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Fraud—Recovery of the Defrauding Buyer's Profits on Resale

Fraudulently purporting to act on behalf of a non-profit hospital entitled to purchase medical supplies under a federal subsidy program for less than their market value, defendant bought medical supplies for \$2,000 and immediately resold them for \$34,000. The government sought damages under a federal statute entitling

¹⁷ Fidelity & Deposit Co. of Maryland v. Davis, 127 F.2d 780 (4th Cir. 1942); Lightfoot v. Weiss, 213 F.2d 847 (5th Cir. 1954).

¹⁸ 216 F.2d 609 (9th Cir. 1954).

¹⁹ The court has not done so at the time of this writing.

²⁰ American Hardware Ins. Co. v. Van Vick, *supra* note 1; Sullivan, Long and Haggerty v. Washington, 238 F.2d 241 (7th Cir. 1956).

²¹ Parker v. Checker Taxi Co., 238 F.2d 241 (7th Cir. 1956); c.f. Fidelity & Deposit Co. of Maryland v. Davis, *supra* note 17.

²² 182 F.2d 752 (8th Cir. 1950).

²³ Massachusetts Bonding & Ins. Co. v. Feutz, *supra* note 13, at 759.

it to a flat penalty of \$2,000¹ plus an additional penalty of twice the amount "of any damage which the United States may have sustained by reason" of defendant's fraud. *Held*: The "damage . . . sustained" was the difference between the \$2,000 paid by defendant and the \$34,000 resale price. The court made no attempt to determine either the trial-date market value of the supplies or their value at the time of their purchase from the government. The government was "damaged" to the extent of whatever profit defendant made on the resale and this apparently, even though for all that appeared defendant may have resold the supplies for more than their market value.²

The case is interesting not only for its interpretation of the federal statute involved³ but for its applicability in any case in which a defrauding buyer makes a profit by reselling and more particularly where the defrauded seller is arguably unable to prove any actual damage. Indeed, the court in deciding the instant case relied heavily on common law principles.

In approaching any fraud damage problem the lawyer thinks immediately of the traditional fraud damage rules, the "loss-of-bargain" rule under which the defrauded party recovers the difference between the value of the property received and its value as represented and the so-called "out-of-pocket" rule under which damages are measured by the difference between the amount paid and the amount received.⁴ The difficulty with these rules

¹ The Surplus Property Act § 26 (b), 58 Stat. 780 (1944) [later re-enacted by 63 Stat. 392 (1949), 40 U.S.C. 489 (1958)] provides that the wrongdoer:

(1) shall pay to the United States the sum of \$2,000 for each act, and double the amount of any damage which the United States may have sustained by reason thereof, together with the cost of suit;

² *United States v. Bound Brook Hospital*, 251 F.2d 12 (3d Cir. 1958).

³ According to the opinion in the principal case, the government seems only to have sought the \$2,000 fine in previous cases. The principal case appears to be first in allowing the United States to recover damages sustained. Apparently the United States failed to prove damages in the previous cases. For example, in *Rex Trailer Co. v. United States*, 350 U.S. 148 (1955) the defendant alleged veteran priority rights in order to buy certain motor vehicles from the United States at a discount. Since the defendant's gain was not shown, the government's recovery was limited to \$2,000 for each overt act.

⁴ The "loss-of-bargain" rule is illustrated by the case of *Beaver Drug Co. v. Hatch*, 61 Utah 597, 217 P. 695 (1923). A seller represented certain stocks to be worth \$4,000. After the buyer discovered the

as applied to the instant case, of course, is that they are fashioned primarily for cases where the buyer rather than the seller has been defrauded. In addition the seller here is actually out of pocket nothing and, economically speaking, has the same bargain with the fraud as without it.

A third possibility, equally as obvious as the traditional measures, would be to fix the loss by the difference between the amount paid by defendant and the market value of the supplies either at the time of the transaction or at the time of the trial. This measure is the one applied when a defrauded seller waives the buyer's fraud and sues for conversion⁵ and is the practical result obtained by a rescission action. As noted above, however, the court did not consider this possibility.

The court instead applied the restitutional measure and fixed the government's "loss" according to the full benefit of defendant's gain in the transaction. The court relied heavily on section 151 of the *Restatement of Restitution* providing for a defrauded seller's recovery of the buyer's profit.⁶ The result seems sensible except for a case where the defrauding buyer resells for less than market value. The defrauding seller should in any event be entitled to the difference between the amount paid by the buyer and actual

stocks to be worth only \$2,834.59, the buyer was allowed to recover \$1,165.41. An example of the "out-of-pocket" rule is *Mullin v. Gano*, 299 Pa. 251, 149 A. 488 (1930). A buyer was induced to invest \$6,000 in certain property represented to be very valuable. The court refused to recognize the seller's represented value, and computed damages as the difference between the actual value, \$3,187.50, and the amount paid, \$6,000, or \$2,812.50.

⁵ See, e.g., *Thurston v. Blanchard*, 39 Mass. (22 Pick.) 18, 33 Am. Dec. 700 (1839); *Richmyer v. Mutual Live Stock Comm'n Co.*, 122 Neb. 317, 240 N.W. 315 (1932); *Yeggy v. Fidelity Co.*, 118 Neb. 792, 226 N.W. 444 (1929).

⁶ *Restatement, Restitution* § 151 provides:

Where a person is entitled to a money judgment against another because by fraud, duress or other consciously tortious conduct the other has acquired, retained or disposed of his property, the measure of recovery for the benefit received by the other is the value of the property at the time of its improper acquisition, retention or disposition, or a higher value if this is required to avoid injustice where the property has fluctuated in value or additions have been made to it.

Comment (f) provides the wrongdoer:

. . . is subject to liability at the election of the rightful owner for the value of anything received in exchange therefor. He is also liable for profits made by its use.

market value and, indeed, this qualification is made by the *Restatement*.⁷

Nebraska appears to have no case even remotely in point but it is submitted that the instant case is correct and would be followed by our supreme court should the problem arise. Nebraska fraud damage precedents reveal an extremely broad and flexible approach designed to meet the equities of the particular case.⁸

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