OFFSETTING BENEFITS

Ariel Porat[*] *and Eric Posner*[**]

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INTRODUCTION

IN many areas of the law, the victim of a wrongdoing is entitled to damages that compensate her for the harm that she has suffered. This

[*] Alain Poher Professor of Law, Tel Aviv University, and Fischel-Neil Distinguished Visiting Professor of Law at the University of Chicago Law School.

[**] Kirkland and Ellis Distinguished Service Professor, University of Chicago Law School. We thank Yun-chien Chang, Ehud Guttel, participants at the Legal Theory workshop at Tel Aviv University, and participants at the 2014 annual meetings of the American, Turkish, and Asian Law and Economics Associations for very helpful comments, and Siobhan Fabio, Julia Park, and Dana Zuk for excellent research assistance. We are also grateful to Sarah Bily, Megan Colville, Stephen Guynn, Szeman Lam, Trevor Lovell, Brian Mammarella, Allison Smith, Ben Tyson, and Robert Warshaw from the *Virginia Law Review* for their excellent suggestions and editorial assistance.

deceptively simple statement of the law hides many complexities. One such complexity involves the treatment of "offsetting benefits"—benefits that the victim or a third party receives as a result of the same act that caused the harm. For the simple two-party case, imagine that the victim is badly injured in an automobile accident but also makes millions of dollars on a memoir that describes her struggle to recover and build a better life. Should the wrongdoer pay damages that compensate the victim for the entire harm, or the harm offset by the benefits (with the possibility that damages could therefore be zero)? For an example of a three-party case, imagine that a wrongdoer causes an accident because he was rushing an injured person to the hospital or because he swerved to avoid injuring someone else. Should the wrongdoer's damages be reduced to account for the benefit to the third party?

The legal rules that govern these cases and cases like them are widely acknowledged to be a mess. One example is the rule that courts should offset benefits from harms when the benefits affect the same "interest" as the harms do. Where the perpetrator of a Ponzi scheme periodically makes small payments to a victim but never pays off the principal, it is intuitive that the victim should recover for the net loss. But courts are never clear about how "interest" is defined, and so the rule does not resolve our memoir example. Nor is it clear why it should matter that the same interest is affected by the benefit and the harm. If the purpose of law is to deter harm or ensure that a victim is properly compensated, and the damages are set to the harm without netting out the benefits, then wrongdoers will be overdeterred and victims will be overcompensated.

Adding to the confusion are cases where a wrongdoer hurts a victim while simultaneously benefiting a third party. Here, the law sometimes (1) gives the victim a full recovery against the wrongdoer and the wrongdoer a right of restitution against the third party; (2) gives the victim a full recovery against the wrongdoer and the wrongdoer *no* right of restitution against the third party; or (3) gives the victim only a partial recovery against the wrongdoer, netting out the benefit to the third party even though the victim does not receive that benefit herself. These inconsistencies appear to arise from conflicts between different principles that animate different areas of the law that overlap in these cases—including tort, restitution, and takings—but when placed side by side, these cases reveal that the overall pattern cannot be justified on normative grounds.

In this Article, we propose some principles to bring order to the law of offsetting benefits. The starting point is to distinguish the social and private effects of a wrongful act. When a single act causes a harm of 100 to the victim but a separate benefit of 80 to the victim or a separate benefit of 80 to someone else, without causing any other harm or benefit to anyone else, then the social cost of the act is only 20. As a general rule, the legal system should ensure that the wrongdoer pays only 20, and not 100—although in the three-party case, this could mean paying 100 to the victim and obtaining restitution of 80 from the third party.

However, as we discuss, a number of further conditions need to be met before a court should offset benefits. Benefits should not be offset when the wrongdoing does not increase the probability that the benefits exist. Such is the case, for example, when an accident that prevents the victim from being on an airplane that crashes is of the same type as an accident that would cause a victim to miss an airplane that does not crash and instead take an airplane that crashes. Benefits also should not usually be offset when doing so would cause the victim or (in the three-party case) beneficiary to neglect precautions. We also explore how difficulties of measuring losses and benefits may justify damages that do not net out benefits. A theme throughout this Article is that there is an asymmetry between restitution law (which typically does not allow benefactors to obtain restitution when benefits they provide are gratuitous) and tort law (where such benefits often may be deducted from a loss if a loss is proven), and this may play havoc with people's incentives. We find that, as a general proposition, courts are justifiably reluctant to offset benefits, but there are many cases in which they should offset benefits where they currently do not.

A terminological point should be made to avoid confusion. Our question is when the law should reduce the amount of money that a wrongdoer should pay because the wrongful act also produces benefits. From the theoretical standpoint of social welfare, one can say that those benefits (fully or partially) "offset" the loss. However, in legal terminology, the word "offset" is used only in the case when the wrongdoer's damages are reduced by the benefit. In some cases that interest us, however, the law does not allow the wrongdoer to "offset" the benefits from the loss; instead, the wrongdoer may have a right of restitution against the beneficiary (if the beneficiary is a third party). In these cases, in functional terms there is an offset, but in legal terminology there is no offset.

In Part I, we discuss two-party cases, where a wrongdoer both harms and benefits a victim and third parties are not benefited. In Part II, we discuss three-party cases, where a wrongdoer harms a victim and in the process benefits a third party. Three-party cases are more complex because there are more ways to allocate losses and benefits, but the underlying principles are the same as those that apply to two-party cases. We conclude by summarizing our recommendations for changes in the law of offsetting benefits.

I. TWO-PARTY CASES

There are various situations where a wrongful act results in distinct harms and benefits to the victim, and the question arises whether to deduct the benefits from harms and impose liability accordingly. Sometimes the benefit is that the wrongdoing saved the victim from another injury. In other cases, the benefit is an increase in the victim's welfare, which can relate to the same interest or to a different interest adversely affected by the wrongdoing. In yet other cases, the benefit is created by reparation of the harm: After the harm is repaired, the victim is left in a better position than the position she would have been in if she had not been wronged. Lastly, the benefit is sometimes created by a third party who sought to compensate the victim for the injury.

In Section A, we present the law's approach to offsetting benefits in five categories of cases, with some overlap among them, built upon the variables mentioned above. In Section B, we develop our theory of offsetting benefits and apply it to the case law.

A. Prevailing Law

The following example illustrates the first category of cases which we call "saving from another injury." In those cases, the wrongdoing saved the victim from an injury, which could be either more or less severe than the actual injury inflicted upon him by the wrongdoer.

> *Example 1: Air Crash*. While driving his car, the defendant negligently hits the plaintiff, who was on her way to the airport to catch a flight, causing a minor injury to her leg. As a result of the accident, the plaintiff misses her flight, which later crashes. Should the defendant be liable to the plaintiff for the harm done to her leg?

There is common agreement among legal writers that the benefit of saving the plaintiff's life does not, and should not, count for purposes of offsetting damages and that the defendant should be held liable for the injury to the plaintiff's leg. However, it is less clear *why* that benefit should not count. Some writers argue that there is no causal relationship between the wrong and the benefit,[1] while others maintain that ignoring the benefit is intuitive.[2] Another example that illustrates the first category of cases is that of a doctor who failed to receive the patient's informed consent prior to the operation that saved her life but also left her with certain injuries. Assume that if the patient had been fully informed, she would have refused to undergo the operation. Should the doctor bear any liability towards the patient for the injuries? Courts do not resolve such cases consistently: While some courts impose liability,[3] other courts refuse to do so.[4]

[1] See Leo Katz, What to Compensate? Some Surprisingly Unappreciated Reasons Why the Problem Is So Hard, 40 San Diego L. Rev. 1345, 1347 (2003); see also Restatement (Second) of Torts § 920 cmt. d, illus. 8 (1979) ("A knocks B down, as a result of which B is prevented from taking a ship that later sinks with all on board. B's damages for the battery are not diminished by his escape from death resulting from A's act.").

[2] See John C.P. Goldberg, Rethinking Injury and Proximate Cause, 40 San Diego L. Rev. 1315, 1333 (2003).

[3] See Warren v. Schecter, 67 Cal. Rptr. 2d 573, 576–77 (Cal. Ct. App. 1997) (holding that the plaintiff was entitled to compensation for all damages proximately resulting from a gastric surgery, which cured her stomach ulcer but caused her to develop a bone disease, since the defendant who performed the surgery failed to disclose some of the associated risks and therefore did not receive the plaintiff's informed consent).

[4] See Restatement (Second) of Torts § 920 cmt. a, illus. 2 (1979) ("A, a surgeon, without B's consent, operates upon B's eye, causing B to lose the sight in that eye. In an action of battery, it may be shown in mitigation of damages for the loss of the eye that had A not operated, the sight of the other eye would have been lost."); id. § 920 cmt. a, illus. 1 ("A, a surgeon, having been directed to examine but not to operate upon B's ear, performs an operation that is painful but that averts future pain and suffering. The diminution in future pain is a factor to be considered in determining the amount of damages for the pain caused by the operation."). This latter illustration is based on *Maben v. Rankin*, 358 P.2d 681, 682–84 (Cal. 1961) (en banc). See also 2 Dan B. Dobbs, Law of Remedies: Damages-Equity-Restitution 489 (Practitioner Treatise Series, 2d ed. 1993) ("[W]hen the tort itself causes both harm and benefit, as in the case of a technical battery by a surgeon whose operation, though wrongful, also alleviates the plaintiff's medical condition . . . [a] credit is given [to] the defendant for . . . [the] benefit."); John Marks, Symmetrical Use of Universal Damages Principles—Such as the Principles Underlying the Doctrine of Proximate Cause—To Distinguish Breach-Induced Benefits That Offset Liability from Those That Do Not, 55 Wayne L. Rev. 1387, 1412 (2009) ("Under this 'same interest' rule, for example, a plaintiff's recovery of damages for 'pain and suffering' caused by an unauthorized surgical procedure could be offset by 'averted future suffering' also caused by the surgery."). For other cases where courts seem to consider the benefits of the unauthorized medical treatment, see *Shinn v. St.*

In a second category of cases, "harm and benefit to the same interest," the benefit that comes along with the injury relates to the same interest harmed by the wrongdoing. The question that then arises is whether the benefit should be deducted from the harm. The general answer is yes: "[T]he damages allowable for an interference with a particular interest [must] be diminished by the amount to which the same interest has been benefited by the defendant's tortious conduct."[5] Thus, if a plaintiff, a victim of defamation, suffers lost income, but because of the publicity earns large lecture fees, those fees should be deducted from damages.[6] But this is not always the case. Consider the following example:

> *Example 2: Remarriage.* In a wrongful death case, the plaintiff, the surviving widow who sues for dependency losses, remarries. Should the benefits from remarriage—emotional, pecuniary, or both—be taken into account by the court when it awards damages to the plaintiff for her dependency losses?

In Example 2, part of the benefit of remarriage is the new spouse's income, which supports the plaintiff, and that benefit relates to the same

James Mercy Hospital, 675 F. Supp. 94, 96, 99–100 (W.D.N.Y. 1987) (holding the physician defendants not liable for administering Dilantin to treat patient's life-threatening seizure activity despite the risk that patient could, and did, develop Stevens-Johnson Syndrome and the fact that patient would have refused the treatment had he known), aff'd, 847 F.2d 836 (2d Cir. 1988); *Stewart-Graves v. Vaughn*, 170 P.3d 1151, 1154–55, 1163 (Wash. 2007) (en banc) (finding no negligence for failing to withhold resuscitative medical treatment and no duty to obtain parents' consent before resuscitating an infant born without a heartbeat that saved the infant's life but left him with severe and permanent disabilities).

[5] Restatement (Second) of Torts § 920 cmt. a (1979). According to § 920:

> When the defendant's tortious conduct has caused harm to the plaintiff or to his property and in so doing has conferred a special benefit to the interest of the plaintiff that was harmed, the value of the benefit conferred is considered in mitigation of damages, to the extent that this is equitable.

Id. § 920; see Guenther v. Novartis Pharm. Corp., No. 6:08-cv-456-Orl-31DAB, 2013 U.S. Dist. LEXIS 116369, at *2–3, *6, *8 (M.D. Fla. Aug. 16, 2013) (allowing an offset for the positive effect of a drug on plaintiff's medical condition, when plaintiff took the drug to reduce the incidence of pathological bone fractures and sued for lack of adequate warning when the drug resulted in harm to her jaw and teeth).

[6] Restatement (Second) of Torts § 920 cmt. b, illus. 5 (1979) ("A charges B with being a member of a secret order. B brings an action for defamation alleging as special damage the loss of income by B as a surgeon. A can show in mitigation of damages that because of the false charge, B has been enabled to attract crowds to lectures given by him, to his great profit."). The informed consent cases discussed in supra note 4 and accompanying text can also be analyzed under the second category of cases. In particular, see Restatement (Second) of Torts § 920 cmt. a, illus. 1 (1979) (illustrating the second category of cases by using an informed consent example); Dobbs, supra note 4, at 489.

interest harmed by the wrongdoing (the stream of income which came to the plaintiff from the deceased). Therefore, one should expect that an offset would be allowed. In fact, however, courts are split on that issue: Some courts allow an offset,[7] but most courts disallow it.[8] In other cases where the widow has not remarried but there is a chance of remarriage, the question arises as to whether the likelihood of remarriage should be taken into account by the court in awarding damages. The arguments that are raised against an offset are that any estimate of the benefits of remarriage is speculative, that the cause of action arises at the time of the injury before remarriage took place and therefore the benefits of remarriage should be ignored,[9] and that offsetting those benefits, which were forced upon the plaintiff, is inequitable.[10] Counterarguments raised by courts and commentators are that measurement problems are not good enough reasons for disallowing an offset and that events occurring after the victim's death should count in measuring damages.[11]

[7] See, e.g., Jensen v. Heritage Mut. Ins. Co., 127 N.W.2d 228, 234 (Wis. 1964) (permitting the jury to consider plaintiff's remarriage six months after her husband died in a road accident in its assessment of the damages).

[8] The paradigmatic case is represented in *Coleman v. Moore*, 108 F. Supp. 425, 425, 427 (D.D.C. 1952), which held that the plaintiff's remarriage two years after his wife was killed in a road accident should not be taken into account because "it is an event subsequent to the death when the right to recover damages vested finally and absolutely." In a similar case, *Bunda v. Hardwick*, 138 N.W.2d 305, 308, 313 (Mich. 1965), the court refused to permit the defendant to introduce a birth certificate of the plaintiff's child, who was born after plaintiff's husband's death, from which the jury might have inferred that she had remarried. In an English case, *Thompson v. Price*, [1973] 1 Q.B. 838 at 840, 842–43, where plaintiff's husband was killed in a road accident, the court held that the widow's remarriage should not be taken into account when assessing damages as to her; it also held, however, that it was a relevant consideration when assessing the damages payable to their child.

[9] See Alexander H. Lindsay, Jr., Note, Damages for Wrongful Death and the Possibility of Remarriage, 32 U. Pitt. L. Rev. 119, 119–21 (1970) (explaining why courts are reluctant to offset the benefits of remarriage).

[10] Marks, supra note 4, at 1414 ("[T]he torts Restatement's open-ended qualification takes into account the extent to which a tort-induced benefit is thrust upon the plaintiff 'against his will.' A poignant illustration is the widowed spouse who remarries and thus enjoys the 'benefits' of a new spouse—after the defendant has tortiously killed the prior spouse. To be sure, the new spouse may well provide the same sort of companionship and income-stream that the deceased one did, but is it 'equitable' to give a credit to the defendant who imposed these benefits by tortiously killing the plaintiff's prior spouse?" (footnotes omitted)).

[11] See Papizzo v. O. Robertson Transp., Ltd., 401 F. Supp. 540, 542 (E.D. Mich. 1975) ("[J]urors can be trusted to give [the evidence of remarriage] its proper weight without allowing it to mislead or unfairly prejudice them."); Peter C. Kober, The Case of the "Wife After Death": Reflections on the Admissibility of Evidence of Remarriage Under the Massachusetts Wrongful Death Statute, 15 New Eng. L. Rev. 227, 241 (1980) (arguing that ignoring remarriage brings in a greater danger of excessive compensation); Francis E. Shields &

In a third category of cases, "harm and benefit to different interests," the benefit that accompanies the injury relates to a different interest from the one harmed by the wrongdoing. Here, the general rule is that "[d]amages resulting from an invasion of one interest are not diminished by showing that another interest has been benefited."[12] The application of this rule by courts is often inconsistent. For example, in wrongful birth cases, a question arises as to whether the non-pecuniary benefits of raising the undesired child should be deducted from damages for the monetary costs incurred by the parents in raising him. Although the benefits and harms relate to different interests of the plaintiff, most courts allow a deduction, while only a minority disallow it.[13] In other cases, such as those involving trespass on the land that resulted in property damages, the no-offset rule is consistently applied. Thus, a defendant who committed a trespass on the plaintiff's land by flooding it was not allowed to offset the profits made by the plaintiff from selling ice that he

James T. Giles, Remarriage and the Collateral Source Rule, 36 Ins. Couns. J. 354, 354–55 (1969) ("[T]he fact that there may be some uncertainty in measuring damages should not preclude evidence of the marital status of the surviving spouse, because even greater speculation is involved if the true situation is withheld from the jury. . . . [A]lthough the right to wrongful death damages may vest at the time of death, facts relating to those damages extend beyond that date and, to refuse to go beyond it, ignores the realities of the situation.").

[12] Restatement (Second) of Torts § 920 cmt. b (1979); see id. § 920 cmt. b, illus. 4 ("A charges B with murder. In an action for defamation in which B claims no special damages, the defendant cannot show in mitigation that the business of B, a seller of soft drinks, has been increased as the result of the charge.").

[13] See, e.g., Univ. of Ariz. Health Sci. Ctr. v. Superior Court, 667 P.2d 1294, 1299 (Ariz. 1983) (en banc) (allowing an offset); Stills v. Gratton, 127 Cal. Rptr. 652, 658–59 (Cal. Ct. App. 1976) (same); Custodio v. Bauer, 59 Cal. Rptr. 463, 476–78 (Cal. Ct. App. 1967) (disallowing an offset); Bowman v. Davis, 356 N.E.2d 496, 498–99 (Ohio 1976) (per curiam) (same); see also Dan B. Dobbs, Law of Remedies: Damages-Equity-Restitution 666–67 (Hornbook Series, 2d ed. 1993) ("[S]ome courts use the offset under a rule that presumes the parents' emotional benefits to be in excess of all child-rearing costs, the effect being to say that the cost of rearing the child cannot be recovered in wrongful pregnancy cases. But the presumed blessing is *not* usually presumed to outweigh the costs of pregnancy and delivery, emotional and mental distress and consortium interests. . . . In this category of cases, an additional question arises. Should the emotional benefits of unwanted parenthood be offset only against the parent's emotional distress claims? Or should the emotional benefits be offset against the economic losses of the parents' [sic] as well? Decisions in this category have usually concluded that the economic losses and the emotional harm were 'inextricably related to each other,' and that the trier should be allowed to offset emotional benefits against both emotional distress and economic costs. The effect of the offset in this situation is to credit the defendant with benefits to the plaintiff in one category against losses in another. This seemingly violates the normal rules that benefits from a tort are to be offset only against losses to the same 'interest.'" (footnotes omitted)).

cut from frozen spillage on his land, which he could not have done had his land not been flooded.[14] The reason given by courts for not allowing an offset when the benefits and harms are not to the same interest is that the benefit was forced on the victim by the wrongdoer, and therefore the benefit should not count.[15] Others explain that benefits to a different interest from the one harmed do not meet the proximate cause requirements.[16]

The rule against offsetting benefits that relate to a different interest from the harm has an exception in the Restatement: If the benefit and harm are both economic in nature, an offset should be allowed.[17] The extent of this exception, however, is unclear. Consider the following example:

[14] Read v. Webster, 113 A. 814, 818 (Vt. 1921). But the distinction between harm and benefit to the same or to different interests in trespass cases might be hard to make. See, e.g., Burtraw v. Clark, 61 N.W. 552, 552–53 (Mich. 1894) (accepting defendants' argument that the ditch they dug pursuant to void drain proceedings, which was a trespass on the land, was a benefit to the owner's property and thus her damages should be nominal); Restatement (Second) of Torts § 920 cmt. a, illus. 3 (1979) ("A tortiously digs a channel through B's land, thereby making it impossible to grow crops upon the land through which the channel runs. It may be shown in mitigation that the digging of the channel drains the remainder of B's land, making it more valuable.").

[15] Restatement (Second) of Torts § 920 cmt. f (1979) ("The rule stated in this Section is limited by the general principle underlying the assessment of damages in tort cases, which is that an injured person is entitled to be placed as nearly as possible in the position he would have occupied had it not been for the plaintiff's tort. This principle is intended primarily to restrict the injured person's recovery to the harm that he actually incurred and not to permit the tortfeasor to force a benefit on him against his will."); see also Dobbs, supra note 13, at 667 ("[I]f the defendant negligently burns down your trees, reducing the value of your land, he does not get any credit for the pleasures you might get because your view is enhanced at the same time your shade is lost. Although those pleasures might be real, they do not diminish the economic loss." (footnote omitted)).

[16] Marks, supra note 4, at 1412 ("Recall that under the proximate-cause rubric, liability generally is confined to those losses risked that made the defendant's conduct tortious to begin with. Essentially, the torts Restatement's same-interest rule focuses exclusively on the specific range of compensable interests jeopardized by the defendant's tortious conduct, and it symmetrically confines liability offsets to benefits accruing to precisely the same interests (to the extent that those interests were actually harmed by the defendant's tortious conduct)." (footnotes omitted)).

[17] Restatement (Second) of Torts § 920 cmt. b, illus. 5 (1979) ("A charges B with being a member of a secret order. B brings an action for defamation alleging as special damage the loss of income by B as a surgeon. A can show in mitigation of damages that because of the false charge, B has been enabled to attract crowds to lectures given by him, to his great profit.").

> *Example 3: Changing Career*. Plaintiff changes his career as a result of a wrongdoing that injured him, and now he earns more than what he would have earned if he had not been wronged. Should the extra earnings he gained as a result of the wrong be deducted from damages for medical expenses or for pain and suffering?

While courts would not deduct the extra earnings from damages for pain and suffering (since the harms are not economic),[18] it is less clear whether deduction should be allowed from damages for medical expenses.

In the fourth category of cases, "the reparation benefit," the benefit to the plaintiff is not the result of the wrong, but rather the result of the reparation of the harm. Example 4 illustrates such cases:

> *Example 4: The Car*. The defendant negligently hits and damages the plaintiff's car. In order to repair the car, the plaintiff needs to replace the parts that were damaged. The replacements, however, are new parts since used parts are not available. As a result, after reparation, the value of the car with the new parts is higher than its value prior to the accident. Should that added value be deducted from damages awarded for costs of reparation?

Courts reach conflicting decisions in these types of cases, and there is no general rule.[19]

[18] See Bochar v. J. B. Martin Motors, Inc., 97 A.2d 813, 814–15 (Pa. 1953) (holding that even though plaintiff earned a higher salary at a desk job assigned to him after a road accident with defendant left him unable to do his previous job of installation and repair at a telephone company, "[a] tort feasor is not entitled to a reduction in his financial responsibility because, through fortuitous circumstances or unusual application on the part of the injured person, [the] wages [of the injured person] following the accident are as high or even higher than they were prior to the accident. . . . Where permanent injury is involved, the whole span of life must be considered."); cf. Restatement (Second) of Torts § 920 cmt. b, illus. 6 (1979) ("A tortiously imprisons B for two weeks. In an action brought by B for false imprisonment in which damages are claimed for pain, humiliation and physical harm, A is not entitled to mitigate damages by showing that at the end of the imprisonment B obtained large sums from newspapers for writing an account of the imprisonment.").

[19] Some courts have determined that the added value should be deducted from damages awarded for costs of reparation. See Tenn. Valley Auth. v. Vulcan Materials Co. (In re Crounse Corp.), 956 F. Supp. 1377, 1381–82 (W.D. Tenn. 1996) ("If the Court determines that repair or replacement adds new value to or extends the useful life of property, then an appropriate reduction from the full repair or replacement costs should be made."); see also Pillsbury Co. v. Midland Enters., Inc., 715 F. Supp. 738, 764 (E.D. La. 1989) ("[W]here repair or replacement costs form the basis of the damage award, the Court must determine whether the repair or replacement adds new value to or extends the useful life of the proper-

In the fifth and last category of cases, "third party discretionary benefit," a third party conferred a benefit upon the plaintiff following the injury, and the question arises as to whether that benefit should be deducted from damages. The next example is illustrative of such cases:

> *Example 5: The Donation*. Defendant negligently causes a fire, which destroys a synagogue. As a result, twenty million dollars is donated to the congregation in order to facilitate the restoration of the synagogue. Should the donations be deducted from damages and reduce the defendant's liability accordingly?

Example 5 is based on a real case, which was eventually settled out of court.[20] The general rule under the common law is that collateral-source benefits—namely, payments made by third parties to the plaintiff following the injury—should not be offset from damages.[21] This rule often applies to cases where the plaintiff paid for the right to receive the benefits before the injury took place. The typical example is payments made by insurers either to the bodily-injured victim or, in cases of death, to her survivors. In such cases, it is settled law that the injurer should not benefit from the insurance purchased by the victim and therefore an offset should not be allowed.[22] In some cases, the insurer has a right of sub-

ty; if so, an appropriate reduction from the full repair or replacement costs should be made." (footnotes omitted)), aff'd and remanded, 904 F.2d 317 (5th Cir. 1990). Yet other courts have found that the added value should not be deducted from damages awarded for the costs of reparation. See J. W. Paxson Co. v. Bd. of Chosen Freeholders, 201 F. 656, 663 (3d Cir. 1912) (holding that a reduction in damages for injuries caused by the defendant's negligence is not equitable when the plaintiff was compelled to replace the damaged property prematurely); see also United States v. Ebinger, 386 F.2d 557, 561 (2d Cir. 1967) ("[I]t has been generally held that the defendant is not entitled to a credit merely because the plaintiff has acquired a new unit, presumably with a longer life expectancy than the old, if that was the cheapest course available."); Dobbs, supra note 13, at 556 (arguing that the general rule is that the defendant's liability for reparation expenses should be reduced by the enhancement of the plaintiff's property's value, but if the increase in value is not desired by the plaintiff, the enhancement of the property's value should not be deducted from damages).

[20] See Diana B. Henriques & Leslie Eaton, Once and Future Issue: Subtracting Donations from Damage Awards, N.Y. Times, Nov. 18, 2001, at A33 (noting defendant argued that liability for a fire that destroyed a synagogue should be reduced as a result of twenty million dollars that donors had given to help with rebuilding).

[21] See, e.g., Cary v. Burris, 127 P.2d 126, 128 (Or. 1942) ("Damages cannot be reduced by an amount which the plaintiff may have received from third parties, acting independently of the defendant, though it is given to the plaintiff on account of the injury.").

[22] See Tebo v. Havlik, 343 N.W.2d 181, 186 (Mich. 1984) ("The common-law collateral-source rule provides that the recovery of damages from a tortfeasor is not reduced by the plaintiff's receipt of money in compensation for his injuries from other sources."); Restate-

rogation against the wrongdoer; then, an offset from plaintiff's damages is allowed in order to avoid double charging the defendant for the same harm.[23]

Things are more complicated when benefits have not been purchased before the injury, or have not been purchased at all, as in Example 5. Should those benefits be deducted from damages? The general rule is that benefits conferred on the victim from third parties, at their discretion, should not be offset against damages, since the third party aimed to benefit the victim, not the wrongdoer.[24] Furthermore, any such offset would constitute a windfall for the defendant, which he does not deserve.[25] Typical examples belonging to this category of cases are medical services, or other assistance, that the victim received from her family or friends at no cost to herself,[26] salary paid by her employer when she

ment (Second) of Torts § 925 cmt. h (1979) ("The fact that one or more of the beneficiaries receives insurance payable on the death of the deceased or inherits property from the deceased does not diminish the damages recoverable.").

[23] Such is always the case with property damages, but often also with bodily injury. See Dobbs, supra note 13, at 268 ("One of the reasons commonly given in support of the collateral source rule is that the rule preserves subrogation rights of any insurer who paid benefits to the plaintiff.").

[24] See Restatement (Second) of Torts § 925 cmt. h (1979) ("Likewise the fact that support, education or other gratuities have been received from third persons, although induced by the death, or that the survivors will be cared for by third persons, does not mitigate the damages.").

[25] See Dobbs, supra note 13, at 267 ("When the collateral benefit comes in the form of a gratuity from friends or employers, courts sometimes say that the donor intends to benefit the plaintiff, not the defendant, and that therefore the defendant should have no credit for the benefit."); see also Nashville, Chattanooga & St. Louis Ry. v. Miller, 47 S.E. 959, 961 (Ga. 1904) ("Where an employer pays to an injured employé, as a matter of grace, the amount which he would have earned as wages if he had not been disabled, a wrongdoer who brings about the disability has no concern with this transaction between the employer and the employé, and the amount so paid is not to be regarded as in any sense compensation for lost time.").

[26] See Coyne v. Campbell, 183 N.E.2d 891, 894 (N.Y. 1962) (Fuld, J., dissenting) (disagreeing with the majority's disallowance of recovery for medical services the plaintiff doctor received from his colleagues at no cost, reasoning that "a wrongdoer, responsible for injuring the plaintiff, should not receive a windfall. Were it not for the fortuitous circumstance that the plaintiff was a doctor, he would have been billed for the medical services and the defendant would have had to pay for them. The medical services were supplied to help the plaintiff, not to relieve the defendant from any part of his liability or to benefit him"); see also Hudson v. Lazarus, 217 F.2d 344, 347 (D.C. Cir. 1954) (disallowing the offset of the benefits of gratuitous medical services); Oddo v. Cardi, 218 A.2d 373, 377 (R.I. 1966) (same).

was unable to work as a result of the injury, and donations paid to her by charities or other benefactors.[27]

B. Theory

In this Section we develop our theory and apply it to the case law. Courts should calculate damages by subtracting benefits from the loss when those benefits are social rather than private. Benefits are social rather than private when they are themselves not canceled out by a loss to a third person. We further argue that benefits should be deducted only when their likelihood of realization is increased by the wrongdoing. We explore how courts should apply those principles, taking account of various second-order problems, like measurement difficulties and victims' incentives, which may justify exceptions to the general principle.

1. Social vs. Private Benefits

At the heart of our theory is the distinction between private and social benefits: Damages should equal the social, not private, loss caused by a wrongdoing. This means that damages should equal the victim's loss minus any social benefit. A benefit is private but not social when it is offset by an equivalent harm to a third party; if the wrongdoer is not liable to the third party for the harm she suffered, but the benefit to the plaintiff is deducted from damages, the wrongdoer is liable for less than the net social harm he created and is underdeterred. To illustrate, suppose that in Example 1 (the air crash), while the plaintiff missed her flight and was saved from an air crash, a third party, who was assigned the plaintiff's seat on the plane, was killed. The plaintiff gained a huge benefit from the wrongdoing, but the third party suffered an equivalent harm. Under those circumstances, exonerating the defendant from liability is unjustified.

The social versus private distinction could provide a new explanation for courts' reluctance to deduct the benefits of remarriage from damages to the dependent widow (Example 2). The loss of income to the widow represents part of the loss of the deceased's life. That latter loss, which is social, has not been mitigated by remarriage. The pecuniary benefit the widow received is just a transfer of wealth from the new spouse to

[27] See Redpath v. Belfast & Cnty. Down Ry., [1947] N.I. 167, 175–76 (disallowing the offset of payments to victims of a train accident from a local community charity fund established to compensate the victims).

her, which but for the wrongdoing would have been transferred to another person or remained with the new spouse. Therefore, the widow's damages should not be offset by the benefit.[28] By contrast, consider the non-pecuniary loss of consortium. Here, remarriage has mitigated that loss and the widow's damages should be reduced: The affection the widow received from the new spouse is not a "transfer of affection" from another person[29] or an "asset" that would have remained with the new spouse but for the wrong.

The social versus private distinction does not track the legal rule that benefits should be offset only when they relate to the interest that is harmed.[30] We therefore believe that this rule cannot be sustained. The distinction could explain, however, the relevance that the law ascribes to the fact that the benefit is the result of a discretionary act of a third party. Consider Example 5 (the donation case), where people donate money to reconstruct the destroyed synagogue. In this case, no deduction should be made simply because the benefit to the plaintiff is accompanied by an equivalent loss to the donors: Money has merely switched hands.

At first glance, one could argue that a deduction should be made because the loss to the donors is accompanied by a benefit to them (for example, in the form of utility, a kind of "warm glow"[31]) from donating the money. The benefits of donating more than offset the loss to the donors; otherwise they would not have donated the money in the first place. Thus, after the donation takes place, the victim is fully compensated and the donors suffer no losses (and even are better off since they receive a net benefit which is the difference between the benefits they derived from donating the money and their respective costs). The wrongdoer

[28] Similar reasoning would support the view that if a dependent inherited wealth from the deceased, no deduction should be made for the value of the inherited assets: Those assets were just transferred from one entity (the estate) to another (the dependent), and therefore the benefit to the dependent is private rather than social. This conclusion is valid even under the assumption that but for the wrongdoing the dependent would probably not have inherited wealth from the deceased (for example, because the dependent is much older than the deceased).

[29] Theoretically, it might be the case that but for the wrong the affection of the new spouse would have gone to another person, but taking that into account is too speculative: The other person could have received affection even without the new spouse, from yet another person, and so on and so forth.

[30] See supra text accompanying notes 5–16.

[31] See generally James Andreoni, Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving, 100 Econ. J. 464 (1990) (modeling the motivation for giving as a factor in the donor's utility function).

would pay no damages because he or she actually created an opportunity for the donors to feel good about themselves!

This argument, however, is flawed. Although it is true that the donors get a "warm glow" from donating the money, they are worse off because of the wrongdoing. If the wrongdoing had not taken place, the donors could have used their money for consumption or other charitable purposes while the synagogue would have been in existence. That is better for the donors than the world in which the synagogue is rebuilt but their money is gone.

Furthermore, if the rule were that the value of the donations were deducted from damages, many donors, knowing this rule in advance, would not have donated the money in the first place, because the only effect of their donation would be to reduce the liability of the wrongdoer, not to help the victim they care about. Thus, they would not have been able to derive any utility from such donation. This could deter people, in cases represented by Example 5, from making donations immediately after the destruction of the property, as they might fear that if the wrongdoer is then found and sued, their donations will, in effect, go into the wrongdoer's pocket.[32] For those reasons, donations should not warrant any deduction from damages.

An alternative solution could be to deduct donations from damages, but allow the donors to bring restitution claims against the wrongdoer for what they have donated. This latter solution is often impractical (when there are many donors), and might be considered inconsistent with the current rule that voluntarily paying other people's debt does not raise restitution claims against them.[33] If, however, the donors paid the money under the mistaken belief that the wrongdoer is either unknown or insolvent, a restitution claim of the donors against the wrongdoer would be justified and recognized by the law.[34]

2. Ex Ante Increase of Expected Benefits

Even when the plaintiff's benefits are social rather than private, benefits should not be deducted from damages if the probability of their crea-

[32] See supra text following note 31.

[33] See Restatement (Third) of Restitution & Unjust Enrichment § 24 (2011) (allowing a party who performed another party's obligation to recover from that latter party only when the former was performing his own obligation or reasonably protecting his own interests).

[34] See id. § 7 cmt. a (allowing a party who mistakenly performed another party's obligation to recover from that latter party under restitution law).

tion was not increased ex ante by the wrongdoing. To illustrate, even if in Example 1 (the air crash) no additional third party was injured as a result of the wrongdoing, deduction still should not take place since road accidents do not increase the probability that victims of those accidents will be saved from air crashes. Indeed, the probability that a road accident would save a person from an air crash is equal to the probability that a road accident would cause a person to be killed in an air crash. Thus, in one case a person injured in a road accident would miss a flight that crashes and take a flight that does not crash, and in another case he would miss a flight that does not crash and take a flight that crashes. Tort law does not impose liability on the negligent driver in the latter case for good reasons,[35] and once such liability is not imposed, the benefits of saving the plaintiff's life should not be deducted from damages. Otherwise, the negligent driver would be underdeterred: He would not internalize all the negative effects of his negligence but would internalize its positive effects.

Note that our argument has nothing to do with foreseeability, which is another condition for liability under tort law:[36] Even if air crashes were very common, such that every driver would have known that missing a flight as a result of a road accident could save a person's life, liability should not be imposed. Also note the subtle distinction between the current argument and the social versus private argument discussed in the previous Section: While the latter argument is based upon the premise that some actual benefits are accompanied by actual harms which cancel each other out, the former argument is based upon the premise that even if *in fact* the wrongdoing created a benefit with no correlative harm, the wrongdoing might lack the attribute of increasing the likelihood that the benefit actually created would be created.

[35] See Restatement (Third) of Torts: Liability for Physical and Emotional Harm § 30 (2010) ("An actor is not liable for harm when the tortious aspect of the actor's conduct was of a type that does not generally increase the risk of that harm."). For the logic of this condition for tort liability, which Professor Guido Calabresi called "causal linkage," see Guido Calabresi, Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr., 43 U. Chi. L. Rev. 69, 72 (1975).

[36] See Richard A. Epstein, Torts 270 (1999) (arguing that in cases of "freakish events," the "bizarre consequences could never have influenced [a defendant's] primary conduct, and hence should not generate liability for [the defendant], whose negligence is defined with reference to some standard, nonfreakish set of consequences"); see also Dan B. Dobbs, The Law of Torts 446–47 (Hornbook Series 2000) (noting that courts will not award damages if the harm or the plaintiff were unforeseeable, even though the defendant was found negligent).

The ex ante increase in expected benefits ("EIB") condition, as we will call it, does not support the common legal distinction between cases where the harms and benefits are to the same interest and cases where the harms and benefits are to different interests.[37] It also does not support the legal rule that disallows deduction of a third party's discretionary benefits.[38] As long as the wrongdoing increased the likelihood that a certain benefit would be created, be it discretionary or not, the EIB is met.

The EIB could justify a non-deduction rule in Example 3 (changing career). In this example, the victim changes his career because of the wrongdoing that caused physical injury, and now he earns more than what he would have earned but for the wrongdoing. The question that arises is whether the extra earnings should be deducted from other items of losses, such as medical expenses. It seems that the EIB is not met in Example 3: Wrongdoing does not increase the likelihood that victims will change their minds and improve their earning capabilities (or earning opportunities). Although the changing of minds as a result of injury might happen from time to time, it might also happen—and does even more so—without an injury. So, wrongdoing does not have the attribute of increasing the likelihood of people changing their minds and improving their earnings. Furthermore, if a victim decides to change his career because of an injury—not because of his diminished capabilities, but just because of a change of mind which has been triggered by the wrongdoing—and now he earns *much less* than what he would have earned but for the injury, he would not be compensated for the lost earnings which are the result of his change of mind (as opposed to change of capabilities). In the same way, the wrongdoer should not be credited for a change of mind of the victim that makes him earn *much more* than what he would have earned but for the injury. In the next section, we will see that there could be other reasons for not crediting the wrongdoer for the victim's extra earnings, so the EIB is only one possible reason among others for non-deduction.

3. Victims' Incentives

In the previous two Subsections, we have discussed two necessary conditions for deducting benefits from damages. In this and the next two

[37] See supra text accompanying notes 5–16.
[38] See supra text accompanying notes 24–27.

Subsections, we discuss considerations—rather than conditions—that should be taken into account in deciding which types of benefits should be deducted from damages.

Deduction could affect victims' incentives. In particular, when victims can affect the accumulation of the benefits that will later be deducted from their damages, they might underinvest in creating those benefits, change their activity to reduce the magnitude or likelihood of those benefits, or postpone their realization until after trial. Consider Example 2 (remarriage): If the benefits of remarriage are deducted from the damages, the widow might avoid remarriage before trial in order to be entitled to higher compensation. Interestingly, victims' incentives will be differently affected by an offset rule if, in addition to remarriage, the *possibility* of remarriage is also taken into account in awarding damages. Under this latter rule, a victim who knows that even if she does not remarry her damages will be reduced as a result of the possibility of remarriage will be less deterred from getting remarried (especially if she believes that the court will consider the likelihood of her remarriage as high) than if only actual remarriage will be taken into account. But the rule that the possibility of remarriage—not only actual remarriage—be taken into account in awarding damages also has its flaws. In addition to measurement difficulties—which we discuss in the next section—widows might inefficiently reduce the possibility of remarriage, or at least make efforts to make that possibility hidden, or non-verifiable, until after trial. Therefore, a possible solution to the remarriage example—assuming the main obstacle for allowing deduction of benefits is the distortion of the victims' incentives[39]—is to allow deduction for the possibility of remarriage at a fixed rate, regardless of the actual possibility of remarriage, and regardless of whether actual remarriage takes place. Under our solution, widows would know that they cannot affect the compensation awarded to them for dependency losses and the distortion of their incentives would be removed.[40]

Example 3 (changing career) and Example 5 (donations) also raise the issue of the victims' incentives. If deduction of benefits is allowed in Example 3, victims' incentives to change careers and earn more will di-

[39] But see supra Subsection I.B.1.

[40] Cf. Robert Cooter, Unity in Tort, Contract, and Property: The Model of Precaution, 73 Calif. L. Rev. 1, 14–15 (1985) (proposing that by incorporating a liquidated damages clause into their contracts, the parties avoid the risk of the promisee's overreliance on the contract, since the promisee's entitlement to damages does not depend on her actual loss).

minish since some, if not all, of their extra earnings will be credited to the wrongdoer. A similar problem arises with Example 5: With deduction of donations from damages, victims would not make efficient efforts to raise donations. At least when donations might increase social welfare,[41] a no-deduction rule would be preferable.

There might be a tension between the goal of improving victims' incentives and the goal of making the injurer pay for no more than the harm caused by his wrongdoing, in order to avoid overdeterrence. When this tension exists, one possible way to attenuate or even remove it is to allow an average or fixed-rate deduction of benefits where the magnitude is independent of the actual benefits accrued to the victim.[42]

4. Measurement of Unrequested Benefits

The law treats negative externalities—the harms that injurers cause to victims—and positive externalities—the benefits that benefactors confer on the recipients of those benefits—in completely different ways. Whereas the law requires that injurers bear the cost of the harms they wrongfully inflict upon victims, benefactors are only rarely entitled to recover from recipients for unrequested benefits.[43] There are various reasons, economic and non-economic alike, for the law's different treatment of negative and positive externalities. One main reason, which is our focus here, is that if benefactors are routinely allowed to create unrequested benefits and to obtain restitution for those benefits, they have an incentive to circumvent the market. For example, a painter might paint someone's house without asking permission and then sue for restitution of the benefit conferred. If a court awards damages—say, equal to the market price—the owner may end up paying for a paint job that she does not want. In theory, a court could award damages equal to the actual benefit to the owner—if she would have been willing to pay only $100 for a paint job that has a market price of $500, she should pay only $100, not $500—and then the painter would avoid painting houses un-

[41] See supra text accompanying notes 31–32.

[42] See supra text accompanying notes 39–40.

[43] See Ariel Porat, Private Production of Public Goods: Liability for Unrequested Benefits, 108 Mich. L. Rev. 189, 190 (2009) (referring to the law's differing treatment of negative and positive externalities); see also Giuseppe Dari-Mattiacci, Negative Liability, 38 J. Legal Stud. 21, 22–23 (2009) (same); Scott Hershovitz, Essay, Two Models of Tort (and Takings), 92 Va. L. Rev. 1147, 1147–48 (2006) (same); Saul Levmore, Explaining Restitution, 71 Va. L. Rev. 65, 67 (1985) (same).

less he has good reason to believe that the owner wants the paint job. In such a world, the law replaces consensual transactions. But no one believes that courts could make proper valuations, and instead courts deny restitution so that the painter will bargain with the owner, and in that way elicit the owner's true valuation.[44] Moreover, allowing restitution in such cases would infringe the recipient's autonomy.[45]

These considerations are less convincing when transaction costs are high, and market transactions are therefore infeasible. Indeed, the major exceptions to the rule against liability for unrequested benefits are characterized by the presence of high transaction costs between the parties.[46] Benefits forced on the victim through wrongdoing can be considered another exception to the rule against liability for unrequested benefits: In the typical tort case, transaction costs between the parties, prior to the infliction of the harm and the creation of the benefit, are prohibitively high, and market transactions are not feasible. Therefore, measuring both the harms and benefits and awarding the victim the difference between the two seems to be both vital and right.

[44] Oren Bar-Gill & Lucian Ayre Bebchuk, Consent and Exchange, 39 J. Legal Stud. 375, 375–77, 394–95 (2010) (arguing that when transaction costs are low and consensual exchange is possible, there should be no liability under restitution law, mainly because of evaluation difficulties); Porat, supra note 43, at 209–10 (discussing the difficulties in evaluating unrequested benefits).

[45] Porat, supra note 43, at 215–17.

[46] In one category of cases, the benefactor confers the benefits upon the beneficiary under circumstances of emergency, when obtaining the beneficiary's prior consent is impossible. See Restatement (Third) of Restitution & Unjust Enrichment § 20(1) (2011) ("A person who performs, supplies, or obtains professional services required for the protection of another's life or health is entitled to restitution from the other as necessary to prevent unjust enrichment, if the circumstances justify the decision to intervene without request."); id. § 2(3) ("There is no liability in restitution for an unrequested benefit voluntarily conferred, unless the circumstances of the transaction justify the claimant's intervention in the absence of contract."); see also, e.g., Cotnam v. Wisdom, 104 S.W. 164, 165–66 (Ark. 1907) (awarding restitution damages for his services to a doctor who performed emergency surgery on an unconscious, injured passerby). In another category of cases, a beneficiary of a common fund who acts to increase the fund's value can recover a share of her costs from the other beneficiaries even if they refused to support these efforts on behalf of the common fund. In those cases, by imposing liability, restitution law aims at overcoming a free-riding problem that otherwise might arise and prevent efficient transactions between the beneficiaries of the common fund. The Restatement (Third) of Restitution & Unjust Enrichment § 29 (2011) allows recovery in cases of common funds, clarifying that "a 'common fund' consists of money or other property in which two or more persons . . . are entitled to share by reason of their common or parallel interests therein." For examples of common fund suits brought by an heir against her coheirs, see id. § 29 cmt. g, illus. 23–25, and 2 George E. Palmer, The Law of Restitution § 10.7 (1978).

Still, the benefits accrued to the victim have not been requested by her, and measurement problems do often exist. Some commentators believe that as between faulty injurer and innocent victim, errors should be allocated to the former,[47] which implies that doubts about the existence of a true benefit for the victim as well as about its magnitude should be resolved in the victim's favor.[48]

From an efficiency perspective, the question is harder. Take the case of wrongful birth, where the question arises as to whether to deduct the non-pecuniary benefits of raising the child from the expenses incurred in raising him.[49] The benefits are very hard to measure, not only because they are intangible, but also because the parents will typically want to avoid inflicting emotional harm on their child by publicly arguing that they obtain no benefit from his existence. It is difficult to know how to resolve such a case. The usual rule is that the plaintiff must prove the loss. If the medical bills are plausibly offset by large non-pecuniary gains, then perhaps the plaintiff should receive only a nominal award.

The measurement problem might also arise with pecuniary losses. Example 2 (remarriage) involves uncertain benefits. Even if remarriage takes place, it will be difficult to measure the benefit to the widow; and if marriage were just a possibility, the "option value" of marriage would be even harder to value. Even when remarriage takes place, the new marriage will not necessarily last forever. There are too many contingencies, which are hard to predict, that could affect the stability of the new marriage. The same problem exists with a *possibility* of remarriage; indeed, the speculative nature of the benefits of the possibility of remar-

[47] See, e.g., Jules L. Coleman, Mental Abnormality, Personal Responsibility, and Tort Liability, *in* Mental Illness: Law and Public Policy 107, 120–21 (Baruch A. Brody & H. Tristram Engelhardt, Jr. eds., 1980) (arguing that justice considerations favor the victim over the wrongdoer); Stephen R. Perry, The Moral Foundations of Tort Law, 77 Iowa L. Rev. 449, 468 (1992) (quoting the previous argument).

[48] The "difficulties of measurement" argument is usually used in remarriage cases. See Marks, supra note 4, at 1414 ("[C]onsider . . . the case of a wrongful-death plaintiff who remarries, and just imagine the kind of burden presented if the law of damages actually pressures him or her to testify in court to the effect that the new spouse is not nearly as good as the deceased one. Is that 'equitable'?" (footnote omitted)). For a different approach, see Shields & Giles, supra note 11, at 354–55 ("[T]he fact that there may be some uncertainty in measuring damages should not preclude evidence of the marital status of the surviving spouse, because even greater speculation is involved if the true situation is withheld from the jury. . . . [A]lthough the right to wrongful death damages may vest at the time of death, facts relating to those damages extend beyond that date and, to refuse to go beyond it, ignores the realities of the situation.").

[49] See supra text accompanying note 13.

riage is one of the main reasons, mentioned by both courts and commentators, to completely ignore them. One could question that latter argument: If remarriage, when it lasts, produces benefits, the measurement problem only justifies a cautious offset, instead of no offset at all.[50]

Example 4 (the car) illustrates another case that at first glance does not raise measurement difficulties. In that example, the victim repaired his car, and after the repairs its value exceeded the value it had before it was damaged by the wrongdoer. Why should that value not be deducted from damages? Some courts allow such deduction, while others do not.[51] On the one hand, measurement seems to be easy in Example 4: The market value of the car increased, and the added value can be objectively quantified. On the other hand, it is unclear whether the victim would have agreed to pay for the added value of the car if he had been asked about it before the injury. In other words, it is unclear whether the victim *really* received a benefit, and if so, at what magnitude. Things become especially complicated when the added value is significant. Suppose that instead of a car, it was a $10 million house that was damaged, and after repair its market value increases to $11 million. The owner might argue that he is not interested in selling the house, and that he has not received any intangible benefit equivalent to the amount of $1 million. If his compensation is reduced by $1 million, the victim might argue that he would not be able to maintain the house unless he takes loans that he prefers not to take. The victim would claim, then, that it does not make sense that his life and plans would change because of the wrongdoing, even if, economically speaking, he would be restored to the same position he would have been in if the wrongdoing had not occurred.

In theory, it is easy to determine what the right damages are. In some cases, the victim fully consumes the improvement. A victim might place zero value on a shiny new fender that is functionally identical to the old, or a victim might place a great deal of value on it. This value that the victim obtains would then provide a benchmark for determining the magnitude of the benefit that is offset. In other cases, the improvement increases the resale value of the asset, in which case the benefit to the victim is that amount reduced to present value. In both cases, a further complexity is that the victim might not have been willing to pay for the

[50] But see supra Subsection I.B.1, where we questioned the social-benefit nature of remarriage.

[51] See supra note 19 and accompanying text.

improvement because of capital constraints—it is hard to borrow. Forcing the victim to pay for the increased value of the new fender forces her to convert a liquid asset (dollars) into an illiquid asset (part of a car). For large amounts of money, as in the house case, this will be a relevant consideration. However, one solution to this problem would be to place a lien for the added value of the house to the wrongdoer's benefit.[52] In this way, the victim would enjoy the added value but would not be required to pay for it until she sells or otherwise liquidates the item.

In general, one might authorize courts to take into account all these factors when deciding whether, and how much, to credit the wrongdoer for the increase in property value caused by the repair. In practice, simple rebuttable presumptions—either in favor of an offset or against—may be justified.

5. Interlinking Non-Compensable Harms

A third and last consideration is that the presence of uncompensated harms to the plaintiff could justify, under certain conditions, no deduction of benefits that otherwise would have been deducted. In particular, there is no sense in deducting a benefit that is derived from, or interlinked with, a harm that is not compensated. Thus, if a person is wrongfully injured and as a result works less and earns less than prior to the injury, he is entitled to compensation for lost earnings, but the benefit of the longer leisure time he enjoys following the injury should not be de-

[52] Cf. Restatement (Third) of Restitution & Unjust Enrichment § 26 cmt. a (2011) ("If the claimant has made expenditures to protect an interest in common property that potentially exceed the value of the defendant's interest, the basic requirement that a liability in restitution not prejudice an innocent recipient (§ 50(3)) is implicitly observed by giving a remedy by equitable lien or subrogation, rather than by money judgment."); Graham v. Inlow, 790 S.W.2d 428, 430 (Ark. 1990) ("It is well settled that a tenant in common has the right to make improvements on the land without the consent of his cotenants; and, although he has no lien on the land for the value of his improvements, he will be indemnified for them, in a proceeding in equity to partition the land between himself and cotenants, either by having the part upon which the improvements are located allotted to him or by having compensation for them, if thrown into the common mass."); Bennett v. Bennett, 36 So. 452, 453 (Miss. 1904) (holding that a tenant in common is entitled to a lien on the shares of his cotenants in the land for taxes paid by him beyond his proportionate share and for any sum due him for improvements or rent from his cotenants); In re Mach, 25 N.W.2d 881, 883 (S.D. 1947) (discussing an equitable lien in circumstances of performance of another's duty); 1 Palmer, supra note 46, at § 1.5(a) (explaining how equitable liens are used to protect plaintiff rights); Porat, supra note 43, at 212 (suggesting the lien solution for unrequested benefits).

ducted from damages.[53] A possible reason is that working less because of the injury could cause emotional harms side by side with the benefits of longer leisure time. As long as the former is not compensated, the latter should not be deducted from damages.

Consider the example of the wrongful birth cases:[54] The benefits to the parents of having the unwanted child—that is, the emotional attachment that will usually develop despite the fact that the parents sought to avoid having a child—might be accompanied by sorrow and frustration. Those harms are generally uncompensated; they are emotional harms that are hard to measure. Given that those harms are not compensated, it makes sense not to deduct the benefits of having the child.

Finally, consider again Example 3 (changing career). Should the extra earnings be deducted from damages? It might be the case that the victim who changed careers following the injury and now earns more has lost something: After all, he had not chosen that new career before the injury. For example, imagine that the victim enjoys the outdoors, and can no longer perform his job as a forest ranger as a result of the injury, and would not enjoy the indoor clerical job that is available. In principle, the court could deduct the extra earnings and award damages for the forgone enjoyment, but measuring forgone enjoyment may be difficult. The court could address this problem instead by refusing to deduct the benefit (the extra earnings) and also refusing to award damages for the forgone enjoyment. This might suggest that the victim does not derive as much enjoyment from the new career as he did from the old career, in which case his greater earnings does not mean he is necessarily better off with his new occupation. Crediting the injurer for the extra earnings without charging him for the intangible losses that the victim probably suffers does not make sense.[55]

[53] See Katz, supra note 1, at 1353. Professor Katz presents an example of a professional athlete who lost her legs as a result of the defendant's tortious conduct. As a result of the defendant's act she is much happier since she can redirect her life into a route from which she ends up deriving greater benefit.

[54] See supra text accompanying note 13.

[55] The outcome might have been different if the wrongdoing itself created an opportunity for a new career for the victim that otherwise would not have existed. Imagine a dependent widow who took her deceased husband's position in the family business, and now the business's earnings are much higher than before her husband's death. It can be argued that if the dependent widow is entitled to any compensation from the wrongdoer, the extra earnings she has made should count to decrease the wrongdoer's liability toward her.

6. Summary

Our starting point is that liability should be imposed for the net social harm. Therefore, there should be two necessary conditions for offsetting benefits from harm: (1) The benefits are social rather than private (meaning that they are not offset by harms to others), and (2) the wrongdoing increased, from an ex ante perspective, the probability that those benefits would be created. If those two conditions are met, courts should answer the following questions before allowing the offset of benefits: (1) Would an offset adversely affect victims' ex ante incentives? (2) Would it be too difficult to measure the benefits? (3) Are there uncompensated harms that interlink with the benefits? If the answers to all three questions are negative, an offset should be made.

If instead some or all answers are positive, then courts must make a complex, all-things-considered decision. The table below summarizes the examples discussed in Part I, along with the two necessary conditions and three considerations for offsetting benefits discussed above. As the table shows, the case for offsetting benefits is rarely very strong, and this may explain courts' reluctance to offset benefits in many settings.

Table 1: Summary of the Two-Party Analysis

	Social Benefit?	**Ex Ante Increase?**	**Victims' Incentives Problem?**	**Measurement Problems?**	**Interlinking Harms?**
Air Crash	sometimes	no	no	no	no
Remarriage	Income–no; affection–yes	yes	yes	yes	no
Changing Career	yes	no	yes	no	yes
The Car	yes	yes	no	sometimes	no
Donations	no	yes	sometimes	no	no
Wrongful Birth	yes	yes	no	yes	yes

II. THREE-PARTY CASES

In many cases, a wrongdoer harms a victim but in the process also benefits a third party. Thus, the social cost of the act is, as a first approx-

imation, the harm minus the benefit. Typically, the law does not offset benefits in these cases, with the result that the wrongdoer must pay full compensation to the victim, and the damages are greater than the social loss. In some cases, however, the law reduces the liability of the wrongdoer—either by directly reducing damages by the benefit, or by giving the wrongdoer a restitution right against the beneficiary.

A. Prevailing Law

The victim of a tort may sue the wrongdoer for damages that compensate the victim for the loss caused by the tort. As we saw in Part I, in some cases the victim's damages may be offset if the wrongdoer confers benefits upon her. However, the law is much less likely to reduce the damages by the value of any benefits conferred on third parties.

> *Example 6: Injured Passenger*. The passenger in a car has a heart attack and the driver rushes her to the hospital, hitting a pedestrian along the way. The driver saves the life of the passenger but badly injures the pedestrian.

No legal rule permits the driver to deduct the benefit that he confers to the passenger from the damages that he must pay to the pedestrian.

It is easy to think of numerous other everyday settings where an act harms one person but benefits another and the law does not calculate damages by subtracting the benefits from the loss: An employer exposes workers to a toxin but gives free health screenings that allow doctors to catch both related and unrelated diseases at an early stage.[56] The employer might argue that even if it must pay damages to workers harmed by the toxins, it should receive a credit for workers whose lives are saved by the early detection of the diseases unrelated to the toxins. A pharmaceutical company manufactures a drug that produces unanticipated negative side effects for one group of customers but unanticipated positive side effects for another group. If the injured customers sue the

[56] Such is the case of firefighters. The National Fire Protection Association ("NFPA"), a leading organization intended to protect firefighters' safety, recommends that all fire departments establish occupational medical evaluation programs. See Nat'l Fire Prot. Ass'n, NFPA 1582: Standard on Comprehensive Occupational Medical Program for Fire Departments ch. 7 (2013). The recommendation is based on the increase in occurrences of cardiac diseases among firefighters. Although the examination's aim is to detect work-related medical problems, it is also intended to find unrelated problems that interfere with the firefighter's physical ability. Id. ¶ 7.2.2.

pharmaceutical company for damages, it is unlikely that the damages would be reduced to reflect the benefit to the other group.

One might argue that if defendants are entitled to credit for benefits, then the victims will be undercompensated. But this is not the case if the victim who is partly compensated can recover from the beneficiaries or if the victim is fully compensated by the defendants, who then obtain restitution from the beneficiaries. As we will see, restitution is available in some related cases, but not in Example 6 (the injured passenger) or other examples.

Let us now consider some exceptions to the rule that defendants receive no credit or deduction for benefits conferred on third parties. The first exception is only a quasi-exception. A number of doctrines permit a defendant to completely *avoid liability* (rather than pay reduced damages) when the defendant injures or kills someone in order to protect a third party who is being threatened by the victim.[57]

> *Example 7: Defense of Another*. Robber threatens to inflict harm on Victim unless Victim hands over her wallet. Third Party tackles Robber, causing an injury to Robber of $100; Victim's wallet contains only $20.

If Robber sues Third Party in tort, Third Party may avoid liability by showing that he acted reasonably to protect Victim. But if the court finds that Third Party acted unreasonably, then the damages will not reflect the offsetting benefit—so the damages will be $100 rather than $80 (we assume for simplicity that $20 reflects the entire benefit of preventing the robbery). There is a discontinuity here: Third-party effects are relevant until a certain point—for the purpose of determining liability. Once we reach that point (negligence is found), third-party effects are completely ignored.[58]

[57] Restatement (Second) of Torts § 76 (1979) (privileging an actor to "defend a third person from a harmful or offensive contact or other invasion of his interests of personality under the same conditions and by the same means as those under and by which he is privileged to defend himself").

[58] See Ariel Porat, Offsetting Risks, 106 Mich. L. Rev. 243, 245 (2007). For example, in *Cooley v. Public Service Co.*, 10 A.2d 673 (N.H. 1940), the court held that a telephone company that harmed a customer by emitting a loud noise while he was on the phone did not act negligently because the noise was the result of precautions that reduced the risk of electrocution to bystanders. Needless to say, if the court had found the telephone company negligent, it is likely that no offset would have been made for the benefits to bystanders. For the argument that under current law courts do not consider third-party effects in awarding damages, see Porat, supra, at 254–58.

Our second exception is the economic loss doctrine, which provides that plaintiffs cannot recover for purely economic loss caused by the negligence of a wrongdoer.[59]

> *Example 8: Economic Loss.* Defendant ship owner negligently causes a collision with another ship at the mouth of a river, which blocks traffic for a period of time. Numerous people and companies—ports, other ship owners, shippers, and so on—lose money as a result of the blockage.[60]

The various third parties may not recover damages from the defendant because of the pure economic loss rule. A common explanation for this rule is that the losses to the third parties are offset by gains to other people in the economy,[61] for example, trucking companies that compete with river traffic. On this theory, the victims cannot recover because of benefits to third parties. But note that the defendant cannot use this argument to avoid paying damages to the owner of the ship that was physically damaged by the collision. Indeed, it could be the case that the economic benefits to third parties exceed the economic losses to victims, and the balance could have been offset against the physical harm. As far as we can tell, courts have not addressed this possibility.

Our third example involves settings in which the action of a wrongdoer creates clearly identifiable transfers from those who are injured by the action to those who are benefited by the action:

> *Example 9: The Fiscal Agent.* A fiscal agent mistakenly calculates Medicaid reimbursements so that a state overpays a hospital. The state

[59] Restatement (Second) of Torts § 766C (1979) ("One is not liable to another for pecuniary harm not deriving from physical harm to the other, if that harm results from the actor's negligen[ce] . . . ."). There are exceptions to the rule that are beyond the scope of this Article.

[60] Cf. Louisiana ex rel. Guste v. M/V Testbank, 752 F.2d 1019, 1020–21 (5th Cir. 1985) (concerning lawsuits brought against two ships that collided in the Mississippi River Gulf Outlet and caused a chemical spill that closed the outlet).

[61] See generally William Bishop, Economic Loss in Tort, 2 Oxford J. Legal Stud. 1 (1982) (arguing that a major consideration for non-recovery for pure economic losses is that those losses are often transfers of wealth from one person to another); Giuseppe Dari-Mattiacci & Hans-Bernd Schäfer, The Core of Pure Economic Loss, 27 Int'l Rev. L. & Econ. 8 (2007) (making the same argument but explaining that non-recovery may encourage the victim to take precautions that are social costs); Mario J. Rizzo, A Theory of Economic Loss in the Law of Torts, 11 J. Legal Stud. 281 (1982) (discussing the economics of the rule against compensation for pure economic loss).

> recovers its overpayment from the fiscal agent, who in turn obtains restitution from the hospital.[62]

The state can sue the fiscal agent because the fiscal agent caused the state to overpay the hospital. When the state recovers from the fiscal agent, the hospital is now no longer liable in restitution to the state. But this means that the hospital keeps its windfall while the fiscal agent has paid damages greater than the social loss. To address this problem, the law permits the fiscal agent to avoid the loss it suffered because of its liability for the state's loss by giving it the ability to recover the benefit from the hospital, thus eliminating the windfall. The law could provide for an equivalent result by denying the state a remedy against the fiscal agent (which is equivalent to deducting the benefit to the hospital from the harm to the state) and forcing it to obtain a recovery directly from the hospital that received the windfall.

This rule is not applied in many settings. Consider the following example:

> *Example 10: The Prisoner*. A prisoner murders another prisoner. The government provides the victim with a funeral and then sues the wrongdoer for the funeral costs. The wrongdoer argues that the government's small loss should be offset by its enormous cost savings, for it avoided the expense of feeding and sheltering the victim for the duration of his imprisonment.[63]

The government in this case is like the hospital in the last case. It receives a benefit (it no longer must pay for food and shelter, which costs more than a funeral, which it would eventually have to pay for anyway), thanks to the murderer, who took the life of the victim. This would clearly be a third-party case if the victim's estate brought a lawsuit against the murderer for wrongful death and sought funeral expenses, and then the murderer turned around and sued the government for restitution on account of the benefit to the government. In the actual case addressing this situation, the murderer's argument was in essence that the government stepped into the shoes of the estate, and if it receives damages for funeral expenses, the savings for room and board should be off-

[62] State ex rel. Palmer v. Unisys Corp., 637 N.W.2d 142, 147–48 (Iowa 2001) (concerning a lawsuit brought by the State and Department of Human Services against a Medicaid fiscal agent for miscalculating payments to a health maintenance organization).

[63] United States v. House, 808 F.2d 508, 509 (7th Cir. 1986).

set. However, the court denied the offset and the government recovered the full funeral expenses.[64]

The murderer's argument resembles a famous argument made by Professor W. Kip Viscusi that a state that sues tobacco companies for the cost of public medical care for people with tobacco-related illnesses should recover no damages because smokers die young and so spare the state end-of-life medical expenses that are greater than the costs of caring for people with tobacco-related illnesses.[65] Here again, the states benefit from the wrongful acts of the tobacco companies, and yet, based on a legal theory that they are entitled to step into the shoes of victims, they sue the tobacco companies for damages. The courts' reluctance to allow an offset would be even stronger if the victims themselves had brought their suits and the tobacco companies had argued that the benefits to the state should reduce their liability.

Less extreme examples are also available. When a corporation fraudulently exaggerates its profitability, investors can sue based on the theory that they overpaid for the stock, and can recover damages equal to the difference between the inflated price and the "true" price—the price that would have existed but for the fraud.[66] The corporation is not permitted to deduct from the damages the windfall to people who sold the stock to the investors and thus received a higher price than they would have obtained but for the fraud.[67] When firms conspire to fix prices, people who buy products from *non*-conspirators, who are able to overcharge because of the reduced competition, may be able to recover damages for these overcharges from the conspirators under the theory of umbrella liability. The damages are not reduced by the benefit to the non-conspirators who charge higher prices, nor are the conspirators given a restitution claim against the non-conspirators.[68]

Or consider examples of index manipulation. A major seller, which also manages or participates in the management of a price index, enters

[64] Id. at 509–10.

[65] See W. Kip Viscusi, Smoke-Filled Rooms: A Postmortem on the Tobacco Deal 67–77 (2002). For criticism of this argument, see Eric A. Posner, Tobacco Regulation or Litigation?, 70 U. Chi. L. Rev. 1141, 1142–43 (2003).

[66] See Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. Chi. L. Rev. 611, 642 (1985).

[67] Id. at 635 ("These gainers have not violated any rule, however, and cannot plausibly be called on to pay their gains to the losers.").

[68] See Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 347 (3d ed. 2007 & Supp. 2014).

into numerous contracts where the price is partly a function of the index. Other independent parties also set prices by reference to the index. The seller then manipulates the index so that contract prices are inflated. The seller's counterparties, who paid more than they bargained for, are obviously entitled to recover for damages. But what of buyers who are not counterparties of the seller? They could sue their own sellers for restitution, but instead they sue the manipulator in tort. It is not clear whether the windfall to the non-counterparty sellers will be deducted from the damages that the non-counterparty buyers can recover from the manipulator.[69]

Our final example comes from the law of takings:

> *Example 11: Takings.* The government takes a piece of Owner's land and redevelops it. As a result, the value of the land of Owner's neighbors increases. Should Owner's compensation for the taking be reduced by the benefit to the neighbors?

Black letter law says no—Owner's compensation should not be affected by the benefit to the neighbors.[70] However, in practice the contrary result sometimes occurs. For example, in *Penn Central Transportation Co. v. New York City*, the owners of Grand Central Terminal unsuccessfully sought compensation for a taking caused by a landmark preservation law that prevented them from building atop the existing structure.[71] The U.S. Supreme Court held that the owners were compensated by reciprocal economic and "quality of life" benefits created by the law.[72] As Professor Daryl Levinson explains,

> These benefits would hardly be sufficient to compensate the owners for their enormous economic loss; as the Court recognized, the owners may have been personally "more burdened than benefited" by the landmark preservation law. Nevertheless, the Court suggested, average reciprocity of advantage might obtain at the level of "all New York citizens," a group that includes the beneficiaries of historic

[69] For an example of this factual setting, see *Loeb Industries v. Sumitomo Corp.*, 306 F.3d 469, 470, 474–78 (7th Cir. 2002). However, the court did not resolve this issue. One of us (Posner) is involved in a case addressing this issue as of the date of this Article's publication.

[70] See, e.g., Hendler v. United States, 175 F.3d 1374, 1380, 1382 (Fed. Cir. 1999) (noting the rule that "general benefits" to the community are not offset from damages; only "special benefits" to the owner are offset).

[71] 438 U.S. 104, 116, 138 (1978).

[72] Id. at 134–38.

> preservation along with the immediate economic losers. As long as the benefits of regulation are at least equivalent to the costs across all members of this group, the argument would go, there has been no taking requiring compensation. The distribution of costs and benefits *within* the group, on this theory, is of no consequence: Benefits and burdens need not net out nonnegative at the level of any particular individual.[73]

The reciprocity language masks the fact that the owners receive no compensation because third parties receive a benefit.[74]

B. Theory

1. Social vs. Private Costs and Benefits

In Example 6 (the injured passenger), we have three persons: the driver who drove too fast, the pedestrian who was injured, and a passenger who was saved. The driver injured the pedestrian but benefited the passenger. From a social perspective, we want the driver to pay the net cost that he imposed on all others—the pedestrian *and* the passenger—and that means that the driver must pay damages that equal the cost to the pedestrian minus the benefit to the passenger.[75] In other words, the private cost of the pedestrian is more than the aggregate social cost. As we have explained, the law should ensure that the wrongdoer pays the social cost, not the private cost.

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[73] Daryl J. Levinson, Framing Transactions in Constitutional Law, 111 Yale L.J. 1311, 1341 (2002) (footnotes omitted); see also Abraham Bell & Gideon Parchomovsky, Givings, 111 Yale L.J. 547, 553–54 (2001) (pointing out that benefits as well as costs should be taken into account when determining damages for takings).

[74] But see Hanoch Dagan, Takings and Distributive Justice, 85 Va. L. Rev. 741, 795–99 (1999). Professor Dagan suggests a possible reading of the *Penn Central* decision in which the reciprocity argument should be understood as relating to long-term reciprocity:

> [I]nstead of thinking of the advantages from preservation as the purported quid pro quo of the multimillion-dollar loss the appellants have encountered—a tenuous proposition, to be sure—we can think of the preservation status as merely part of a continuous flow of advantages they receive as citizens of New York City. Their current burden is indeed both significant and disproportionate, but this immediate disproportionate impact may still be counterbalanced by long-term reciprocity.

Id. at 797.

[75] If the benefit to the passenger (for example, life saved) exceeds the cost to the pedestrian (for example, broken ankle), damages should be zero, or conceivably negative, as we will discuss.

The law can ensure that the wrongdoer pays only the social loss in two main ways. For clarity, suppose that the loss to the pedestrian is 100 and the gain to the passenger is 80. The social cost is thus 20. First, the wrongdoer could pay the pedestrian damages equal to the net social cost of 20, leaving the pedestrian undercompensated. (The pedestrian could also be given a right of restitution of 80 against the passenger.) Second, the wrongdoer could pay the pedestrian damages equal to her private cost of 100, and be given a right of restitution of 80 against the passenger.

It is clear that the different rules can result in different allocations of the loss between the pedestrian and the passenger. If the wrongdoer pays damages of 20 to the pedestrian, and the pedestrian has no remedy against the passenger, then the outcome is one in which the pedestrian loses 80 and the passenger gains 80 against the pre-accident status quo. Alternatively, suppose the wrongdoer pays damages of 100 to the pedestrian and has a right of restitution of 80 against the passenger. Then the outcome is a loss of 0 for the pedestrian and a gain of 0 for the passenger against the status quo. Other sharing rules can also be imagined. We return to the question of how damages can be allocated so as to give victims and beneficiaries the proper incentives in Subsection II.B.4.

Consider now Example 9 (the fiscal agent). When the fiscal agent makes a mistake, the state transfers, say, an extra $100 to the hospital. The state sues the agent, arguing that it lost $100. But to calculate the social loss, we must subtract the hospital's $100 benefit from the state's $100 loss. Thus, the fiscal agent should not be liable. If it is important for the state to be compensated, then it should have a restitution claim against the hospital; or, if it is permitted to recover from the fiscal agent in tort, then the fiscal agent should have a restitution claim against the hospital to the extent of the agent's liability. Here, the law is consistent with the efficient outcome.

Courts do not account for the benefit to the passenger (either by reducing the driver's damages or giving the driver a restitution claim against the passenger), but they do account for the benefit in the fiscal agent case. These outcomes seem inconsistent.[76] If social rather than private losses should be counted, then the outcome in the fiscal agent case

[76] As we discuss below, there may be other explanations for the outcome in the injured passenger example.

is correct, and similarly the wrongdoer should receive credit for the benefit to the passenger.

The *Penn Central* case also illustrates the idea that social rather than private losses should be counted.[77] Let us make some very simple assumptions about the government.[78] When it takes property, it must pay whatever the court orders it to pay. But it does not benefit from gains to neighboring property that result from development of the taken property. (Or it gains only partially, from tax revenues.) If the government attempts to balance its budget and must pay the owner's entire private loss, then it will not make socially optimal takings that benefit third parties. *Penn Central* corrects this problem by allowing the government to take for free when the benefits to third parties are great enough.

Penn Central muddied this result by purporting to base the outcome on the supposed reciprocal benefits to the owner.[79] However, the underlying logic of *Penn Central* implies that the government should not pay compensation whenever the benefits to third parties from a taking exceed the costs to the owner. For example, if the government takes houses in order to build a road and the benefits are greater than the costs, it should not pay damages. As we saw, the usual explanation for requiring the government to compensate the owner in all cases is that if the government is not forced to pay the costs of takings, it will take too often. But this explanation ignores the fact that government officials do not internalize the benefits as well as the cost. If the government simply tries to balance its budget, and must compensate the owner for a taking while not receiving the benefits to third parties in the form of a restitution claim, then the government will take too rarely. One might reconcile this doctrinal tension by positing that if benefits are spread across many people, there will be greater political pressure to take too much than to take too little.[80] We are skeptical, but in any event these political issues lie outside the scope of this Article.

[77] See supra text accompanying notes 71–73.

[78] The government's possible motives in such cases are the subject of a large literature. See, e.g., Lawrence Blume & Daniel L. Rubinfeld, Compensation for Takings: An Economic Analysis, 72 Calif. L. Rev. 569, 620–22 (1984) (discussing fiscal illusion and related phenomena); Yun-chien Chang, Empire Building and Fiscal Illusion? An Empirical Study of Government Official Behaviors in Takings, 6 J. Empirical Legal Stud. 541, 566–77 (2009) (showing empirically that political interests substantially affected Taiwanese officials' decisions in takings cases). We adopt the present assumptions for illustrative purposes only.

[79] *Penn Cent.*, 438 U.S. at 134–35.

[80] Blume & Rubinfeld, supra note 78, at 620–21.

2. The Problem of Residual Harms

The distinction between social and private losses—where social losses are private losses minus benefits to others—is found in many areas of the law where offsets are recognized. But the law does not always respond consistently, and one hypothesis for why is that the law must grapple with what we call the problem of residual harms.

In our Example 8 (economic loss), when the ships collide and block the river mouth, other shipping companies are harmed but competing trucking companies are benefited. Thus, when shipping companies sue for damages, they are awarded zero because the benefits to others offset their losses. This is required by the economic loss doctrine.

But consider the case of corporate fraud. The CEO of X Corp. announces at time 1 that the company has discovered gold. The stock price soars from 10 to 20. At time 2, an investigation reveals that the CEO lied; the stock falls back to 10. Investors who bought stock in X Corp. after the announcement at time 1 paid 20, but now own stock worth 10. They sue X Corp. for the difference—damages of 10.

The investors are entitled to these damages under the law. However, as we noted before, their private loss does not equal the social loss. Another set of investors benefited from the fraud: They sold shares worth 10 at 20. If their benefits were subtracted from the losses to the other investors, then the net would be 0. From a social perspective, the fraud appears to cause no harm at all.

But this is not quite right. If investors know that CEOs can lie about the company, then they will be reluctant to buy stock—or they will buy stock only at a low price.[81] This means that when corporations raise capital, they must pay a premium above what they would pay if CEOs were deterred from lying—an amount that compensates investors either for the higher risk that management wrongdoing or error will be concealed or the greater efforts investors will take to obtain information from other sources. In our example, this premium is neither 0 (the ex post social loss) nor 10 (the ex post private loss); it is most likely something in between. The correct figure depends on all kinds of complicated factors. Suppose, for example, that a firm's business is largely public, and so CEOs do not have much private information. (Consider the CEO of an exchange whose members are major firms, or the CEO of a mutual fund

[81] See Frank H. Easterbrook & Daniel R. Fischel, Mandatory Disclosure and the Protection of Investors, 70 Va. L. Rev. 669, 675, 692–93 (1984).

that approximates an index of publicly traded companies.) Then, CEO fraud is not much of an issue, and if it occurs, will not cause much harm. By contrast, where CEOs possess private information that matters to the value of the firm, investors will want to be able to rely on statements by the CEO, in which case the absence of an effective fraud remedy will greatly raise the cost of capital for the firm. This same point applies to our index manipulation example,[82] and it echoes our analysis of Example 8 (economic loss), where potential victims will take precautions to avoid their private loss, and those precautions create a social loss even if other economic losses and benefits from a tort net out.

In sum, we think that in the present context, courts should allow the wrongdoer to pay damages for the private harm but obtain restitution from the beneficiaries equal to the benefit minus the social harm. When the social harm is thought to be large but cannot be precisely calculated, a case can be made that benefits should not be recovered.[83]

3. Ex Ante Increase of Expected Benefits

As in the two-party case, a benefit should not be subtracted from a loss for the purpose of calculating damages when the probability of the benefit's creation was not increased by the wrongdoing.[84] In Example 6 (the injured passenger), imagine that in most such cases, the passenger would have been taken (safely) to the hospital by an ambulance if the driver had not acted, and would receive the same benefit or an even larger one (getting to the hospital faster, with immediate medical treatment). In the robber case, imagine that in most such cases the police would have arrested the robber if the third party had not intervened and benefitted the victim.

This principle provides an important and pervasive constraint on restitution damages. It is often the case that benefactors cannot obtain restitution from a beneficiary. The doctrinal reason is that the benevolent act was gratuitous.[85] The underlying economic reason is that if the benefactor had not acted, the beneficiary would have purchased the good or service on the market, or the government would have supplied it.[86] Moreo-

[82] See supra text accompanying note 69.

[83] This is technically a problem with measurement. See infra Subsection II.B.5.

[84] See supra Subsection I.B.2.

[85] See Levmore, supra note 43, at 67–82 (explaining the logic of no liability for unrequested benefits).

[86] Id.

ver, it is plausible that the market and the government provide goods and services more efficiently than random benefactors do. Thus, the gratuitousness rule deters people from inefficiently supplying goods and services, or providing goods and services that others do not in fact want.

This principle carries through to our three-party case. Suppose, for example, that ambulance services are plentiful and reliable in the area where the passenger had a heart attack. To encourage the driver to pull over and call an ambulance, or in any other way to cause the driver to internalize all social costs, the law should require him to pay the full (private) loss to the pedestrian if an accident occurs, and deny him a right of restitution against the passenger. But if ambulances are not readily available, the law should either calculate damages by subtracting the benefit to the passenger from the cost to the victim, or by allowing the victim full recovery coupled with the driver's entitlement to recover from the passenger, so as to provide optimal incentives.

This may be an excessively complicated way of noting that one must take account of context. When an apparent benefit (driver saves passenger) is not a real benefit (ambulance would have saved passenger), then obviously the benefit should not be offset. Our larger point is that courts must pay attention to the context in order to determine whether the apparent benefit is real or not. Moreover, the existence of background substitutes helps to explain why the norm is not to offset benefits.

4. Victims' and Beneficiaries' Incentives

As is well known, if the victim is fully compensated, she may take insufficient precautions to protect herself from the accident. This problem can be addressed at the level of liability: If the wrongdoer does not pay if he is non-negligent, or the victim does not receive damages if she commits contributory negligence, then she will have the optimal incentive to take precautions.[87] However, in some cases—for example, if the victim's behavior cannot be verified in court, or the tort rule is strict liability—damages should be reduced to ensure that the victim takes precautions.[88] A rule that gives the victim damages equal to the social loss rather than her private loss (when the social loss is smaller than the pri-

[87] See Steven Shavell, Foundations of Economic Analysis of Law 184–87 (2004) (analyzing victims' incentives under different liability rules).

[88] Id. at 184 (arguing that strict liability with no contributory negligence defense provides the victim with deficient incentives to take care).

vate loss) would nudge her to take precautions. Thus, an argument could be made that the benefit to the passenger in Example 6 should be offset from the damages the driver must pay to the pedestrian, and that the pedestrian should not have a right of restitution against the passenger.[89]

However, we also need to take into account the beneficiaries' incentives. Imagine that the passenger had a heart attack on the side of the road and was about to dial 911 when the driver pulled up and offered her a ride to the hospital. Suppose the ambulance would cost $100, while the driver offers a ride for free, but the ambulance imposes an expected risk on pedestrians of $0 while the driver imposes an expected risk on pedestrians of $200. Otherwise, the driver and the ambulance offer an identical service in terms of speed, safety to the passenger, and so on.

In the absence of a legal rule that creates liability for the passenger, she will choose the driver over the ambulance because the driver offers the ride for free. In doing so, she effectively (albeit jointly with the driver) externalizes a cost on pedestrians. To prevent her from doing so, the law should impose an expected liability of $200 on her (or on the driver). In principle, the passenger should be exposed to tort liability, but proximate causation would probably spare her. A second best outcome would be to give either the driver or the pedestrian a right to restitution against the passenger. The exact amount of restitution raises further questions. It could be the cost savings from avoiding the ambulance ($100), or it could be the health benefits ($80). In the context of this example, restitution should be at least $100, so as to cause the passenger to choose the ambulance.

The basis for this argument is that we want all parties to internalize both negative and positive externalities. The beneficiary internalizes the positive externalities; he should ideally internalize the negative externalities also. A second best option is that he would disgorge the benefits he received (as long as harm is higher than benefit, disgorgement of benefits is clearly an improvement from a situation where he pays nothing).

5. Measurement Issues

Measurement issues in three-party cases are similar to those in two-party cases, so we need not repeat our earlier discussion.[90] It is sufficient

[89] The same argument applies also to two-party cases: Decreasing the victim's liability below his private loss could often improve his incentives. See supra Subsection I.B.3.

[90] See supra Subsection I.B.4.

to note again that the frequent difficulty of measuring benefits provides a reason for denying restitution or not offsetting benefits in three-party as well as two-party cases. Indeed, the residual harm issue, the ex ante increase in benefit issue, and the victim/beneficiary incentive issue can all be described as issues that implicate measurement problems. For example, the residual harm issue is that the residual harm often cannot be measured. In such cases, it may make sense not to allow the wrongdoer to offset benefits, for if the law allowed him to do this, he would be underdeterred.

6. Interlinking Non-Compensable Harms

Should Example 10 (the prisoner) have the same result as Example 9 (the fiscal agent)? Recall that in the fiscal agent example, the fiscal agent should recover restitution from the hospital if it must pay damages to the state on account of a transfer from the state to the hospital. The social costs the fiscal agent should bear are the loss to the state minus the benefit to the hospital. The prisoner example is different because the victim (who is dead) does not recover damages from the murderer. The state, which has an interest in keeping prisoners alive (even though they are in prison and must be maintained at great expense), steps into the victim's shoes and rightly demands money so as to deter future prison murders. If the government could successfully recover full compensation for the victim's death, then an argument could be made that room and board savings should be deducted. But since the government cannot, funeral expenses provide at least a small deterrent. In other words, if the government (or victim's family) does not recover the victim's private loss, leaving wrongdoers underdeterred, it would make no sense to offset benefits to the government in a separate action to recover for funeral expenses. The same analysis applies to Viscusi's argument about tobacco litigation.[91]

7. Activity Levels and the Asymmetry Problem

Consider again Example 6 (the injured passenger). Suppose the driver can choose between two routes to the hospital: a populated route and a safe route. If the driver takes the populated route, he imposes a risk on pedestrians; if he takes the safe route, he does not. Suppose now that the

[91] See Posner, supra note 65, at 1149.

rule of law is strict liability and that the law gives the pedestrian the right to recover in tort against the driver and the driver the right to recover in restitution against the passenger. Then the driver will speed if and only if the benefit to the passenger exceeds the cost to the victim. This was the result of our earlier analysis.

The problem, however, is that the driver does not get a right to recover against the passenger if he takes the safe route and injures no one. To understand this point, suppose the two routes get the passenger to the hospital in exactly the same time (giving the passenger a benefit of $80). If the driver takes the populated route, he imposes an expected cost of $50; if he takes the safe route, he imposes an expected cost of $0. Now if an accident occurs, he must pay the victim $50 but may offset the benefit or separately obtain restitution from the passenger, so that his liability is $0. This means that the driver is indifferent between the safe route and the populated route—in both cases his liability is $0. But we want the driver to take the safe route.

This problem arises from an asymmetry: If we credit injurers who create benefits without crediting non-injurers who create benefits, we bias behavior in favor of injuring. In other words, a rule that allows wrongdoers to offset benefits from private losses can distort behavior because no rule allows non-wrongdoers who create benefits to obtain restitution for those benefits.

There are three ways to solve this problem. The first is to allow people who provide benefits to obtain restitution even if they are gratuitous. But as we have seen, the law has good reasons not to allow this.[92] The second is to make sure that the pedestrian can obtain restitution from the passenger so that the passenger will order the driver to take the safe route. But this seems a bit complicated. The third is to forbid wrongdoers to deduct benefits from damages and disallow them to recover from the passenger. But if this is done, then, as we have seen, deterrence will be excessive. A possible middle path is to permit an offset only in limited circumstances—for example, when the wrongdoer can prove that this distortion is not likely—or to limit the magnitude of restitution damages. But we again see why courts may be reluctant to award an offset too freely.

Or consider another example. Suppose Jones, the wealthy resident of a neighborhood, would like to build a large park on her property that she

[92] See supra text accompanying notes 85–86.

will allow neighbors to use and enjoy. These neighbors would value the park at 100. But other neighbors would be irritated by the noise that occurs when people use the park, and the harm to these other neighbors would be 100. Jones could build the park in a slightly different way that would minimize the noise, but the cost of building the park would then be slightly higher.

If the offended neighbors can sue Jones for nuisance but their damages would be completely offset by the benefit to the other neighbors, then Jones has no reason to spend slightly more to build the quiet version of the park. From the social perspective, however, Jones should build the quiet version of the park.[93]

Again, the problem arises because of the law's different treatment of injurers who create benefits (and enjoy a deduction) and non-injurers who create benefits (who do not receive restitution). The problem arises only in the special case when people voluntarily create benefits. The problem does not arise in a market setting. If Jones plans to build a park and then charge people for admission, she will take into account the harm to neighbors because her liability to them will be subtracted from her profits.

8. Summary

Our starting point was that, all else equal, the wrongdoer should be liable for the social loss, not the private loss, where the social loss equals the private loss minus any private benefits. The residual private loss should be allocated between the victim and the beneficiary. As we have seen, the law does provide for such an outcome some of the time. Our puzzle was why it does not do so more often. And the answer to that puzzle, painting in broad terms, is that not all else is equal: Numerous factors provide reasons for denying either the offset or the recovery of the benefits from the beneficiary. These include: (1) The law often aims at fully compensating the victim and there are factual or legal limitations to recovering from the beneficiary; (2) there are residual harms, so that deduction of private benefits would lead to underdeterrence of wrongdoing; (3) the private benefit would have been supplied more efficiently by the market or the government; (4) deduction of the private benefit or al-

[93] Note that this point is also relevant to two-party cases. If the same neighbor, who suffers a loss of 100, also receives another benefit of 100, and an offset is allowed, Jones's incentives will be distorted in the same way as in the three-party case.

lowing recovery from the beneficiary would give victims and beneficiaries perverse incentives; (5) private benefits can be hard to measure; (6) the benefit might be offset by a hard-to-measure harm to the victim; and (7) deduction of private benefits or allowing recovery from the beneficiary can lead to activity-level distortions. By the same token, when these problems do not exist—as is clearest in Example 9 (the fiscal agent), and perhaps in certain eminent domain cases—a strong case exists for reducing the wrongdoer's liability by the amount of the benefits to third parties.

Assuming that the benefit should reduce the wrongdoer's liability: *How* should it be done? We saw two main approaches: (1) Give the victim a right to damages for the entire loss while giving the wrongdoer a right of restitution against the beneficiary; and (2) give the victim a right to damages only for the social loss while also giving her a right of restitution against the beneficiary. The first approach thus puts the burden on the wrongdoer, while the second approach puts the burden on the victim.

It might seem intuitive that the wrongdoer should bear the burden, but the law does not always impose such ancillary costs on wrongdoers (for example, they do not generally pay victims' attorneys' fees), and if we are concerned about incentives, that is where our focus should be. The choice between the two approaches matters from a social standpoint only when the beneficiary is judgment-proof—insolvent—or effectively so, as when numerous small beneficiaries are too costly to identify and sue, or when there are substantive reasons not to allow recovery from a beneficiary who received unrequested benefits. In the securities fraud example,[94] the investors who benefited from the fraud because they sold to the victims when the price was artificially inflated probably cannot be identified, and would be difficult to sue even if they could be. If the wrongdoers must pay the victims' full loss with no offset, and are given a (worthless) restitution right against the beneficiaries, overdeterrence will occur. If the wrongdoers must pay only the social loss (zero, or a small residual amount), and the victims are given the worthless restitution right, optimal deterrence will occur but the victims will be undercompensated. So the choice between the two approaches depends on how much one weighs the risk of overdeterrence and the harm from undercompensation. Since victims are generally diversified, and thus effectively have insurance against such losses (which are usually small rela-

[94] See supra Subsection II.B.2.

tive to their portfolio), it seems that the second approach of giving victims the restitution right is correct.[95]

Table 2: Summary of the Three-Party Analysis

	Social Benefit	Residual Harms	Ex Ante Increase	Victims' Incentives Problem	Measurement Problems	Interlinking Harms	Activity Level
Injured Passenger	yes	no	maybe	maybe	no	no	maybe
Defense of Another	yes	no	maybe	yes	yes	no	usually irrelevant
Economic Loss	yes	yes	yes	yes	no	no	usually irrelevant
The Fiscal Agent	yes	yes	yes	no	sometimes	no	usually irrelevant
The Prisoner	yes	no	yes	no	no	yes	usually irrelevant
Takings	yes	yes	yes	no	yes	no	usually irrelevant

CONCLUSION

Wrongdoing often creates harms and benefits at the same time. Victims seek damages that compensate them for the entire harm, while defendants try to persuade courts to offset benefits that the victims or third parties received as a result of the same act that caused the harm, or acts related to the original wrongdoing. The recurrent question is when should the benefits be offset?

Our starting point was the assumption that the law should minimize social costs, and it immediately follows that the benefit should be offset from the harm as long as the benefit was itself not offset by another harm (that is, the benefit is social rather than private), and the wrongdoing increased the probability of the creation of the benefit. But even when these two conditions are satisfied, there are several considerations

[95] Unless, as we argued above, see supra Subsection II.B.2, the residual loss cannot be calculated, and overdeterrence is superior to underdeterrence.

that could tilt the scale toward the conclusion that an offset should not be made.

First, the court must ensure that offsetting the benefits does not give the victim perverse incentives—for example, incentives not to avoid the harm or mitigate it. Second, the court should avoid offsetting benefits when they are too hard to measure. Third, and relatedly, the court should avoid offsetting measurable benefits that are plausibly offset by harms that are not compensated because they are too hard to measure. Fourth, in three-party cases, the court should not offset benefits (or allow recovery from the third-party beneficiary) when doing so gives wrongdoers an incentive to inefficiently change their activity level.[96] Fifth, in three-party cases, courts also need to ensure that if they do offset benefits (or allow recovery from the beneficiary), they also order the wrongdoer to pay damages equal to the residual harm. If the residual harm is difficult to measure, offsetting benefits (or allowing recovery from the beneficiary) may be unwise.

Three-party cases also raise the question as to how the benefits should be credited to the wrongdoer. Often, there is a choice as to whether to reduce the wrongdoer's liability and give the victim a right to restitution against a beneficiary, or to maintain the wrongdoer's liability to the victim while giving the wrongdoer a right to restitution against the beneficiary. The choice boils down to who should bear the risk that the beneficiary is judgment-proof, or for some other reason cannot be sued. If the beneficiary is judgment-proof or otherwise cannot be sued, the first approach leads to undercompensation of the victim, while the second approach leads to overdeterrence of the wrongdoer.

Interestingly, the law typically allows third-party effects to be taken into account in setting the standard of care, but not in awarding damages. The driver who crashes into one pedestrian because she swerved to avoid another avoids liability if she acted justifiably but must pay full damages if not, even though she benefited the second pedestrian. Perhaps this rule reflects intuitions about corrective justice, which implies that third-party considerations should be disregarded altogether once liability has been established.[97] However, the lens of corrective justice is too narrow. The law frequently rewards people who benefit others in or-

[96] This consideration could also be relevant to two-party cases. See supra note 93.

[97] Jules L. Coleman, Risk and Wrongs 380–85 (1992) (discussing the focus of corrective justice on the relationship between the injurer and the victim); Ernest J. Weinrib, The Idea of Private Law 63–66 (1995) (same).

der to provide socially beneficial incentives. Cases like Example 9 (the fiscal agent) show that the social goals of remedying harm and rewarding benefits are often implicated by a single act. Thus, we believe courts should seriously consider offset and restitution arguments in three-party cases.

Still, one of the lessons of our discussion is that the general legal reluctance to offset benefits is frequently justified. Even when the benefits are social, numerous complex issues touching on causation and measurement must be confronted, and they often indicate that the wrongdoer should bear the entire private harm suffered by the victim.

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