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Rethinking Section 142 of the Restatement of Restitution: Fault, Bad Faith, and Change of Position

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Rethinking Section 142 of the Restatement of Restitution: Fault, Bad Faith, and Change of Position

John D. McCamus*

Abstract

As a general rule, benefits transferred by mistake, such as moneys paid when mistakenly thought due, are recoverable in a restitution claim. Section 142 of the First Restatement of Restitution creates a defense to such claims to the extent that the payee, in reliance on the receipt, engages in a detrimental change of position, thereby making it inequitable to require repayment. The defense is unavailable, however, where the conduct of the payee in initially inducing the payment or in subsequent retention or dealings with the payment was either tortious or more at fault than the payer or, further, in the context of subsequent dealings, was undertaken by the payee with knowledge of the circumstances entitling the payer to recovery. Under the Section 142 scheme, then, if payer's conduct lacks fault, payee fault disqualifies the defense. Where both payer and payee were at fault, the payee's ability to raise the defense rests on establishing that the payee's conduct was not tortious and was no more at fault than that of the payer. This "balancing test" aspect of Section 142 has proven to be particularly controversial. Harsh criticism of the test by John P. Dawson has been influential abroad. After examining rationales underlying the basic recovery rule and the change of position defense, this Article provides an analysis of the various threads of Section 142 and concludes that they are essentially sound. In particular, Dawson's critique of the balancing test is rejected as unpersuasive. The Article further suggests, however, that the Section 142 disqualification rule is both over- and under-inclusive in certain respects and proposes reforms designed to achieve a more satisfactory reconciliation of payer and payee interests. The Article also considers whether payee crime should disqualify the payee from raising the defense and argues that an absolute bar is unwarranted.

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I. Introduction

Section 142 of the *Restatement of Restitution* articulates a set of rules establishing the restitutionary defense of change of position.¹ In so doing, it has made an important contribution to the clarification and simplification of the analysis of restitutionary claims, in particular, claims pertaining to the recovery of benefits transferred by error. The paradigm case in this category of restitutionary claims is the recovery of moneys paid by the plaintiff to the defendant under a mistake. Consistent with the prior common law, the *First Restatement* articulates a series of rules supporting recovery of moneys paid on the basis of a series of different types of mistakes.² Thus, where, for example, the payer has mistaken the identity of the payee, recovery of the moneys paid is allowed.³ The *First Restatement* then sets out in Section 69 a defense to such claims of "Change of Circumstances."⁴ The defense is essentially repeated in

1. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

2. *Id.* §§ 15–28, 44–55.

3. *See id.* § 22 (stating that when one mistakenly pays an individual money believing that the individual is someone else, he or she is entitled to restitution from the individual that he or she mistakenly paid).

4. *Id.* § 69.

Section 142 of Chapter 8, the chapter of the *First Restatement* that sets forth the restitutionary defenses. By way of illustration, if the recipient of the mistaken payment reasonably believes that the payment was due and undertakes an unusual expenditure in reliance on the receipt—let us say, a spur of the moment vacation at an expensive resort—that would otherwise not have been made, the defense of Change of Circumstances or, as it is commonly called, "Change of Position," would be presumptively available to the payee as a complete or partial defense to the payer's claim for recovery. This change of circumstances defense is set forth in generalized language in Section 142 of the *First Restatement* in the following terms: "The right of a person to restitution from another because of a benefit received is terminated or diminished if, after the receipt of the benefit, circumstances have so changed that it would be inequitable to require the other to make full restitution."⁵

The following commentary further explains that this rule is an application of a more general principle that "restitution is granted only where it is equitable so to do"⁶ and indicates that such a defense might be available where the benefits transferred to the recipient have been "lost, transferred, stolen or destroyed without benefit"⁷ to the recipient. It is widely accepted that the recognition of the change of position defense represents an important contribution to the rationalization of restitutionary doctrine.⁸

In addition to its articulation of the general defense, Section 142 sets forth further rules—and here we enter into more controversial territory—establishing the relevance of fault on the part of the recipient. Subsection 2 of Section 142 permits the recipient to raise the defense only if "the conduct of the recipient was not tortious and he was no more at fault for his receipt, retention or dealing with the subject matter than was the claimant."⁹ This provision thus famously creates what is often referred to as a "balancing test," which requires the court to compare the relative fault of the payer and the payee and permit the defense only if the payee was "no more at fault" than the payer.¹⁰ Subsection 3 then precludes the recipient or payee altogether from relying on the defense if either the "conduct of the recipient in obtaining, retaining or dealing with the subject

5. *Id.* § 142.

6. *Id.* § 142 cmt. a.

7. *Id.* § 142 cmt. b.

8. See, e.g., PETER BIRKS, *UNJUST ENRICHMENT* 207 (2d ed. 2005) (stating that after the "liberalization of the grounds for restitution," restitution defenses like change of position are necessary to "fine-tun[e]" the "right to restitution").

9. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

10. *Id.*

matter was tortious"¹¹ or in circumstances where the change in circumstances occurred only "after the recipient had knowledge of the facts entitling the other to restitution and had an opportunity to make restitution."¹² A consideration of whether Section 142 adopts a sound treatment of the relevance of fault on the part of the recipient in making the change of circumstances defense available is the primary focus of this Article.

Consideration of the soundness of Section 142 of the *First Restatement* is timely for a number of reasons. First, and most importantly, the work on the *Restatement of Restitution and Unjust Enrichment Third* ("R3RUE") is proceeding apace, and the Reporter will soon turn to the task of restating the rules pertaining to restitutionary defenses. Second, the provisions of Section 142, and in particular, the provisions in Subsections 2 and 3, have proven to be controversial both in the United States and abroad. Two issues may be considered. First, it has been questioned whether a general rule precluding reliance on the defense where the recipient is at fault is satisfactory. Indeed, English jurisprudence has recently come to the rather startling conclusion that the fault standard adopted in Section 142 as a basis for precluding the defense ought to be rejected in favor of a general principle that recipient is entitled to raise the defense of change of circumstances as long as it can be considered that the recipient has acted in "good faith."¹³ It will be suggested here that the English replacement of the fault standard by a good faith standard is an unattractive development. The second controversial issue relates to the balancing test set out in subsection 2. In a well known 1981 law review article, the influential American restitution scholar, John P. Dawson, offered a brief but forceful criticism of the treatment of recipient fault in Section 142.¹⁴ Noting that the *First Restatement* proposed a test of comparative fault, precluding the defense where the conduct of the recipient was either "tortious" or "more at fault . . . than . . . the claimant,"¹⁵ Dawson observed, "[t]he introduction of these complex themes would have been, I believe, a real disservice. Fortunately they have been disregarded in court decisions."¹⁶

11. *Id.*

12. *Id.*

13. See *Dextra Bank & Trust Co. v. Bank of Jam.*, [2001] UKPC 50, 1 All E.R. (Comm.) 193 at [42] (appeal taken from Jam.) (U.K.) (stating that a good faith standard should be used to determine the parties' liability). For an account of the development of this doctrine in English law, see John D. McCamus, *Wrongful Conduct and Change of Position*, in UNJUST ENRICHMENT IN COMMERCIAL LAW 385 (Simone Degeling & James Edelman eds., 2008).

14. See generally John P. Dawson, *Restitution Without Enrichment*, 61 B.U. L. REV. 563 (1981).

15. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

16. Dawson, *supra* note 14, at 571.

Dawson's criticism of the Section 142 scheme will be considered here at some length and it will be suggested, somewhat tendentiously, that it is ill-considered. Dawson's swipe at Section 142 has, however, been of considerable influence abroad. Peter Birks, a leading English restitution scholar, simply adopted Dawson's critique of the balancing test as a basis for rejecting its suitability for English law.¹⁷ Further, English jurisprudence has recently rejected the balancing approach, placing reliance on the article by Birks.¹⁸ It will be argued here that the rejection of the balancing test favored by Dawson and Birks and accepted in recent English jurisprudence is misconceived.

This Article proceeds by first examining the basic mistaken payments rule, its underlying rationale, its essential difference from contractual mistake doctrine, the relevance of payer fault to the right to recover, and the role of the modern change of position defense. We then turn to an extended treatment of the Section 142 scheme, largely in its defense. The Dawson critique of Section 142 is then considered and rejected. Finally, we turn to consider the relevance of criminal misconduct by the payee. Throughout and for purposes of simplification and clarity of the analysis, the focus of discussion will be on the problem of the mistaken payment and the rights of the payer and payee rather than more general issues concerning mistaken transfers of other types of assets such as goods or mistaken improvements to land.

II. *The General Rule and the Role of the Defense*

The general rule favoring recovery of mistaken payments is well established in American jurisprudence.¹⁹ The soundness of a general principle awarding recovery is so broadly accepted that neither judges nor academic observers appear to feel obliged to articulate a rationale for the rule. Similarly,

17. See Peter Birks, *Change of Position and Surviving Enrichment*, in *THE LIMITS OF RESTITUTIONARY CLAIMS: A COMPARATIVE ANALYSIS* 36, 41 (William Swadling ed., 1997) (citing Dawson to support the conclusion that a balancing of relative fault should be "firmly rejected").

18. See *Dextra Bank*, [2001] UKPC 50 at [45] ("Their Lordships find themselves to be in agreement with Professor Peter Birks who . . . rejected the adoption of the criterion of relative fault in forthright language."). The court did not refer, however, to the valuable defense of the balancing test, on efficiency grounds, provided by J. Beatson & W. Bishop, *Mistaken Payments in the Law of Restitution*, 36 U. TORONTO L.J. 149, 157-58 (1986). The article is reprinted in J. BEATSON, *THE USE AND ABUSE OF UNJUST ENRICHMENT: ESSAYS ON THE LAW OF RESTITUTION* 137 (1991).

19. See generally WILLIAM A. KEENER, *A TREATISE ON THE LAW OF QUASI-CONTRACTS* (1893) (providing an account of the early American jurisprudence related to recovery of mistaken payments).

the *First Restatement* does not articulate a rationale for the rule beyond the implicit suggestion that recovery is awarded in order to avoid the unjust enrichment of the recipient of the payment.²⁰ Nonetheless, in the present context, it will be useful to attempt to measure the force of the underlying rationale for recovery.

A number of possible rationales have been suggested in the literature. One of the rationales appears to be related to the rationales for the recognition of property interests.²¹ Although identification of the underlying rationale of the institution of private property is a subject not lacking in controversy, it may be acceptable for present purposes to suggest that the philosophical defense of private property is usually considered to rest on a proposition to the effect that "it rewards labour and in the process promotes autonomy, virtue and efficiency."²² A legal system that recognizes the ownership of private property arguably encourages individuals to expend their labor, practice thrift and exercise personal autonomy by enjoying the fruits of their labors. Turning then to the question of the recovery of mistaken payments or, indeed, other assets transferred by mistake, it may be argued that the rule permitting recovery of such accidental losses of wealth may be considered to serve the same broad range of interests. Just as the law recognizes the creation and enforcement of property interests in assets for various reasons, so too the law abhors and remedies the accidental loss of wealth. "Losers' weepers, finders' keepers" probably never had much appeal in the schoolyard. The virtues promoted by the recognition of the property interests might be considered to be undermined by rules which permitted or facilitated accidental loss of wealth.

Further, one might defend the general rule favoring recovery on the alternate ground that it promotes personal autonomy by correcting *involuntary* transfers.²³ As Dagan explains, "a mistaken transfer is not the result of an autonomous decision of the actor, but rather subverts her control over her resources."²⁴ This argument rests on an assumption that mistaken payments are properly characterized as "involuntary."²⁵ Not all observers would agree with

20. See RESTATEMENT (FIRST) OF RESTITUTION § 29 (1937) (offering no explanation for the general rule that a party who mistakenly makes a payment is entitled to restitution).

21. See Beatson & Bishop, *supra* note 18, at 151 (explaining how a rationale for requiring restitution in mistaken payment situations "arises from consideration of the economics of property rights").

22. CRAIG ROTHERHAM, PROPRIETARY REMEDIES IN CONTEXT: A STUDY IN THE JUDICIAL REDISTRIBUTION OF PROPERTY RIGHTS 220 (2002).

23. For an account and assessment of this argument, see HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 40–52 (2004).

24. *Id.* at 42.

25. See, e.g., PETER BIRKS, AN INTRODUCTION TO THE LAW OF RESTITUTION 147 (1985)

this characterization. As will be seen below, it is well established that a payer's negligence is irrelevant to the payer's entitlement to recovery. The description of a careless payer's conduct as "involuntary" may meet resistance. Careless driving is not involuntary driving. Nonetheless, the basic point that denying recovery of accidental or unintended transfers of wealth may undermine the payer's personal autonomy carries some force.

A third possible rationale rests on efficiency grounds. A rule denying recovery, if internalized and acted upon by individuals about to make the payments, might result in undesirably expensive attempts to ensure that the proposed payments are not erroneous. Excessive checking is inefficient and would be discouraged by a rule permitting recovery.²⁶ This rationale can also be linked to autonomy concerns on the ground that releasing the payer from excessive checking enhances the payer's freedom of action.²⁷ In short, a number of more or less appealing reasons can be articulated for the well-recognized general rule that, in the absence of considerations gainsaying relief, recovery should be awarded.

It will be useful to note in passing that the strength of the claim for recovery in the context of the paradigm case of recovery of a mistaken payment is quite different from the claim for relief that might be asserted by one who has made a payment discharging an obligation under an agreement which, it is argued, has been entered into on the basis of error. In a simple mistaken payment case, the recipient has not received the payment on the understanding that the payment is being made under what appears to be a valid contractual arrangement between the parties. Where a payment is made under an agreement affected by error, recovery will be permitted only where the contractual relationship is one which, because of the error infecting its formation, is an agreement that ought not to be enforced. In a mistaken contracts case, the threshold question must be whether such a mistake should lead to the unenforceability of the agreement on which the payment was made. In evaluating Professor Dawson's critique of Section 142 of the *First Restatement*, it is useful to note that in making that determination, it is well understood that one must determine whether the risk of the error in question is one that ought to be considered to have been assumed by the mistaken party. If

(characterizing mistaken payments as involuntary and arguing, further, that one who acts based on a prediction cannot say that he was mistaken or acting involuntarily when the predicted event does not occur).

26. See generally Beatson & Bishop, *supra* note 18.

27. See DAGAN, *supra* note 23, at 43 (arguing that restitution encourages individuals to engage in transactions with one another because they know that if a mistake is made, the money mistakenly given over is not lost).

this is so, the contract remains enforceable and the payment made in performance thereof is irrecoverable.²⁸ By way of illustration, an individual who purchases an annuity contract from an insurer in favor of a third party cannot set aside the agreement when it is discovered, contrary to the expectation of both the payer and insurer, that the third party is afflicted with an incurable fatal disease. The contract cannot be set aside and the payment is irrecoverable.²⁹ No similar problem arises in the context of a simple mistaken payment case. There is no contractual arrangement between the payer and the payee under which it might conceivably be determined that the risk of the error that troubles the payer may be one with respect to which the payer has assumed the risk of being mistaken. In other words, in a simple mistaken payment case, the right to recovery is uncomplicated by the need to consider the contractual expectations of the payee.

Returning to the context of a simple mistaken payment case, then, it is easily seen why, under traditional law, the carelessness or, indeed, negligence of the payer has been considered irrelevant to the payer's entitlement to recovery. To take the simple case where the payee has not in any sense detrimentally relied on the receipt of the payment—we may imagine that the payment sits quietly in the payee's savings account—the force of the plaintiff's argument for recovery appears undiminished by the carelessness of the payment. In such a case, the requirement placed upon the payee to return the payment does not appear to significantly prejudice the interests of the payee. To be sure, the payee may have assumed that an increase in disposable wealth had occurred and may have engaged in the pleasant exercise of planning how to utilize this perhaps unexpected resource. Such psychological interests of the payee, however, do not weigh heavily in the balance against the payer's strong interest in return of the payment. The rationales favoring relief generally also support recovery of carelessly mistaken payments. Accordingly, it is not surprising that a general rule allowing recovery is well accepted and that, as well, the earliest authorities also accept that the carelessness of the payer in making the payment is generally considered irrelevant.³⁰ In such

28. See RESTATEMENT (SECOND) OF CONTRACTS § 154 (1981) ("A party bears the risk of a mistake when . . . the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.").

29. *Id.* § 154 illus. 3.

30. See, e.g., *Appleton Bank v. McGilvray*, 70 Mass. 518, 522 (1855) ("It is no answer to the plaintiffs' claim, that the mistake arose from the negligence of the plaintiffs."); *Kelly v. Solari*, (1841) 152 Eng. Rep. 24, 25 (finding that the plaintiff's negligence did not prevent him from recovering money mistakenly paid to defendant).

circumstances, the payer's carelessness has essentially imposed no injury upon the payee.

It is otherwise, however, where the receipt of the payment has induced the payee to engage in acts of detrimental reliance. Let us assume, for example, that the defendant has engaged in expenditures that have produced no enduring value and that would not otherwise have been incurred but for the receipt of the mistaken payment. In such a case, the awarding of recovery palpably visits an injury upon the payee. The payee's legitimate interest in such circumstances may be characterized as the payee's interest in the security of the receipt or as the payee's interest in not being harmed by the mistaken payment. Both English and American law reacted to the obvious interest of the payee in such circumstances in various ways. One approach was to restrict recovery to certain defined types of error rather than to recognize a broad right of recovery. Thus, in American law, at least until the publication of the *First Restatement*, and in English law until quite recently, it was accepted that recovery should be permitted only in circumstances where the mistake made by the payee concerned a fact which, if true, would make the payee *liable* to make the payment to the payer.³¹ Restricting recovery in this way offers at least an indirect means of protecting the payee's interest in the security of the receipt. The explanation for the development of this limitation on relief is not easily yielded by the historical record. It may be that the doctrine was developed on the basis of a judicial instinct that in the absence of such a requirement, recovery would be granted too easily. It may be that the relationship between the parties appeared, in such circumstances, to be more contractual in nature and therefore suitable for "quasi-contractual" relief. In any event, the obvious consequence of such a rule is that recovery of moneys mistakenly paid as a gift would be irrecoverable, and both English and American law appear to have accepted this view.

A more direct response to the payee's interest in security of the receipt began to emerge in 19th century American law. Thus, Keener reports: "If, however, where the mistake was due to the plaintiff's negligence [and] the defendant would suffer a loss if a recovery were allowed, it seems clear that negligence should operate as a bar to a recovery."³² Although this approach has

31. See KEENER, *supra* note 19, at 27 ("Since the payment was unnecessary, the plaintiff must be regarded . . . as attempting to shift his position from that of a defendant to that of a plaintiff,—a course . . . which is not allowed in any case where the law deems the payment a voluntary one."); PETER D. MADDAUGH & JOHN D. MCCAMUS, *THE LAW OF RESTITUTION* 283–90 (2d ed. 2004) (describing the history in English law of the requirement that a mistake be of a nature which makes the payee liable to the payer in order for the payer to recover a mistaken payment).

32. KEENER, *supra* note 19, at 71.

the virtue of directness, this response to the problem is plainly unsatisfactory as a result of its under-inclusiveness. That is to say, treating plaintiff's negligence as a bar to recovery in circumstances where, as Keener phrased it, the payee "cannot be put in *statu quo*,"³³ offers recognition of the payee's interest in security of the payment only where the plaintiff has engaged in a negligent act. The intensity of the payee's interest in security of the payment, however, is quite unrelated to the carelessness of the plaintiff's conduct. Thus, a strong argument can be made to the effect that the payee's interest in security of receipt should prevail over the payer's interest in recovery even in a case where the payer has not acted negligently or carelessly in some sense. This, of course, is the principle implemented in the change of position defense. The payee's acts of detrimental reliance create a defense to the extent that subsequent events have made it inequitable to require the payee to restore the mistaken payment. Recognition of the defense, then, and its ultimate expression in the *First Restatement*,³⁴ thus established a comprehensive scheme for protecting the payee's interest in security of the payment that was not contingent upon a finding of negligence or other carelessness on the part of the payer.

With recognition of a general defense of change of position, it can be seen that the negligence or other carelessness of the payer is truly irrelevant to the granting of recovery. In a case where no change of position has occurred, the granting of relief may be considered to visit no harm upon the payee. Accordingly, the rationale for granting recovery of mistaken payments can be given expression in a general rule awarding recovery in such circumstances. If, however, a change of position has occurred and the payee's interest in security of the receipt is engaged, the availability of the defense is not contingent upon a finding that the conduct of the payer is or is not negligent in some sense. Even a non-careless mistake by the payer should not be allowed to visit an injury upon the payee. Payer's negligence is thus irrelevant to the denial of relief in circumstances where a change of position defense has arisen. In both the granting and denying of relief, then, the negligence or carelessness of the payer is simply irrelevant. As we shall see, it was eventually Dawson's view that a failure of the drafters of Section 142 to appreciate the general irrelevance of payer negligence is a source of what he considered to be the confusion underlying the drafting of that section.³⁵ It will be suggested below, however, that this criticism is misplaced.

33. *Id.*

34. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

35. See Dawson, *supra* note 14, at 571 (stating that adoption of Section 142 would create confusion because "contributory negligence is irrelevant in actions for restitution").

A less obvious impact or potential impact of the recognition of the defense is the opportunity that recognition provides for a rationalization and restatement of a broader ground for recovery. Thus, for example, with recognition of the defense, there appears to be no compelling reason to limit recovery of mistaken payments on the basis of the liability mistake rule.³⁶ There is no obvious reason for denying recovery in the context of mistaken gifts, provided that the donee has not suffered a detrimental change of position subsequent to the receipt of the mistaken gift payment. It is therefore of some interest that in the *First Restatement* itself, a black-letter rule was stated in the mistake chapter permitting recovery in the context of mistaken gifts.³⁷ Though the illustrations relied upon by the Reporters relate essentially to equitable relief in the form of rescission and reformation of deeds, the rule is stated as one that would embrace the recovery of moneys paid by mistake, a claim that, in historical terms, would be a common law quasi-contractual claim. Although the rule in question states explicit types of mistakes that would ground recovery of mistaken gifts—such as mistakes as to the identity of the donee or as to the amount given³⁸—the section does appear to reflect a modest rationalization of the law in the direction of a broader ground for recovery for the mistaken payer.

It is unclear whether the Reporters, when drafting the mistake sections in the *First Restatement*, consciously intended to expand the grounds for relief on the basis that the explicit defense of change of position satisfactorily protected the payee's interest in security of the payment and thus facilitated a recovery rule stating broader substantive grounds for relief. The connection between recognition of the defense and a modern rationalization of the substantive ground for relief was explicitly drawn, however, by a leading restitutionary scholar and jurist, Lord Goff, in his decision, while a trial judge, in the leading modern English decision on mistaken payments, *Barclays Bank Ltd. v. W.J. Simms Son & Cooke (Southern) Ltd.*³⁹ in

36. See *supra* note 31 and accompanying text (explaining that at one point under both American and English law, the rule was that a mistaken payment could only be recovered when the payee made a mistake which made him liable to return the mistaken payment to the payer).

37. See RESTATEMENT (FIRST) OF RESTITUTION § 26 (1937) (stating that "a person is entitled to restitution from another to whom gratuitously and induced thereto by a mistake of fact he has given money").

38. *Id.*

39. See *Barclays Bank Ltd. v. W.J. Simms Son & Cooke (Southern) Ltd.*, [1980] Q.B. 677, 695 (U.K.) (finding that a party who mistakenly pays another party has a presumptive right to recovery). The connection between recognition of the defense and liberalization of the substantive grounds for recovery has been explicitly noted in the literature. See, e.g., Caroline A. Needham, *Mistaken Payments: A New Look at an Old Theme*, 12 U. BRIT. COLUM. L. REV.

1980.⁴⁰ In that decision, Goff offered a careful re-reading of the earlier English authorities and concluded that a modern rule concerning the recovery of mistaken payments can be articulated in the following terms:

From this formidable line of authority certain simple principles, can, in my judgment, be deduced: (1) if a person pays money to another under a mistake of fact which causes him to make the payment, he is *prima facie* entitled to recover it as money paid under mistake of fact.⁴¹

Goff then proposed certain limitations on that general principle which, as it happens, accurately reflect existing American law. Recovery would not be permitted where the payer intends that the payee have the money regardless of whether the fact inducing the payment be true or not, where the payment is made for good consideration and, importantly, where the payee has changed its position in reliance on the receipt of the payment.⁴² In sum, then, Goff proposed that the existing and complex body of English law articulating the right to recover mistaken payments could be restated as a rule permitting recovery in any circumstance in which a payment was *caused* by a mistake and where a change of position defense was not available to the payee. Similarly, once one couples a right to recover moneys mistakenly assumed to be liable to the payee with a rule allowing recovery of moneys mistakenly paid as a gift to the payee, a comprehensive right to recover moneys whose payment has been caused by mistake is established. The opportunity provided by the recognition of a modern and simplified general statement of the substantive ground for recovery has been partially implemented in the draft mistake provisions of R3RUE. Thus, Section 6 states a general rule permitting recovery of moneys mistakenly paid which were "Not Due," thereby replacing several sections of the *First Restatement*.⁴³ Further, Section 11 states more broadly the rule for the

159, 220–21 (1978) (anticipating this development in English law); Birks, *supra* note 17, at 39–41 (noting a connection between the adoption of the change of position defense and the expansion of the grounds upon which recovery of a mistaken payment is permitted).

40. *Id.*

41. *Id.* English law has since recognized that the moneys should also be recoverable in cases where the mistake is a mistake as to law. See *Kleinwort Benson Ltd. v. Lincoln City Council*, [1999] 2 A.C. 349, 353 (U.K.) ("The rule . . . that money is not recoverable on the ground that it was paid under a mistake of law ought no longer to apply.").

42. *Barclays*, [1980] Q.B. at 695. Goff was likely ahead of his time in suggesting that the defense of change of position had been accepted as an element in the English law of mistaken payments. Most observers would agree that the defense was not truly recognized until 1991 in *Lipkin Gorman v. Karpnale Ltd.*, [1991] 2 A.C. 548, 558 (U.K.) (stating explicitly that English law should recognize the change of position defense).

43. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 6 (Tentative Draft No. 1, 2001) (replacing Sections 15–22 and 23–25 of the *First Restatement*).

recovery of mistaken gifts than the equivalent rule in the *First Restatement*.⁴⁴ The combined effect of these provisions appears to be essentially similar to the perhaps more elegant restatement offered by Goff in the *Barclays Bank* case. For present purposes, however, the important point is that recognition of the change of position defense has facilitated a modern rationalization and restatement of the mistaken payments rule and has given proper expression to the interests of the payee in security of the payment.

III. In Defense of (a Modified Version of) Section 142

The *First Restatement* restates the change of position defense in two different locations, though essentially in the same terms in each instance. Chapter 2 of the *First Restatement* addresses the subject, "Mistake Including Fraud."⁴⁵ Topic 2 of that Chapter, "Mistake of Fact," sets out the rules establishing a general entitlement to restitution of moneys paid under a mistake of fact.⁴⁶ In Section 69, a particular defense to mistaken payment claims of "change of circumstances" is set forth.⁴⁷ It is described in the commentary to that section as "a specific application to transfers made by mistake of the principle applicable to all proceedings for restitution; that relief will not be granted where circumstances have so changed that it would be inequitable to require the other to make full restitution."⁴⁸ In Chapter 8 of the *First Restatement* setting out "Rules Generally Applicable to Actions for Restitution," the *First Restatement* articulates a more generalized statement of the defense which is nonetheless quite consistent with the particular defense set out in Section 69.⁴⁹ Section 142 reads as follows:

142. Change of Circumstances

(1) The right of a person to restitution from another because of a benefit received is terminated or diminished if, after the receipt of the benefit, circumstances have so changed that it would be inequitable to require the other to make full restitution.

44. See *id.* § 11 (expanding the rule stated in Section 26 of the *First Restatement*).

45. RESTATEMENT (FIRST) OF RESTITUTION §§ 6-69 (1937).

46. *Id.* § 7.

47. *Id.* § 69.

48. *Id.* § 69, cmt. a.

49. *Id.* §§ 139-59.

(2) Change of circumstances may be a defense or a partial defense if the conduct of the recipient was not tortious and he was no more at fault for his receipt, retention or dealing with the subject matter than was the claimant.

(3) Change of circumstances is not a defense if

(a) the conduct of the recipient in obtaining, retaining or dealing with the subject matter was tortious, or

(b) the change occurred after the recipient had knowledge of the facts entitling the other to restitution and had an opportunity to make restitution.⁵⁰

There are essentially five propositions embraced by Section 142. First, subsection 1 sets out the basic change of circumstances or change of position defense.⁵¹ Four further propositions can be drawn from subsections 2 and 3. First, if the payer is innocent of fault and the payee is guilty of fault in the "receipt, retention or dealing with" the payment, the defense is not available.⁵² Second, if both the payer and the payee are guilty of fault with respect to the "receipt, retention or dealing with" the payment, the defense is only available if the payee "was no more at fault" than the payer.⁵³ This is often referred to as the "balancing test" of Section 142. Third, if the payee is guilty of fault in the form of tortious wrongdoing, this constitutes an absolute bar against reliance on the defense.⁵⁴ Fourth, the defense is unavailable if the payee "had knowledge of the facts entitling the other to restitution and had an opportunity to make" restitution before the change of position occurred.⁵⁵

There appears to be virtually no controversy with respect to the soundness of the basic change of position defense set out in Section 142(1). There is a broad professional and academic consensus that the recognition of the defense of change of position represents a substantial improvement of the doctrine relating to the recovery of mistaken payments. The defense has been adopted for this reason in other common law jurisdictions.⁵⁶ The change of position

50. *Id.* § 142.

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *See, e.g.,* *Lipkin Gorman v. Karpnale Ltd.*, [1991] 2 A.C. 548, 558 (U.K.) (recognizing a change of position defense); *Storthoaks v. Mobil Oil Can. Ltd.*, [1976] 2 S.C.R. 147 at [53] (Can.) (same); *David Sec. Pty Ltd. v. Commonwealth Bank of Austl.* (1992) 175 C.L.R. 353 at [59] (Austl.) (same).

defense has appropriately recognized the legitimate interest of the payee in security of the receipt and has provided a satisfactory means for reconciling the competing interests of the payer in recovery and the payee in being permitted a defense where harm caused by detrimental reliance on the receipt will result from recovery. Recognition of the doctrine has also facilitated a rationalization and clarification of the substantive grounds for recovery. This is not to suggest that all aspects of the basic defense have been established with clarity. Thus, for example, the outer limits of the defense are not clear. Plainly the defense is available in the context of mistaken payments and, presumably, mistaken transfers of other forms of value. The extent to which the defense operates more generally within the law of restitution as yet remains unclear.⁵⁷ The defense evidently applies to expenditures undertaken in detrimental reliance on the receipt of the payment. It is less clear whether expenditures taken in anticipation of the receipt should count as a change of position. These sorts of difficulties will not be explored here. For present purposes, it is accepted that the central elements of the defense set out in Section 142(1) are sound and require no further defense.

The four propositions that can be drawn from subsections 2 and 3 of Section 142, however, are much more controversial. A defense of the general nature of the first, second, and fourth propositions in Section 142, and some suggestions for their revision, are the principal preoccupations of this paper. Each of the four propositions may be examined in turn.

A. Payee Fault as a Disqualification for the Defense

We first consider whether default on the part of the payee in the "receipt, retention or dealing with"⁵⁸ the payment should count as a disqualification for raising the defense.⁵⁹ Although instinctively one might conclude that the payee who has engaged in tortious or other wrongdoing ought to be precluded from raising the defense, it must be recalled that English law has recently rejected this notion and has adopted the view that bad faith conduct by the payer should be the only disqualification for the defense.⁶⁰ Accordingly, the instinctive

57. See Dawson, *supra* note 14, at 568 (suggesting that the defense should be available in cases of "substantial breach, impossibility, and frustration").

58. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

59. The analysis set forth in Parts A and B of this section was first developed by the present author in *McCamus*, *supra* note 13, from which portions of these Parts have been drawn.

60. See *Dextra Bank & Trust Co. v. Bank of Jam.*, [2001] UKPC 50, 1 All E.R. (Comm.) 193 at [45] (appeal taken from Jam.) (U.K.) ("Their Lordships are however most reluctant to . . .

assumption that payee fault should disqualify recovery requires careful consideration. Parenthetically, we may note that the combined effect of subsections 2 and 3 indicates that the commission of a tort counts as an *absolute* disqualification. That is to say, the intention of Section 142 appears to be that in the event that the payee has committed a tort, the balancing test set out in Section 142(2) appears to be unavailable to the payee in circumstances where the payer has also engaged in tortious or other faulty conduct. We put that point to one side and consider first whether tortious or other misconduct on the part of the payee should disqualify the payee in circumstances where the payer has acted without fault in making the initial payment. We will return to consider situations where both parties are at fault below.

In assessing the validity of the Section 142 approach to this issue, it is of particular interest to consider the question of negligence or other carelessness as a disqualification because it is on this point that English and American law currently diverges. In the leading English case, *Dextra Bank*, the Privy Council held that a payee would be disqualified from raising the defense only if the payee had failed to act in good faith.⁶¹ Negligent and careless conduct could clearly be undertaken in good faith and would therefore not constitute a disqualification under English law. Such conduct would, however, disqualify the payee from raising the defense under the Section 142 rule. Where the payee has engaged in intentional wrongdoing such as fraud, the problem is captured by the proposition to be further considered below that a change of position that occurs in circumstances where the payee is aware of the error cannot count as a defense. Accordingly, the discussion here is focused on innocent forms of wrongdoing. In considering the relevance of payee fault, it is helpful, in my view, to disentangle the three threads of "receipt, retention or dealing with"⁶² the payment that are subjected to identical treatment in Section 142(2). As I shall attempt to argue, the relevance of payee fault is not identical in each of these contexts. In particular, cases in which the payee has induced the payment through faulty conduct give rise to different considerations than cases in which the payee has not induced the payment by fault but has engaged in faulty conduct in either retaining or dealing with a mistaken payment. In the latter category are cases in which the conduct of the payee that is alleged to amount to a change of position is itself either tortious or otherwise faulty. We begin,

[recognize] the propriety of introducing the concept of relative fault into this branch of the common law, and indeed decline to do so. They regard good faith on the part of the recipient as a sufficient requirement in this context.").

61. *Id.*

62. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

then, with consideration of the relevance of negligence and other forms of innocent fault in the context of inducement by the payee.

1. *Fault in the Inducement*

A payee who negligently induces the initial payment by the payer will be precluded by Section 142(2) from raising a change of position defense.⁶³ In the typical case, the negligence would be constituted by the tort of negligent misstatement. The disqualification of the payee in such circumstances can be defended on the basis that the payment of the money by the payer is an injury resulting from the recipient's tortious misconduct. The loss of the money is therefore a compensable harm for which the payee bears responsibility. If the law of restitution were to deny the payer recovery in such circumstances, the payer could assert, presumably, a valid claim in tort to recover the loss. Surely it is idle, therefore, to suggest that the payer should be entitled to delay that result by successfully raising a change of position defense in the payer's restitution claim. Denial of the change of position defense represents a more elegant solution to the problem. The English position, then, to the effect that the restitution claim is to be denied since the negligent payee, who has acted in good faith, appears indefensible. The approach taken by Section 142 is plainly superior.

The English adoption of the good faith disqualification was defended by the Privy Council in *Dextra Bank* on the basis that since the negligence of the payer is irrelevant to the assertion of the claim, the negligence of the payee should also be considered irrelevant. This argument rests, I suggest, on a *non sequitur*. The reasons why negligence of the payer is normally irrelevant simply have no bearing on the question of whether the payee's negligence should be considered relevant. Once the change of position defense has been recognized, it is evident that the carelessness of the plaintiff payer in making the original payment is generally irrelevant to a determination of the merits of the restitution claim. On the hypothesis that no change of position on the part of the recipient has occurred, the payer's negligence is irrelevant because the payer has simply caused no harm to the payee. The payee is not prejudiced by a liability to repay the money which, *ex hypothesi*, is simply sitting in his or her bank account. If the payee has changed position, the defense is available whether or not the payer was negligent. In either case, then, payer's negligence

63. See *Blue Cross & Blue Shield of Ala. v. Weitz*, 913 F.2d 1544, 1549 n.9 (11th Cir. 1990) (finding that defendant could not assert a change of position defense when his actions precipitated the mistaken payment).

is irrelevant. On the other hand, if the change of position defense is available to the payee, the payee's negligence in inducing the payment will have the effect of causing an injury to the payer. The payer will have lost money because of the payee's negligent conduct and, on this ground, it can plausibly be argued that the negligent payee should be precluded from relying on the change of position defense. We may call this the "harm principle." If a party's fault is causing harm to the other party, that fault becomes relevant. Thus, if the payee's negligence is causing harm to the payer—here through invocation of the change of position defense—the payee's negligence arguably becomes relevant to a determination as to whether the defense ought to be available to the payee. In short, payer's negligence is normally irrelevant because the payee is amply protected by the change of position defense. Payee's negligence is relevant if allowing the defense will cause harm to the payer. There is simply no inconsistency between the proposition that negligence is generally irrelevant in establishing the claim but constitutes a disqualification for the defense. The *Dextra Bank* analysis is thus unconvincing and presents no obstacle to the conclusion, adopted by Section 142, that payee's negligence in inducing the payment should constitute a disqualification.

The tort of negligence is not the only context in which a tortfeasor may have acted innocently or in good faith. Indeed, the plight of the innocent converter is a matter that has attracted some attention in the present context.⁶⁴ When someone innocently comes into possession of another's property as a result of the owner's error, in circumstances involving the commission of an act of conversion, and then subsequently detrimentally relies on the presumed ownership and suffers a loss, it can plausibly be argued that it would be attractive to allow the innocent converter a change of position defense. Strict application of Section 142, however, would lead to the conclusion that the tortious misconduct of the innocent converter would be a basis for disqualifying the converter from raising the defense. Indeed, the *First Restatement* explicitly adopts the proposition that an innocent converter is not entitled to raise a defense of change of position.⁶⁵ The rule is illustrated by a conversion scenario in which a purchaser of expensive wines from a thief at a bargain price

64. See, e.g., ANDREW TETTENBORN, *THE LAW OF RESTITUTION IN ENGLAND AND IRELAND* 278 (3d ed. 2002) (asking why an innocent converter would not be able to use the change of position defense).

65. See *RESTATEMENT (FIRST) OF RESTITUTION* § 142 cmt. d (1937) ("[A] person who innocently converts the property or the things of another is not entitled to a defense because subsequently, without his fault, the things have been destroyed."); *id.* § 154 cmt. a ("Change of position is no defense to a converter, even though innocent.").

immediately consumes them.⁶⁶ Such a purchaser is unable to raise a change of circumstances defense to the owner's claim for restitution of the full value of the stolen wine even though this is an innocent conversion by the defendant. In favor of the position taken by the *First Restatement*, it may be argued that the law of torts obviously manifests an inclination to vigorous protection of the owner's security of title. The innocent purchaser is liable in tort as a converter.⁶⁷ Parenthetically, we may note that in this particular scenario, it may be argued that the conversion did not induce the initial transfer and accordingly, this case does not come within the present category of tortiously induced mistakes. It is possible, however, to imagine cases in which the original transfer might be induced by innocent conversion as where, for example, the converter innocently but mistakenly asserts ownership to the goods to which the owner simply and mistakenly acquiesces. If the law of torts is correct in exposing the converter to liability, there is obviously a plausible argument that the law of restitution should do no less and that the *First Restatement* is correct in denying the innocent converter a change of position defense. Further, a simple rule that bars the defense of change of position where transfers have been induced by tortious misconduct—including innocent conversion—possesses the twin merits of simplicity and predictability of application.

A more difficult question, however, is whether fault or misconduct that does not rise to the level of tortious misconduct on the part of the recipient can similarly act as a disqualification for the defense. It can easily be imagined that a payment could be induced by careless conduct on the part of the recipient where the recipient's misconduct would not be considered to constitute the tort of negligent misstatement. Perhaps, for example, the payee's utterances upon which the payer relied constituted opinions rather than statements of fact. Or perhaps the misconduct or fault of the recipient was simply one of acquiescing in the receipt of the payment without making what would be considered to be appropriate inquiries. The recipient's failure to object may have induced the payer to assume that the payment was warranted. Again, the *First Restatement* explicitly adopts the proposition that fault of this kind should or could preclude the recipient from raising a change of position defense. Thus the *First Restatement* commentary indicates that a failure to "use care to ascertain

66. *Id.* § 154 cmt. a, illus. 1.

67. See RESTATEMENT (SECOND) OF TORTS § 229 (1965) (stating that a person who is granted possession of property by a party who does not have the power to make such a grant is liable to the rightful owner of such property); DAN B. DOBBS, THE LAW OF TORTS 146–47 (2001) (stating that an innocent purchaser is "fully liable for conversion" if he or she bought the converted items from a "thief-converter").

relevant facts⁶⁸ would constitute (presumably non-tortious) fault in the relevant sense for the purposes of Section 142 and could preclude the availability of the change of position defense.⁶⁹

In favor of the *First Restatement's* position, it may be argued that there is no reason why the disqualification rule should necessarily track precisely the rules on liability in tort. One could take the view in the words of Section 142(1) that it is not "inequitable to require" the claimant to make restitution in circumstances where the recipient could have prevented the loss that has occurred by making appropriate inquiries, or where the recipient has otherwise non-tortiously encouraged the payer in the belief that the payment was appropriate. Where the payee's belief in his or her entitlement to the payment results from payee carelessness, the payee's claim to the protection accorded to security of receipt by the change of position defense is plainly and substantially weakened.⁷⁰

2. *Misconduct in the Change of Position*

When we turn to consider the potential role of fault occurring in the very change of position itself, a number of concerns that arise from the fact that the recipient has caused the initial transfer obviously fall away. As we shall see, this may lead to a rather different analysis of desirable outcomes in this context. Section 142 stipulates that where the payee's receipt or dealing with the payment was tortious or otherwise faulty, the payee is disqualified from raising the defense.⁷¹ It is difficult to conceive of circumstances where retention would be tortious or otherwise faulty except in circumstances where the payee is aware of the payer's initial error. This proposition is addressed separately in Section 142(3) and will be considered below. Here, then, we consider whether Section 142 is sound in holding that where "dealing with"⁷² the mistakenly transferred assets constitutes a tort, the payee is unable to rely on the defense. If, indeed, the dissipation of the value of the moneys mistakenly paid results from tortious breach of a duty owed by the payee to the payer, there would appear to be a very strong argument for disallowing the defense. The conduct of the payee would constitute an actionable harm and would support a damages

68. RESTATEMENT (FIRST) OF RESTITUTION § 142 cmt. c (1937).

69. *Id.*

70. Such recipients might be saved by a good faith standard along the lines proposed in *Dextra Bank*, and this too is a potential deficiency in the English good faith standard.

71. *Id.* § 142(3).

72. *Id.* § 142.

claim. As suggested above, it would be difficult to justify a restitutionary rule which allowed the payee to raise a defense to the restitution claim even though the payee was exposed to a claim for a similar amount of money in a tort claim.

In the present context, however, where the payee is unaware of the fact that the money in question is not the payee's, it is surely rather unlikely that a cause of action in tort would arise. A payee who carelessly disposes of moneys which he or she sincerely believes to be their own would not, in the usual case, constitute the commission of a tort of negligence against the claimant payer.

Again, however, the problems of the innocent converter may invoke a sympathetic concern. The *First Restatement's* illustration of the innocent purchaser of stolen wine from a thief at a bargain price who subsequently consumes the wine but is nonetheless unable to raise a change of position defense, neatly illustrates the problem.⁷³ As noted above, however, if the law, under the heading of conversion, properly attributes such importance to proprietary interests that the innocent converter must remain liable in tort, it is not obvious that the law, under the heading of restitution, should treat the owner's proprietary interests less respectfully. Apart from the problem of the innocent converter, however, the law of torts is likely to be irrelevant to the payee's position in the present context.

The much more likely scenario, of course, is that the payee will have engaged in careless conduct in effecting a change of position that does not constitute the tort of negligence. A useful illustration is provided by the recent English decision in *Abou-Rahmah v. Abacha*.⁷⁴ The plaintiffs had been induced by third party fraud artists to make payments to the defendant bank.⁷⁵ The bank had been instructed to hold the money for the benefit of "Trust International" but was induced by the same fraud artists to pay the money to a "Trusty International."⁷⁶ The mistaken change of position on the bank's part was an innocent one but arguably careless in nature. The trial judge held that the defendant was nonetheless able to raise a change of position defense.⁷⁷ The defendant had no reason to believe that the initial payment may have been made in error. Accordingly, applying the good faith test drawn from *Dextra Bank*,⁷⁸ the defendant's conduct, however careless, was not undertaken in bad

73. See *supra* note 66 and accompanying text (discussing the innocent converter of wine hypothetical).

74. See *Abou-Rahmah v. Abacha*, [2007] 1 Lloyd's Rep. 115, 126 (U.K.) (finding that the defendant's carelessness did not prevent it from relying on a change of position defense).

75. *Id.* at 118.

76. *Id.*

77. *Id.* at 126.

78. See *supra* note 13 and accompanying text (discussing the good faith test).

faith and the defendant was therefore not disqualified from raising a change of position defense.⁷⁹ As this case illustrates, the English good faith test would appear to protect the careless payee in circumstances of this kind. A more convincing justification for the irrelevance of negligence in such circumstances, however, is surely that the payee who believes that he or she is dealing with their own money is entitled to handle that money in a careless fashion. The payer has created a situation in which the payee reasonably believes that the money in question belongs to the payee. Accordingly, it is reasonable to impose on the payer the risk that the payee might deal with the property in the same way, that is carelessly, that the payee is entitled to deal with his or her own money.

This line of analysis exposes a substantial flaw in Section 142 of the *First Restatement*. Section 142 would disallow the defense in a case of this kind if the mistaken conduct of the payer was innocent rather than careless. This would provide a basis for concluding that the payee is palpably "more at fault" for the dissipation of the moneys paid than the payer and is, therefore, disqualified from raising the defense by Section 142(2). In this respect, the drafting of the Section 142 disqualification is overly broad.

The more difficult case is one in which the payee is not aware of the payer's initial mistake but nonetheless has grounds for suspecting that a mistake may have occurred. This, indeed, may be the type of situation the drafters of Section 142 had in mind. In such circumstances, where the conduct of the payer is mistaken but free of fault, whereas the conduct of the payee in changing position is undertaken in circumstances where the payee had reason to suspect that a mistake may have occurred, Section 142 would suggest that the payee is more at fault for the loss of the asset and should be disqualified from the change of position defense. Such a result is defensible. Where the payee has reason to believe there may have been an error, the convincing rationale for ignoring the payee's carelessness—the fact that in the normal case the payee believes that he or she is dealing with his or her own money—may be considered to be significantly undermined.⁸⁰ Where the payee's belief is a genuine but unreasonable one, the payee's claim to be able to assert a legitimate interest in the security of the receipt is substantially weakened. Moreover, it may be argued that the payee in such circumstances has a significant role in causing the loss and is captured by the kinds of considerations that will lead the

79. *Abou-Rahmah*, [2007] 1 Lloyd's Rep. at 126.

80. For a recent English decision reaching this result on good faith grounds, see *Niru Battery Mfg. Co. v. Milestone Trading Ltd.*, [2002] 2 All E.R. (Comm.) 705 (U.K.).

payee to be disqualified in a case where his or her carelessness has induced the initial payment.

In sum, then, the approach taken by Section 142 in disqualifying a payee who has induced the payment by tortious or other faulty conduct is sound. On the other hand, a similar disqualification for tortious or otherwise faulty conduct in the change of position is overly broad. A careless change of position with moneys reasonably believed to be owned by the payee should not disqualify.

B. The Balancing Test

In circumstances where both the payer and the payee are at fault with respect to "receipt, retention or dealing with" the payment, Section 142(2) states that the payee should be disqualified from raising the defense only if the payee is more at fault than the payer with respect to these aspects of the mistaken payment scenario.⁸¹ As we have noted, this balancing test approach has been recently rejected in the English jurisprudence. In the *Dextra Bank* case, the Privy Council, relying in part on Professor Dawson's criticism of Section 142(2),⁸² concluded that the concept of relative fault should not be introduced into this branch of the law.⁸³ We may note that two different versions of a balancing approach are conceivable. One might take the approach, as does Section 142(2), that the defense should be precluded only in circumstances where the payee is "more at fault" than the payer. If the parties are equally at fault or if the payee is less at fault than the payer, the payee can raise the defense. An alternative approach would be to apportion blame to the respective parties, in the manner of a contributory negligence assessment, and to reduce the availability of the defense to the payee to the extent that the payee's fault has contributed to the mistaken payment or its subsequent loss. If the payer was seventy percent to blame and the payee thirty percent, the defense would be available to the payee for only seventy percent of the loss caused by the detrimental change of position. In effect, the payee would absorb thirty percent of the loss caused by the mistaken payment. A contributory or comparative balancing test of this latter kind has been adopted in New

81. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

82. See *supra* note 16 and accompanying text (discussing Dawson's criticism of Section 142).

83. *Dextra Bank & Trust Co. Ltd. v. Bank of Jam.*, [2002] 1 All E.R. (Comm.) 193 at [45] (U.K.).

Zealand.⁸⁴ Under the Section 142 approach, by way of contrast, the balancing test has the effect of an "on-off" switch. If the payee's fault is merely equal to or less than that of the payer, the payee is entitled to raise a full defense resulting from the change of position. In considering the validity of the Section 142 approach, it is again useful to distinguish between fault on the part of both parties that bring about the initial payment and secondly, fault on the part of both parties where the fault of the payee is related to the change of position itself.

1. *Mutual Fault in the Initial Payment*

We first consider cases in which both the payer and the payee have committed torts or engaged in non-tortious carelessness in bringing about the initial payment. The initial payment has then been followed by the payee's change of position. As we have seen, there is a plausible argument for the view that the payee's tort or non-tortious carelessness should disqualify the payee from raising the defense. Support for this view was drawn from the "harm principle." Payee's fault will inflict harm on the payer through invocation of the change of position defense. Accordingly, payee's fault becomes relevant. When considering the potential relevance of payer's fault, in a case where both parties are at fault, we confront an initial difficulty that, as noted above, it is well established that payer's negligence or fault is generally irrelevant to the payer's right to recovery. How then can it be relevant in the present context? Again, however, the harm principle comes into play and demonstrates why payer fault is relevant in deciding whether the change of position defense should be available to the payee. In the ordinary case, payer fault is irrelevant because either recovery causes no harm to the payee (because no change of position has occurred) or because potential harm to the payee is precluded by application of the change of position defense. But in the present context, the payee, because of his own fault, is about to lose the benefit of the change of position defense and suffer a loss. The payer's fault now therefore becomes relevant. Payer's fault is now, in some degree at least, responsible for harm being inflicted on the payee. The harm principle suggests that the payer's negligence or fault is a relevant consideration in deciding whether to harm the payee by disqualifying him from raising the defense. In these circumstances, it may be asked whether there is merit to be found in the *First Restatement's*

84. See *Nat'l Bank of N.Z. Ltd. v. Waitaki Int'l Processing (NI) Ltd.*, [1999] 2 N.Z.L.R. 211, 1998 NZLR LEXIS 71, 35-36 (C.A.) (N.Z.) (limiting the plaintiff's recovery to 10% in recognition of the defendant's change of position defense).

suggestion that where the payment results from the combined effect of misconduct on the part of both parties, one should nonetheless permit the recipient to raise a change of position defense in circumstances where "the conduct of the recipient was not tortious and he was no more at fault for his receipt"⁸⁵ than was the claimant. At an intuitive level, where both parties have engaged in faulty behavior that is about to visit a loss on one of the parties, the idea that the party that is more at fault should bear the loss has obvious appeal.

In the real world, such cases do not appear to be common. The more common context in which the relevant fault notion has been considered is in cases where the initial payment was carelessly made and so too was the recipient's detrimental reliance. The *First Restatement* provides the following illustration where the initial payment results from careless conduct on the part of both the payer and the payee:

A sells goods to B on credit and consigns the goods to him by the C railway which delivers the goods to B. By collusion with an agent of C, B successfully misrepresents to both A and C that the goods have not been received and A sends duplicate goods to B, receiving from C reimbursement for the goods supposed to have been lost. Thereafter B disappears. C is not entitled to restitution for the amount paid A, since C was at least as careless as A.⁸⁶

Another illustration of a fact situation in which both the claimant and recipient contributed to the initial transfer is provided by the nineteenth century Ontario decision in *Clark v. Eckroyd*.⁸⁷ The defendant seller, Eckroyd, had often supplied goods to his customer, the plaintiff H.E. Clark & Company, delivered in each case by rail.⁸⁸ On one occasion, however, Eckroyd invoiced Clark for goods it had mistakenly shipped to "J.H. Clark & Co."⁸⁹ The plaintiff buyer, carelessly it might be said, failed to check as to whether or not the particular goods had arrived and, mistakenly acting on the assumption that they had done so, paid the invoice in question.⁹⁰ The railway company, not realizing that the goods were intended for the buyer, held the goods and, when they remained unclaimed, sold them in the exercise of their right to realize their value for

85. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

86. *Id.* § 142 cmt. c, illus. 12.

87. See *Clark v. Eckroyd*, 12 O.A.R. 425, 431 (1886) (Can.) (finding that the plaintiff, despite its negligence, was entitled to full recovery of the payment it mistakenly made to the defendant).

88. *Id.* at 425.

89. *Id.* at 426.

90. *Id.*

storage charges.⁹¹ The seller's careless failure to address the goods properly, compounded by the buyer's careless failure to check to ensure that the goods had arrived, thus resulted in the making of a mistaken payment by the buyer to the seller. Thus lulled into a false of security, the seller changed his position by failing to follow up with the railway company and redirect the shipment to the correct buyer.⁹² In sum, seller's initial carelessness was followed by buyer's carelessness which resulted in the seller's change of position. Careful conduct by the buyer could have "caught" seller's mistake and prevented seller's change of position.

How would Section 142 resolve the *Clark v. Eckroyd* problem? Section 142(2) would allow the defense only if the seller's conduct "was not tortious and he was no more at fault for his receipt . . . than was" the buyer.⁹³ In the actual case, the Ontario Court of Appeal denied relief on the basis that since the seller's initial carelessness had caused the problem, it should be considered to have no defense to the claim by the buyer.⁹⁴ A "who made the first mistake" rule of this kind does not seem persuasive. Under Section 142, however, assuming that the seller's conduct was not properly considered to be tortious, the seller would only be allowed to raise a change of position defense if it could be said that the seller was no more at fault than the buyer. This is sometimes said to be an impossible inquiry and one to be avoided. I am not persuaded that it is impossible. Reading between the lines of the opinions in *Clark v. Eckroyd* itself, I suspect that the Ontario Court of Appeal felt that the seller was more to blame for this mishap. I am inclined to agree. The seller carelessly shipped goods to one person and invoiced another. The buyer trusted a regular supplier to have invoiced accurately. Assessments of relative fault of this kind, of course, are delicate and, perhaps, unpredictable as a result. They are, however, commonly made in the tort context in claims of contributory negligence, and they are not dismissed as impossible in that context. The English approach would, as I understand it, take the view that the carelessness of the buyer, as payer, is irrelevant and the only remaining question, then, is whether the seller acted in good faith. It seems very likely that the seller acted innocently and in good faith in mislabeling the package. Accordingly, under English law, the seller would be able to raise the change of position defense. This does not appear to be the better result.⁹⁵

91. *Id.*

92. *Id.*

93. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

94. *Clark v. Eckroyd*, 12 O.A.R. 425, 431 (1886) (Can.).

95. See Beatson & Bishop, *supra* note 18, at 174 (defending the American rule on the basis that it creates incentives for both payer and payee to exercise appropriate levels of

If one takes the view that the level of carelessness of the parties in *Clark v. Eckroyd* is roughly equal, Section 142 would direct that the seller should be able to raise the defense because the seller/payee was no more at fault than the buyer/payer. In the event of a tie, then, Section 142 allows the payee to raise the defense. Beatson and Bishop defend this tie-breaking rule on the basis that in the normal case the payer, who has initiated the problem by making the careless payment, will be denied recovery.⁹⁶ They assume, that is, that where both are at fault, the payer has probably been the initial cause of the mess and therefore ought to absorb the resulting loss.⁹⁷ As *Clark v. Eckroyd* indicates, however, it can occur that it is the payee who initiates the problem through careless statements made to the payer. Perhaps a desirable gloss to Section 142, therefore, would be to preclude the payee from asserting the defense where, in the case of equality of fault, it is the payee who initiated the chain of events leading to the loss.

2. *Balancing Payee Fault in the Change of Position*

In the usual case, the payee will have carelessly changed his or her position, acting in the reasonable belief that he or she is entitled to the moneys mistakenly paid. I have suggested above that in these circumstances, the careless treatment of the money is simply irrelevant. The payer has transferred money in circumstances where the payee reasonably believes that he or she has become the owner thereof. The payee should be entitled to treat the money in whatever way he or she would treat it if the money was in fact his or her own property. The payer has created a situation in which such conduct might occur and should be saddled with the risk of its occurrence. This analysis holds whether or not the initial mistaken payment was one made carelessly by the payer. The critical question is the reasonableness of the payee's belief that he or she is entitled to the money. The fact that the payer may or may not have engaged in careless conduct in creating that belief is irrelevant. As suggested above, if this is correct, this constitutes a major defect in the *First Restatement* rule. Section 142 indicates that in all such cases one would compare the respective fault of the payer and the payee and disqualify the payee from relying on the change of position if the payee's fault was greater.⁹⁸

precaution).

96. *Id.* at 174–75.

97. *Id.*

98. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

Again, illustrations from the real world of the common law are hard to come by. A Texas case provides an illustrative fact situation.⁹⁹ The plaintiff railway mistakenly paid twice for work done by a general contractor.¹⁰⁰ In turn, the general contractor, not realizing the railway's mistake and appreciating that the second payment was for work done by subcontractors, mistakenly paid the subcontractors a second time.¹⁰¹ By the time the railway's mistake was discovered, the subcontractors had vanished.¹⁰² It seems likely that the payee's change of position might be considered to be a careless one, though no more so than the initial payment by the railway. Under Section 142(2), the defendant would be permitted to raise a change of position defense only if it was considered that the payee was no more at fault than the payer.¹⁰³ This is certainly a plausible conclusion in these circumstances and arguably provides a better result than the Texas court which permitted recovery.¹⁰⁴ Similarly, a payee who reasonably believes that the money is his own might suffer a detrimental change of position by making a foolish investment in reliance on the receipt. The carelessness of that conduct should not preclude the change of position defense. As suggested above, however, the payee's carelessness is only irrelevant if the payee reasonably believed that he was dealing with his own money.

In sum then, the Section 142(2) balancing test arguably provides an appropriate solution to the problem where both payer and payee are guilty of tortious or other faulty conduct in the inducement or making of the initial payment. In the context of a contest between a payer guilty of fault and a payee whose fault is involved in the change of position, the fault of the payee, provided that the payee reasonably believes that the mistakenly paid moneys belong to the payee, should not constitute a disqualification for the defense.

It remains to consider whether the balancing test adopted by Section 142(2)—which provides for a complete defense in cases where the payee is no more at fault than the payer¹⁰⁵—is more satisfactory than a balancing test that would calculate the respective fault of the parties, in the manner of contributory

99. See *Houston & T.C. Ry. Co. v. Hughes*, 133 S.W. 731, 733 (Tex. Civ. App. 1911) (finding that one can recover a mistaken payment despite his or her negligence in making the payment).

100. *Id.* at 732.

101. *Id.*

102. *Id.*

103. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

104. See *Houston*, 133 S.W. at 733 ("[T]he mere fact that the mistake was due to negligence on the part of the payer will not preclude him from recovering of the payee.").

105. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

negligence, and reduce the payee's ability to rely on the defense to the extent of the payee's fault or carelessness even though it is lesser in gravity than that of the payer. By way of illustration, if the payee was thirty percent at fault, whereas the payer was seventy percent at fault, the payee's ability to rely on the change of position defense would be reduced by thirty percent.

Interestingly, in a New Zealand case, *National Bank of New Zealand Ltd. v. Waitaki International Processing (NI) Ltd.*,¹⁰⁶ a balancing test of the latter kind was applied.¹⁰⁷ The payee initially protested the receipt of a substantial payment from the payer on the ground that it was not due.¹⁰⁸ Eventually, however, the payee acquiesced in the receipt even though remaining unconvinced of the legitimacy of the payment.¹⁰⁹ Fully expecting that a claim to recover the payment would ultimately be made, the payee invested the money in a first mortgage that ultimately proved to be worthless.¹¹⁰ When the payer eventually discovered this error and sought repayment, the payee pleaded change of position.¹¹¹ The New Zealand Court of Appeal affirmed a decision at trial in which the equities of the respective parties were "balanced" and the trial judge concluded that the payee should bear some responsibility for the loss and therefore reduced its ability to rely on a change of position defense by a factor of ten percent.¹¹²

Although this decision has been much criticized,¹¹³ it is not entirely clear that a balancing of the respective fault of the parties is unacceptable in a case of this kind. Let us suppose, for example, that the payee, unconvinced of the legitimacy of the initial payment, spent the moneys in question on lottery tickets, enjoying no benefit therefrom. It is very tempting to conclude in such circumstances that the payee's foolishness should be taken into account by disqualifying the payee from a change of position defense. If, however, the

106. See *Nat'l Bank of N.Z. Ltd. v. Waitaki Int'l Processing (NI) Ltd.*, [1999] 2 N.Z.L.R. 211, 1998 NZLR LEXIS 71, 35-36 (C.A.) (N.Z.) (limiting the plaintiff's recovery to 10% in recognition of the defendant's change of position defense).

107. See *id.* (finding that the bank's recovery should be limited to 10% of the mistaken payment).

108. *Id.* at 8.

109. *Id.*

110. *Id.* at 8-11.

111. *Id.* at 13.

112. *Id.* at 35-36.

113. See, e.g., Ross Grantham & Charles Rickett, *Change of Position and Balancing the Equities*, [1999] RESTITUTION L. REV. 158, 162-63 (arguing that the court deviated from the traditional view of the change of position defense); Peter Watts, *Restitution and Change of Position*, 115 L.Q. REV. 198, 201 (1999) (arguing that the court should have viewed the arrangement as an involuntary bailee situation rather than a voluntary bailee situation).

payee reasonably believed that it owned the money in question, the fact that it lost the money in this fashion should not preclude it from raising the defense. Where, on the other hand, the recipient is aware of the problematic nature of the transfer or has reasonable grounds for suspicion, a disqualification of the defense does have merit. Section 142, we may note, would not achieve the result favored by the New Zealand courts in the *Waitaki* case. If we assume, as seems rather likely, that the *Waitaki* payer was rather careless, the fact that ten percent of the blame should be assigned, in the court's view, to the payee would not disqualify the payee from a change of position defense under Section 142. The payee is disqualified only if the payee is "more at fault" than the payer.¹¹⁴

The choice between the New Zealand approach and the Section 142 approach may not be an obvious one. In favor of Section 142, one might argue that where the responsibility of the payee is a modest one, the dominant cause of the loss is the conduct of the payer and accordingly, a change of position defense is appropriate. In favor of the New Zealand approach, it might be argued that the payee in that case could easily have placed the asset in a much safer investment and that its failure to do so constituted a degree of carelessness that should be reflected in a reduction in its ability to rely on the defense. Such a rule creates an incentive for careful conduct in cases of this kind. Moreover, in the seemingly analogous context of contributory negligence in tort, a balancing test of the contributory New Zealand type is employed. The claim is reduced by the degree of the plaintiff's fault. The tort contributory negligence analogy may, however, mislead. In the tort context one is comparing relative degrees of tortious negligence. In the mistaken payments context, one may be balancing payer's tortious misconduct against payee's non-tortious failure to enquire. In other words, one may be balancing apples and oranges. The Section 142 rule which simply requires a determination of which party is more at fault may thus provide the more elegant solution.¹¹⁵

C. Payee Tort as an Absolute Disqualification

Section 142(3)(a) provides that if the conduct of the recipient in obtaining, retaining, or dealing with the value transferred was tortious, this constitutes an

114. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

115. Beatson and Bishop favor the *First Restatement's* approach on an efficiency analysis, on the basis that it provides suitable incentives for both parties to engage in error avoidance measures. See Beatson & Bishop, *supra* note 18, at 174 (concluding that Section 142 "sets up clear conduct-based rules which yield incentives to efficient avoidance of mistakes").

absolute disqualification for the defense.¹¹⁶ Accordingly, in the context of payee tort, the balancing test set out in Section 142(2) is simply inapplicable. It is not obvious why this should be the case. The illustration provided in the Commentary to Section 142 focuses on the innocent converter and states the following:

Change of circumstances is not a defense to a person who, however innocently, has been guilty of tortious conduct in receiving, retaining or disposing of the subject matter. Thus, a person who innocently converts the property or the things of another is not entitled to the defense because subsequently, without his fault, the things have been destroyed.¹¹⁷

This discussion is obviously focused on the transfer of goods rather than payment of money. Be that as it may, it is highly questionable that an absolute bar is desirable even in these circumstances. Imagine, for example, that the transferor has placed the chattels in the hands of the innocent converter by fraudulent means and for fraudulent purposes. The innocent converter, then, believing the goods to be his or her own, engages in an innocent act of conversion. In such circumstances, it appears entirely appropriate to engage in a weighing of the fault of each party. The transferor's fraud is evidently a more serious fault than the innocently tortious act of the transferee. In such circumstances, Section 142(2) ought to be applicable.

In the context of mistaken payments, the much more likely tort analysis is that the payee may have engaged in the tort of negligent misstatement in inducing the payment. As suggested above, the commission of a tort in the course of changing a position by the payee does not appear to be a likely scenario. In the context of negligent inducement by the payee, it does indeed seem unlikely that the proper course will be to disqualify the payee from raising the defense. Nonetheless, where the payer has also engaged in negligence, indeed perhaps gross negligence, in making the payment, it appears that the balancing test of Section 142(2) provides a better solution.

D. Payee Knowledge of the Error as an Absolute Bar

Subsection 142(3)(b) stipulates that the payee is absolutely disqualified from raising the change of position defense if the change of position occurred after the payee "had knowledge of the facts entitling the other to restitution and

116. RESTATEMENT (FIRST) OF RESTITUTION § 142 (1937).

117. *Id.* § 142 cmt. d.

had an opportunity to make restitution."¹¹⁸ In the Commentary, it is clearly indicated that the fact situation envisaged by such Section 142(3)(b) is one in which the payee "subsequently learns facts from which he realizes the existence of a mistake."¹¹⁹ Plainly, in such circumstances, the payee has no basis for asserting an interest in security of the receipt, and an absolute disqualification, therefore, appears sound.

Some hesitation on this point, however, is occasioned by the New Zealand decision in the *Waitaki* case, briefly described above,¹²⁰ in which the payee protested the receipt of a payment and acquiesced in the receipt only upon the insistence of the payer.¹²¹ Fully expecting that a claim by the payer would be forthcoming in due course, the payee placed the moneys in an investment which ultimately proved to worthless.¹²² On these facts, or in the event that the money was stolen from the payee, it would appear harsh to deprive the payee of the change of circumstances defense simply because he was aware of the payer's initial mistake and was not sufficiently vigorous in protesting or returning the payment. Perhaps the payee in such circumstances would be saved by a generous interpretation of Section 142(3) on the basis that the payee may well have had a residual doubt as to whether the original payment might not have been a correct one. Where the payee's knowledge of the mistake is clearly established, however, an absolute bar to raising the defense appears defensible.

IV. *A Response to Dawson's Critique of Section 142*

In his 1981 article, "Restitution Without Enrichment," John P. Dawson advanced a critique of the Section 142 balancing test and, further, offered a novel explanation as to why, in at least some cases where the payee has been negligent, the payee should be disqualified from raising the defense.¹²³ In my view, neither the critique nor the novel explanation are at all convincing. In his brief discussion of this issue, however, Dawson begins with a strong point. Dawson explains, quite persuasively, that the correct reason for denying

118. *Id.* § 142.

119. *Id.* § 142 cmt. e.

120. See *supra* notes 106–11 and accompanying text (discussing the New Zealand case of *National Bank of New Zealand, Ltd. v. Waitaki Int'l Processing Ltd.*).

121. *Nat'l Bank of N.Z. Ltd. v. Waitaki Int'l Processing (NI) Ltd.*, [1999] 2 N.Z.L.R. 211, 1998 NZLR LEXIS 71, 8 (C.A.) (N.Z.).

122. *Id.* at 8–11.

123. See generally Dawson, *supra* note 14.

recovery in a case where a change of position has occurred is because of the detrimental reliance of the payee on the security of the payment.¹²⁴ In making this point, Dawson was critical of earlier American authority which sometimes explained the denial of relief on the basis that the conduct of the payer had been negligent or was such as to give rise to an estoppel.¹²⁵ Among the illustrations relied on by Dawson was a Kentucky case, *Jefferson County Bank v. Hansen Lumber Co.*,¹²⁶ in which a fraudulent seller of lumber advised the buyer that the lumber had been shipped and sent a sight draft to its assignee bank.¹²⁷ Although the seller warned the buyer not to make payment until the bill of lading arrived, the buyer, carelessly it might be said, paid the purchase price to the bank without receiving the bill.¹²⁸ The bank, in turn, released the funds to the seller who, in due course, became insolvent.¹²⁹ The lumber paid for by the buyer had, in fact, never been shipped.¹³⁰ The buyer's claim to recover the mistaken payment from the bank was denied on the ground that the buyer's conduct in ignoring the seller's instructions and in paying without having received the bill of lading was grossly negligent.¹³¹ In such a case, Dawson argued, the negligence of the purchaser is irrelevant.¹³² The fact that the assignee bank had been irretrievably worsened by the receipt of the payment was the true basis for denying the claim.¹³³ In taking this view, Dawson was surely correct. As we have seen, negligence of the payer is typically irrelevant to the question of whether relief should be allowed. If no change of a position has occurred, relief will normally be granted. If a change of position has occurred, recovery will be denied. In neither case is the negligence of the mistaken payer a relevant consideration.

124. *Id.* at 569–70.

125. *Id.* at 570–71.

126. *See* *Jefferson County Bank v. Hansen Lumber Co.*, 55 S.W.2d 54, 57 (Ky. 1932) (finding that, under the doctrine of equitable estoppel, a payee should not have to bear a loss when the payer was grossly negligent in making the mistaken payment).

127. *Id.* at 55.

128. *Id.*

129. *Id.* at 55–56.

130. *Id.* at 55.

131. *Id.* at 57.

132. Dawson, *supra* note 14, at 571–72.

133. *See id.* ("[C]omments [denouncing payer's negligence] were clearly superfluous, for . . . there was good reason to deny restitution—claims against third persons that could previously have been enforced had been irretrievably cut off through inaction induced by the payment.").

Dawson fell into error, however, when he further observed that it was cases of this kind that had inspired the drafting of the balancing test in Section 142. Dawson boldly asserted the following:

Influenced by similar language of disapprobation that a few other cases have expressed, the authors of the *Restatement of Restitution* proposed a test of comparative fault, to the effect that "change of circumstances" could be a defense to restitution if the recipient was not "tortious" and "was no more at fault" than the claimant. The introduction of these complex themes would have been, I believe, a real disservice. Fortunately, they have been disregarded in court decisions.¹³⁴

Dawson's inference that it was cases like *Jefferson County* that the drafters of Section 142(2) had in mind appears unwarranted. Section 142(2) resorts to a comparative fault test only in cases where change of position is in issue and the payee is guilty of fault. The *Jefferson County* case is not a case where either the payee or both parties were at fault, and it, therefore, was not necessary to balance or compare the respective fault of the parties. There was no evidence to suggest that the assignee bank was in any way careless. *Jefferson County* was a claim by a negligent payer whose payment resulted in the change of position of a payee which was innocent of fault. *Jefferson County* is an illustration of Section 142(1) and not Section 142(2). As we have seen, the drafters of Section 142(2) plainly had in mind circumstances in which either the payee or both parties engaged in tortious or other faulty conduct and it was therefore necessary to determine whether payee fault should make the defense unavailable. Nothing in the drafting of Section 142 can fairly be taken to suggest that its authors failed to appreciate that, in the absence of payee fault, payer's carelessness is irrelevant both to the right to recover and to the availability of the change of position defense. Section 142 is consistent with this view. Nothing in the drafting of Section 142 can fairly be taken to suggest that Section 142(2) is the by-product of a confusion on this basic point.

Having dismissed the balancing test of Section 142(2) more or less out of hand, Dawson then proceeded to provide a somewhat surprising explanation for the result in cases where the payee has behaved carelessly and nonetheless wishes to rely on a change of position defense. Section 142(2), of course, would allow the payee to do so only if the payee was no more at fault than the payer. Dawson suggested, however, that in such a case, "the weighing on scales of relative moral fault provides no help at all."¹³⁵ Dawson's illustration of this proposition came from a Texas case, *Houston & T.C. Railway v.*

134. *Id.* at 571.

135. *Id.* at 572-73.

Hughes, discussed above,¹³⁶ in which a railway negligently overpaid a general contractor which it had retained to build a stretch of road bed by paying for a portion of the work a second time.¹³⁷ In turn, the general contractor, perhaps also acting without due care, made a similar overpayment to its subcontractors.¹³⁸ Before the mistakes of the railway and the general contractor were discovered, the subcontractors disappeared and were no longer vulnerable to suit.¹³⁹ The court concluded that the negligence of the railway was irrelevant, and therefore, that it was entitled to recover its mistaken payment.¹⁴⁰

Section 142(2) would have denied the claim, presumably on the basis that if the general contractor was careless in paying his subcontractors, he was surely no more careless than the railway and accordingly he remained entitled to raise a change of position defense on the basis of the payment he made to the vanishing subcontractors. Indeed, Dawson noted that George Palmer, the author of the 1978 treatise, *The Law of Restitution*,¹⁴¹ was critical of the result in the case.¹⁴² Nonetheless, Dawson considered the result satisfactory for a somewhat surprising reason. In his view, the critical question was whether or not the general contractor must be considered to "take the risk that the subs he had chosen would vanish."¹⁴³ Moreover, he suggested, "for this event there was surely no fault in the railroad."¹⁴⁴ Expanding upon this line of analysis, Dawson suggested that a similar result would be appropriate if the general contractor had purchased a truck which he used for a time in his business but was then stolen.¹⁴⁵ Again, it appears to be Dawson's view that no change of position would arise because the general contractor would be assumed to have taken the risk of losing a truck in this manner. The stolen truck example does not appear to be of assistance however, as the illustration suggests that the use of a truck was required in the general contractor's business. If so, the purchase and eventual loss of the truck would not constitute a detrimental change of position. Presumably, the general contractor would have acquired the necessary truck in any event. If we assume that the truck was purchased only

136. See *supra* notes 99–102 and accompanying text (discussing *Houston & T.C. Ry. V. Hughes*).

137. *Houston & T.C. Ry. Co. v. Hughes*, 133 S.W. 731, 732 (Tex. Civ. App. 1911).

138. *Id.*

139. *Id.*

140. *Id.* at 733.

141. See generally GEORGE PALMER, *THE LAW OF RESTITUTION* (1978).

142. Dawson, *supra* note 14, at 573.

143. *Id.*

144. *Id.*

145. *Id.*

because of the receipt of the payment, the loss of the truck might well be considered a detrimental change of position. The payment has vanished. The situation is no different from one in which the payment was stolen from the payee before the payee purchased the truck. Nor is it convincing to suggest that on the *Hughes* facts the general contractor should be assumed to take the risk that the subcontractors might vanish and that this constitutes an explanation for denying a change of circumstances defense. This point requires further explication.

It is not at all obvious why Dawson felt that a risk allocation analysis would be of assistance in the present context. It is perfectly clear, of course, that in a general sense the general contractor had taken the risks that flow from having selected unreliable subcontractors. If the subcontractors failed to do their work properly, stole money from the general contractor, or otherwise misbehaved, it would be of no account to the railway. None of this suggests, however, that the general contractor, having been misled by the careless conduct of the railway into believing that he had received an appropriate payment for work done by the subcontractors and then passed the money on to the subcontractors for what he assumed to be their just compensation, assumed the risk that it would subsequently be discovered that the moneys were mistakenly paid to him and are now irrecoverable from the subcontractors. Similarly, if the general contractor had not paid the moneys to the subcontractors but, mistakenly believing that the moneys paid by the railway constituted profits at his disposal, he then spent the money on lottery tickets, the defense should arise. The foolishness of that investment of what he mistakenly believed to be his own money, a mistake induced by the railway, would not deprive him of recovery on some sort of risk allocation analysis. We might say that the general contractor assumes the risk that he might not enjoy a return from purchasing lottery tickets purchased with his own money. That is not the problem here. The problem is that the general contractor falsely believed that the money belonged to him.

Further, it is important to note that there has been no contractual allocation of risk with respect to the mistaken payment. Hughes and the railway did not enter into an agreement as to what would occur if an overpayment was made. If Hughes had contracted to return the moneys, there might well be an argument that he had assumed the risk, under such an agreement, that the moneys might be lost by payment to unreliable subcontractors. No such contractual risk allocation has occurred. Indeed, it may be that Dawson has committed the error of introducing into the mistaken payment context the type of risk allocation analysis that is appropriate in a contractual setting. Whatever may have induced Dawson's error, however, it seems clear that both Palmer and Section

142(2) are correct in concluding that in the circumstances of this case, the general contractor should have been entitled to raise a change of position defense.

In sum, Dawson's critique of the balancing test of Section 142(2) is quite unconvincing. As has been noted above, however, this has not prevented it from exercising some influence in the scholarship of Professor Birks¹⁴⁶ and ultimately in the decision of the Privy Council in the *Dextra Bank* case,¹⁴⁷ in which the balancing test approach was dismissed for purposes of English law.¹⁴⁸ Dawson's critique should not similarly provide a ground for rejecting a balancing test approach to problems of this kind in R3RUE.

V. *The Relevance of Crime*

An interesting question that is not explored in the commentary to Section 142 is whether the concept of fault that counts as a disqualification for payee reliance on the defense includes the commission of a crime. Intuitively, one might conclude that the commission of crime must obviously constitute payee fault and accordingly, whether it was associated with the inducement of the initial payment by the payee or with the eventual change of position, the commission of criminal misconduct would simply preclude the payee from raising the defense.

At first impression, at least, it may appear obvious that the recipient whose demand for payment, or whose change of position constitutes a crime, should be plainly disqualified from relying on the defense of change of position. One possible justification for such an approach is that it might be considered to be an application of the principle that a wrongdoer, especially one that commits a crime, should not be able to profit from such misconduct. In this context, however, we are considering the misconduct as a disqualification for relying on a change of position defense. By definition, then, we are considering situations in which no profit has been secured. An alternative rationale for disqualification might be an assumption that the commission of a crime would normally constitute a tort, thus disqualifying the recipient under Section 142.

146. See *supra* note 17 and accompanying text (discussing Birks's adoption of Dawson's critique of the balancing test).

147. See *supra* note 18 and accompanying text (discussing the *Dextra Bank* decision and its treatment of Birks's scholarship).

148. See *Dextra Bank & Trust Co. Ltd. v. Bank of Jam.*, [2002] 1 All E.R. (Comm.) 193 at [45] (U.K.) ("Their Lordships are however most reluctant to . . . [recognize] the propriety of introducing the concept of relative fault into this branch of the common law, and indeed decline to do so.").

However, not all crimes constitute torts. Accordingly, there may be cases where in addition to the fact that there is no profit, there is also no tort basis for disqualification. Further, one can, of course, commit a crime unintentionally in the sense that one is unaware of the prohibition. It may be asked, then, whether Section 142 precludes someone who unwittingly commits a crime from relying on the change of position defense. Such a case could involve a non-tortious inducement to make a payment, albeit one made in good faith, or a non-tortious, good faith change of position. Should this be considered to be "fault" of a kind which precludes reliance on the change of circumstance defense? Finally, where a payment has been induced or ultimately lost by the commission of an offence, it is possible that the payer is, in some sense, the victim of the crime. Is there not likely, therefore, to be a plausible argument that the denial of restitution would frustrate or stultify the objectives of the prohibition? If so, this argument may be thought to weigh heavily in favor of considering the commission of a crime to be a disqualifying fault for purposes of Section 142. Two recent cases, however, one Canadian and one English, suggest that crime should not be considered to constitute an absolute bar to the raising of a change of position defense. Again, it may be useful to distinguish between crime in the inducement—where the payer is more likely to be a victim of the crime—and crime in the change of position—where this is less likely to be so.

The possibility that there might be a case where it would not be "inequitable" to deny relief where a crime has induced the mistaken payment is presented by the recent decision of the Supreme Court of Canada in *Garland v. Consumers' Gas Co.*¹⁴⁹ This case involved a class action brought on behalf of customers of the defendant gas utility who had been required to pay late payment penalties ("LPPs") as a result of having failed to pay their accounts in a timely fashion, a practice in which the utility had been engaged in since 1979.¹⁵⁰ Indeed, the defendant was a regulated entity and its regulator, the Ontario Energy Board, had included a requirement that such charges be exacted in its annual rate decisions.¹⁵¹ The late payment penalty scheme had been adopted by the Ontario Energy Board after public hearings into the question of possible responses to the phenomenon of late payments.¹⁵² The LPPs were one-time penalties and were thought to be preferable to interest charges that

149. See *Garland v. Consumers' Gas Co.*, [2004] 1 S.C.R. 629 at [64] (Can.) (finding that a party who has received a mistaken payment through criminal conduct cannot use a change of position defense to avoid returning the mistaken payment).

150. *Id.* at [1]–[4].

151. *Id.* at [5].

152. *Id.*

would compound over time.¹⁵³ In 1981, the federal government enacted Section 347 of the Criminal Code¹⁵⁴ which created the offence of charging a criminal rate of interest.¹⁵⁵ Although explicitly proposed and enacted as a measure to control so-called "loan sharking", the concept of "interest" was defined very broadly in Section 347 with the result that the provision captured many commercial arrangements to the surprise of the commercial parties in question and members of the commercial bar that had advised them.¹⁵⁶ In the *Garland* litigation, the plaintiff class successfully claimed that the LPPs constituted "interest" in excess of the prohibited rate of sixty percent per annum.¹⁵⁷ The LPPs were typically paid by customers within a relatively short period of time and when considered as "interest" for the short period of time in question, the effective rate of interest exceeded the ceiling created by the Section 347 prohibition.¹⁵⁸ The plaintiff class thus successfully persuaded the Supreme Court of Canada that the charging and receiving of LPPs constituted an offence under Section 347 notwithstanding the fact that the defendant utility had been required to do so by its regulator.¹⁵⁹ The question then arose as to whether members of the plaintiff class were entitled to restitutionary recovery of all or some of the LPPs exacted by the defendant since the enactment of Section 347 in 1981. Among the arguments made in defense by the defendant utility was an attempt to invoke the defense of change of position.¹⁶⁰ The LPPs had been included in the defendant's regulated rate structure by the regulator.¹⁶¹ It was accepted by the Court that if the LPPs had not been included in the annual rate structure, some other source of revenue would have been included, permitting the utility to recover its cost and a profit margin satisfactory to the regulator.¹⁶² In short, the defendant utility claimed that it had, in anticipation of the receipt of LPPs, changed its position by foregoing an opportunity to have

153. *Id.* at [4]–[5].

154. *See* Criminal Code, R.S.C., § 347 (1985) (Can.) (prohibiting interest charges that exceed an annual rate of sixty percent).

155. *Id.*

156. *See id.* (defining interest as "the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement").

157. *Garland v. Consumers' Gas Co.*, [2004] 1 S.C.R. 629 at [6] (Can.).

158. *Id.* at [5]–[6].

159. *See id.* at [6] (stating that the Ontario Energy Board, the regulator of Consumers' Gas Company, required Consumers' Gas to charge the late payment penalties).

160. *Id.* at [28].

161. *Id.* at [5].

162. *Id.* at [63].

secured the revenue in some other form in its approved rate structure.¹⁶³ The most likely source would involve increased charges for the gas supplied to its customers. Alternatively, then, the change of position could be viewed as one of passing on the benefits of the LPPs to its customer base generally, including the members of the plaintiff class, through reduced rates.

In rejecting the utility's change of position defense, Justice Iacobucci observed that "[a]s a matter of public policy, a criminal should not be allowed to keep the proceeds of his crime."¹⁶⁴ This observation misses the point that the defendant did not in fact "keep the proceeds of his crime"¹⁶⁵ but, rather, passed the proceeds on to its customers in the form of lower rates for gas.¹⁶⁶ This rationale for withholding the change of position defense is therefore unconvincing. In the circumstances, given the good faith conduct of the defendant, the fact that the "loan-sharking phenomenon" targeted by the prohibition was not present and the technical nature of the contravention, it appears at least arguable that a change of position defense should have been available to the utility.

Similar issues arise where the payee's change of position constitutes a crime. Again, a leading Commonwealth authority may be considered to illustrate the tendency, arguably evident in *Garland*, of judicial overreaction to the presence of criminal misconduct by the payee. In an English case, *Barros Mattos Junior v. MacDaniels Ltd.*,¹⁶⁷ the defendant engaged in a change of position that contravened Nigerian foreign exchange regulations.¹⁶⁸ The claim arose from a large fraud committed by fraudsters based in Nigeria.¹⁶⁹ Carrying out the fraudulent scheme, the fraudsters engineered a payment of approximately \$US 8 million from the plaintiff Brazilian bank to the defendants who were not involved in the fraud.¹⁷⁰ Pursuant to instructions from the fraudsters, however, the defendants paid the moneys to the third parties, having

163. *Id.*

164. *Id.* at [57].

165. *Id.*

166. Thus, one of the factual ironies of the case is that the members of the plaintiff class also, of course, enjoyed the benefit of lower rates for their gas. Indeed, the evidence filed indicated that the average member of the plaintiff class, who would have paid very few LPPs, benefited on balance through the LPP scheme. *Id.* at [33].

167. See *Barros Mattos Junior v. MacDaniels Ltd.*, [2005] 1 W.L.R. 247, 253–54 (U.K.) (finding that one cannot use a change of position defense if he or she has engaged in any wrongdoing during the transaction that resulted in the mistaken payment).

168. *Id.* at 256–57.

169. *Id.* at 248.

170. *Id.* at 249.

first converted the money to Nigerian currency.¹⁷¹ The transactions failed to comply with the Nigerian foreign currency regulations.¹⁷² The defendants, nonetheless, asserted a change of position defense; the plaintiffs, who were assignees of the Brazilian bank, countered that as the defendants had participated in transactions that were unlawful, the defendants were wrongdoers and could not rely on a change of position defense.¹⁷³ The trial judge agreed.¹⁷⁴ The court considered that it had no discretion to weigh the heinousness, or lack of same, of the payee's misconduct in imposing the disqualification.

The result in *Barros Mattos* is difficult to defend. The plaintiffs are not in any sense victims of the apparent offense. To the extent that the defendants had merely passed the moneys on to others, they obviously did not profit from the transaction. The defendants were not attempting to enforce the illegal transactions. Rather, they merely sought to rely on them as evidence of the fact that the benefits had been passed on to third parties. Further, giving effect to the change of position defense could not be said to defeat the legislative purpose expressed in the regulations. Disqualification from the defense would simply have the effect of meting out a harsh penalty to the defendants, a penalty, be it noted, that would be collected, in effect, by the plaintiff. Again, considering crime to be a *per se* disqualification for raising the change of position defense seems unsatisfactory in such circumstances. A more nuanced approach in which the relevance of the crime to the plaintiff's circumstances and a weighing of the gravity of the offence would appear to be preferable. To accommodate such an approach, it might be sufficient to note in the Commentary to any new version of Section 142 that might be contemplated that crime might, depending on factors such as these, constitute fault for purposes of the Section 142(2) disqualification.

VI. Conclusion

The question addressed in this Article—the potential relevance of fault, either of the payee or the payer or both, as a disqualification for the raising of the defense of change of position—raises questions of some complexity. What the subject lacks in simplicity, it also lacks in practical importance. In particular, cases in which both the payer and the payee are at fault with respect to either the initial mistake in payment or the eventual change of position seem

171. *Id.*

172. *Id.* at 254–55.

173. *Id.* at 252–54.

174. *Id.* at 257.

to be as rare as hen's teeth. Nonetheless, thinking carefully about the proper treatment of such issues may be a useful intellectual exercise in the sense that it requires one to think carefully about the rationales underlying both the general rule of recovery and the change of position defense and their inter-relationship. Moreover, from a practical point of view, in the rare instances when such problems do arise, it is very useful to have a source of the type of guidance provided by the Section 142 rule. As has been noted, however, the Section 142 rule has proven to be contentious. Thus, in recent English jurisprudence, the Section 142 approach of utilizing payee fault as a disqualification for raising the defense has been rejected in favor of a good faith standard.¹⁷⁵ That is to say, a payee who has acted in good faith is entitled to raise the defense. Further, the Section 142(2) balancing test, permitting the payee to raise the defense only where the payee is not "more at fault" than the payer, has come in for a particularly heavy barrage of criticism. Dismissed by both John Dawson¹⁷⁶ and Peter Birks,¹⁷⁷ the balancing test approach has been firmly rejected in recent English jurisprudence.¹⁷⁸ The main burden of this article has been to mount a defense, in the main at least, for the general approach adopted by Section 142, including the balancing test.

The new English good faith test, intended to supplant the Section 142 payee fault disqualification, is unsatisfactory as it enables a negligent or careless payee, who has acted in good faith to raise the defense, even though the payee's actionable negligence or other carelessness may have been the very act that induced the making of the mistaken payment in the first place. It is argued above that the approach taken by Section 142 in disqualifying the payee from raising the defense in such circumstances is by far the preferable approach. Further, this Article attempts a defense of the balancing test on the basis that it offers the most appropriate solution to situations where both payer and payee are at fault either in inducing the payment or, on the part of the payee, in effecting or suffering the change of position. To consider, for example, that the negligent payee should be barred from the defense where the payment results from payer fraud or gross negligence seems an unacceptable

175. See *Dextra Bank & Trust Co. Ltd. v. Bank of Jam.*, [2002] 1 All E.R. (Comm.) 193 at [42] (U.K.) (stating that a good faith standard should be used to determine the parties' liability).

176. See *supra* notes 14–16 and accompanying text (discussing Dawson's rejection of the balancing test approach).

177. See *supra* note 17 and accompanying text (discussing Birks's adoption of Dawson's balancing test critique).

178. See *Dextra Bank*, [2002] 1 All E.R. (Comm.) 193 at [45] ("Their Lordships are however most reluctant to . . . [recognize] the propriety of introducing the concept of relative fault into this branch of the common law, and indeed decline to do so.").

result. Where both parties have engaged in fault, the common sense solution that saddles the party more at fault with the loss does appear to be the more sensible approach. The criticisms offered by Dawson of the Section 142(2) balancing test appear to be quite unconvincing, notwithstanding the influence they have enjoyed abroad in recent years.

At the same time, this Article suggests that subsections (2) and (3) of Section 142 could benefit from some retooling. First, in cases where an innocent payer claims against a payee whose negligence or other fault has induced the payment, the current approach taken in Section 142 appears sound. The payee cannot raise a change of position defense. Where the payee fault relates to the change of position, however, a similar disqualification for tortious or otherwise faulty payee conduct is overly broad. A careless change of position taken by a payee with respect to moneys the payee reasonably believed to be his or her own should not disqualify the payee from asserting the defense.

Similarly, in the context of the Section 142(2) balancing test, payee fault with respect to the change of position should normally be considered irrelevant in cases where payees reasonably believe themselves to be dealing with their own funds. Further, the balancing test which, it might be said, gives the tie (i.e., the situation where both parties are equally at fault) to the payee requires adjustment. Section 142(2) breaks the tie in favor of the payee on the theory, presumably, that it is normally the payer who has initiated the problem by carelessly making the payment. As we have seen, however, there may be cases in which it is the payee rather than the payer who has carelessly induced the payment. In such circumstances, it would be appropriate to break the tie in favor of the payer. Finally, it has been noted that the *First Restatement* is silent on the question of the relevance of payee crime as a disqualification for raising the change of position defense. It has been suggested here that, notwithstanding one's initial instincts to the contrary, there may well be cases in which the commission of a crime, either in the inducement of the initial payment or in the change of position, should not be considered, in all of the circumstances, a disqualification for raising the defense.

