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Disgorgement of Profit: What Every Defendant Needs to Know

By Marco P. Falco

At the end of July, the Supreme Court of Canada released a major decision about disgorgement—the remedy that restores the defendant’s “wrongful gain” to the plaintiff, even where the plaintiff may not have suffered any damages at all.

In *Atlantic Lottery Corp. v. Babstock*, 2020 SCC 19, the majority of the Court made a number of important rulings that limit the ability of plaintiffs to claim disgorgement against a defendant. These rulings include that:

1. Disgorgement is an equitable remedy, not an independent cause of action;
2. In order for a plaintiff to claim disgorgement for the defendant’s negligence, the defendant must have caused the plaintiff’s damages; and
3. Only in exceptional circumstances is disgorgement available for a breach of contract.

Babstock is grounded in the principle that disgorgement, as an equitable remedy, is necessarily limited when dealing with private law causes of action such as negligence and breach of contract.

The Court’s approach conforms to a “corrective justice” understanding of tort and contract liability—where a plaintiff must prove its entitlement to a remedy.

How the Record was Set Straight on Disgorgement

Babstock involved a class action against the defendant maritime governments (collectively, the “Government”) which operated video lottery terminal games (“VLTs”) in their respective provinces. The plaintiffs claimed that these games were “inherently dangerous and deceptive”.

Apart from an action involving the *Criminal Code*, the plaintiffs sought to certify their class action against the Government for breach of contract, waiver of tort and unjust enrichment.

Critically, the plaintiffs sought a “gain-based” award, i.e. one calculated by determining the amount of profit earned by the Government in licensing VLTs. The plaintiffs claimed that “waiver of tort” was an independent cause of action which provided for a gain-based remedy, without the need to determine the damages suffered by an individual class member at trial.

Both the Supreme Court of Newfoundland and Labrador and the Newfoundland and Labrador Court of Appeal certified the class action.

The majority of the Supreme Court of Canada reversed. The Court struck the claims as disclosing no reasonable cause of action.

Disgorgement is a Remedy, Not a Cause of Action

Since *Babstock* was released, most critical analyses of the case have focused on the Supreme Court of Canada’s ruling that “waiver of tort”, as a term of art and as an alleged cause of action, was extinguished by the Court at Canadian common law. But this is arguably a minor aspect of *Babstock*.

The importance of *Babstock* lies in the Court’s recognition that disgorgement for the defendant’s wrongful conduct is a “gain-based” remedy, not an independent cause of action.

The Court began its analysis by noting the difference between restitution and disgorgement, which it identified as two types of gain-based remedies.

In restitution, a benefit moves from the plaintiff to the defendant and the defendant has to give it back as compensation for the defendant’s unjust enrichment. By contrast, disgorgement only looks at the defendant’s wrongful gain and wrongdoing--the plaintiff’s damages are largely irrelevant:

....restitution stands in contrast to another measure of relief, *disgorgement*, which refers to awards that are calculated exclusively by reference to the defendant’s wrongful gain, irrespective of whether it corresponds to damage suffered by the plaintiff and indeed, irrespective of whether the plaintiff suffered damage at all...

In *Babstock*, the plaintiffs were seeking disgorgement, not restitution. They wanted damages based solely on the Government’s gain from VLTs, without referring to their own damages.

The Court held that disgorgement was a remedy for the Government’s wrongdoing, not an independent cause of action. The plaintiffs’ action was misconstrued because it sought to create a new cause of action based on the defendant’s wrongful conduct, which the Court characterized as “akin to negligence”, but not requiring “proof of damages”.

Applying a “corrective justice” approach to tort law, which demands that liability be ascribed on the basis of the plaintiff’s entitlement to a remedy, the Court declined to create a new tort of disgorgement based on the Government’s negligence:

I acknowledge that disgorgement is available for some forms of wrongdoing without proof of damage (for example, breach of fiduciary duty). But it is a far leap to find that disgorgement without proof of damage is available as a general proposition in response to a defendant’s negligent conduct. Determining the appropriate remedy for negligence, where liability for negligence had not already been established, is futile and even nonsensical since doing so allows “the remedy tail [to] wag the liability dog”...

Accordingly, the Court refused to certify the plaintiffs’ novel cause of action based on disgorgement.

Disgorgement for Tortious Wrongdoing

Recognizing that disgorgement is not a free-standing cause of action, the Court then considered whether the plaintiffs’ claim for disgorgement could survive as a remedy for the Government’s negligent conduct.

The Court refused to wade into the debate about whether disgorgement is available for negligence in certain contexts. The question now remains unsettled.

The Court simply noted that the plaintiffs in this case could not make out one of the basic elements of negligence—causation of damages.

In *Babstock*, while the plaintiffs alleged that the Government was required to warn them about the inherent perils of VLTs, they did not allege that “proper warnings would have caused them to spend less money playing VLTs or to avoid them altogether”.

The plaintiffs did not plead causation of damages, so the action in negligence could not stand.

Disgorgement for Breach of Contract

The Court observed that, historically, disgorgement was not available as a remedy for breach of contract. This is because breach of contract damages are only intended to restore the plaintiff to its position had the contract been performed.

However, citing a 2001 House of Lords decision, *Attorney General v. Blake*, [2001] 1 A.C. 268 (H.L.), the Court noted that disgorgement is possible for breach of contract at common law in “exceptional circumstances”. These circumstances include: (i) where any other remedies are inadequate; or (ii) where the plaintiff had a legitimate interest in preventing the defendant’s profit-making activity.

The Court in *Babstock* had no issue recognizing disgorgement for breach of contract in these limited contexts because Courts have long deviated from the simple measure of expectation damages for breach of contract. Monetary damages that go beyond the “economic position that [the plaintiff] would have occupied had its contract been performed” is nothing new.

In *Babstock*, however, none of the limited circumstances for disgorgement existed. Other remedies were not inadequate for breach of contract. Here, ordinary compensatory damages were adequate—disgorgement could not be ordered simply because the plaintiffs were unwilling or lacked evidence to prove their loss. There was nothing “exceptional” about the plaintiffs’ breach of contract claim in this case.

Disgorgement: A Narrow Remedy for Private Law

The message of *Babstock* is clear: where private law claims such as negligence and breach of contract are advanced, disgorgement is a limited remedy, if a remedy at all.

Babcock draws a clear line between common law and equity.

Where a Canadian Court would not hesitate to award disgorgement of a wrongful gain for a breach of fiduciary duty, there is a clear reluctance to do so for ordinary common law causes of action such as tortious misconduct or breach of contract.

Babstock provides a principled basis for this distinction: common law already has adequate remedies to compensate plaintiffs in tort and contract. Usually, there is no need to rely on equitable remedies like disgorgement to do so.

Principles of corrective justice require that a plaintiff claiming negligence or breach of contract prove their loss. The extraordinary remedy of disgorgement, which awards the defendant’s gain in the absence of a proof of loss, should be reserved for “exceptional” circumstances.

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