granting compound interest in cases of expropriation is to compensate fully the landowner who has lost the value of his or her land. In *Mannix v. The Queen*,[34] the Alberta Court of Appeal stated that compound interest is appropriate in cases of expropriation, because the landowner is entitled to be compensated so as to be left economically whole.[35] The Court further held on the facts of the case it could be expected that the landowner would have followed prudent investment practices had the money been available, and would have invested at investor's rates, rather than at lower borrower's rates.[36] Again there is a presumption that

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[30] *Claiborne, supra* note 28 at para. 166.
[31] 1980 CarswellBC 575 (S.C.C.)[*British Pacific Properties*].
[32] R.S.C. 1985, c. I-15.
[33] *British Pacific Properties, supra* note 31 at para. 10.
[34] [1984] A.J. No. 722 (C.A.) (QL) [*Mannix*].
[35] *Ibid*. at para. 13.

the person kept out of funds would have made the best available use of those funds had they been promptly available.

Finally, it should be noted that compound interest has been available in some cases not involving equitable remedies for breach of trust, fraud or expropriation. For example, in *Roman Catholic Diocese of Calgary Association for Seniors v. Century Insurance*,[37] a dispute arose between the insured plaintiff and the insurer as to whether or not a fire insurance policy had lapsed. In finding that the policy had not lapsed, the Court held that the insured was entitled to compound interest on the insurance proceeds equal to the amount the insured would have earned had it been able to deposit the proceeds in an existing term deposit which was compounded monthly.[38] The Court felt that the plaintiff had proved that it regularly deposited funds into a term deposit during the time it was kept out of the insurance proceeds, and presumed that the plaintiff would have invested the proceeds in the same account had they been promptly available. Hence, in cases not involving breach of trust, breach of fiduciary duty, or expropriation, a plaintiff may be entitled to compound interest if he or she can prove that money withheld by the defendant would otherwise have been invested at a compound rate.

As the foregoing cases demonstrate, there is ample authority to support an award of compound interest in equity for breach of trust or breach of fiduciary duty, expropriation and in cases where a plaintiff has been kept out of money rightfully due that would have otherwise been invested at compound rates. While compound interest was readily available in such cases, it was not traditionally available at common law prior to *Bank of America*.

The traditional position of refusing awards of compound interest at common law was adopted by the House of Lords in *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council*.[39] Speak-

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[36] *Ibid*. at para. 14.

[37] (1984) 8 D.L.R. (4th) 435 (Alta. C.A.).

[38] *Ibid*. at 441.

ing for the majority, Lord Browne-Wilkinson held that in the absence of fraud, compound interest has never been awarded except against a trustee or other person owing a fiduciary duty who is accountable for profits made from his position.[40] The award of compound interest was restricted to cases where the award was in lieu of an account of profits made improperly by the trustee.[41] Since there was no trust or fiduciary relationship between the bank and the borough, compound interest could not be awarded. Lord Browne-Wilkinson went on to state that Parliament expressly forbid the awarding of compound interest in the *Supreme Court Act, 1981*. However, the Act did not impinge on the awarding of interest in equity. He forcefully stated that:

> your Lordships would be usurping the function of Parliament if, by expanding the equitable rules for the award of compound interest, this House were now to hold that the Court exercising its equitable jurisdiction in aid of the common law can award compound interest which the statutes have expressly not authorized the Court to award in exercise of its common law jurisdiction.[42]

Both Lord Slynn of Hadley[43] and Lord Lloyd of Berwick[44] agreed that creating a common law power to award compounded judgment interest would usurp the function of Parliament, and that legislative reform was needed if there was to be any change.

Given the state of authorities leading up to the Supreme Court's decision in *Bank of America*, it is apparent that the Ontario Court of Ap-

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[39] [1996] H.L.J. No. 15 (QL) [*Westdeutsche*]. The case involved an interest rate swap agreement between a bank and the Islington London Borough Council. Such agreements are in effect wagers, where one party agrees to pay interest at a fixed rate on a notional capital sum over a fixed period, while the other party agrees to pay a floating rate of interest calculated by market rates on the same sum over the same period. No payment is actually made until the end of the stipulated period, where the unsuccessful party pays the difference between the two results. However, the bank made an upfront payment of £2,500,000 to the borough. The agreement was an attractive way for the borough to raise some additional capital while avoiding statutory controls. However, such agreements were *ultra vires* the borough. The bank paid £1,354,474 on the agreement. At trial, the borough was ordered to pay £1,145,526, which amounted to the balance of the £2,500,000 originally put up front. The borough did not object to paying the amount ordered, but did appeal the award of compound interest.

[40] *Ibid*. at para. 69.

[41] *Ibid*.

[42] *Ibid*. at para. 129.

[43] *Ibid*. at paras. 135, 137.

[44] *Ibid*. at paras. 202, 206.

peal decision was consistent with precedent. Further, the clear wording of s. 128(4)(b) of the *Courts of Justice Act* seemed to prevent an award of compound interest at common law. Hence, in similar fashion to the House of Lords decision in *Westdeutsche*, the Ontario Court of Appeal was reluctant to usurp the function of the legislature by stretching the meaning of the *Courts of Justice Act*. This leads one to ask why the Supreme Court of Canada would reverse a decision that was consistent with precedent?

The Supreme Court's decision is correctly premised on the compensatory nature of compound interest as discussed by Denning M.R. in *Wallersteiner* and in subsequent cases. Compound interest was awarded as a method of ensuring full compensation for the plaintiff. It provides the plaintiff the full time value of the money owed to him. Major J. simply did not think that it was appropriate to limit full compensation to cases invoking the equitable jurisdiction of the Court. To adhere to such a restriction effectively prevents full compensation in other cases. The time value of money is always affected in any judgment award, regardless of whether a court's equitable jurisdiction is exercised.

Several commentators have argued that there was no principled basis to restrict the awarding of compound interest.[45] The refusal to award compound interest keeps the plaintiff out of money that is properly due at the date of the wrong, which the plaintiff could have in turn invested at compound rates.[46] Mary Anne Waldron, in *The Law of Interest in Canada*, notes that the primary reason for excluding compound interest has been that it was considered too difficult to calculate. She argues, however, that

> since commercial practice virtually without exception compounds interest, and considering the substantial difference that compounding can make in time of high rates and slow litigation, no rationale remains for prohibiting compound interest.[47]

It is no longer the case that it is too difficult to calculate compound interest.

[45] S.M. Waddams, *The Law of Damages*, 3rd ed. (Toronto: Canada Law Book, 1997) at 437 [*The Law of Damages*]. Mary Anne Waldron, *The Law of Interest in Canada*, (Toronto: Carswell, 1992) at 142 [*Law of Interest*].

[46] *The Law of Damages, ibid*. at 437.

[47] *The Law of Interest in Canada, supra* note 45 at 142.

The Supreme Court of Canada in *Bank of America* was cognizant of the unfairness of limiting compound interest to courts' equitable jurisdiction, and of the fact that it is no longer too difficult to calculate compound interest.[48] The Court held that it no longer makes sense to limit compound interest to cases involving equitable principles. Major J. realised that the full measure of expectation damages for breach of contract cannot not be achieved if compound interest is limited to the Court's equitable jurisdiction. Full compensation is not awarded if a plaintiff is limited to receiving simple interest on a judgment award, as the plaintiff does not receive the full time value of the principal sum of the award.[49] Hence, Major J. strayed from precedent and the clear wording of the *Courts of Justice Act* to create a common law power permitting the awarding of both pre-judgement and post-judgment compound interest. In doing so, Major J. correctly used compensatory principles for the reasons set out above. He also, however, remarkably used restitution principles to support his decision, even though the case was premised on an action for breach of contract. Restitution for an unjust enrichment was traditionally not available where a plaintiff claims damages for breach of contract.

While the change to the common law to allow compound interest is desirable so as to compensate the plaintiff in full, the change could have been made solely on compensatory principles; anything further would have been best left to the legislature. The references to restitution were most likely used to ease the transition to allowing compound interest at common law; in other words, the restitution analysis assisted Major J. to make the transition appear to be an "incremental change." Compound interest can be viewed as similar to a disgorgement of profits if the plaintiff is awarded the actual compound interest made by the defendant on the money that is rightfully due to the plaintiff. Disgorgement of profits, a type of restitution remedy, has been awarded in cases where plaintiffs have sought damages for breach of contract where proprietary interests were involved. The plaintiff in *Bank of America* was suing in breach of contract over the non-payment of a debt. An action on a debt entitles a plaintiff to specific performance as a matter of course, not as of right.[50]

[48] *Bank of America, supra* note 1 at para. 44.

[49] *Bank of America, supra* note 1 at para. 23.

[50] *The Law of Damages, supra* note 45 at 122.

Since specific performance is available as a matter of course for a debt owed, it can be argued to be akin to a proprietary right in the sense that the plaintiff is generally entitled to the actual debt owed. Since a remedy in specific performance is in effect proprietary in nature, it could be argued that the issue in dispute in *Bank of America* was proprietary. Hence, in this light, using disgorgement principles to award compound interest assists Justice Major's claim that he was making an incremental change to the common law.[51] Implicit in Major J.'s reasoning is that he was merely allowing a disgorgement of profits in a claim involving proprietary interests – the disgorgement being the shifting of compound interest, presumably earned by Mutual Trust, to Bank of America.

As will be discussed below, the reference to restitution principles in awarding compound interest was unnecessary and creates problems which are difficult to resolve. In order to understand better Major J.'s use of restitution principles in an action for breach of contract, it will be helpful to address the availability of restitution in contract prior to *Bank of America*.

III. Restitution in a Claim for Damages for Breach of Contract?

1. Expectation Damages, Reliance Damages and Specific Performance

In *Bank of America*, the plaintiff claimed damages for breach of contract. The usual measure of damages in breach of contract is the expectation measure. As Parke B. held in *Robinson v. Harman*:

> the rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation with respect to damages, as if the contract had been performed.[52]

This proposition was followed by the Privy Council in *Wertheim v. Chicoutimi Pulp Co.*,[53] and was expressly adopted by the Supreme

[51] *Bank of America, supra* note 1 at para. 43.

[52] (1848), 154 E.R. 363 at 365.

[53] [1911] A.C. 301.

Court of Canada in *Haack v. Martin*.[54] In an ordinary claim for breach of contract, the plaintiff is entitled to receive the value, not the cost, of the expected performance of the contract at the date of the breach.

While the usual measure of damages for breach of contract will be the expectation measure, this is not invariably so. The plaintiff may also receive reliance damages or specific performance. Reliance damages are awarded to compensate the plaintiff for actual costs incurred in contemplation of, or in preparation for, the performance of the contract. They are awarded where expectation damages are inappropriate (when, for example, they are too speculative). Further, reliance damages are an alternative measure of damage; the plaintiff is not entitled to both expectation and reliance damages.[55] Specific performance may be awarded in certain circumstances, especially in contracts dealing with land.

In *Bank of America,* the trial judge awarded the shortfall between the sale price obtained by the receiver and the amount outstanding under the Loan Agreement and the TOC Assignment. This award was never in dispute. Major J. could have exercised the Court's equitable jurisdiction and awarded compound interest as an extension of the trial judge awarding specific performance in enforcing the debt. But, as is evident from the above analysis, the specific enforcement of a debt alone is not traditionally sufficient to invoke the Court's power to award compound interest in equity. The Supreme Court in *Bank of America* did not think it appropriate to extend the scope of awarding compound interest in equity to include the specific performance of a debt. Further, it was stated earlier that Major J. did not think it desirable to limit compound interest to the Court's equitable jurisdiction, as such a scheme ignores the need to extend fully the compensatory character of compound interest to all judgment awards.

Rather than extend the circumstances under which a court could award compound interest in equity, Major J. indicated that he was making an incremental change to the common law so as to allow the awarding of compound interest. As is discussed below, it appears that the change was not incremental but substantial. In making the allegedly incremental change, Major J. relied upon restitution principles, despite the fact that restitution is not traditionally a remedy for breach of contract.

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[54] [1927] S.C.R. 413 at 416.

[55] *Sunshine Vacation Villas Ltd. v. Hudson's Bay Co*. (1984), 13 D.L.R. (4th) 93 at 99 (B.C. C.A.).

2. Restitution in Actions For Unjust Enrichment

Until recently, courts have generally refused to award restitution for a mere breach of contract. The traditional view was that where there was a repudiatory breach,[56] the non-breaching party had two courses of action. He or she could decide to treat the contract as ongoing and seek expectation damages or specific performance; alternatively, the innocent party could consider the contract as at an end and choose to pursue a claim of restitution for any benefits it had conferred on the guilty party. The term "restitution" as used here denotes situations in which one party seeks to retrieve benefits that it has conferred on another party – it is a claim for unjust enrichment. This is distinct from "disgorgement of profits." In cases of disgorgement, one party seeks to obtain profits made by the other party, which can be unrelated to any benefit conferred by the other party. Disgorgement of profits can be awarded regardless of whether the defendant has been enriched. Both claims for unjust enrichment and claims for disgorgement of profits are said to be restitutionary remedies. It is important to note, however, that the two remedies are distinct in nature, and are available in different circumstances.

In contractual relations, it is not open to the innocent party both to affirm the contract and to seek restitution.[57] In pursuing restitution, the parties are treated as if there never was any contract between them. This is not, however, entirely realistic. It has been suggested that the contract cannot be entirely ignored, as the plaintiff's restitution claim can only be established if it is unjust for the defendant to retain a benefit conferred, and it is only unjust if the benefit expected to be received by the plaintiff under the contract has substantially failed.[58]

A plaintiff claiming restitution traditionally had to establish that a benefit was conferred upon the defendant, and that the defendant had completely failed to give any consideration in return. If, however, a contract was fully performed by the plaintiff, and the defendant refused to

[56] A repudiatory breach occurs where the innocent party is deprived of substantially all of the benefit, which it was intended to receive from the contract. See *Hong Kong Fir Shipping Co. v. Kawasaki Kisen Kaisha Ltd*, [1962] 2 Q.B. 26 (Eng.C.A.) at 66.

[57] *Deglman v. Guaranty Trust Co.,* [1954] S.C.R. 725.

[58] *The Law of Damages*, *supra* note 45 at 474.

pay the contract price, restitution was not available.[59] The requirement for a total failure of consideration was set out in *Hunt v. Silk*.[60] In that case, a landlord agreed to grant early possession to his tenant in exchange for a deposit. The landlord further agreed to execute a lease for a period of nineteen years, and promised to perform certain repairs within ten days of the tenant taking possession. After the ten days had elapsed, with no action taken by the landlord, the tenant attempted to rescind the agreement and sought the return of his deposit. Lord Ellenborough C.J. held that in order for restitution to be available, the parties must be capable of being restored to the *status quo*.[61] Since the agreement had been partially executed and the plaintiff had received some of the benefit of the bargain through his use of the premises, restitution was not available.

The need for a total lack of consideration on the part of the defendant has since been relaxed, so as to permit the plaintiff to receive some benefit under the bargain. As Maddaugh and McCamus point out, *Giles v. Edwards*[62] is now the preferred authority among contemporary scholars.[63] In *Giles*, the defendant was to cut, cord and deliver all of his cordwood at given location. A fixed sum was to be paid for every cord of wood. The defendant cut and corded some wood, and the plaintiff paid him twenty guineas. When the defendant failed to cord the rest of the wood, the Court awarded the plaintiff the return of its twenty guineas.[64] Hence, even though the plaintiff had received some benefit, it was still possible to recover the funds it had advanced to the defendant.[65] Madd-

[59] *Morrison-Knudsen v. British Columbia Hydro and Power Authority (No.2)* (1978), 85 D.L.R. (3d) 186 (B.C.C.A.). Where the plaintiff fully performed his or her end of the bargain, a claim for damages for breach of contract will be limited to the agreed contract price, as this will give the plaintiff exactly which he or she expected to receive. Anything more would allow the plaintiff to recover for making a bad bargain.

[60] (1804), 5 East 449 (K.B.).

[61] *Ibid*. at 452.

[62] (1797), 101 E.R. 920 [*Giles*].

[63] Peter D. Maddaugh & John D. McCamus, *The Law of Restitution*, (Toronto: Canada Law Book, 1990) at 423.

[64] *Giles, supra* note 62 at 920-921.

[65] That a plaintiff can receive restitution, even though he or she has received some consideration from the defendant is further supported in *Rowland v. Divall*, [1923] 2 K.B. 500 at 506 (C.A.) [*Rowland*]. In *Rowland*, the defendant sold a stolen car to the plaintiff. Despite having had the interim use of the car and having derived some benefit therefrom, the plaintiff was held entitled to a return of the full purchase price.

augh and McCamus note that *Hunt* can be reconciled with the approach in *Giles,* if it is interpreted as positing that the plaintiff's occupation after knowledge of the breach amounted to a waiver of his right to terminate the agreement.[66]

Courts have shown some willingness to offset the partial benefit derived from a plaintiff against awards of restitution. In *Gibbons v. Trapp Motors,*[67] the plaintiff was sold a defective car by the defendant. Numerous attempts were made by the defendant to repair the defects to no avail. The plaintiff was awarded the full purchase price paid for the car, but a reasonable allowance was deducted for the value of the use of the car and for the failed repair attempts.[68] The foregoing cases demonstrate that the law has been modified somewhat to allow a plaintiff to receive restitution, despite having received some consideration from the defendant, and such partial consideration received from the defendant may be offset against the plaintiff's claim for restitution.

As mentioned above, restitution, in the sense being discussed here, is based upon principles of unjust enrichment. The leading Canadian authority on unjust enrichment is *Peter v. Beblow*.[69] In that case, there was no contract; rather the Court was dealing with a property dispute of a cohabiting couple. The plaintiff was seeking recompense for twelve years of household labour. The Court held that to establish unjust enrichment, the defendant must have been enriched, the plaintiff must have been correspondingly deprived of a benefit, and there must have been no juristic reason for the enrichment.[70] Once an unjust enrichment has been established, the court will then award either a constructive trust or damages. In order for a constructive trust to be awarded, monetary compensation must be inadequate, there must be a link between the benefit conferred and the property over which the trust is claimed, and the contribution must be sufficiently substantial and direct so as to entitle the claimant to a portion of the proceeds of disposition. [71] Despite having been decided in the family law context, the principles in *Peter v. Beblow* could argu-

[66] *The Law of Restitution*, *supra* note 63 at 423-424.

[67] (1970), 9 D.L.R. (3d) 742 (B.C. S.C.).

[68] *Ibid*. at 745.

[69] 1993 CarswellBC 44 (S.C.C.).

[70] *Ibid*. at para. 3.

[71] *Ibid*.

ably be applied in cases where a party to a contract decides to sue in restitution where the stated criteria are met. The twelve-year cohabitation of the parties in *Peter v. Beblow* was akin to a marital relationship, and some argue that marriages are in essence contracts.[72] Hence, it is at least plausible to apply the *Peter v. Beblow* principles to contracts generally.

In *Bank of America*, the plaintiff bank can be said to have conferred a benefit upon the defendant trust company. The plaintiff, however, clearly chose to affirm the ATOC and pursue its action in breach of contract, rather than to disaffirm the contract and claim in restitution. At first glance, then, it appears that Major J. was ignoring precedent in applying restitution principles in *Bank of America*. However, a more probing analysis reveals that Major J. was relying upon the disgorgement of profits branch of restitution in his judgment. On this view, his decision is arguably consistent with precedent applying disgorgement principles in cases of breach of contract.

3. Disgorgement of Profits

In cases of disgorgement the defendant is ordered to account for profits wrongfully made and to pay them to the plaintiff whether or not the plaintiff suffered any corresponding loss. Disgorgement of profits has been awarded in cases of waiver of tort, where the interest of the plaintiff is proprietary in nature, and where there have been breaches of fiduciary duty.

In cases of waiver of tort, the plaintiff is said to have retrospectively authorized the wrongful conduct of the defendant, and the defendant is liable to account as an agent on the plaintiff's behalf. The remedy is highly artificial,[73] as the wrong is never actually condoned, but it is one way for the plaintiff to retrieve profits wrongfully made by the defendant where the plaintiff has not suffered any damage that would be recoverable in tort. The artificial nature of the doctrine of waiver of tort has created injustices, especially in cases of trespass where it was commonly, but erroneously, held that waiver of tort was not available.[74]

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[72] *Miron v. Trudel*, [1995] 2 S.C.R. 418.

[73] See Lord Atkin's comments in *United Australia Ltd. v. Barclays Bank Ltd.,* [1941] A.C. 1 at para. 28 (H.L.).

[74] See *Phillips v. Homfray* (1883), 24 Ch. D. 439 (C.A.) [*Phillips*].

Wayleave cases, where trespassing defendants are ordered to pay plaintiffs a reasonable hire for the unauthorized use of land and the value derived from the tort, have partially corrected this injustice.[75]

A similar remedy of disgorgement has been awarded to plaintiffs whose proprietary interests were at issue in cases of breach of contract. As noted above, the ordinary measure of damages for breach of contract is the expectation measure. Whether the plaintiff held a proprietary interest was only relevant to the issue of whether to award specific performance; it did not entitle the plaintiff to disgorge the gains made by the defendant through his or her breach. A plaintiff was not entitled to an account of profits or disgorgement for a mere breach of contract, but was only entitled to the value of his or her loss. This principle was applied even in cases dealing with proprietary interests. [76]

Maddaugh and McCamus offer two explanations for the exception of allowing a disgorgement of profits for a breach of contract where the plaintiff's proprietary interests are at stake. First, the party in default could also be concurrently in breach of another existing restitution obligation, such as breach of fiduciary duty. Second, there are

> instances in which contractual damages in the traditional measure are inadequate in a matter which has traditionally attracted equitable relief, but where such relief is not, by reason of the circumstances of the particular case, available to the plaintiff.[77]

The last category of cases allowing disgorgement of profits for breach of contract involves breaches of fiduciary duties. These cases often in-

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[75] See *Whitham v. Westminster Brymbo Coal and Coke Company,* [1896] 2 Ch. 538 (C.A.).

[76] *Tito v. Waddell*, [1977] Ch. 106 at 332 [*Tito*]. *Peevyhouse v. Garland Coal & Mining,* 382 P.2d 109 at 114 (Okla. S.C. 1963). *See* also *Occidental Worldwide Investment Corp. v. Skibs A/S Avanti, The Siboen and The Sibotre,* [1976] 1 Lloyd's Rep. 293 (Q.B.), where a claim for an account of profits was rejected when ship owners terminated their ship-leases with the lessees, when market prices began to rise.

[77] *The Law of Restitution*, *supra* note 63 at 436. In this second instance, Maddaugh and McCamus appear to be referring to instances where a Court uses its discretion to award damages in lieu of specific performance or in lieu of an injunction pursuant to s.99 of the *Courts of Justice Act*. For examples see the following cases: *Lake v. Bayliss,* [1974] 2 All E.R. 1114 (Ch.D.); *Wrotham Park Estate Co. v. Parkside Homes,* [1974] 1 W.L.R. 798 (Ch.D.); *Surrey County Council v. Bredero Homes*, [1993] 1 W.L.R. 1361 (C.A.). But see *Jaggard v. Sawyer*, [1995] 2 All E.R. 189 (C.A.).

[78] *Reading v. A.-G.,* [1951] A.C. 507 (H.L.) [*Reading*].

volved public servants that had either abused positions of trust[78] or misused state secrets in the course of their employment in order to profit.[79] In such cases, the wrongdoers are often ordered to account for their profits made as a result of the breach, and to repay the same to their employers.[80]

The last word on this subject comes from *Attorney General v. Blake,* [81] although the case did not involve a breach of fiduciary duty. The House of Lords in *Blake* came to a similar result as *Reading* and *Snepp*, but it took a startlingly different approach in arriving at its decision. George Blake acted as an agent for the Soviet Union while employed by the British Government. He was found guilty of offences under the *Official Secrets Act* and was sentenced to forty-two years in prison. He escaped and fled to Moscow, where he subsequently wrote his autobiography. While the information released in the autobiography was no longer confidential at the time of publication, its release nonetheless breached Blake's employment contract.

At trial, the Crown's claim for breach of fiduciary duty was rejected, and was subsequently dismissed on appeal. The Crown decided not to appeal this aspect of its claim before the House of Lords. Notwithstanding that decision, Lord Nicholls stated that he found it unsatisfactory that an account of profits would have been available had the release of information constituted a breach of fiduciary duty, but not where the same release of information merely amounted to a breach of contract. He stated that:

> if confidential information is wrongfully divulged in breach of a non-disclosure agreement, it would be nothing short of sophistry to say that an account of profits may be ordered in respect of the equitable wrong but not in respect of the breach of contract which governs the relationship between the parties.[82]

He continued:

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[79] *Snepp v. United States*, 444 U.S. 507 (U.S.S.C. 1980) [*Snepp*]. *Attorney-General v. Guardian Newspapers Ltd. (No. 2)***,** [1988] H.L.J. No. 42 (QL) [*Guardian*]**.**

[80] *Reading, supra* note 78 at 517. *Snepp, ibid.* at 516. *Guardian, ibid.* at para. 81.

[81] [2000] H.L.J. No. 47 (QL) [*Blake*].

[82] *Ibid.* at para. 32.

> in contract, as well as tort, damages are not always narrowly confined to recoupment of financial loss. In a suitable case damages for breach of contract may be measured by the benefit gained by the wrongdoer from the breach. The defendant must make a reasonable payment in respect of the benefit he has gained.[83]

Lord Nicholls decided that damages, specific performance and injunctions, with the characterization of some contractual obligations as fiduciary, would ordinarily provide an adequate response to a breach of contract.[84] It is only in *exceptional* cases, "where those remedies are inadequate, that any question of accounting for profits will arise. No fixed rules can be prescribed."[85] Even though no fixed rule can be set out, Lord Nicholls states "a useful general guide…is whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit."[86] Lord Nicholls thought that the present situation was one in which the plaintiff had a legitimate interest. The Crown had a legitimate interest in deterring this type of conduct in the future, and a disgorgement of profits would send a strong message that conduct similar to Blake's would not permit a wrongdoer's gain.[87] He noted that Blake's undertaking, if not a fiduciary obligation, was closely akin to such an obligation where an account of profits is a standard remedy in the event of breach.[88] Hence, Lord Nicholls' decision seems to be more concerned with the substance rather than the form of the contractual relationship. He was not deterred from awarding an account of profits simply because there was no fiduciary relationship.

Blake is a ground-breaking decision in England. It awarded a restitutionary account of profits or disgorgement for a breach of contract where there was no concurrent breach of fiduciary duty, nor any proprietary interests at stake. The decision seems to stray from the reasoning in the earlier cases of *Surrey County Council v. Bredero Homes*[89] and *Jag-*

[83] *Ibid*. at para. 28.
[84] *Ibid*. at para. 33.
[85] *Ibid*.
[86] *Ibid*.
[87] *Ibid*. at para. 39.
[88] *Ibid*. at para. 40.
[89] *Supra* note 77.
[90] *Supra* note 77.

gard v. Sawyer,[90] which were concerned with the distinction between awarding damages under the *Lord Cairns' Act*[91] against damages for breach of contract alone. Lord Nicholls did not want to strain existing concepts in order to reach his desired result, which was something he perceived earlier decisions as doing.[92] He created a new general principle, rather than a rule, which allows disgorgement in cases of simple breach of contract in exceptional cases. The plaintiff must have a "legitimate interest in preventing the defendant's profit making activity." How this latter requirement will be interpreted remains to be seen. It is clear, however, that in the English courts disgorgement will no longer be limited to cases involving fiduciary breaches or special proprietary interests of the plaintiff.

Interestingly, the Supreme Court of Canada did not consider *Blake* in *Bank of America*, even though the Court decided to apply restitution principles in a case of breach of contract. Just as the House of Lords sought to avoid the constraints of fitting into the categories of equitable remedies when applying restitution in contract, the Supreme Court of Canada did not want to be constrained by the traditional categories allowing compound interest on judgment awards in equity. In both cases, traditional equitable principles restricted the availability of a remedy at common law. It did not appear open to the Court to use restitution principles in the sense of unjust enrichment from a benefit conferred, as the dispute in issue was brought in an action for breach of contract, not for rescission and restitution. Instead, Major J. presumably relied on the proprietary nature of the debt owed by Mutual Trust to Bank of America in order to introduce disgorgement principles. While he does not explicitly use the term "disgorgement," both the context of *Bank of America* and the absence of any discussion of *Blake* suggest that this was his intended meaning. Such an application of disgorgement principles would be consistent with earlier case law involving proprietary interests in contract cases. The use of disgorgement principles in *Bank of America* was presumably based on an attempt to make the "incremental change" to the common law of allowing compound interest on judgment awards appear less drastic.

In deciding to use restitution along with compensatory principles to award compound interest on judgment awards, the Supreme Court of

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[91] 1858 (U.K.), 21 & 22 Vict., c.27.

[92] *Supra* note 81 at para. 30.

Canada implicitly seemed to realize that it was making another substantial change by making restitution available for a mere breach of contract. Major J. realized that he needed to minimize the availability of restitution in cases of breach of contract. Instead of relying on the principles set out in *Blake,* the Court chose to limit its application to cases involving inefficient breaches.

The Supreme Court of Canada should have restrained itself to using compensatory principles in deciding to award compound judgment interest at common law. Trying to limit the availability of compound interest by limiting restitution to cases of inefficient breach or by using the *Blake* principles were both inappropriate options. As will be discussed below, it is unclear whether the use of disgorgement in cases of breach of contract will be constrained to cases of inefficient breach. By allowing disgorgement in cases of breach of contract where there is an inefficient breach, the Court may have inadvertently transformed contract rights to property rights, as the cost of performance, rather than its value, becomes available to plaintiffs in the event of such a breach.

IV. Efficient Breach as a Limit to Restitution in Contract

Instead of relying upon the general principle in *Blake* as a method to limit restitution in contract to exceptional cases, the Supreme Court of Canada chose to limit the use of restitution in contract with the doctrine of efficient breach. Major J. held in *Bank of America* that restitution should only be available in cases where there is no efficient breach, as "efficient breach should not be discouraged by the Courts."[93] The Court describes efficient breach as a Pareto optimal situation where one party is better off, and no party is worse off.[94] In such a situation, Major J. ruled that a court should "usually award money damages for breach of contract equal to the value of the bargain to the plaintiff."[95] In brief, expectation damages for breach of contract support the theory of allow-

[93] *Bank of America, supra* note 1 at para. 31.

[94] *Bank of America, supra* note 1 at para. 31

[95] *Bank of America, supra* note 1 at para. 31

ing efficient breaches. This was recognized by R.A. Posner in *Economic Analysis of Law*.[96]

Posner writes that expectation damages are value maximizing: if the profits gained from a breach of contract would exceed the profits expected to be made by the other party from the completion of the contract, and if damages are limited to the expectation measure, then there is an incentive for the breach to occur (assuming that the breaching party would stand to make less of a profit had the contract been performed to completion). The party in default would likely be sued for breach of contract, and would be liable to pay the plaintiff the expected value or profit to be made from the full completion of the contract. The result is that the plaintiff would receive the expected value of the bargain, and the defendant would be able to profit from escaping its obligations under the contract. Posner reasons that since neither party is worse off, and one is better off, then the breach coupled with expectation damages is value maximizing.[97] Had the defendant been forced to complete the performance of the contract, the plaintiff would be in the same situation, but the defendant would be in a worse situation. Thus, expectation damages are more efficient.

Several commentators have criticized the theory of efficient breach.[98] They argue that efficient breach ignores transaction costs, relational costs and externalities.[99] It has been argued further that it is impossible to determine whether a breach will be more efficient under an expectation rule as opposed to a rule supporting specific performance, because transaction costs are unique in every situation.[100]

The critics argue in favour of a rule that prefers specific performance[101] over expectation damages, because the bargaining fostered by

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[96] 2d ed. (Boston: Little, Brown, 1977).

[97] *Ibid*.

[98] I.R. Macneil, "Efficient Breach of Contract: Circles in the Sky" (1982) 68 Va. L. Rev. 947 at 950 [*Macneil*]. Lionel D. Smith, "Disgorgement of the Profits of Breach of Contract: Property, Contract and 'Efficient Breach'" (1994) 24 Can. Bus. L.J. 121 [*Smith*]. Daniel Friedmann, "The Efficient Breach Fallacy" (1989) 18 Journal of Legal Studies 1 [*Friedmann*]. Joseph M. Perillo, "Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference" (2000) 68 Fordham L. Rev. 1085 [*Perillo*].

[99] *Macneil*, *ibid*. at 957-958. Relational costs include loss of reputation from the breach and loss of future opportunies to deal.

[100] *Ibid*. at 952.

[101] *Ibid*. at 960.

such a rule "seems ideally designed to prevent omission from the decisional calculus of the costs of either party."[102] They argue further that condoning efficient breaches may lead to an unwillingness to rely upon suppliers.[103] They contend that the law wants to discourage breaches, efficient or otherwise.[104] This is evidenced by the tort of interference with contract,[105] which shows that the law does not want to encourage wilful efficient breaches of contract.[106] The common thread among critics of efficient breach is their preference of specific performance[107] and disgorgement of profits[108] instead of expectation damages for breach of contract. These preferences lead the critics to the view that contract rights should have the same status as property rights.[109]

The critics of efficient breach go too far in asserting this position. The objective of expectation damages is to compensate the plaintiff, not to punish the defendant by disgorging his or her profits.[110] To allow a remedy of specific performance or disgorgement of profits for every contract could amount to extortion against the party who breaches. One would have to negotiate in every case where one wishes to be relieved from the obligations of a contract. A reasonable non-breaching party will only accept a settlement amount close to, or at, the value of the cost of the expected performance.

It is incorrect to state that there is no difference between property rights and contractual ones as suggested by the authors above. Contractual rights exist in *personam,*[111] whereas property rights exist in *rem*. Property rights face exposure to damage or conversion by anyone and everyone, whereas the integrity of contract rights face a lower risk and

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[102] *Ibid*.

[103] *Friedmann*, *supra* note 98 at 7.

[104] *Perillo, supra* note 98 at 1092.

[105] *Friedmann, supra* note 98 at 20. *Perillo, supra* note 98 at 1100. The tort of interference with contract is inconsistent with the theory of efficient breach, as it is incongruent to allow one party to breach with relative impunity (other than paying expectation damages), while another party who procured the breach may be liable for the tort of interfering with the contract.

[106] *Perillo, ibid*.

[107] *Macneil*, *supra* note 98 at 960. *Perillo*, *supra* note 98 at 1105-1106.

[108] *Smith*, *supra* note 98 at 123.

[109] *Macneil, supra* note 98 at 960. *Smith*, *supra* note 98 at 115. *Perillo*, *supra* note 98 at 1105-1106.

[110] *Tito, supra* note 76.

[111] Except in the tort of interfering with a contract.

generally this risk is confined to the acts or omissions of another party to the contract. One is in a better situation to assess the risks of a contract upon formation as one can learn about the other party's credit history, for example. No degree of preparation can protect against all the risks posed by acquiring property as against the world at large. Since property rights face more risk, it is justifiable to allow a stronger remedy when they are breached. Since the risk can be calculable in cases of contract, it is reasonable to have a weaker remedy in most instances.

Additionally, if expectation damages were not the ordinary rule and specific performance or disgorgement of profits were available for all breaches, then one would naturally be more reluctant to enter contracts. More time and money would be invested into ensuring that one is entering a profitable bargain. This in itself is inefficient. On the other hand, if one restricts ordinary breaches of contract to expectation damages generally, then there is commercial certainty and no one will ever be any worse off. Parties will be more willing to enter contracts if they *know* that they will ordinarily be limited to paying for the value of the performance on the event of a breach, as opposed to its cost.

The belief that contract rights should attract the same legal protection as property rights leads to opposition to any theory which supports finding a distinction between such rights. Efficient breach clearly embraces such a distinction, as it relies upon the availability of expectation damages for breach of contract. As noted above, there is a clear distinction between contract rights and property rights, and the same protection should not be offered to both. Expectation damages are necessary to promote the willingness to enter contracts and they are fair in that they fully compensate the plaintiff without punishing the defendant. Further, expectation damages have the incidental effect of deterring some breaches; contractual parties will want to avoid tarnishing their goodwill, for example.

Efficient breach recognizes the difference between contractual rights and property rights and the Supreme Court of Canada was correct in recognizing this difference. In doing so, Major J. chose to limit the availability of restitution in contract to cases involving non-efficient breaches. He chose to adopt restitution principles to expand the availability of compound interest, but he realized that this would have the unfortunate result of elevating contractual rights to the status of property rights. Hence, it was necessary for him to backtrack and endorse efficient breach effectively to negate the impact of allowing restitution in contract. However, this distinction was already inherent in the common law which generally supports expectation damages for breach of contract. The need specifically to endorse efficient breach could have been avoided had the Supreme Court restricted its analysis to compensatory principles.

V. Future Implications of *Bank of America*

While it was necessary to place a check on the availability of restitution in contract, the application of restitution principles in *Bank of America* was unnecessary in the first place. Mitchell McInnes points out that the award of compound interest could have stood on compensatory principles alone in *Bank of America*.[112]

Considering the plaintiff was owed a sum of money by the defendant, the award needed to reflect the time value of money to comprise adequate compensation. This could only be achieved through compound interest. Instead of simply extending the common law to allow compound interest on compensatory principles, the Court chose to apply restitution principles. To limit the availability of restitution, the Supreme Court indicated that restitution should not be available where a breach is efficient. Major J. held that since the breach in the case at hand was a zero sum optimal (inefficient), as opposed to a Pareto optimal, then restitution could be awarded as there was no efficient breach. McInnes points out that if restitution is limited to cases involving inefficient breach, then its use is redundant.[113] Where there is no efficient breach, a plaintiff's loss is capable of supporting the same relief on compensatory principles alone.[114] It is only where a defendant's gain exceeds the plaintiff's loss (an efficient breach) that disgorgement makes any difference, as compensation alone would allow the defendant to retain his profit. McInnes therefore concludes "the restitution principle appears limited to cases in

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[112] Mitchell McInnes, "Restitutionary Damages for Breach of Contract: *Bank of America Canada v. Mutual Trust Co*." (2002) Can. Bus. L.J. 125 [*McInnes*].

[113] *Ibid*. at 132.

[114] *Ibid*.

which it is unnecessary. It can only catch those wrongful gains that are mirrored by compensable losses."[115]

While McInnes is correct in stating that the Court has effectively limited the applicability of restitution to cases where it is redundant, this appears to have been Major J.'s intent. He wanted to implement restitution principles merely as a vehicle to change the common law incrementally to allow compound interest. He did not want to make restitution available in contract generally – thus, he chose to limit its effect by confining its employment to cases of non-efficient breach. As noted above, the redundancy of restitution in these circumstances supports the position that Major J. introduced restitution principles for the sole reason of facilitating his incremental change to the common law.

McInnes feels that it is unfortunate that Major J. restricts the application of disgorgement principles to cases involving inefficient breaches, and he would have preferred that disgorgement be available to breaches of contract generally where the defendant is guilty of some wrongdoing.[116] But McInnes' desire supports the view that contract rights should have the same status as property rights. Further, McInnes' position ignores the purpose of expectation damages in contract, which is compensation, rather than punishment.[117] To punish a wrongdoer for breaching a contract and thereby making a profit is a remedy best suited to the public law or criminal law setting, not to private law claims; it is a societal, not a private, objective.

Unfortunately, there is evidence in *Bank of America* which might be relied upon in future cases to extend restitution in contract beyond cases of inefficient breach. If one considers closely the facts in *Bank of*

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[115] *Ibid*.

[116] *Ibid*. at 132.

[117] McInnes notes *City of New Orleans v. Firemen's Charitable Assoc*. (1891), 9 So. 486 (S.C. La.) as an example. McInnes thinks that disgorgement would have been appropriate to punish the fire protection company that did not acquire firefighting equipment needed to protect its client, even though during the term of the contract no damages were suffered by the client. The author submits that had a fire occurred, the client would have suffered damages and would have been entitled to the value of the contract, namely the value of the fire protection. Since no damages occurred, there was no need to compensate the client. In effect, the fire protection company took a risk and decided to act as an insurer. While such conduct may have amounted to a wrongdoing, is was not a civil wrongdoing; rather, it is was a criminal wrongdoing. If anything, the acts of the fire protection company may have amounted to a fraud. Disgorgement principles should not be used as a means to deal with criminal conduct.

America, it becomes apparent that the Supreme Court in effect awarded restitution in a case of efficient breach. Mutual Trust may have relied on the state of the law as it stood prior to *Bank of America* in making its decision to breach the TOC and the ATOC. Mutual Trust may have reasoned that if it breached the TOC or the ATOC, then under the existing state of the law only simple interest would have been available on a judgment award given to Bank of America. At the same time, Mutual Trust could have planned on investing the money that it owed to Bank of America at compound rates. Mutual Trust would profit by breaching, as it would pay simple interest on any judgement award to Bank of America, while earning compound interest itself.[118] The Supreme Court actually presumed that Mutual Trust engaged in this exact scheme.[119] Since Justice Major's decision effectively does exactly what it holds is impermissible (i.e. awards restitution in a case of efficient breach), then his decision might be interpreted by subsequent cases as merely setting forth a general discretionary principle. This is further supported by Major J.'s statement that "efficient breach *should* not be discouraged by the Courts."[120] He did not state that it *must* not be discouraged.

Apart from the ambiguity as to whether restitution could ever be awarded in cases of efficient breach, the Court is also unclear as to what meaning it ascribes to the term "restitution." Looking at the language used, it could be argued that the Court was referring to restitution in the unjust enrichment sense. However, considering its actions, it appears that a disgorgement of profits was taking place. In support of finding that the Court was referring to unjust enrichment, it is noteworthy that it did not address the need for Bank of America to mitigate its loss. Since mitigation is not a requirement in a claim for unjust enrichment,[121] this would seem to suggest that the Court was not referring to disgorgement. Further, the Court cites Waddams' *The Law of Damages*[122] when it explains the availability of restitution in contract.[123] The passage referred

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[118] Major J. seemed to have recognized this problem. *Bank of America*. *supra* note 1 at para. 46.

[119] *Bank of America*. *supra* note 1 at para. 59.

[120] *Bank of America*. *supra* note 1 at para. 31.

[121] G.H. Fridman & J.G. McLeod, *Restitution* 2nd ed. (Toronto: Carswell, 1992) at 211.

[122] *Supra* note 45.

[123] *Bank of America*. *supra* note 1 at para. 30.

to examines cases where an action was brought to recover benefits conferred by the plaintiff, not to cases of disgorgement.

As has been stressed throughout this article, however, there is ample evidence indicating that the Court was referring to disgorgement when it used the term “restitution.” It is important to recall that Bank of America had a proprietary interest at stake in the case, and violations of proprietary interests have given rise to disgorgement of profits in the past. Perhaps most importantly, Bank of America’s claim was for damages for breach of contract. This was determinative for McInnes, and led him to conclude that the Court was referring to disgorgement.[124] Finally, since the award of compound interest essentially deprived Mutual Trust of any compound interest it may have gained from a third party, and the compound interest was not a benefit conferred by Bank of America, it is suggested that the Court was referring to disgorgement of profits. Although the balance is tipped in concluding the Supreme Court was referring to disgorgement, the equivocal nature of its decision leaves open the possibility for future decisions to interpret *Bank of America* as referring to unjust enrichment.

In addition to the ambiguity over which sense of the term “restitution” was used by the Court, it is unclear how restricted the application of compound interest is meant to be in future cases. At first glance, it may appear that the Court is restricting the application of compound interest to situations which are factually similar to those in *Bank of America*; that is, where the parties are both commercial lenders and are familiar with the operation of compound interest schemes. This was a significant factor in Major J.’s analysis. Major J. relied on the foreseeability principle set out in *Hadley v. Baxendale*[125] for limiting the application of compound interest to cases where the parties contemplated at the outset of their relationship that compound interest would govern their transactions.[126] In this regard, Major J. stated:

> With respect to the failure to repay the loan in this appeal when due, it cannot be said that the cost of such delay was not in the contemplation of both parties at the time they made the contract, particularly as both parties were in the business of lending. … Absent

[124] *McInnes, supra* note 112 at 130.
[125] (1854), 9 Exch. 341 (Ex. Ct.).
[126] *Bank of America, supra* note 1 at para. 47.

> exceptional circumstances, the interest rate which had governed the loan prior to breach would be the appropriate rate to govern the post-breach loan.[127]

Despite the apparent limiting effect of the passage above, Major J. later stated:

> an award of compound pre- and post-judgment interest will *generally* be limited to breach of contract cases where there is evidence that the parties agreed, knew, or should have known, that the money which is the subject of the dispute would bear compound interest as damages. *It may by awarded as consequential damages in other cases but there would be the usual requirement of proving that damage component*.[128] [Emphasis added].

It is therefore clear that the Court is not necessarily restricting the awarding of compound interest to cases where the test in *Hadley* is met. Compound interest may be available where a plaintiff suffers consequential losses in mitigating his or her damages. At the very least, it appears that that compound interest could be awarded as consequential damages.

Bank of America has subsequently been followed in provinces other than Ontario. British Columbia lacks provisions similar to Ontario's s.128 and s.129 of the *Courts of Justice Act*. Notwithstanding that fact, its Supreme Court initially embraced *Bank of America*.[129] Only a month later, however, the British Columbia Supreme Court held *Bank of America* did not apply in British Columbia, as "there are no sections in the British Columbia statute which are comparable to ss. 128 and 129 of the Ontario statute."[130] Although *Pacific Playground Holdings* was a case dealing with sophisticated commercial parties, it does suggest a willingness to apply the *Bank of America* decision broadly. Still, there is obviously disagreement in British Columbia as to whether *Bank of America* applies to its legislation.

Fortunately, the cases to date referring to *Bank of America* have focussed on the compensatory portion of the Supreme Court's analysis.

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[127] *Bank of America*. *supra* note 1 at para. 49.

[128] *Bank of America*. *supra* note 1 at para. 55.

[129] *Pacific Playground Holdings v. Endeavour Developments* 2002 CarswellBC 2727 at para. 35 (B.C. S.C.) [*Pacific Playground Holdings*].

[130] *Hallam v. Shen*, [2002] B.C.J. No. 2871 at paras. 24, 25 (S.C.) (QL).

The Alberta Court of Appeal in *Alberta (Minister of Infrastructure) v. Nilsson*[131] viewed *Bank of America*

> as abrogating the narrow interpretation compound interest is available under the common law. …*Bank of America* mandates a common law availability where compound interest is necessary to compensate accurately for the proven damages.[132]

As McInnes suggested, *Bank of America* could have been decided on compensatory principles alone. This would have resulted in a fairer application of awarding compound interest.

The purpose of awarding judgment interest is to compensate plaintiffs rather than to punish defendants: the plaintiff is to receive the time value of money that is rightly due to him or her under a judgment award. The Supreme Court acceded to this point in the course of its judgment.[133] In not applying mitigation principles, however, the Supreme Court may have overcompensated the plaintiff and punished the defendant. In *Bank of America,* the cause of action was breach of contract. Therefore, mitigation principles should have applied. Suppose Bank of America had mitigated its loss by borrowing money from another party. It could then have lent that money to a third party for the same rate of compound interest set out in the ATOC and the TOC. It would have saved itself from losing any compound interest on the principal amount, except for the intervening time that it took to secure a loan, and except for the interest that it would have owed to the creditor. Mutual Trust should then only have been held liable to repay the interest paid to the creditor, and for the interest lost during the intervening period. Perhaps this overly complicated scenario was something which the Supreme Court wished to avoid, and it introduced restitution principles in the hopes that mitigation principles would no longer apply. But, as was stated above, it is unclear to which sense of the term "restitution" the Supreme Court referred.

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[131] [2002] A.J. No. 1474 (QL).

[132] *Ibid*. at para. 185.

[133] *Bank of America, supra* note 1 at para. 36.

VI. Conclusion

The effects of the *Bank of America* decision are as far reaching as they are equivocal. Due to the uncertain effects that this judgment will have, the majority of the House of Lords appears to have been correct in *Westdeutsche* when it was stated that extending the availability of compound interest on judgment awards is a matter that is best left to the legislature. Awarding compound interest does serve better to compensate a plaintiff. The unforeseen difficulties that may arise from *Bank of America*, however, suggest that law reform studies should have been undertaken prior to making such a drastic change.

However, since the Supreme Court did not think it appropriate to wait for legislative intervention, it could have at the very least restricted its analysis to compensatory principles and avoided the use of restitution principles in contract. By so doing, it could have achieved the same result, but without the confusion that results from its ambiguous use of the term "restitution."