THE MISTAKE ABOUT MISTAKES: RETHINKING PARTIAL AND FULL RESTITUTION

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Abstract. This Article offers a critique of the conventional analysis of restitutionary claims; that is, claims arising from the law of restitution that governs unintended transfers of wealth. Currently, restitutionary claims are mostly analyzed under a tort-style framework. This Article demonstrates that this framework offers a distorted perspective, not fully capturing the unique characteristics of claims of this type. As an alternative to this existing account, this Article offers the first formal model designed specifically to study restitutionary claims and the law of restitution. By introducing this model, this Article strives to position restitution more clearly as its own subject, independent of the familiar tort-style analysis. Adopting this perspective, this model pays close attention to the architecture of the law of restitution and to its unique structural features, specifically regarding three common doctrines employed as defenses in the law of restitution. The analysis produces novel, counterintuitive results, and thereby disproves the main conclusions adopted under the existing tort-style account. In particular, the existing account supports regimes of partial restitution, whereas this Article demonstrates and concludes that, contrary to conventional wisdom, regimes of full (rather than partial) restitution can be preferable. This Article highlights the significance of this conclusion for current policy debates and for the appropriate design of restitution doctrine.

INTRODUCTION

The law of restitution governs unintended transfers of wealth. Law and economics literature has never systematically studied this area of the law.

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The economic-oriented accounts that do exist are informal, and they mostly follow the general logic of the far more developed economic analysis of torts. This Article begins to fill this gap by offering the first formal model of restitution for mistaken payments, which is considered the core category of this area of law. While existing literature supports limited restitution regimes, the formal analysis in this Article offers some counterintuitive results that directly contradict this perspective and disprove the main conclusions adopted under the existing tort-style account. The objective of this Article is twofold. First, this Article challenges the prevailing view, which supports the general superiority of limited restitution regimes, such as that described in the hypothetical below. Second, this Article outlines the specific conditions under which each regime—limited or full restitution—should dominate. In doing so, this Article offers a rich doctrinal account and highlights the implications of the analysis for current policy debates.

To outline the argument, consider the following hypothetical. Suppose you are a well-established and busy lawyer, and your daughter recently started going to college in another town. To help her get started, you make a money transfer to her newly opened bank account. However, several days later, you discover that you absentmindedly misprinted your daughter's new bank account number, and the money was erroneously transferred to someone else. Bad luck—but these things happen sometimes.[1] Further investigation reveals that this other person, the unintended recipient of the payment, has already spent some of the money. This hypothetical raises the question of restitution: should the person who received the money be obligated to make restitution of the mistakenly transferred sum?[2] And if so, should you, the payer, be entitled to recover the *entire* sum you transferred, or just *part* of it?

The latter question, namely the question of the scope of the right for restitution, stands at the center of this Article. In many cases of mistaken transfers, the law supports only partial restitution. For instance, according to prevailing law, in the hypothetical above you are likely to be entitled to

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1 Mistaken money payments are common and occur for a wide array of reasons. Those reasons include combinations of clerical errors, *see, e.g.*, Gen. Elec. Capital Corp. v. Cent. Bank, 49 F.3d 280, 286 (7th Cir. 1995); Credit Lyonnais v. Koval, 745 So. 2d 837, 838 (Miss. 1999), misunderstanding of pay orders, *see, e.g.*, Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 190–91 (N.Y. 1991), or mistaken interpretations of the legal validity of existing debts, *see, e.g.*, Sears v. Grand Lodge A.O.U.W., 57 N.E. 618, 619 (N.Y. 1900); Estate of Hatch *ex rel.* Ruzow v. NYCO Minerals, Inc., 270 A.D.2d 590, 591 (N.Y. App. Div. 2000); Pilot Life Ins. v. Cudd, 36 S.E.2d 860, 861 (S.C. 1945); Meeme Mut. Home Prot. Fire Ins. v. Lorfeld, 216 N.W. 507, 508 (Wis. 1927).

2 The case of mistaken payments is considered the core example of the law of restitution. *See* PETER BIRKS, UNJUST ENRICHMENT 3 (2003) ("The law of unjust enrichment is the law of all events materially identical to the mistaken payment of a non-existent debt."); HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 19 (2004); Andrew Burrows, *Restitution of Mistaken Enrichments*, 92 B.U. L. REV. 767, 767 (2012) ("The restitution of a mistaken payment is generally regarded as the paradigm example of the restitution of an unjust enrichment.").

restitution only of the sums still held by the recipient, provided that the recipient made her spending while relying on the payment in good faith.[3] More generally, current legal doctrine limits restitution for numerous reasons, in many different types of restitutionary claims.[4] Those regimes of limited restitution are supported by current economic theory, and scholars consider those regimes superior from an economic standpoint.[5]

The existing analysis of restitutionary claims provided by Professor Hanoch Dagan is a useful starting point for the discussion.[6] Dagan rightly notes that current analysis of restitutionary claims largely follows the far more developed economic analysis of torts.[7] This statement is a familiar theme in the restitution literature.[8] In the prevailing tort-style framework, restitution cases are conceptualized as no different from accidents.[9] As Professor Dagan explains, this framework focuses on the harm caused by an unintended event and on the costs of precautions against this harm.[10] Thus, in the hypothetical previously described, the starting point for the analysis would be on the harmful results of your mistake, specifically how your mistake (transferring the money to the wrong recipient) caused harm to the recipient in the form of unwarranted reliance.[11] The unintended recipient relied on your payment and

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3 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 (AM. LAW INST. 2011) (stating that a recipient's liability in restitution will not be reduced if he is a conscious wrongdoer); *id.* § 52 (stating that a recipient's liability in restitution will not be reduced if he acted in bad faith); *id.* § 65 (indicating that the recipient's liability in restitution should be reduced to the extent of his change of position in reliance on the payer's mistake).

4 See *infra* Parts I–III for a discussion of reasons for limiting restitution. Numerous federal and state courts have limited restitutions for these and other reasons. *See, e.g.*, Equilease Corp. v. Hentz, 634 F.2d 850, 853 (5th Cir. 1981) ("'In situations of endless variety, courts have denied restitution because money paid by one party was received in good faith by the other, in satisfaction of or as security for a valid claim against a third person.' It is patently unfair to require an innocent payee who has received and used the money to satisfy a debt to repay the money." (quoting 3 GEORGE PALMER, THE LAW OF RESTITUTION 490–91 (1978)); NBase Commc'ns, Inc. v. Am. Nat'l Bank & Tr. Co. of Chi., 8 F. Supp. 2d 1071, 1076 (N.D. Ill. 1998) ("The reason why creditors should be able to keep mistaken payments upon receipt is to further the policy goal of finality in business transactions." (citing *Banque Worms*, 570 N.E.2d at 196)); Commonwealth v. Collingdale Millwork Co., 454 A.2d 1176, 1180 (Pa. Commw. Ct. 1983) ("The rationale for this rule is that the judgment creditor who by definition has an entitlement, is a bona fide purchaser for value in giving up his claim and is therefore not unjustly enriched.").

5 *See* discussion *infra* Parts I–III.

6 Hanoch Dagan, *Mistakes*, 79 TEX. L. REV. 1795, 1795–98, 1809–10 (2001).

7 *Id.* at 1810 (discussing "the traditional economic analysis of accidents law").

8 *See, e.g.*, Melvin A. Eisenberg, *Mistake in Contract Law*, 91 CALIF. L. REV. 1573, 1593 n.26 (2003); Peter K. Huber, *Mistaken Transfers and Profitable Infringement on Property Rights: An Economic Analysis*, 49 LA. L. REV. 71, 71 (1988); Andrew Kull, *Defenses to Restitution: The Bona Fide Creditor*, 81 B.U. L. REV. 919, 922 (2001). As shown in this Article, the tendency to follow tort law makes current analysis of restitutionary claims inaccurate.

9 Dagan, *supra* note 6, at 1810.

10 *Id.*

11 Thus, the change-of-position defense, on which the Authors elaborate *infra* Part I, is usually conceptualized as a loss-allocation device. *E.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST

already spent some of the money. If she is now obligated to make full restitution to you, she might actually be left worse off.[12] In this sense, your mistake is no different from any other accident, which is defined as an unintended harmful event.[13]

Once the harm is identified, the tort-style framework then aims to find an appropriate mechanism to assign this harm to the party causing it in order to induce efficient precautions. Assuming the harm of unwarranted reliance can be attributed to your mistake and not to some carelessness by the recipient, you should be made to bear this harm. Accordingly, scholars argue that the law should limit restitution in order to induce you to invest optimally in ex ante precautions against this harmful "accident."[14] Under this regime of limited restitution, you are entitled to restitution of the mistakenly transferred sum—minus any harm you caused to the recipient through her reliance on the payment. This measure of recovery assures that you bear the harm caused by your mistake. Supposedly, this will induce you to invest optimally in order to prevent mistaken transfers ex ante. This account is no different from the standard tort analysis of accidents that aims to induce injurers to invest in precautions. As Professor Dagan notes, a solution of full restitution is considered "inappropriate" in these circumstances, as it will leave you with insufficient incentive to prevent the harm to the recipient.[15]

This Article challenges this prevailing tort-style analysis of restitutionary claims, as well as the normative recommendations that this mode of analysis supports. In particular, the existing analysis errs in its assumption of equating mistakes with accidents because this prevailing conceptualization neglects the unique features of the restitutionary claim, namely, its being based on the enrichment of the defendant. This feature has an important effect on the parties' incentives to invest in precautions ex ante. To exemplify, consider once again the hypothetical previously discussed. First, under any legal regime, you clearly have a strong incentive to try to avoid mistakes of the type you made. Mistakenly transferring your money to a stranger is simply a bad idea: once this happens, it is possible that you will never see the money again. This will be the case, for instance, if you never realize ex post that a mistake has occurred, if the recipient is judgment-proof, or, if you simply are not able to find the unintended recipient to recover the transferred

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ENRICHMENT § 65 cmt. a (AM. LAW INST. 2011) (indicating that in cases of detrimental change of position: "The law of restitution, like the law of torts, assigns losses on the basis of fault. Loss incurred as a result of the recipient's change of position may be allocated to the claimant by eliminating or reducing the recipient's liability in restitution, so long as the recipient is no more responsible than the claimant for the transaction the claimant seeks to reverse."); *see also infra* note 33 and accompanying text.

12 Lipkin Gorman v. Karpnale Ltd, [1991] 2 AC 548 (HL) 560 (appeal taken from Eng.).

13 Dagan, *supra* note 6, at 1806 ("[F]ollowing the conventional wisdom, this Article also uses the recipient's reliance as the measure for the harm the recipient may potentially incur from an award of restitution to the mistaken party."); *see also* DAGAN, *supra* note 2, at 39.

14 J. Beatson & W. Bishop, *Mistaken Payments in the Law of Restitution*, 36 U. TORONTO L.J. 149, 153 (1986); Huber, *supra* note 8, at 105.

15 Dagan, *supra* note 6, at 1813.

money. As giving away your money to random strangers is obviously bad for you, you will have a natural incentive to invest in avoiding such mistakes. Second, this strong incentive to avoid mistaken transfers is not correlated with any social interest in precautions. Mistakenly transferring a sum of money to another is harmful to *you*, but it is not *socially* harmful. The reason for this is that your mistake benefited the recipient, so that any harm to you is (at least partly) offset by a gain by the recipient. As the mistake itself is not socially harmful, your investment in preventing it is wasteful.

Consider the significance of this fact to the question of the scope of restitution. Any limitation on restitution will induce you to *increase* your investment in precaution. Therefore, as any investment in precautions might already be higher than what is socially optimal, limiting restitution can further distort your incentives, rather than improve them.

This Article begins by considering the unique incentive structure underlying restitutionary claims, which is essential in order to design an optimal restitutionary regime. Parts I through III study the three doctrinal tools commonly used to limit restitution: the change-of-position defense, the doctrine of devaluation, and the doctrine of the bona fide payee. Part I articulates the change-of-position defense, used to limit restitution when the recipient relied on the mistaken transfer to her detriment. Part II elaborates on the doctrine of devaluation, which limits restitution when the transfer itself caused a reduction in the value of the transferred assets. Part III studies the doctrine of the bona fide payee, which limits restitution when the recipient of a mistaken payment holds a valid debt against the payer. In each of the first three parts, the prevailing justification for limiting restitution found in the existing literature is reviewed and then followed by a critical analysis. In particular, in each of the three Parts, the critical analyses demonstrate that focus should be shifted from a tort-based to a restitution-based analysis, and further shows that the regimes of limited restitution do not offer any general advantage. Part IV then proposes a formal model based on the analyses offered in Parts I through III. The model describes more explicitly the intuitions underlining the analyses in Parts I through III and delineates the conditions under which regimes of full restitution or limited restitution would dominate. Ultimately, the discussion contained in Parts I through IV leads to the conclusion that the existing incentives to avoid mistakes may lead to favoring a regime of full restitution instead of the limited restitution regime currently applied by courts and supported by economic theorists.

I. CHANGE OF POSITION

The change-of-position defense is used to limit restitution when the recipient relied on the mistaken transfer of money to her detriment. This Part highlights the main features of this doctrine and the current economic theory that justifies its assertion as a defense. While the economic justification proposed is a standard tort-style analysis, Part I concludes that this analysis misses the distinctive features of the mistaken-payment scenario, that is, the fact that the recipient's enrichment was at the payer's expense.

A. *The Main Features of the Doctrine*

In cases of mistaken transfers of benefits, restitution is sometimes limited under the change-of-position defense.[16] This defense is most often used in cases of mistaken money payments.[17] In such cases, a recipient is considered to have "changed her position" if she relied on the payment (transferred to her by mistake) in good faith, so that returning it to the payer would cause her actual loss.[18] If the recipient indeed changed her position based on a payment, restitution might be limited, or even denied outright.[19] To illustrate, assume that following a mistaken payment, the recipient decided to go on an expensive vacation. Importantly, had the recipient known the money was not hers, she would not have gone on such an expensive vacation. This means that the recipient's expense, or the change in her position, was made *in reliance on the payment* she mistakenly received.

The connection between the added expenditure and the mistaken payment is important here. The assumption is that the recipient was willing to pay for the expensive vacation only based on the erroneous belief that the transferred sum was duly hers. In other words, the recipient was willing to pay for the vacation only based on an overestimate of her own true wealth. In this sense, the mistake harmed the recipient, as it caused her to spend not in accordance with her true marginal preferences. If the recipient was made to make full restitution and was thereby returned to her true wealth before the mistaken transfer, she would be left worse off. Under these conditions, the change-of-position defense limits the sum of restitution in accordance with the vacation expenditures made by the recipient, assuring the recipient is not harmed by the mistake, by instead allocating the harm to the payer—the one who caused it. This reasoning likewise applies when banks make mistaken monetary transfers following erroneous interpretations of their clients'

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16 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. d (AM. LAW INST. 2011).

17 *Id.* cmt. a.

18 A change of position is considered detrimental only if the restoration of the mistake entails significant and unavoidable losses for the recipient. *See, e.g.*, First Nat'l City Bank v. McManus, 223 S.E.2d 554, 558–59 (N.C. Ct. App. 1976).

19 To be entitled to the change-of-position defense, the recipient must demonstrate a causal link between the receipt of payment and the expenditure she made based on it: in other words, she must show that the expenditure is one that would not have been made by her but for the payment for which the claimant claims restitution. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. c (AM. LAW INST. 2011).

orders.[20] Thus, if a bank transfers a sum of money to the wrong recipient due to a clerical error, the bank's right for restitution would be limited if the recipient changed her position and relied on the payment to her detriment.

Another feature of the change-of-position defense relates to the recipient's fault. Typically, the recipient is entitled to enjoy the defense only if she relied on the payment in good faith.[21] The defense is therefore unavailable to a recipient who was careless in her reliance on the mistaken payment,[22] or who was primarily responsible for the mistake that occurred.[23] This makes intuitive sense, as a different rule would leave no incentive for the recipient to act cautiously. In accordance with this practice, the change-of-position defense is operational only if the harm of detrimental reliance can be causally attributed to the payer rather than to the recipient.[24]

Scholars have debated at length as to the correct measure by which restitution should be limited under the change-of-position defense.[25] The traditional position is that restitution of mistaken payment is restricted to the sum the recipient still holds, while the money she already spent should be exempt from restitution.[26] It has been pointed out, however, that this position is flawed, since it focuses solely on the recipient's harm resulting from her reliance on the mistaken payment, while ignoring the benefit the recipient generated from spending the money.[27] To exemplify, going back to the vacation example, if all the money the recipient spent on her vacation were exempted from the sum of restitution, the mistake actually would leave the recipient better off.[28] Indeed, if the recipient returned only the cash sums that she still holds, she would be left with whatever benefit she gained from going on her vacation, for which she paid with the payer's money. As long as the value of

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20 Such mistakes can occur when banks erroneously transfer money to unintended recipients, or when they accidentally transfer excessive sums of money. Banks (and other institutional payers) sometimes execute a payment greater than what was ordered by their clients.

21 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. g (AM. LAW INST. 2011).

22 *Id.* § 51(3) & cmt. a; *see also* Beatson & Bishop, *supra* note 14, at 154–55; Dagan, *supra* note 6, at 1814–15. While scholars are in agreement that restitution should be limited, they support different rules in order to optimally incentivize both the payer and the recipient. Such rules differ in the cost of their application and in their ability to achieve optimal results under different factual assumptions regarding the information parties have and the possibility of error in adjudication. For example, compare Dagan, *supra* note 6, at 1816–17 (arguing the rule of comparative fault is superior), with Huber, *supra* note 8, at 86–87 (preferring the rule of contributory fault, considerations of fairness aside).

23 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 52(3) (AM. LAW INST. 2011).

24 *Id.* § 65 cmt. a.

25 For examples, see *supra* notes 16–19 and accompanying text.

26 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. c (AM. LAW INST. 2011) (indicating that the recipient's liability in restitution should be reduced to the extent of the recipient's change of position in reliance on the payer's mistake).

27 Beatson & Bishop, *supra* note 14, at 151–52.

28 *Id.*

the vacation for the recipient is greater than zero, the existing rule of change of position would leave the recipient better off as a result of her interaction with the payer. Therefore, scholars have argued that a proper implementation of the change-of-position defense should exempt from restitution the sums already spent by the recipient on the one hand, and reduce from this exemption the enjoyment the recipient derived from her spending on the other hand.[29] The recipient's enjoyment equals the amount the recipient would have been willing to pay for the vacation had she known her true wealth.[30] Of course, this measurement is speculative and difficult to determine, but ideally, the court should aim to approximate this sum. Under the current regime of limited restitution, such a calculation would allow a more accurate measure of the change-of-position defense, based on the actual harm caused to the recipient.

B. *The Prevailing Economic Justification*

Current economic theory justifies the change-of-position defense under a standard tort-style analysis.[31] This analysis focuses on the social harms of a mistake, in the form of detrimental reliance, and on precautions designed to prevent this harm. Once the harm of detrimental reliance is identified, current theory focuses on allocating this harm correctly to the party responsible for creating it.[32] In this sense, the mistaken payment case is conceptualized in the same way tort theory treats accidents, defined as unintended harmful events.[33] The mistaken payment caused the harm of unintended reliance, so this harm must be borne by the party responsible for the mistake.[34] This will induce optimal investment in precautions designed to prevent the mistake.

In this tort-style framework, the bulk of the analysis is dedicated to comparing rules of contributory, relative, and comparative fault.[35] Under all three rules, the focus of analysis is on the harm of detrimental reliance caused to the recipient.[36] The difference between these rules is in the way they split this harm between the payer and the recipient. Under a rule of contributory fault, restitution would be limited (and the harm will be borne by the payer) only

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29 *Id.* at 153.

30 This would make the recipient indifferent to the mistake. *Id.*

31 *Id.* ("The search for the optimum rule is aided by the scholarship on the economics of accident avoidance about which so much has been written in recent years because analytically the economics of precaution against mistakes is virtually identical to the economics of accident avoidance.").

32 *Id.* at 154–56, 174; Dagan, *supra* note 6, at 1808.

33 *See, e.g.*, RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. a (AM. LAW INST. 2011); Beatson & Bishop, *supra* note 14, at 153–54; Dagan, *supra* note 6, at 1796–99, 1810.

34 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 65 cmt. a (AM. LAW INST. 2011); Dagan, *supra* note 6, at 1814–15, 1820.

35 *See* Beatson & Bishop, *supra* note 14, at 154–55; Dagan, *supra* note 6, at 1814–16.

36 *See* Beatson & Bishop, *supra* note 14, at 153–54; Dagan, *supra* note 6, at 1806.

if the recipient was not negligent in relying on the payment.[37] Under the rule of relative fault, restitution would be limited only if the recipient's responsibility for the harm of detrimental reliance was less than the payer's responsibility.[38] Finally, under the rule of comparative fault, the harm of detrimental reliance would be divided between the parties based on their contribution to its creation.[39] This form of analysis is identical to the classic economic analysis of accidents in tort law, whereby, first, a harmful effect is identified, and then the rules of contributory, relative, and comparative fault are considered in accordance with their ability to assign the harm to the party causing it, in order to induce optimal precautions.

C. *From Tort to Restitution*

The standard tort-style analysis described above misses the distinctive features of the mistaken-payment scenario, that is, the fact that the recipient's enrichment was at the payer's expense. While a mistaken payment can indeed cause harms to the recipient in the form of detrimental reliance, this is hardly the core feature of the interaction between the payer and the recipient. Instead, the defining characteristic of such interactions is a potential loss for the payer, coupled with a benefit to the recipient. In particular, by making a mistaken payment, a payer faces a significant risk of losing the mistakenly transferred sum. Thus, a payer will have a strong incentive to invest in order to avoid mistakes and the risk they entail. At the same time, the risk for the payer of losing the paid sum is offset by a parallel benefit to the recipient, who stands to *gain* that same sum at the payer's expense. This means the payer invests to prevent an event that constitutes a loss for herself, notwithstanding the fact that it also benefits a recipient at the same time. The payer's investment in preventing the mistake is therefore socially wasteful.

The possibility of harm to the recipient in the form of detrimental reliance is acknowledgeable; however, the search for this type of harm must not eclipse the basic incentive structure of restitutionary claims. Therefore, a full analysis of the use of the change-of-position defense must not only focus on the harm of detrimental reliance to the recipient but also include the cost of precautions designed to prevent mistakes, the potential of the loss of the transferred sum for the payer, and the potential benefit to the recipient

37 *See* Beatson & Bishop, *supra* note 14, at 154.

38 *See id.* at 154–55.

39 *See id.* at 155; Dagan, *supra* note 6, at 1815–17. Both Professor Dagan and Professors Beatson and Bishop maintain that individual and institutional liability should relate the ability to avoid mistakes. *See* Beatson & Bishop, *supra* note 14, at 156–57; Dagan, *supra* note 6, at 1819 (noting that "the capped-individual-liability rule . . . allocates asymmetrical liabilities to individuals and institutions corresponding to their differing mistake-avoidance capacities").

(including the potential benefit that the recipient obtained from using the mistaken payment).[40] This dynamic is captured in Example 1:

> *Example 1*: A bank regularly makes money transfers. Occasionally, the bank errs in its operation and transfers money to an unintended recipient. The average transferred sum is 1,000, and the bank makes a mistake in 1% of the transfers. The bank can avoid mistakes entirely by investing 6 per transfer in additional precautions. The bank's investment decision depends on the cost incurred in case of a mistake and on the ability of the bank to retrieve a mistakenly transferred sum. Assume that in case of a mistake there is a 50% chance the bank will not be able to recover the money.[41] Also, assume that when the bank is able to retrieve the money after a mistake has occurred, this will involve an administrative cost of 100, entirely borne by the bank. Finally, assume that in case of a mistake the recipient will increase her expenses through detrimental reliance. Particularly, assume that if the recipient returns the money mistakenly transferred to her to the bank, she will be left with harm of 200 (a loss that is a result of the bank's mistake and is caused through no fault of the recipient).

Under the current regime of limited restitution, the bank in Example 1 is entitled to recover the mistakenly transferred sum, but it must also pay the administrative cost of retrieving the sum (100), as well as any harm caused to the recipient due to her detrimental reliance (200).[42] Importantly, the bank is made to bear this harm only assuming there was no carelessness by the recipient. Remember also that restitution is possible only in 50% of the cases, so the bank stands to lose the mistakenly transferred sum in 50% of the cases. Therefore, a mistake entails a cost of 6.5 for the bank: $(50\% \times 300 + 50\% \times 1{,}000) \times 1\%$. Accordingly, the bank will prefer investing 6 per transfer in added precautions in order to prevent the mistake, instead of bearing the expected cost of 6.5. As mistakes never occur,[43] the total social cost in Example 1 equals 6 per transfer (the cost of the bank's added investment in precautions).

Consider now a regime of full restitution, under which the bank will be entitled to restitution of the full sum that was mistakenly transferred, when

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40 *See* Beatson & Bishop, *supra* note 14, at 154–55; Dagan, *supra* note 6, at 1810; *see also supra* notes 23–27 and accompanying text.

41 That is the case, for instance, if the bank never finds the recipient, or if the bank never realizes a mistake has occurred. This may also be the case when a recipient becomes insolvent, or otherwise judgment-proof.

42 This analysis assumes that the recipient here relied on the payment in good faith and that the harm of detrimental reliance was entirely the payer's fault.

43 As noted in Example 1, by investing 6 per transfer in additional precautions, the bank can entirely avoid mistakes.

the bank is able to secure it (in 50% of mistakes).[44] Under this regime, when restitution is attainable, the bank in the example must pay the administrative cost (100); however, it is not required to pay for the recipient's harm (200), even if the recipient was not careless. In this case, a mistake represents an expected cost of 5.5 for the bank: (50% × 100 + 50% × 1,000) × 1%. As the cost of a mistake is only 5.5, the bank will choose not to invest 6 per transfer in added precautions. This means that the total social cost associated with a regime of full restitution consists of the administrative costs of retrieving the money mistakenly transferred and the cost of the detrimental reliance of the recipient: (50% × 300) × 1%. Therefore, the total social cost under a regime of full restitution in Example 1 equals only 1.5 per transfer, which represents a significant improvement and a superior result compared to the total cost of 6 calculated under the current regime of limited restitution.[45]

This result is rather surprising as, intuitively, under the standard economic view, a limited restitution regime should lead to optimal results because it makes the payer bear the full harm she is causing.[46] Yet the analysis of Example 1 demonstrates that the standard analysis is inaccurate, as it neglects the distinct incentive structure underlying the restitutionary claim. In other words, a rule that makes the payer, the party causing the harm, fully internalize the recipient's harm is not necessarily efficient in cases of mistaken transfers. The reason for this is that the payer already has ample incentive to invest in precautions in order to avoid losing the transferred sum. As previously noted, this strong incentive is beyond the social interest in precautions, due to the fact that the payer is investing to prevent a harm that is offset by the recipient's enrichment. Therefore, there is little need to incentivize payers to further invest in precautions by using the change-of-position defense to limit restitution.

II. DEVALUATION

The devaluation doctrine, the second defense to limit restitution discussed in this Article, is employed in situations where a benefit, typically something other than money, is transferred to an unintended recipient and

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44 *See supra* note 41 and accompanying text.

45 Note that even if generally speaking *preventing* unintended transfers is cheaper, per transfer, than *reversing* unintended transfers using the litigation system, the option of reversing unintended transfers through liability is still valuable for the payer. This is because the cost of ex ante precautions is borne for every transfer, while the cost of litigation is probabilistic and is incurred only for those rare transfers where a mistake actually occurred. This advantage of litigation over precautions is comparable to the advantage of litigation over regulation described by Professor Steven Shavell. *See generally* Steven Shavell, *A Fundamental Enforcement Cost Advantage of the Negligence Rule over Regulation*, 42 J. LEGAL STUD. 275 (2013).

46 Thus, Professors Beatson and Bishop claim that the regimes of limited restitution (together with contributory, relative, and comparative fault) are potentially efficient, while the regime of full restitution is not. Beatson & Bishop, *supra* note 14, at 155.

cannot be adequately reverse-transferred. This Part addresses the main features of the doctrine and provides a hypothetical for illustration. After providing the popular economic justification for the defense, this Part concludes that, similar to the change-of-position defense, the existing economic framework is insufficient to fully and fairly address restitution.

A. *The Main Features of the Doctrine*

Restitution in cases of mistake is also limited under a doctrine of devaluation. The doctrine is particularly relevant in cases of non-monetary transfers, where some asset other than money is mistakenly transferred from a benefactor to an unintended recipient. In such cases, the value of the asset to the benefactor (who mistakenly made the transfer) is typically greater than its value to the recipient. As recovery of the actual asset is often impossible, the court will order monetary restitution as a way of reversing the unintended transfer.[47] Under the doctrine of devaluation, the court will limit monetary restitution, measuring it according to the (lower) value of the asset from the recipient's point of view.[48]

To illustrate, consider the following hypothetical, featuring an online food delivery service. Assume a supermarket receives an online order for a delivery of five pounds of tomatoes, worth $5. Due to some clerical error, the supermarket sends the goods to the wrong address and leaves them there. The residents there are actually happy about the unanticipated delivery, but they have no need for such a large amount. They therefore consume two pounds of tomatoes, worth $2, and the rest is thrown out. Under a regime of full restitution, the supermarket would be entitled to a payment for the value of five pounds of tomatoes—the value of the benefit to the supermarket. In contrast, under the doctrine of devaluation and a rule of limited restitution, the supermarket is entitled, at the most, to a payment for two pounds of tomatoes—the value of the benefit to the beneficiary. Under these circumstances, if full restitution is ordered, the recipients are actually left worse off, with a harm of $3. As this simple illustration shows, in cases of devaluation, the potential harm to the recipient if full restitution is ordered is not a result of the recipient's reliance, but a product of the benefactor's initial mistake. That

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[47] *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. e(1) (AM. LAW INST. 2011). For a broader description of the use of specific recovery in common law countries, see Colleen P. Murphy, *What Is Specific About "Specific Restitution?"*, 60 HASTINGS L.J. 853 (2009).

[48] This would be the case, for example, when a benefactor confers benefit upon a recipient by accidently improving the latter's asset, mistakenly believing it was her own. In such a case, unless the recipient was aware of the benefactor's mistake and stood by, permitting the work to proceed, the relief to the benefactor would be limited to the benefit conferred from the recipient's point of view. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 10 cmts. a, c (AM. LAW INST. 2011)*; id.* § 25 cmt. c (indicating that if a benefactor seeks restitution for performance in the absence of agreement, she will bear "the burden of establishing the value to the defendant of the performance in question"); Beatson & Bishop, *supra* note 14, at 155; Shavell, *supra* note 45, at 299.

is, the tomatoes are worth $5 to the supermarket, but only $2 to the beneficiary. Assuming it is prohibitively expensive to re-ship the tomatoes (as they are at their best when consumed fresh), the supermarket caused a harm of $3 by transferring the tomatoes to the wrong address.

B. *The Standard Economic Explanation*

Existing economic analysis justifies the devaluation doctrine based on the same tort-style logic used in the analysis of the change-of-position defense discussed in Part I of this Article. The devaluation doctrine is operational in those cases in which the transfer resulted in a decrease in the value of the benefit. In such cases, requiring the recipient to make full restitution will leave her worse off than she would have been had the benefactor not made the mistaken transfer to her. That is, full restitution, measured by the value of the benefit to the benefactor, would result in an overall loss for the recipient. As this loss is a product of the benefactor's mistake, economists argue it makes sense to make the benefactor bear it.[49] If restitution is reduced to reflect the harms of devaluation, benefactors will be incentivized to invest in precautions and prevent value-reducing mistakes ex ante.

C. *From Tort to Restitution*

The standard tort-style analysis is once again lacking and essentially ignores the core feature of the unique dynamic between the benefactor and the recipient in restitution cases. In particular, this form of analysis disregards the nature of the parties' incentives. In the analysis of Example 1 in Part I of this Article, it was established that a full analysis of the restitutionary claim must consider five core elements: (1) the harm to the payer in case she loses the mistakenly transferred benefit; (2) the benefit to the recipient if she is allowed to keep the transferred assets;[50] (3) the cost of the payer's precautions against the mistake; (4) the harm to the recipient in case she is made to make full restitution; and (5) the administrative cost of reversing the transfer. These elements are captured in Example 2 below, which is based on the facts of the case in *Michigan Central Railroad v. State*.[51]

> *Example 2*: A coal mining company mistakenly transferred a shipment of high quality coal, worth 1,000, to a prison house. The chance of such a mistake is 1% and the coal company can prevent

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[49] *Cf.* Ariel Porat, *Private Production of Public Goods: Liability for Unrequested Benefits*, 108 MICH. L. REV. 189, 226–27 (2009).

[50] See *supra* notes 27–28 and accompanying text.

[51] 155 N.E. 50 (Ind. App. 1927) (en banc). For more details on this case, see Andrew Kull, *Rationalizing Restitution*, 83 CALIF. L. REV. 1191, 1203 (1995).

> mistakes completely by investing 7 per transfer in additional precautions. Importantly, the prison house cannot derive any special benefit from the fact the coal is of high quality; instead, the prison house can use it for heating as it would use any other coal of lower quality. The value of a shipment of regular coal in the same amount is 500. Unaware of the mistake, the prison house indeed used the coal. Assume that there is a 50% chance that the coal company will not be able to recover for its mistakes (this would be the case if, for instance, it never realizes a mistake has occurred, or if the recipient is insolvent, or otherwise judgment-proof). When the coal company is able to retrieve the money after a mistake has occurred, this involves an administrative cost of 100, borne entirely by the coal company.[52]

Under the current regime of limited restitution, the coal company is entitled to recover the mistakenly transferred sum, and it must also pay the administrative cost of retrieving the sum (100). Additionally, restitution is limited further by the fact that the coal company is made to bear the costs of devaluation. Thus, restitution is reduced by 500 to prevent the recipient from bearing the loss of the decrease in the value of the coal. Remember that restitution is possible only in 50% of the cases, so the coal company stands to lose the mistakenly transferred asset in 50% of the cases. Therefore, a mistake represents an expected cost of 8 for the coal company: (50% × 600 + 50% × 1,000) × 1%. Accordingly, the coal company will prefer investing 7 per transfer in added precautions in order to prevent the mistake, instead of bearing the expected cost of 8. As mistakes never occur, the total social cost equals 7 per transfer (the cost of the coal company's added investment in precautions).

Consider now a regime of full restitution, according to which the benefactor is entitled to restitution of the full value of the assets she transferred when she is able to secure it (in 50% of mistakes). When restitution is possible, the coal company must pay the administrative cost (100). In this case, a mistake represents an expected cost of 5.5 for the coal company: (50% × 100 + 50% × 1,000) × 1%. As the expected cost of a mistake for the coal company is only 5.5, it will choose not to invest 7 in added precautions. This means that the total social cost associated with a regime of full restitution is the administrative cost of retrieving the money mistakenly transferred and the cost of the recipient's loss from bearing the reduction in the value of the coal: (50% × 600) × 1%. The total social cost under a regime of full restitution in Example 2 therefore equals only 3 per transfer, a significant improvement compared to the total cost of 7 calculated under the current regime of limited restitution.

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52 *See Mich. Cent. R.R.*, 155 N.E. at 50.

This result is equivalent to the result of the analysis in Part I of this Article. That is, there is no general justification for limiting restitution to reflect the devaluation generated by the mistaken transfer of property. It should be noted that this analysis is also relevant for claims for restitution for services mistakenly provided (instead of goods). To illustrate, consider the classic case in *Upton-on-Severn Rural District Council v. Powell*.[53] In this case, a fire department saved property outside its jurisdiction, and so conferred a benefit on an unintended recipient.[54] However, the help had zero market value to the recipient, who was entitled to services from a different fire department for free.[55] The court nevertheless granted full restitution.[56] This makes economic sense when considering the above analysis and conclusion regarding Example 2: if there is no restitution, this can cause the firefighters to overinvest in precautions designed to prevent similar mistakes. The deciding court's conclusion in this case aligns with the argument that Part II of this Article proposes. However, it is contrary to conventional wisdom found in the legal literature, which considers the case to be wrongly decided in granting full instead of limited restitution.[57]

III. BONA FIDE PAYEE

The last doctrine addressed in this Article is the doctrine of bona fide payee, which is used as a defense to free the recipient of what would otherwise be a valid claim in restitution in cases in which the recipient was already in fact owed a debt by the benefactor. This Part addresses the main features of the bona fide payee and establishes the common fact patterns associated with this doctrine. Just as in Part I and Part II of this Article, Part III also provides the widely accepted economic justification for this defense, then criticizes this justification through an alternative analysis. This analysis results in the conclusion that limiting restitution under the bona fide payee doctrine is not desirable, which differs slightly from the conclusions reached in the analyses of the doctrines in Parts I and II.

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53 [1942] 1 All ER 220 (CA).
54 *Id*. at 220.
55 *Id*. at 221.
56 *Id*.
57 Kull, *supra* note 51, at 1203.

A. *The Main Features of the Doctrine*

The doctrine of bona fide payee primarily treats three-party scenarios of a mistaken money payment from a payer to a recipient through an intermediary.[58] The cases incorporating this doctrine share the following fact pattern: a payer transfers money to a recipient through a third party; the intermediary makes a mistake in the transfer (for instance, she transfers the money to a different recipient or mistakenly ignores the payer's notice to abort the payment); the recipient receives the mistaken transfer of money in good faith;[59] and the payer has a valid debt owed to the recipient.[60] In this, the cases studied here present an extra complication: a mistake was made and the payer did not intend to make a payment—but a debt was nevertheless owed to the recipient.[61] In these circumstances, the bona fide payee doctrine would free the recipient of what would otherwise be a valid claim in restitution.[62] This result is particularly crucial when the intermediary who accidently transferred the money is insolvent.[63] In such cases, limiting the recipient's duty to make restitution means the payer will never be able to recover her losses.

The doctrinal justification for this result is that the recipient in the above scenario accepts the payment in discharge of the payer's antecedent debt, so she is actually receiving what is rightfully hers.[64] Under these circumstances, the recipient is not considered to be unjustly enriched at the payer's expense, despite the fact that the payment originated with the payer's mistake.[65] Accordingly, the recipient's liability in restitution is reduced, partially or in whole, in the amount of the previous debt she held against the mistaken

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58 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 (AM. LAW INST. 2011).

59 The term "good faith" signifies that only a recipient without notice of the payer's mistake may use the affirmative defense of bona fide payee. *Id.* § 67(2).

60 *Id.* § 67(1).

61 *See* Mich. Cent. R.R. Co. v. State, 155 N.E. 50, 50 (Ind. App. 1927) (en banc); Lipkin Gorman v. Karpnale Ltd, [1991] 2 AC. 548 (HL) 560 (appeal taken from Eng.); Upton-on-Severn Rural Dist. Council v. Powell, [1942] 1 All ER 220, 221 (CA).

62 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 (AM. LAW INST. 2011).

63 *See, e.g.*, Kull, *supra* note 8, at 943; Menachem Mautner, *"The Eternal Triangles of the Law": Toward a Theory of Priorities in Conflicts Involving Remote Parties*, 90 MICH. L. REV. 95, 147–48 (1991). In cases of insolvency, a relief to the payer might come in the form of subrogation. This may be the case, for example, when the mistaken payment of another's debt has the effect of discharging a lien on the other's property, the payer may obtain restitution via subrogation to the discharged lien. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 7 cmt. b (AM. LAW INST. 2011). For an extended research study on subrogation, see CHARLES MITCHELL & STEPHEN WATTERSON, SUBROGATION: LAW AND PRACTICE (Adam Fenton & Henry Legge eds., 2007).

64 For this reason, the title of a former version of this doctrine was "discharge for value." *See* RESTATEMENT (FIRST) OF RESTITUTION § 14 (AM. LAW INST. 1937).

65 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 (AM. LAW INST. 2011).

payer.[66] In these terms, the bona fide payee defense is analogous (though not identical[67]) to the bona fide purchaser defense: the recipient in this case is perceived as a bona fide purchaser of the money.[68]

It should also be noted that the scenario of bona fide payee described above reflects only one possible tale of a three-party chain of mistaken payment.[69] In fact, the bona fide payee doctrine protects payees across a wider range of three-party payment transactions, especially under current U.S. law. In the United States, the bona fide payee defense enjoys a dominant status and is applied in a wide array of factual situations.[70] Importantly, outside the United States, the status of the bona fide payee defense is less clear, and its application is significantly narrower.[71] Thus, in the United States, the doctrine also covers so-called "exotic cases,"[72] in which a payer is induced by fraud or mistake to pay money to an assignee who receives the payment while erroneously believing that it enforces a third party's valid obligation, which in fact does not exist.[73] Despite the factual differences, U.S. courts tend to limit restitution in all types of three-party-transactions cases, as long as they share the basic pattern of good faith receiver of money and include an antecedent debt that the mistaken payment purportedly discharged.[74] The factual differences between the various scenarios in which the doctrine may apply have no substantial influence over the incentive structure of the payer and the recipient. Furthermore, the economic explanations for the bona fide payee doctrine also concentrate on the basic pattern that the different types of three-party conflicts share rather than on their factual differences.[75]

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66 The elementary consequence of this limitation is that the bona fide payee doctrine allows the recipient to retain the payment up to the amount by which it reduces the valid obligation. It affords no defense to restitution of an overpayment. *See, e.g.*, J.C. Penney Co. v. West, 230 S.E.2d 66, 68 (Ga. Ct. App. 1976).

67 The bona fide payee doctrine provides greater protection for the recipient, compared to the change of position doctrine. For a comparison of the two doctrines, see, for example, CHARLIE WEBB, REASON AND RESTITUTION: A THEORY OF UNJUST ENRICHMENT 230–32 (2016); Kull, *supra* note 8 at 924–25.

68 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67 cmt. a (AM. LAW INST. 2011).

69 For a profound description of different types of payment transactions regulated through the bona fide payee doctrine, see Kull, *supra* note 8, at 936–48.

70 *See id.* at 929.

71 *See* Barclays Bank Ltd v. W.J. Simms Son & Cooke (Southern) Ltd, [1980] 1 QB 677 at 695 (Eng.); Daniel Friedmann, *Payment of Another's Debt*, 99 L.Q. REV. 534, 551 (1983).

72 For the use of the phrase "exotic cases" in this context, see Kull, *supra* note 8, at 936.

73 For cases in which restitution was denied for this reason, see, for example, Cal. Pac. Title & Tr. Co. v. Bank of Am. Nat'l Tr. & Sav. Ass'n, 55 P.2d 533, 537 (Cal. Dist. Ct. App. 1936); Gaffner v. Am. Fin. Co., 206 P. 916, 918 (Wash. 1922); Krebs v. World Fin. Co., [1958] 14 D.L.R. 2d 405, 408 (B.C.C.A.).

74 Cal. Trade Tech. Schs., Inc. v. United States, 923 F.2d 641, 649 (9th Cir. 1991).

75 *See infra* Section III.B.

B. *Existing Economic Explanations*

As in the case of the doctrines discussed in Parts I and II, the economic explanation for the bona fide payee doctrine also leans on tort-style reasoning. In this framework of equating mistakes with accidents, the payer is most often considered to be better able to avoid mistakes and the losses that such mistakes produce.[76] This is especially true when the payer is believed to have better access to information regarding the risks a mistake entails and the costs of preventing it ex ante. In other words, the payer is typically perceived as the "cheapest cost avoider" or "best decision maker" when compared to its bona fide payee counterpart.[77] This may especially be the case when the payer is a bank, a sophisticated repeat player with the supposed ability to avoid the mistake at low cost.[78]

A similar justification for the bona fide payee doctrine focuses on commercial certainty and the finality of payments. To enjoy the defense, the payee must show the payment was complete and final.[79] The rationale of this requirement is that the law seeks to protect the finality of payments and allow recipients to rely on them.[80] This feature is considered necessary for the smooth operation of the payment system, as protecting the finality of a present transaction is believed to facilitate the next one.[81] This focus on commercial certainty is intimately linked to the aforementioned tort-style framework. Again, the focus of analysis is on the potential harms caused by the mistake, here in the form of commercial uncertainty, or on the potential inability to rely on payments.[82] As the payer caused this harm, it would make sense to limit restitution, thereby incentivizing the payer to invest in precautions and avoid mistakes ex ante. Following this logic, the defense is available only if the payee was indeed unable to prevent the mistake.[83] If, on the

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76 *See supra* note 78 and accompanying text.

77 The concept of best decisionmakers was articulated in the celebrated article of Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1070 (1972).

78 *See, e.g.*, Nat'l Bank v. FCC Equip. Fin., Inc., 801 N.W.2d 17, 21 (Iowa Ct. App. 2011); Banque Worms v. BankAmerica Int'l, 570 N.E.2d 189, 194 (N.Y. 1991); Bayerische Hypo-Und Vereinsbank AG v. HSBC Bank USA, No. 602,761/2009, 2015 N.Y. Misc. LEXIS 2602, at *8 (N.Y. Sup. Ct. July 15, 2015), *aff'd* 144 A.D.3d 501 (N.Y. App. Div. 2016).

79 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67(2) (AM. LAW INST. 2011).

80 *Id.* § 67 cmt. b.

81 Kull, *supra* note 8, at 929–30. For more details on the relationship between finality of payment and restitutionary claims, see Andrew Kull, *Restitution and Final Payment*, 83 CHI. KENT L. REV. 677 (2008).

82 *See, e.g.*, WEBB, *supra* note 67, at 230.

83 *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 67(2) (AM. LAW INST. 2011). Indeed, section 67 states that the bona fide payee defense is applicable only for recipients "without notice." *Id.* § 67(1). This is not a fixed rule, but a flexible standard, referring to the ability of the recipient to notice the mistake and thus prevent its occurrence. In any event, it is hard to imagine circumstances

other hand, the payee knew of the mistake or was otherwise able to prevent it, she will not be considered to have received the money in good faith.[84]

Finally, the bona fide payee defense seems appealing from a fairness perspective. As the payee was entitled to the payment, she is not considered to be "unjustly enriched" by it, so restitution is seemingly unnecessary regardless of the payer's mistake.

C. *From Tort to Restitution*

The bona fide payee doctrine is puzzling from an economic perspective, despite its apparent moralistic appeal. The reason for this is that restitution is limited under the bona fide payee doctrine even if the recipient cannot specifically demonstrate that she was harmed by the mistake.[85] Of course, the payee will typically wish to avoid restitution of the mistaken payment, but this does not mean the interaction as a whole constitutes a loss for her.[86] In fact, even if the payee is ordered to make restitution, her position following restitution is not worse than her position prior to the mistake.[87] In other words, the payee received a sum of money; if she is now made to give it back, she is not left worse off by the interaction with the payer.

The bona fide payee doctrine seeks to limit restitution in cases in which the payee is unable to demonstrate any specific harm that she suffered as a result of her interaction with the payer.[88] In this, the bona fide payee doctrine is different from the doctrines studied in Parts I and II. The doctrines analyzed in Parts I and II limit restitution only when the recipient was actually harmed. Limiting restitution may be undesirable even if the mistake *did* harm the recipient. The case for limiting restitution is even weaker under the bona fide payee doctrine, where the payee is not required to demonstrate she was harmed in any specific way. To evaluate the doctrine's limitation on

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where the bona fide payee defense will be available to a recipient who could have noticed the mistake and prevented the transfer's finality but did not do so. *See also* U.C.C. § 4A-102 cmt. (AM. LAW INST. & UNIF. LAW COMM'N 2018) (indicating that a critical consideration in the drafting of Article 4A that treats payment by funds transfer "was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately").

84 This does not mean that the payer was negligent. The bona fide doctrine does not require any fault on behalf of the payer. However, this way or the other, one of two innocent parties—either the payer or the recipient—must suffer a loss.

85 See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 66 cmt. a (AM. LAW INST. 2011).

86 Kull, *supra* note 8, at 929–30.

87 Naturally, after returning the payment she received by mistake, the recipient will continue to hold her debt against the payer, as she did before the mistaken transfer of money occurred. *See id.* at 930.

88 RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 66 cmt. a (AM. LAW INST. 2011).

restitution more systematically, consider the following example, based on the facts of the case *Banque Worms v. BankAmerica International*:[89]

> *Example 3*: A payer sends its bank a pay order late at night, instructing the bank to make a transfer of $1 million to Recipient A. Early the following morning the payer sends another bank order, this time canceling the first order and ordering the bank to pay the same sum to Recipient B instead. Both recipients have previously issued loans to the payer, and the payer currently owes each of them a significant sum of money. At noon the same day, the payer's bank mistakenly ignores the second pay order, and sends a payment to Recipient A instead of Recipient B. After the mistake is revealed, a short investigation into the bank's records shows that a mistake of this type is quite rare and occurs once every 10,000 transfers. To prevent this type of mistake, the bank will have to review all outstanding pay orders before issuing any one of them, at a cost of $90 per transfer. The administrative cost of retrieving the money in case of mistake is $100.[90]

Under the circumstances of Example 3, the bona fide payee doctrine allows Recipient A to retain the money despite the fact that it was transferred to her by mistake. As previously described, the doctrinal reasoning behind this result is that the money transferred by mistake was in fact owed to Recipient A, and therefore the result of the payer's mistake was simply that Recipient A received what was rightfully hers. Since restitution is not available, a mistake represents an expected cost of $100 for the payer: (0.01% × $1,000,000). Thus, the payer will invest the $90 per transfer in added precautions in order to prevent mistakes of this type. This option entails a total social cost of $90 per transfer.

Conversely, if restitution is available, the payer only loses a sum of $100 for retrieving the payment in the event of a mistake. Therefore, the expected cost of a mistake is just one cent per transfer: (0.01% × $100). The payer will thus not invest in precautions and instead will pay for restitution ex post in the rare case of a mistake. In this scenario, the social cost of precautions ($90 per transfer) is saved, and the total social cost is only one cent per transfer.

According to this analysis, it seems that limiting restitution under the bona fide payee doctrine is never desirable. This type of limitation on

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89 570 N.E.2d 189 (N.Y. 1991).

90 *See id.* at 190–91. In the actual case, the payer, Spedley Securities ("Spedley"), sent a first payment order to its bank, Security Pacific International Bank ("Security Pacific"), requesting an electronic payment be sent from its account to a first creditor, Banque Worms. Before Security Pacific sent the payment, Spedley sent a second payment order to Security Pacific, cancelling the first order and requesting that the electronic payment be sent instead to a second creditor, National Westminster Bank USA ("Natwest USA"). Disregarding the cancellation, Security Pacific sent electronic payments to both Banque Worms and Nat-west USA from Spedley's account, resulting in an overdraft. *Id.*

restitution is different from the ones studied in Parts I and II. Under the doctrines studied in Parts I and II, limited restitution was not generally superior, but it was also not always inferior to the rule of full restitution. Conversely, the bona fide limitation of restitution seems to be always inferior to the rule of full restitution. The reason for this difference is that in the case of the bona fide payee doctrine, restitution is limited even though there is no harm to the recipient. This means that in Example 3, any investment to prevent the mistake is by definition wasteful, so any limitation of restitution is inefficient. In terms of optimal incentives, it should not matter whether the payer owed money to Recipient A; as long as the transfer was based on the payer's mistake, restitution should be available in order to lower investment designed to prevent the mistake. Any limitation on restitution can only serve to increase precautions and is, therefore, undesirable. This conclusion is of special importance in light of the fact that the status of the bona fide payee doctrine is currently under debate, and its application varies greatly between different common law jurisdictions.[91] The general implication of this analysis, and the precise nature of the difference between Example 3 and Examples 1 and 2 is further illustrated in Part IV of this Article.

IV. MODEL

This Part offers a formal model generalizing on the examples presented in Parts I through III. The model studies the investment by the payer in preventing mistakes. Mistakes represent a potential loss for the payer (and an equivalent gain for the recipient), but restitution can result in a loss for the recipient. The purpose of the model is to state more explicitly the intuitions explored in Parts I through III and delineate the conditions under which each rule (full restitution or limited restitution) should dominate. However, the main argument of this Article—that limited restitution is not a priori superior to full restitution—stands regardless of the specifics of the model and is unambiguously established in the examples analyzed in Parts I through III. In this sense, the aim of the formal analysis below is merely to clarify and provide context for the argument.

A. *Setting*

A payer makes a monetary transfer. With probability p, the payer makes some kind of mistake in making the transfer and transfers an unintended sum to the recipient. And p decreases with the payer's investment in precautions, c (assume $p'(c) < 0, p''(c) > 0$ for any c). If a mistake occurs, the payer stands to lose the transferred sum, t. In particular, the payer is able to secure restitution only in part of the cases of a mistake; this part is denoted π, so that

[91] See *supra* notes 70–73 and accompanying text.

in $1-\pi$ of cases the payer will not be able to retrieve the mistakenly transferred sum. If the payer is able to retrieve the sum, the payer will bear an administrative cost of l for doing so. Also, if a mistake occurred but the sum is returned to the payer, the recipient may suffer a loss of h. This loss can represent the recipient's detrimental reliance, or any devaluation in the value of the transferred assets. For simplicity, assume the harm h is caused by the payer's mistake and cannot be prevented by the recipient at reasonable cost. Also, assume there is always a possibility the payer loses the transferred sum ($0 < \pi < 1$), and that there is always some harm to the recipient in case of restitution ($0 < h$).

B. *First Best*

While the payer may fear the loss of the transferred sum t, this does not represent a social loss (as it entails an equivalent benefit to the recipient). The social cost therefore includes the cost of precautions by the payer (c), the administrative cost of retrieving the money ex post (l), and the harm of detrimental reliance (h). Therefore, the social planner minimizes:

$$(1) \quad c + p(c)\pi(l+h)$$

The first-order condition is:

$$(2) \quad -p'(c) = \frac{1}{\pi(l+h)}$$

This first-order condition defines the first best level of investment, c^*. Note that as the cost of restitution $(l+h)$ increases, so does the optimal level of investment. This makes intuitive sense.

C. *Limited Restitution*

This Section studies investment levels under the rule of limited restitution. Under a rule of limited restitution, the payer is entitled to recover the mistakenly transferred sum if this is possible (in π of cases of mistake). If restitution is possible, the payer pays the administrative cost of restitution (l) and the recipient's harm of detrimental reliance (h). The payer minimizes:

$$(3) \quad c + p(c)[\pi(l+h) + (1-\pi)t]$$

The first-order condition is:

$$(4) \quad -p'(c) = \frac{1}{\pi(l+h)+(1-\pi)t}$$

This first-order condition defines the level of investment under a regime of limited restitution, c_l.

D. *Full Restitution*

Under a rule of full restitution, the payer is entitled to recover the mistakenly transferred sum if this is possible (in π of cases of mistake). If restitution is possible, the payer pays the administrative cost of restitution (l). The payer minimizes:

$$(5)\quad c + p(c)[\pi * l + (1-\pi)t]$$

The first-order condition is:

$$(6)\quad -p'(c) = \frac{1}{\pi * l + (1-\pi)t}$$

This first-order condition defines the level of investment under a regime of full restitution, c_f.

E. *Investment Levels*

By comparing (4) and (6) with (2), one can see that investments under both rules differ from the optimal level of investment, c^*. Comparing (4) and (6) also shows that:

$$(7)\quad c_f < c_l$$ [92]

These results can be summarized in the following proposition:

> *Proposition 1: The rule of limited restitution results in a higher level of precautions compared to the level of investment under the rule of full restitution; neither rule can always guarantee the first best.*

Looking at (2) and (6), the rule of full restitution generates optimal levels of investment ($c_f = c^*$) only if:

$$(8)\quad \pi h = (1-\pi)t$$

When the condition in (8) holds (and full restitution is optimal), the rule of limited restitution leads to overinvestment (from (7)). To explain, under the rule of limited restitution, the payer overinvests here as she considers both the risk of losing the transferred sum as well as the risk of detrimental reliance by the recipient.

Similarly, from (2) and (4), the rule of limited restitution leads to optimal investment ($c_l \to c^*$) if:

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[92] $c_f < c_l$ follows immediately from (4) $p'(c) = \frac{1}{\pi(l+h)+(1-\pi)t}$ and (6) $p'(c) = \frac{1}{\pi * l+(1-\pi)t}$, by the assumption that $0 < h$ and $\pi < 1$.

(9) $\pi \rightarrow 1$

That is, investment under limited restitution is optimal only if there is virtually no possibility for the payer to lose the transferred sum. When limited restitution is optimal, full restitution leads to underinvestment by the payer (from (7)). This can be summarized as follows:

> *Proposition 2: The rule of full restitution is optimal when the risk for the payer of losing the transferred sum is equal to the possible harm for the recipient in case restitution is granted* $[\pi h = (1-\pi)t]$. *The rule of limited restitution is optimal only if there is no possibility that the payer will lose the transferred sum* $(\pi \rightarrow 1)$.

To delineate when each rule is superior, define as $\dot{\pi}$ the π for which the condition in (8) holds. Note that when $\pi < \dot{\pi}$ the result is $c^* < c_f < c_l$, which means that full restitution dominates limited restitution. When $\pi \rightarrow 1$, the result is $c_l \approx c^* > c_f$, which means that limited restitution dominates full restitution. Thus, there must be a π between $\dot{\pi}$ and 1 for which the social cost of limited restitution and full restitution are equal. Define this π as $\bar{\pi}$. This means, generally, that the desirability of the different rules depends on the magnitude of π, the probability that the payer is able to find the recipient and secure restitution. These results can be summarized in the following proposition:

> *Proposition 3: Limited restitution dominates full restitution when the likelihood that the payer will be able to retrieve the mistakenly transferred sum is high* $(\pi > \bar{\pi})$. *Full restitution dominates limited restitution if the likelihood that the payer will be able to retrieve the mistakenly transferred sum is low* $(\pi < \bar{\pi})$.

This result also explains why in cases of the bona fide payee doctrine, full restitution is always superior to limited restitution. Under the bona fide payee doctrine, there is no harm to the recipient, or $0 = h$. The law nevertheless limits restitution not by making the payer bear any harm caused to the recipient (as $0 = h$), but instead by lowering the number of cases where restitution is available by making some transfers irreversible. In the language of the model, the law intervenes to artificially make π lower, or substitute π with $\hat{\pi}$ so that $\hat{\pi} < \pi$. This is never desirable. To see this, remember that the optimal level of precaution is given by (2); assuming $0 = h$, the equation becomes: $p'(c^*) = \frac{1}{\pi l}$. Now, if the law substitutes $\hat{\pi}$ for π, precautions become needlessly higher: $p'(c) = \frac{1}{\hat{\pi} l + (1-\hat{\pi})t}$. This result can be summarized in the following proposition:

> *Proposition 4: Limiting restitution using the bona fide payee doctrine, where the mistake caused no harm to the recipient and no devaluation of the transferred assets, is always inferior to a rule of full restitution.*

The formulaic equations of this model seek to identify the steps taken to support the four propositions identified. By outlining the conditions under which full or limited restitution are optimal, this formal model demonstrates the analyses of Parts I through III of this Article in order to support and better describe the conclusion this Article purports.

CONCLUSION

This Article demonstrates that, contrary to conventional wisdom of the tort-style economic explanation, regimes of limited restitution do not enjoy a general advantage over regimes of full restitution. Benefactors, mistakenly transferring their assets to others, have a strong incentive to invest in precautions in order to prevent mistakes. However, such investments in precautions are wasteful, as benefactors' mistakes are not socially harmful. Rather, such mistakes benefit unintended recipients. For these reasons, there is no clear need to limit restitution in order to deter benefactors and augment their incentive to avoid mistakes. In fact, doing so might be harmful, rather than helpful. This analysis leads to a somewhat unintuitive result, according to which there is no need to make benefactors internalize the harms they cause through their mistakes. For further demonstration of this conclusion, the formal model provided in Part IV outlined the conditions under which each regime—full restitution or limited restitution—should lead to optimal results.

The findings of this Article demonstrate the need for reconsideration of some of the central doctrinal features of the law of restitution. The comprehensive analysis of the change-of-position defense, the devaluation doctrine, and the bona fide payee doctrine provided in this Article treats restitution as its own subject, independent of the economic analysis of torts. In doing so, the analysis highlights additional considerations, which suggest that the law's preference for limited restitution regimes may be unsatisfactory. This conclusion is of special importance for the current policy debate regarding the bona fide payee doctrine, which is established law in the United States but is applied much more narrowly in other common law jurisdictions. This Article offers support for the more skeptical approach toward the bona fide payee defense specifically, and for the reevaluation of the full and limited restitution regimes in the United States generally.