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Cover Page Footnote

Distinguished Professor of Law, Fordham University School of Law. The Law School's generous support for this Essay is gratefully acknowledged. I wish to thank James Bowers, Mark Gergen, John Murray, Steve Thel, and Ben Zipursky for helpful comments on earlier drafts of this Essay.

ESSAY

MISREADING OLIVER WENDELL HOLMES ON EFFICIENT BREACH AND TORTIOUS INTERFERENCE

Joseph M. Perillo*

OLIVER Wendell Holmes's most notorious statement about contract law was that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else."¹ This generally has been interpreted to mean that a contracting party has a lawful option to perform or not. In this tradition, Clark Remington recently wrote: "The law has come to regard the obligation to perform a contract as being generally equivalent to an option to perform or pay damages. Holmes saw the matter this way more than one hundred years ago."² From this

* Distinguished Professor of Law, Fordham University School of Law. The Law School's generous support for this Essay is gratefully acknowledged. I wish to thank James Bowers, Mark Gergen, John Murray, Steve Thel, and Ben Zipursky for helpful comments on earlier drafts of this Essay.

1. Oliver Wendell Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 462 (1897). Holmes recognized that this statement did not account for the remedy of specific performance, but stated that "I hardly think it advisable to shape general theory from the exception." *Id.* He failed to note other legal sanctions that were still available in the early nineteenth century for breach of contract; for example, jail time for runaway indentured servants. See Robert J. Steinfeld, *The Invention of Free Labor: The Employment Relation in English and American Law and Culture, 1350-1870*, at 3-4 (1991). In England, imprisonment of breaching employees continued until the late nineteenth century. See generally Alfred Avins, *Involuntary Servitude in British Commonwealth Law*, 16 Int'l & Comp. L.Q. 29 (1967) (surveying the phenomenon in the United Kingdom of criminal enforcement of labor contracts until the late 1800's). Also, corporal punishment of apprentices and "menial" servants was permitted. See Esek Cowen, *Treatise on the Civil Jurisdiction of a Justice of the Peace in the State of New York 193-94* (1821). Imprisonment for debt was frequent. See Richard Ford, *Imprisonment for Debt*, 25 Mich. L. Rev. 24, 29 (1926) ("The number of persons imprisoned [for debt in 1830] was 3,000 in Massachusetts, 10,000 in New York, 7,000 in Pennsylvania, and 3,000 in Maryland . . ." (footnote omitted)). The law also provided that instead of imprisonment, "[p]oor debtors may by law be assigned in service, for the payments of their debts." 1 Zephaniah Swift, *A System of the Laws of Connecticut* 218 (Arno Press 1972) (1795). In other words, poor debtors were impressed into debt slavery.

2. Clark A. Remington, *Intentional Interference with Contract and the Doctrine of Efficient Breach: Fine Tuning the Notion of the Contract Breacher as Wrongdoer*, 47

misreading of Holmes, Remington expresses a natural bewilderment, asking, "[i]f a person is free to breach a contract and pay damages, why should it be tortious for a third party to induce the contract party to do what she is free to do?"³

The purpose here is not to berate Remington, whose article, despite its mistaken premise, is otherwise a fine piece of scholarship, but to point out a common misreading of Holmes's statement, due primarily to the opacity of Holmes's writing style. Remington is in good company. Even Holmes's close friend and correspondent, Sir Frederick Pollock, similarly misunderstood Holmes's point. In the eighth edition of his volume on Contracts, Pollock states:

Mr. Justice Holmes . . . suggests that every legal promise is really in the alternative to perform or to pay damages: which can only be regarded as a brilliant paradox. It is inconsistent not only with the existence of equitable remedies, but with the modern common law doctrine that premature refusal to perform may be treated at once as a breach.⁴

In a letter written by Holmes, he chided Pollock for this passage and clarified its meaning:

I stick to my paradox as to what a contract was at common law: not a *promise* to pay damages or, etc., but an act imposing a liability to damages *nisi*.⁵ You commit a tort & are liable. You commit a contract and are liable *unless* the event agreed upon, over which you may have no, and never have absolute, control, comes to pass.⁶

Buff. L. Rev. 645, 647 (1999) (citing Holmes, *supra* note 1, at 462).

3. Remington, *supra* note 2, at 674.

4. 1 Holmes-Pollock Letters: The Correspondence of Mr. Justice Holmes and Sir Frederick Pollock, 1874-1932, at 177 n.2 (Mark DeWolfe Howe ed. 1941) (quoting Frederick Pollock, Contracts 192 n.K (8th ed. 1911)) [hereinafter Holmes-Pollock Letters]. Pollock criticized Holmes's view of contract—as he understood it—on other occasions as well. See, e.g., *id.* at 80 (discussing historical authorities that differed with Holmes's view of contracts) (letter of Sept. 17, 1897). More recently, Richard Epstein appears to read Holmes's "imperial" statement in the same way, but strongly disagrees with what he deems Holmes to have meant. See Richard A. Epstein, Torts 579-80 (1999). James P. Nehf, apparently reads Holmes the same way, but also with disapproval. See James P. Nehf, *Contract Damages as Substitute for Full Performance*, 32 Ind. L. Rev. 765, 765-66 (1999).

5. *Nisi* in Latin means "unless." Black's Law Dictionary 1047 (6th ed. 1990).

6. 1 Holmes-Pollock Letters, *supra* note 4, at 177 (letter of Mar. 12, 1911) (emphasis in original). In a similar vein, 17 years later, Holmes chided Pollock for falling victim to

the persistence of the impression that I say that a man *promises* either X or to pay damages. I don't think a man promises to pay damages in contract any more than in tort. He commits an act that makes him liable for them if a certain event does not come to pass, just as his act in tort makes him liable *simpliciter*.

2 Holmes-Pollock Letters, *supra* note 4, at 233 (letter of Dec. 11, 1928). Holmes's passage previously quoted in the text was written in the past tense, as if he was writing history. But, here, the language is in the present tense. In an opinion for the United States Supreme Court, however, he had stated that "[t]he old law seems to have

Thus, Holmes equates a contractual breach with a tort, which in French means "wrong."⁷ Consequently, in Holmes's view, the breach of a contract was as much an offense against the law—a legal wrong—as a tort, not the free choice that the misinterpreters of Holmes believe he advocated.⁸ Indeed, from the bench, Holmes described a breach of contract as a wrong.⁹ In his judicial capacity, he certainly had approved of the grant of expectancy damages,¹⁰ and had allowed a price action where the seller had deposited securities in escrow, but the buyer had refused to pay, in essence requiring specific performance at law.¹¹

What does it mean to be a wrongdoer in a legal sense? One consequence of Holmes's view, correctly interpreted, is that if you perform the contract, the state will leave you alone—tax collectors possibly excepted. If you breach, the state, if pressed by the aggrieved party, will ultimately send the sheriff to take your worldly goods, just as it would if you had committed a tort. To illustrate this point,

regarded it as technically in the election of the promisor to perform or to pay damages. *Bromage v. Genning*, 1 Roll. R. 368; *Hubert v. Hart*, 1 Vern. 133." *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 543 (1903) (first emphasis added). In the same opinion, he wrote, "[w]hen a man commits a tort he incurs by force of the law a liability to damages, measured by certain rules. When a man makes a contract he incurs by force of the law a liability to damages, unless a certain promised event comes to pass." *Id.*

7. "The word is derived from the Latin 'tortus' or 'twisted.' The metaphor is apparent: a tort is conduct which is twisted, or crooked 'Tort' is found in the French language, and was at one time in common use in English as a general synonym for 'wrong.'" W. Page Keeton et al., *Prosser and Keeton on The Law of Torts* § 1, at 2 (5th ed. 1984) (footnotes omitted). In law French, the word is used in such titles as Britton's chapter, *De plusours torts*. See *Tort*, in *Oxford English Dictionary* 275 (2d ed. 1989) (citing Britton, I. 77).

Blackstone divided his discussion of contracts under two headings: "Wrongs," 3 William Blackstone, *Commentaries on the Laws of England* ch. 9 (1768), and "Rights," 2 William Blackstone, *Commentaries on the Laws of England* ch. 13 (1766).

8. Thus, the Restatement quite properly, even under Holmes's analysis, refers to the breaching party as a "wrongdoer." Restatement (Second) of Torts § 766 cmt. v (1979). But see Remington, *supra* note 2, at 646 ("The view of breacher as wrongdoer is quite inconsistent with modern contract law.").

9. In *P.P. Emory Mfg. v. Columbia Smelting & Refining Works*, 60 N.E. 377 (Mass. 1901), Holmes, referring to a complaint that the non-breaching party failed to mitigate damages caused by an anticipatory repudiation, stated that "[u]ntil the moment when a refusal to perform is a *wrong*, he has a right to expect that when the time comes a *wrong* will not be done." *Id.* at 378 (emphasis added). Note that the term "wrong" is repeated twice in this short quotation.

10. See, e.g., *Chicago, Milwaukee & St. Paul Ry. Co. v. McCaull-Dinsmore Co.*, 253 U.S. 97, 100 (1920) ("The rule of the common law is not an arbitrary fiat but an embodiment of the plain fact that the actual loss caused by breach of a contract is the loss of what the contractee would have had if the contract had been performed . . ."); see also *St. Louis Dressed Beef & Provision Co. v. Maryland Cas. Co.*, 201 U.S. 173, 180-83 (1906) (explaining the propriety of expectancy damages in an action for breach); *Speirs v. Union Drop-Forge Co.*, 61 N.E. 825, 826 (Mass. 1901) (affirming an award of expectancy damages even though plaintiff "could not prove with prophetic certainty what the exact course of performance would have been").

11. See *Obery v. Lander*, 60 N.E. 378, 378 (Mass. 1901).

consider the 1765 Massachusetts Bay Colony case of *Hanlon v. Thayer*.¹² In this case, judgment had been entered against Hanlon for his debts.¹³ The sheriff seized, among other things, all of Hanlon's wife's garments with the exception of what she was wearing.¹⁴ She brought an action of trover against the sheriff, alleging wrongful seizure of necessities.¹⁵ Nonetheless, the jury found for the sheriff and assessed costs against Mrs. Hanlon.¹⁶ Two judges sustained the verdict.¹⁷ The Chief Justice, dissenting, expressed the thought that the sheriff should not have taken her clothing, and stated apologetically, "must she go naked when that [garment she is wearing] is washing?"¹⁸

The case is harsh and in several respects obsolete,¹⁹ but it illustrates the preposterous nature of the notion that a contracting party has, or ever had, a lawfully free choice to perform or to breach. If Holmes had been on the bench, as a positivist,²⁰ he certainly would have ruled with the majority for the sheriff.²¹

What, then, did Holmes mean by his notorious statement that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else"?²² Holmes's meaning eluded Pollock, who wrote:

I wish some ingenious young fellow would work out, after the manner of non-Euclidian geometry, the consequences of your contract theory if it had prevailed. I forget in what reported case somewhere about 1600 it was argued that equity should not meddle with the promisor's election to perform or pay damages.²³

Holmes replied:

You always have regarded my notion of contract as a pardonable

12. Quincy 99 (Province of Mass. Bay 1765), *reprinted in* 1 Am. Dec. 1 (1910).

13. *See id.* at 99-100 n.2.

14. *See id.* at 100-01 & n.3.

15. *See id.* at 99-100.

16. *See id.* at 103.

17. *See id.* at 102.

18. *Id.* at 103.

19. Otis, on the behalf of Mrs. Hanlon, argued in vain that "Hanlon never bought or paid for a single Rag of his Wife's Cloaths, but that she brought all with her at the Marriage." *Id.* at 102. Of course, a woman's property no longer becomes her husband's by virtue of marriage. Also, a judgment debtor's entitlement to keep necessities has expanded.

20. On the theme of Holmes's positivism, see Albert W. Alschuler, *The Descending Trail: Holmes' Path of the Law One Hundred Years Later*, 49 Fla. L. Rev. 353 (1997).

21. The governing precedent was *Hardisty and Barney*, 90 Eng. Rep. 525 (K.B. 1696) ("Holt said, upon a fieri facias the sheriff may take anything but wearing clothes; nay, if the party hath two gowns, he may take one of them.").

22. Holmes, *supra* note 1, at 462.

23. 2 Holmes-Pollock Letters, *supra* note 4, at 201-02 (letter of July 11, 1927). The editor of the letters dropped a footnote at page 202, saying, "[p]robably Bromage v. Genning, 1 Roll. Rep. 368, described by Holmes in his speech 'The Path of the Law,' 10 Harv. L. Rev. 457, 462 (1897); C.L.P. p.167, at p.175."

eccentricity (that when you commit a tort you incur a liability to damages *simpliciter*. When you commit a contract you incur a liability to damages *nisi*, illustrated by the fact that in most contracts if not in all you have only a limited, and it may be no, power over the event). It is a particular case of my general definition of a right as the hypostasis of a prophecy—like gravitation. I should be glad if we could get rid of the whole moral phraseology which I think has tended to distort the law. In fact even in the domain of morals I think that it would be a gain, at least for the educated, to get rid of the word and notion Sin.²⁴

The basis of Holmes's theory of contract was his attempt to separate legal from moral notions. Note that, in the quotation immediately above, Holmes points out that a breach is an objective event over which the breacher has "limited, and it may be no, power over the event."²⁵ The law, in Holmes's view, is unconcerned with whether or not the breach is a moral failure. Similarly, on the question of contract formation that he discusses on the page following his famous quotation,²⁶ he stresses the objective theory of contract formation: "Yet nothing is more certain than that parties may be bound by a contract to things which neither of them intended, and when one does not know of the other's assent."²⁷ Giving effect to the true intention of a party, he argues, would be a moral notion, not a notion appropriate to the law of contract. Much of the essay in which his views were expounded deals with the utility of banishing "every word of moral significance" from the law.²⁸ Then we could adopt a vocabulary of legal ideas "uncolored by anything outside the law."²⁹

Simply put, Holmes wanted the legal system to consider violations of contract and tort law dispassionately and objectively without a moral coloration, but he never developed a legal vocabulary that

24. 2 Holmes-Pollock Letters, *supra* note 4, at 200 (May 30, 1927). Pollock replied to this by stating:

If the promise in a contract were held to be in the alternative—perform *or* pay damages—then (1) there could be no decrees for specific performance: (2) there would be no reason for allowing any implied exception of frustration or the like: (3) (and chiefly) it would not answer reasonable expectation of promisees. Those are my reasons: I don't see where the moral phraseology comes in. No doubt it might be the law in some other planet.

Id. at 201 (June 13, 1927). In the published Holmes-Pollock letters, Holmes never reacted to these and others of Pollock's specific criticisms of Holmes' theory.

25. *Id.* at 200. He had earlier expressed the same thought on the bench. In *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903), he remarked that "a man never can be absolutely certain of performing any contract when the time of performance arrives, and in many cases he obviously is taking the risk of an event which is wholly or to an appreciable extent beyond his control." *Id.* at 543.

26. See *supra* text accompanying note 1.

27. Holmes, *supra* note 1, at 463.

28. *Id.* at 464.

29. *Id.*

would dispense with words such as "wrong," "duty," or "right." Holmes was, moreover, skeptical as to the reality of these legal concepts. For Holmes, these words represented predictions of how a court would view a course of conduct.³⁰ He coined an ungainly term to describe his jurisprudential outlook—*bettabilitarian*.³¹ His skepticism about the reality of rights and duties finds little support in constitutional jurisprudence today³² and seems to be declining in tort theory.³³ Although it is time for contracts theorists to consider jurisprudence in other fields, this Essay is more modest in its goals.

What is the present significance of the misreading of this idea first expressed by Holmes over a hundred years ago? The misunderstanding of Holmes has led to two different but related phenomena. First, it has become commonplace to tie the economists' notion of efficient breach to the towering legal authority of Holmes, who is incorrectly cast as articulating the idea of a *right* to breach a contract. Second, some employ the authority of Holmes in the mostly academic effort to rein in liability for inducing a breach of contract.³⁴ Holmes, however, was comfortable with the existence of the tort of interference with a contract and indeed is largely responsible for formulating current theory underpinning the existence and contours

30. See *id.* at 457-58 (stating that the object of the study of law is "the prediction of the incidence of the public force through the instrumentality of the courts"). "The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by law." *Id.* at 461.

31. 2 Holmes-Pollock Letters, *supra* note 4, at 252 (letter of Aug. 30, 1929) (emphasis in original).

32. For a survey of constitutional theorists on the question of rights skepticism, see John C.P. Goldberg & Benjamin Zipursky, *The Moral of MacPherson*, 146 U. Pa. L. Rev. 1733, 1777-98 (1998).

33. See *id.* at 1812-47.

34. See, e.g., Lillian R. BeVier, *Reconsidering Inducement*, 76 Va. L. Rev. 877, 880 (1990) (stating that holding inducers liable suppresses behavior that is likely to be socially unproductive); Donald C. Dowling, Jr., *A Contract Theory for a Complex Tort: Limiting Interference with Contract Beyond the Unlawful Means Test*, 40 U. Miami L. Rev. 487 (1986) (discussing a third party's liability when interfering with a contractual relationship); Fred S. McChesney, *Tortious Interference with Contract Versus "Efficient" Breach: Theory and Empirical Evidence*, 28 J. Legal Stud. 131, 133 (1999) (noting the coexistence of efficient breach and the interference tort); Harvey S. Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. Chi. L. Rev. 61, 62 (1982) (arguing for an unlawful means test that restricts tort liability to those cases in which the defendant's act is independently wrongful); Remington, *supra* note 2, at 649 (arguing that a court "should determine the impropriety of mere interference by looking to the nature of the breach that is caused by the interference"); James B. Sales, *The Tort of Interference with Contract: An Argument for Requiring a "Valid Existing Contract" to Restrain the Use of Tort Law in Circumventing Contract Remedies*, 22 Texas Tech. L. Rev. 123, 154-55 (1991) (arguing that commercial dealings do not operate effectively when challenged and are circumvented by the unpredictable results of tort remedies); Gary D. Wexler, Note, *Intentional Interference with Contract: Market Efficiency and Individual Liberty Considerations*, 27 Conn. L. Rev. 279, 282 (1994) (analyzing the tort of intentional interference with contract).

of the tort.³⁵

The linkage between efficient breach theory and the misunderstanding of Holmes's theory is finding its way into the courts, albeit in fairly innocuous ways thus far.³⁶ It is likely, however, to have the pernicious effect of encouraging the adoption of the efficient breach fallacy into the legal arena.³⁷

The theory of efficient breach holds that if a party breaches, and is still better off after paying damages to compensate the victim of the breach, the result is Pareto superior, which means that considered as a unit, the parties are better off because of the breach and the breach makes no party worse off.³⁸ In other words, "by comparison to some original position, no one is, in his own estimation, worse off and at least one person is, in his own estimation, better off."³⁹ Consequently, the theory holds that the party who will benefit from the breach should breach.⁴⁰

Judge Posner, a principal proponent of efficient breach theory, has given this example of an efficient breach:

Suppose I sign a contract to deliver 100,000 custom-ground widgets

35. See Mark P. Gergen, *Tortious Interference: How It Is Engulfing Commercial Law, Why This Is Not Entirely Bad, and a Prudential Response*, 38 Ariz. L. Rev. 1175, 1178-79 (1996).

36. See, e.g., *Ocean Spray Cranberries, Inc. v. Pepsico, Inc.*, 160 F.3d 58, 61 (1st Cir. 1998) (denying a preliminary injunction and citing Holmes and modern efficient breach theorists); *L.L. Cole & Son, Inc. v. Hickman*, 665 S.W.2d 278, 281 (Ark. 1984) (refusing to allow punitive damages for contractual breach); *Freeman & Mill, Inc. v. Belcher Oil Co.*, 44 Cal. Rptr. 2d 420, 433 (Cal. 1995) (stating that a person's intentional breach of contract is not a tort); *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436, 445 (Del. 1996) (stating that "punitive damages are not recoverable for breach of contract unless the conduct also amounts independently to a tort"); *Francis v. Lee Enters. Inc.*, 971 P.2d 707, 715 (Haw. 1999) (stating that punitive damages are not recoverable for breach of contract—restoring a well-established common law rule); *Frankenmuth Mut. Ins. Co. v. Keeley*, 447 N.W.2d 691, 705 n.20 (Mich. 1989) (Levin, J., dissenting) (stating that the duty to keep a contract at common law means that one must pay damages if one does not keep the contract—"and nothing else"); *Cafeteria Operators, L.P. v. Coronado-Santa Fe Assocs.*, 952 P.2d 435, 450 (N.M. Ct. App. 1997) (Harty, C.J., dissenting) (opposing the award of punitive damages); *Eckles v. State*, 760 P.2d 846, 859 (Or. 1988) (stating a breach of contract by the government is not a taking and can be compensated in damages instead of specific performance).

37. A confused student note writer recently asked why the courts have failed to implement efficient breach theory that is so thoroughly grounded in academic theory. See Craig S. Wakol, Note, *Resolving the Paradox Between Legal Theory and Legal Fact: The Judicial Rejection of the Theory of Efficient Breach*, 20 Cardozo L. Rev. 321, 321 (1998). The following discussion will demonstrate that such grounding is far from thorough.

38. See Richard A. Posner, *Economic Analysis of Law* 131 (5th ed. 1998).

39. Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 Mich. L. Rev. 341, 342 n.3 (1984).

40. Another stream of economic thought, based on the Kaldor-Hicks principle, is unconcerned whether the non-breaching party is compensated. If the net gain to the breacher exceeds the loss to the non-breaching party, the result is efficient because the world is wealthier. See Posner, *supra* note 38, at 14-17.

at 10¢ apiece to A for use in his boiler factory. After I have delivered 10,000, B comes to me, explains that he desperately needs 25,000 custom-ground widgets at once since otherwise he will be forced to close his pianola factory at great cost, and offers me 15¢ apiece for them. I sell him the widgets and as a result do not complete timely delivery to A, causing him to lose \$1,000 in profits. Having obtained an additional profit of \$1,250 on the sale to B, I am better off even after reimbursing A for his loss, and B is also better off. The breach is Pareto superior.⁴¹

From this economic analysis, Posner makes a great leap to a legal conclusion. He states:

Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee's actual losses. If he is forced to pay more than that, an efficient breach may be deterred, and the law doesn't want to bring about such a result.⁴²

Whatever value the theory of efficient breach may have as a construct for economic analysis, at most it should be a limited tool for making normative decisions.⁴³ Proponents of the efficient breach theory worry that "an efficient breach may be deterred," by a rule of law, "and the law doesn't want to bring about such a result."⁴⁴ The law, however, *does* want to discourage breaches, efficient or otherwise. The law seeks to protect reliance and expectancies, and to preserve peace and tranquility. Breaches—even efficient breaches—tend not only to disappoint expectations, but also to precipitate private disputes. The legal system knows what economic science does

41. Posner, *supra* note 38, at 119. Posner would make an exception for an "opportunistic" breach, though he fails to define it. Dodge, however, has explained that an opportunistic breach is one that "does not increase the size of the economic pie; the breaching party gains simply by capturing a larger share of the pie at the expense of the nonbreaching party." William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 Duke L.J. 629, 653 (1999). For an example of such a breach, see *Rasnick v. Tubbs*, 710 N.E.2d 750, 751 (Ohio Ct. App. 1998), discussing a case where a mechanic, who was a party to a contract to transform a vehicle into a race car, had been paid a considerable amount, but demanded \$20,000 above the contract price to complete the transformation.

For a recent, detailed, and nuanced defense of efficient breach theory, see David W. Barnes, *The Anatomy of Contract Damages and Efficient Breach Theory*, 6 S. Cal. Interdisc. L.J. 397, 407-11 (1998).

42. *Patton v. Mid-Continent Sys.*, 841 F.2d 742, 750 (7th Cir. 1988) (Posner, J.).

43. Among those arguing against reliance on the efficient breach theory are Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. Legal Stud. 1, 1-2 (1989); Ian R. Macneil, *Efficient Breaches of Contract: Circles in the Sky*, 68 Va. L. Rev. 947, 950 (1982); and William J. Woodward, Jr., *Contractarians, Community, and the Tort of Interference with Contract*, 80 Minn. L. Rev. 1103, 1107-08 (1996). For others, see *infra* note 100.

44. *Patton*, 841 F.2d at 750.

not know: damages and other legal remedies are substitutes for private warfare.⁴⁵ While economics claims to be a value-free science,⁴⁶ the law is most distinctly *not* value free. On the contrary, it is an embodiment of community values, only one of which happens to be economic efficiency.

What is wrong with the efficient breach theory and why do I charge that the theory is pernicious when applied as a normative tool for legal decisions? The theory has two aspects. First, it claims to explain the existing rules of contract damages. Second, it claims to be a basis for the decisions of cases not clearly falling into the damages rules that routinely are applied. There is little basis for the idea of efficient breach theory as a basis for existing rules of contract damages. In addition, the proposition that the theory should be applied to encourage a contracting party to breach is dubious indeed. The cause of encouraging efficient breaches would sacrifice too many other values that the law holds dear.

I. DOES THE EFFICIENT BREACH THEORY EXPLAIN EXISTING RULES OF CONTRACT DAMAGES?

In general, contract damages do not fully compensate the party who is the victim of a breach.⁴⁷ As Karl Llewellyn stated, "[a] contract is no equivalent of performance; rights are a poor substitute for goods."⁴⁸ An official comment to the U.C.C., likely written by Llewellyn, states that "the essential purpose of a contract between commercial men is actual performance and they do not bargain

45. See 5 Arthur L. Corbin, *Corbin on Contracts* § 998, at 23 (2d ed. 1964) ("[T]he chief purposes for which the remedy in damages for breach of contract is given are the prevention of similar breaches in the future and the avoidance of private war."); see also John D. Calamari & Joseph M. Perillo, *The Law of Contracts* § 1.4 (4th ed. 1998) ("Before courts, there was the feud—private vengeance. . . . In modern law, where contract law refuses to enter, vengeance and self-help fill the vacuum."). For a concrete illustration, see *infra* note 96.

46. See Posner, *supra* note 38, at 23 (stating that economic analysis cannot define policy goals, but may still help determine efficient means of attaining these goals).

47. From the perspective of the breaching party, "it is an open secret that a contract breaker rarely stands to lose as much by his breach as he would by performance. And the more deliberate the breach, the more apt he is to gain." Addison Mueller, *Contract Remedies: Business Fact and Legal Fantasy*, 1967 *Wis. L. Rev.* 833, 835.

48. Karl N. Llewellyn, *What Price Contract?—An Exercise in Perspective*, 40 *Yale L.J.* 704, 724 (1931). Epstein expresses a similar thought:

When parties have explicit contractual terms, they may explicitly negate the implicit option to breach on payment of expectation damages: if so, it is hard to see how a practice that is forbidden by contract could be regarded as efficient. But even when the terms are not explicit, the background norm appears to be relentless. When breaches of this sort take place within the organized trades, the opportunist is drummed out of the business as unreliable for any future dealings.

Epstein, *supra* note 4, at 581 (footnote omitted).

merely for a promise, or for a promise plus the right to win a lawsuit."⁴⁹ Attorneys' fees and other transaction costs (information costs, etc.) are generally not a part of the recovery.⁵⁰ Real and sometimes enormous damages are not compensated unless the hurdles of foreseeability⁵¹ and certainty⁵² are overcome. Damages for mental distress caused by a contractual breach are not compensable.⁵³ Furthermore, the rule of mitigation precludes recovery of damages that were incurred but which could have been avoided.⁵⁴ Many jurisdictions fail to award pre-judgment interest and skimp on post-judgment interest.⁵⁵ The award of court costs and disbursements is often a laughable portion of actual outlays for court reporters, printing, expert witnesses, and the like.⁵⁶ Thus, typically, the rules of damages do not deter efficient breaches. Is that because the law wants to encourage such breaches? There is no evidence that this is so. Failure to deter is not the same as encouragement.

Let us examine some of the limitations on contract damages and try to understand why the legal profession crafted them. Were they designed to encourage efficient breaches? First, why did courts develop the foreseeability limitation? Before the foreseeability test was introduced in 1854 by *Hadley v. Baxendale*,⁵⁷ the level of economic activity in England had reached and probably surpassed that of the Roman Empire. Cases decided under the writ of assumpsit had developed into almost a full-blown law of contracts, but there were few rules for assessing damages. The standard that the reasonable expectations of the promisee should be protected, however, was well understood. As Baron Parke had stated in 1848, "where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."⁵⁸ But, as

49. U.C.C. § 2-609 cmt. 1 (1999); see also Karl L. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 Colum. L. Rev. 431, 437 (1930) ("It is a heresy when Coke or Holmes speaks of a man having liberty under the law to perform his contract, or pay damages, at his option.").

50. See Calamari & Perillo, *supra* note 45, § 14.35; E. Allan Farnsworth, *Contracts* § 12.8 n.5 (3d ed. 1999); John Edward Murray, Jr., *Murray on Contracts* § 125(F) (3d ed. 1990).

51. See Calamari & Perillo, *supra* note 45, § 14.5; Farnsworth, *supra* note 50, § 12.14; Murray, *supra* note 50, § 120.

52. See Calamari & Perillo, *supra* note 45, § 14.8; Farnsworth, *supra* note 50, § 12.15; Murray, *supra* note 50, § 121.

53. See Calamari & Perillo, *supra* note 45, § 14.5(b); Farnsworth, *supra* note 50, § 12.17; Murray, *supra* note 50, § 123.

54. See Calamari & Perillo, *supra* note 45, §§ 14.15-14.17; Farnsworth, *supra* note 50, § 12.12; Murray, *supra* note 50, § 122.

55. See Dan B. Dobbs, *Dobbs Law of Remedies* § 3.6(1), at 334 (2d ed. 1993).

56. See, e.g., David D. Siegel, *New York Practice* §§ 413-416 (3d ed. 1999) (explaining the breakdown of the award of court costs and disbursements).

57. 156 Eng. Rep. 145 (Ex. 1854).

58. *Robinson v. Harman*, 1 Exch. 850, 855 (1848).

the old poem had it, if the blacksmith carelessly shod a horse, a kingdom could be lost.⁵⁹ Should the errant blacksmith be liable for the loss of the kingdom? Obviously, some limits had to be placed on the liability of the breaching party whose breach unintentionally and unknowingly produced disastrous consequences.

As Holmes points out in the pronouncements quoted above, the breaching party may have "only a limited and it may be no, power over the event."⁶⁰ It would seem that this line of thinking—that the breaching party most likely is unfortunate and not an intentional reneger—led to the rules that limit damages for breach, rather than the thought that efficient breaches should be encouraged. The efficient breach that economists construct is intentional rather than unfortunate. The fact that the law often fails to deter efficient breaches hardly means that it seeks to encourage such breaches.

Various observers have explained the rule of *Hadley v. Baxendale* from different perspectives. None of them attribute the rule to the law's desire to encourage breaches. Judge Posner, giving an economist's explanation, justifies it as allocating the risk in the most efficient manner; the party who knows that his non-performance will cause consequential damages will exact payment for it and take extra precautions to fulfill his or her agreed task.⁶¹ Others, adopting a penalty-default theory, note that the rule gives the party who anticipates large losses from a potential breach an incentive to advise the promisor of those potential losses.⁶² Richard Danzig explains it as

59. In the words of Benjamin Franklin:

For want of a nail the shoe was lost;
 For want of a shoe the horse was lost;
 And for want of a horse the rider was lost;
 For the want of a rider the battle was lost;
 For the want of the battle the kingdom was lost;
 And all for the want of a horseshoe-nail.

Benjamin Franklin, Poor Richard's Almanacks Preface: Note to Courteous Readers (1758). The poem, in some form, is attributed to George Herbert (1651), *quoted in* John Bartlett, *Familiar Quotations* 270 (15th ed. 1980).

60. See *supra* notes 24-25 and accompanying text.

61. See Posner, *supra* note 38, at 126-28.

62. See generally Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989) (originating the penalty-default theory); Lucian Arye Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. Econ. & Org. 284 (1991) (creating a formal model to discover the *Hadley* Rule's effectiveness); William Bishop, *The Contract-Tort Boundary and the Economics of Insurance*, 12 J. Legal Stud. 241 (1983) (arguing that the *Hadley* rule provides an incentive for disclosure); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 Yale L.J. 1261 (1980) (stating that the *Hadley* rule increases efficiency by stimulating disclosure); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 Colum. L. Rev. 554 (1977) (discussing why pre-contract disclosure results in more efficient allocation of risks); Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. Cal. Interdisc. L.J. 389 (1994) (expressing skepticism of the efficiency of penalty-

easing the task of the courts and lawyers in reaching predictable results, which should be "a rule for judges caught up in their own problems of modernization."⁶³ John Murray explains it as expressing a rule of justice that frees breaching parties who have not assumed the risk of special consequences of their breach from liability for those consequences.⁶⁴ This view is quite similar to that of Posner. Allan Farnsworth's historical perspective is that "[w]ith the advent of the industrial revolution, a solicitude for burgeoning enterprise led to the development of rules to curb this discretion [of the jury] and the 'outrageous and excessive' verdicts to which it led."⁶⁵ Each of these explanations is probably correct. Each of these perspectives shows that the decision encourages contract-making.⁶⁶ None of them involves the thought that any kind of breach is encouraged by the law. Instead, they focus on the protection of the promise breaker from the unforeseen consequences of his or her breach and also on the institutional goal of easing the task of administering justice. Not surprisingly, the court in *Hadley* turned to Roman Law as honed through the centuries and expressed by Joseph Pothier, the French scholar, who wrote that generally the obligor "is only liable for the damages and interest which might have been contemplated at the time of the contract; for to such alone the debtor can be considered as having intended to submit."⁶⁷

The restriction that damages be proved with reasonable certainty is applied with greater strictness in contract cases than in tort cases.⁶⁸ Thus, the rule of certainty, like the rule of foreseeability, encourages entrepreneurial risk taking. Indeed, in *Hadley*, defense counsel made the alternative argument that the calculation of lost profits was

default rules). Barry Adler proposes an "enriched *Hadley* model" in the penalty-default tradition that takes into account the unpredictable ('stochastic') nature of consequential damages when viewed at the time of contracting, and expresses skepticism whether judges or legislators can craft a rule to take this unpredictability into account. See Barry E. Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 Stan. L. Rev. 1547 (1999).

63. Richard Danzig, *Hadley v. Baxendale: A Study in the Industrialization of the Law*, 4 J. Legal Stud. 249, 267 (1975).

64. See Murray, *supra* note 50, § 120 (3d ed. 1990).

65. Farnsworth, *supra* note 50, § 12.14, at 821.

66. See Woodward, *supra* note 43, at 1104.

67. I Robert Joseph Pothier, *A Treatise on the Law of Obligations, or Contracts* 160 (William David Evans trans., 1826 ed.). The development of the foreseeability test is discussed by Reinhard Zimmerman, *The Law of Obligations: Roman Foundations of the Civilian Tradition* 829-33 (1990). The argument of the defendant, Baxendale, included references to the French Civil Code and the American treatise on damages by Theodore Sedgwick, which partially had adopted Pothier's thinking. Nonetheless, its importation into the common law has been skeptically examined. See Guenter Treitel, *Remedies for Breach of Contract*, in VII International Encyclopedia of Common Law ¶ 83 (1976); see also G.H. Treitel, *Remedies for Breach of Contract* ¶ 128 (1988) (discussing the ambiguity in tracing the origins of the *Hadley* foreseeability test).

68. See Charles T. McCormick, *Handbook on the Law of Damages* § 28 (1935).

inherently speculative and therefore non-compensable,⁶⁹ quoting at length from an admiralty opinion by Mr. Justice Story.⁷⁰ Courts in the United States have abandoned Story's idea that profits are not susceptible to proof, but have shown a greater willingness to accept somewhat conjectural proof in tort than in contract cases.⁷¹ Nonetheless, even such a renowned damages expert as Lon Fuller accepted the analysis that courts are prone to relax the standard of certainty in contract cases where the breach is willful.⁷² Corbin concurs⁷³ and the Restatement agrees.⁷⁴ Willfulness is also one factor in the exercise of equitable discretion.⁷⁵ It is also a factor in denying restitution to a defaulting party who brings a restitution claim.⁷⁶ A willful threat to breach a contract constitutes duress where the promisee has no reasonable alternative but to submit to the

69. See *Hadley v. Baxendale*, 150 Eng. Rep. 145, 149 (1854).

70. In an admiralty case for wrongful capture and detention of a ship, Justice Story had written, and *Baxendale's* counsel had quoted:

Independent however of all authority, I am satisfied upon principle, that an allowance of damages upon the basis of a calculation of profits is inadmissible. The rule would be in the highest degree unfavorable to the interests of the community. The subject would be involved in utter uncertainty. The calculation would proceed upon contingencies, and would require a knowledge of foreign markets, to an exactness in point of time and value, which would sometimes present embarrassing obstacles. Much would depend upon the length of the voyage, and the season of arrival, much upon the vigilance and activity of the master, and much upon the momentary demand. After all, it would be a calculation upon conjecture, and not upon facts. Such a rule, therefore, has been rejected by courts of law in ordinary cases, and instead of deciding upon the gains or losses of parties in particular cases, an uniform interest has been applied, as the measure of damages for the detention of property.

The Lively, 15 F. Cas. 631, 634-35 (No. 8,403) (C.C.D. Mass. 1812).

71. See Calamari & Perillo, *supra* note 45, at 554 (stating that the difference in treatment between antitrust actions in which new businesses establish lost profits and contract actions in which such profits are denied "reveals rather clearly that the standard of certainty, like the rule of foreseeability, is based at least partly upon a policy of limiting contractual risks"); see also L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*: 2, 46 Yale L.J. 373, 373-77 (1937) (discussing situations in which the applicability of the "certainty" requirement affects the damage award); McCormick, *supra* note 68, at 105 ("Like the 'contemplation of the parties' doctrine, the standard of 'certainty' was developed, and has been used, chiefly as a convenient means for keeping within the bounds of reasonable expectation the risk which litigation imposes upon commercial enterprise." (footnote omitted)).

72. See Fuller & Perdue, *supra* note 71, at 375 (citing Ralph S. Bauer, *The Degree of Moral Fault as Affecting Defendant's Liability*, 81 U. Pa. L. Rev. 586, 592 (1933) and 1 Sedgwick, *A Treatise on the Measure of Damages* §§ 182-200, especially §§ 193-193a (9th ed. 1920)).

73. See 5 Arthur L. Corbin, *Corbin on Contracts* § 1020, at 126-27 (1964).

74. See Restatement (Second) of Contracts § 352 cmt. a (1981).

75. See *Quigley v. Acker*, 955 P.2d 1377, 1384-87 (Mont. 1998).

76. See Restatement (Second) of Contracts § 374 cmt. b. *But see* *Freedman v. Rector, Wardens & Vestrymen of St. Mathias Parish*, 230 P.2d 629, 632 (Cal. 1951) (Traynor, J.) (rejecting the argument that restitution should be denied to a party who has committed willful breach).

promisor's demands.⁷⁷ In appropriate cases, courts will enjoin a breach, whether or not the breach would be efficient.⁷⁸ Courts sometimes require disgorgement of the breaching party's profits as a remedy for breach even in cases in which the parties are not in a fiduciary relationship.⁷⁹ The relevance of willfulness in these cases presents another problem for theorists of a *legal* rather than *economic* theory of efficient breach.

Because the rule of avoidable consequences is equally applicable to tort and contract damages, the existence of this restriction on the recovery of damages does not support efficient breach analysis any more than it supports efficient conversion analysis. The restriction on the recovery of damages that could have been avoided by reasonable effort is sometimes said to be a rule of causation. Perhaps it is sounder to have a rule of policy that even the victim of a tort or breach of contract passively should not suffer economic losses which the victim's reasonable efforts could have avoided.⁸⁰ Even in this context, the willfulness of the breach can diminish the rights of the breaching party.⁸¹

II. SHOULD EFFICIENT BREACH THEORY BE ADOPTED BY THE LEGAL SYSTEM?

The main focus of this Essay is the unsuitability of efficient breach analysis to the legal system. Nevertheless, a brief synthesis of some of the criticisms of the efficient breach theory from an economic perspective will be presented to round out the discussion. The theory contains simplifying assumptions that do not hold in the real world.

77. See *Austin Instrument, Inc. v. Loral Corp.*, 272 N.E.2d 533, 535 (N.Y. 1971); see also *Roth Steel Prods. v. Sharon Steel Corp.*, 705 F.2d 134, 147-48 (6th Cir. 1983) (stating that coercive threat to breach when seeking contract modification constitutes dishonesty and is evidence of bad faith under U.C.C. § 2-209); Calamari & Perillo, *supra* note 45, at 317-18 & n.11 (collecting cases where "a threat to breach a contract [has been held to] constitute[] duress if the threatened breach would, if carried out, result in irreparable injury").

78. See *Diebold Computer Leasing, Inc. v. Commercial Credit Corp.*, 267 A.2d 586, 590-92 (Del. 1970); *City of New York v. New York Jets Football Club*, 394 N.Y.S.2d 799, 803-06 (Sup. Ct. 1977) (enjoining a football club's breach of a lease even though the breach would not result in immediate economic harm to the city).

79. See, e.g., *148 Investment Group, Inc. v. Elvis Presley Enters., Inc.*, No. 93-6444, 1995 WL 283785, at *1, *2 n.3 (6th Cir. May 10, 1995) (affirming the lower court's grant of damages in the amount equal to the total profits derived from the breach of contract).

80. See McCormick, *supra* note 68, § 33 (discussing the two rationales for the avoidable consequences doctrine and arguing that the policy rationale is the better theory). Another rationale is that the victim has a conflict of interest because, but for the mitigation principle, the victim would have an incentive to run up damages. See Epstein, *supra* note 4, § 17.7.

81. See *Rice v. Community Health Ass'n*, 40 F. Supp. 2d 788, 798 (S.D. W. Va. 1999) (stating that evidence of malicious termination was relevant to the question of whether the employee had a duty to mitigate).

First, it assumes the absence of transaction costs—such as the costs of negotiation and litigation. Second, it assumes a frictionless market that operates instantly. Third, it ignores genuine damages that are not compensable because of the rules of foreseeability, certainty, and avoidable consequences. In calculating whether a breach is Pareto superior, basic rules of mathematics should require that these damages be part of the calculation. Fourth, the theory leaves out idiosyncratic values and mental distress, reputational costs and the negative value of distrust fostered by the legal system that would operate as a drag on the market. Again, simple rules of arithmetic dictate that these costs be part of the calculation of Pareto superiority.

Ian Macneil has demonstrated that efficiency of the breach cannot be evaluated without detailed knowledge of the transaction costs. Moreover, he argues that it is not demonstrable that a damages rule produces greater efficiency than a specific performance default rule. Entitlement to specific performance is a property rule and the holder of the property right would, in economic theory, surrender his right by bargaining to an efficient result.⁸² Thus, in Posner's pianola illustration, A, the original buyer, would be the person with whom B, the second buyer, would bargain, and A would reap the benefit of B's willingness to pay 15¢ per widget. The result is not inefficient; it is simply a question of who should become wealthier, the manufacturer or A, the contract purchaser. Daniel Farber, also basing his analysis largely on transaction costs, argues that "supercompensatory damages should be awarded for bad-faith breaches."⁸³ Robert Birmingham even assails current damages law as inefficient because it does not fully compensate the victim. He writes: "[a]ssumed absence of transaction costs is particularly unrealistic Efficiency demands that the breaching party bear the transaction costs which accompany his actions."⁸⁴ Daniel Friedmann also has observed, "[t]he *total* level of transaction costs should accordingly be reduced when the plaintiff is provided with strong protection against breach of contract."⁸⁵ Posner rather blandly addresses the transaction costs in the widget

82. See Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 Va. L. Rev. 947, 951-53 (1982). Peter Linzer had made basically the same analysis. See Peter Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 Colum. L. Rev. 111, 138-39 (1981). Professor Thomas Ulen also has argued that the efficiency of remedies depends on transaction costs. See Ulen, *supra* note 39, at 401 ("[E]fficiency considerations urge specific performance as the routine remedy."). The conclusion that goods flow to the party who values them at their highest is known as the Coase theorem. For its expression, see generally Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & Econ. 1 (1960) (exploring the intricacies of the Coase theorem).

83. Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 Va. L. Rev. 1443, 1445 (1980).

84. Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 Rutgers L. Rev. 273, 285 (1970).

85. Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. Legal Stud. 1, 7 (1989).

illustration. "True," Posner observes,

had I refused to sell to B he could have gone to A and negotiated an assignment to him of part of A's contract with me. But this would have introduced an additional step with additional transaction costs—and high ones, because it would be a bilateral-monopoly negotiation. On the other hand, litigation costs would be reduced.⁸⁶

One observer has remarked, I believe accurately, that "[i]f the transaction costs of negotiation are compared with the assessment costs of litigation, it becomes clear that negotiation tends to be cheaper."⁸⁷

From the perspective of legal analysis, wholly apart from the weakness of efficient breach theory in economic theory, the theory is at odds with many aspects of existing law. Even if the theory were sound, it is clearly wrong to say that the law does not want to deter efficient breaches. The tort of interference with a contract severely conflicts with the notion that willful efficient breaches are desired by the legal system. Ironically, from the standpoint of those who have misread Holmes to the effect that performance of a contract is merely an option, and that a breach of contract is not a legal wrong, a recent piece of scholarship has demonstrated that Holmes (with Pollock) is the intellectual progenitor of the modern rules on the tort of interference.⁸⁸

What is the basis of this tort? Essentially, there are two theories, each of which could be right, but incomplete. Richard Epstein regards the tort as involving the appropriation of property that the interferer wrongfully makes its own.⁸⁹ Other analysts have understood the tort in relational terms—akin to alienation of affections.⁹⁰ Epstein's theory is appealing, but it leaves no room for two kinds of cases in which the courts frequently have given a remedy: (1) where the interferer did not appropriate the benefit of the contract, but interfered to harm the victim of the tort; and (2) where the contract was unenforceable or terminable at will. The relational perspective explains these two classes of cases. Epstein admits that his account leaves no room for these classes and holds that the interferer should not be liable in such cases. Whether the property or the relational perspective is adopted, it is clear that tort law regards the contractual

86. Posner, *supra* note 38, at 133.

87. Dodge, *supra* note 41, at 675.

88. See Gergen, *supra* note 35, at 1206-18.

89. See Epstein, *supra* note 4, §§ 21.2-21.5; Richard A. Epstein, *Inducement of Breach of Contract as a Problem of Ostensible Ownership*, 16 J. Legal Stud. 1, 2-3, 19-29 (1987) [hereinafter Epstein, *Inducement*]; see also Fred S. McChesney, *Tortious Interference with Contract Versus "Efficient" Breach: Theory and Empirical Evidence*, 28 J. Legal Stud. 131, 140-42 (1999) (summarizing Epstein's view of tortious interference).

90. See W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* § 129, at 978 (5th ed. 1984).

bond to be something other than a mere option to perform or not. Advocates of the efficient breach theory are quite aware of this and urge that the tort be reined in so as to be available only in egregious cases.⁹¹ Nonetheless, the courts and the American Law Institute continue to regard the interferer as a wrongdoing accomplice of the contract breaker. There is a close analogy in tort liability for encouraging others to engage in tortious conduct.⁹²

Other rules of law are at war with the efficient breach analysis. As indicated above, the rule as to certainty of damages is relaxed when the breach is willful.⁹³ This is true whether or not the breach is efficient. Willfulness also surfaces as a factor in determining whether a breach is material.⁹⁴ Consider the following hypothetical breach. Contract specifications call for Reading brand pipe. The contractor orders Reading pipe from the supplier. The supplier calls up and says, "I can offer you a good deal on Cohoes pipe. I bought up a large quantity at a bankruptcy sale of another supplier and I can pass on a savings of 50% to you." Everyone in the trade knows that Cohoes is just as good as Reading. The contractor agrees and installs the Cohoes pipe. The owner detects the deviation from specifications only upon a final inspection. The breach is clearly efficient provided that the court in a damages action would measure the damages by the difference between the market price of the building with Reading pipe properly installed and the market value of it with the Cohoes pipe, that is, zero damages.⁹⁵

The contractor now presses a claim for final payment urging that there is no harm done and the contract substantially has been performed. The court that found substantial performance on similar facts—where, however, the substitution of Cohoes pipe for Reading pipe was unintentional—would have ruled against this contractor who has committed a willful yet apparently efficient breach.⁹⁶ An attorney

91. For a recent expression of this view, see Remington, *supra* note 2, at 710.

92. See Restatement (Second) of Torts § 876(b) (1979); see, e.g., *Shelter Mut. Ins. Co. v. White*, 930 S.W.2d 1, 3-5 (Mo. Ct. App. 1996) (holding that passengers who encouraged reckless driving are liable along with the driver to injured third persons).

93. See *supra* text accompanying notes 68-74.

94. See Restatement (Second) of Contracts § 237 illus. 7, § 241(e) & cmt. f (1981). But see *id.* at 100, Introductory note to ch. 16 (describing traditional law of contract remedies as not distinguishing between willful breaches and other breaches).

95. There are two competing measures of damages for breach of a construction contract where the breach involves a non-conformity between the structure as built and the specifications. The usual measure is the cost of correcting the defect. At times, the courts measure damages by the difference between the value the structure would have had if it were built to specifications and the value it has with the nonconformity. In the hypothetical, the first measure would produce a substantial judgment while the second measure would result in merely nominal damages. See Calamari & Perillo, *supra* note 45, § 14.29.

96. See *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 891 (N.Y. 1921). Three of the seven judges dissented. Certainly Cardozo, writing for the majority, would have joined them if the breach had been willful. Cardozo wrote, "[t]he willful transgressor

who might have advised his client that it was okay to use Cohoes pipe would, of course, be liable to the client for malpractice. Because the breach is willful, some courts would not only deny the contractor any recovery but would also apply a replacement cost measure of damages to a counterclaim by the owner.⁹⁷ For example, in one case the diminution in value of the property was \$3,000. Because the breach was willful, the court sustained an award of \$90,000 representing the cost of completion.⁹⁸ The burden of liability on the attorney who counseled the contractor to breach would be heavy indeed.

Should the contractor in the Reading-Cohoes pipe controversy have inefficiently refused the supplier's proposal of a reduced price for the off-brand pipe? The answer dictated by business ethics and common sense is for the contractor to go to the owner with the news of its ability to cut costs and offer to share the benefit. The contractor is not a fiduciary and need not reveal the full extent of the savings, but to talk is not to breach. In contrast, as Macneil has written, efficient breach, encourages "breach first, talk afterwards."⁹⁹

There is also tension between efficient breach theory and the willingness of the courts to grant specific performance by issuing mandatory injunctions or restraining orders. Observers in the economic analysis of law tradition are divided on the question of the efficiency of specific performance. While some analysts stress that specific performance exactly protects the expectancy interest and thus avoids overcompensation and undercompensation,¹⁰⁰ others have

must accept the penalty of his transgression. For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong." *Id.* at 891 (citations omitted); see also *VRT, Inc. v. Dutton-Lainson Co.*, 530 N.W.2d 619, 623 (Neb. 1995) (holding that bad faith in performance precluded a finding of substantial performance). See generally Patricia H. Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 *Ariz. L. Rev.* 733 (1982) (describing the role of willfulness in the law of contract remedies and arguing for increased emphasis on this factor).

97. See *Shell v. Schmidt*, 330 P.2d 817, 820 (Cal. Ct. App. 1958); *Groves v. John Wunder Co.*, 286 N.W. 235, 236-38 (Minn. 1939); *City Sch. Dist. v. McLane Constr. Co.*, 445 N.Y.S.2d 258, 260 (App. Div. 1981); Marschall, *supra* note 96, at 734-39. Professor Sebert observes that the cost of repair rule in this situation is a form of punitive damages. See John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based upon Contract: Toward Achieving the Objective of Full Compensation*, 33 *UCLA L. Rev.* 1565, 1644-47 (1986).

98. See *American Standard, Inc. v. Schectman*, 439 N.Y.S.2d 529, 531-34 (App. Div. 1981). There are contrary cases. See *Calamari & Perillo, supra* note 45, § 14.29.

99. Macneil, *supra* note 82, at 968.

100. See Alan Schwartz, *The Case for Specific Performance*, 89 *Yale L.J.* 271, 274-78 (1979); Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 *Yale L.J.* 369, 387-89 (1990). Compare Linzer, *supra* note 82, at 138 ("The general use of specific performance will produce truer economic efficiency than a system that counts the money cost of performance to the promisor but not the unquantifiable emotional and other costs of nonperformance to the promisee."), and Ulen, *supra* note 39, at 365-66 ("[S]pecific performance should be, on efficiency grounds, the routine contract

warned that the routine grant of specific performance would be inadvisable. They argue that where the cost of full performance exceeds its value to the claimant, the claimant would be in a position to exact "bribe" money for settling the case or, at any rate, that the cost of negotiating a settlement would be excessive and inefficient.¹⁰¹ But these critics tend to ignore that, in the situation where cost of performance exceeds its value, relieving the breaching party of the duty of performance would result in its unjust enrichment.¹⁰² Why the breaching party's savings should not inure to, or be shared by, the aggrieved party is not clear. It is apparent, however, that the courts are increasingly willing to grant specific performance, and legislators are increasingly willing to authorize such grants of specific performance.¹⁰³

Another take on the economics of the efficient breach theory has been put forward by William Dodge. He urges that willful breaches, whether or not efficient, should be met by the threat of punitive damages, arguing that "[t]he threat of punitive damages would simply . . . force[] [the breaching party] to buy its way out of the contract and would . . . determine[] the nonbreaching party's expectation interest more cheaply and more accurately [than a litigated result]."¹⁰⁴ He recognizes that this proposed rule, like specific performance, gives the promisee a property right in the promise. The argument recognizes that the alternative of specific performance would produce an efficient result by forcing negotiations, but notes that the remedy is unavailable if the subject matter of the contract has been transferred to a bona fide purchaser for value. Penalty clauses

remedy."), with Macneil, *supra* note 82, at 968 (stating that expectation damages can be more efficient than specific performance depending on the situation's specific transaction costs), and Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 Colum. L. Rev. 1365, 1423 (1982) ("[T]he most efficient rule is *not* specific performance, but a rule that awards the cost of completion in all cases.").

101. See Posner, *supra* note 38, at 146; Anthony T. Kronman, *Specific Performance*, 45 U. Chi. L. Rev. 351, 366-67 (1978); Timothy J. Muris, *The Costs of Freely Granting Specific Performance*, 1982 Duke L.J. 1053, 1058-68 (discussing economic, moral, and administrative factors that inform a decision to grant or deny equitable relief); Doug Rendleman, *The Inadequate Remedy at Law Prerequisite for an Injunction*, 33 U. Fla. L. Rev. 346 (1981).

102. See *Farrell Lines, Inc. v. City of New York*, 281 N.E.2d 162, 166 (N.Y. 1972).

103. See M. T. Van Hecke, *Changing Emphases in Specific Performance*, 40 N.C. L. Rev. 1, 1 (1961). The revolution against the subordination of equitable relief from the hegemony of damages has perhaps a bit prematurely declared to have been won. See Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 Harv. L. Rev. 687, 691-92 (1990); see also Rendleman, *supra* note 101, at 347-48 (stating that courts analyze several factors before deciding whether specific performance is an appropriate remedy). Yet, the revolution proceeds apace. See United Nations Convention for the International Sale of Goods art. 46; UNIDROIT Principles of International Commercial Contracts art. 7.2.3 International Institute for the Unification of Private Law (1994); U.C.C. 1999 Revision Draft § 2-807 (last modified Jan. 27, 2000) <<http://www.law.upenn.edu/bll/ulc/ulc.htm#ucc2>>.

104. Dodge, *supra* note 41, at 687.

would serve the same purpose as punitive damages, but would not distinguish between willful and unintentional breaches.

Thus, when we examine the divergent opinions of economic analysts of contract law we find no consensus. Nonetheless, the premise of many of the economic analysts is almost always the same. Most share the presupposition that the legal system is only an adjunct to the economic system. While it is true that the legal system *is* an adjunct to the economy it is also much more. First and foremost, the legal system's primary goal in enforcing contracts is to keep the public peace. This is easily provable. Where illegal agreements dominate the economic system, as in underground economies such as the marketing of illegal drugs¹⁰⁵ and loan sharking,¹⁰⁶ enforcement is activated by threats, torture, mayhem, murder, hostage taking and other unpleasant enforcement and punishment mechanisms.

There are values that contract law serves other than promoting the efficiency of the economic system and preserving the public peace.¹⁰⁷ Many scholars have the strong belief that morality requires the honoring of promises. For some, the moral impetus stems from religion.¹⁰⁸ For others, natural law has a humanistic foundation in human reason and decency.¹⁰⁹ Others find the foundation of contract

105. The following newspaper excerpt provides an example of the enforcement of an illegal drug agreement:

[T]he body of a Colombian named Diego was found on July 14 stuffed into a suitcase beside the Grand Central Parkway. The man, who law-enforcement officials said had been accused of withholding payment of \$350,000 to a group of drug traffickers, was found bound and gagged with duct tape. A cord was wound around his neck, a rotting onion was taped into his mouth and his leg had been cut with a knife.

Clifford Krauss, *In Queens, Deadly Echoes of Colombia's Drug War*, N.Y. Times, Nov. 25, 1995, at A1.

106. A naïve borrower approached a loan shark for a loan and inquired what collateral the lender might want. He was informed that "[y]our body is your collateral." N.Y. State Comm'n. of An Investigation of the Loan Shark Racket 11 (1965).

107. See Robert Hillman, *The Richness of Contract Law* (1997).

108. Birmingham quotes an extreme statement by St. Bernardine:

[A]ll the saints and all the angels of paradise cry then against him, saying, 'To hell, to hell, to hell.' Also the heavens with their stars cry out, saying, 'To the fire, to the fire, to the fire.' The planets also clamor, 'To the depths, to the depths, to the depths.'

Birmingham, *supra* note 84, at 275-76 n.10 (quoting St. Bernardine, *De Evangelio Aeterno* sermon 45, art. 3, cl. 3 in 2 Opera Omnia (de la Haye ed. 1745)). This precious reference, however, is not about contract breachers. Rather, St. Bernardine was condemning usurers. It is likely, however, he would have so condemned promise breakers. See James Gordley, *Contracts in General*, in 7 International Encyclopedia of Comparative Law ch 2 §§ 24-29 (1997) (detailing Roman, Medieval and Aristotelian traditions of contract doctrine).

109. Modern proponents of a natural law basis for the enforcement of contracts, based on Aristotelian philosophy, include Henry Mather, *Contract Law and Morality* 67-68 (1999) (arguing that intentional breaches should be dealt with more severely than unintentional breaches). See also John Rawls, *A Theory of Justice* 342-47 (1971) ("The obligation to keep a promise is a consequence of the principle of fairness.").

law in the ideal of personal autonomy and the power of the will.¹¹⁰ My own notion is very much like that stated by Harry S. Truman in response to an interviewer's question about honoring contracts. He replied, "it has always seemed to me that unless you can trust a man and he can trust you, why, everything breaks down. . . . [T]rust is absolutely fundamental in every possible kind of relationship."¹¹¹

Theories abound, but as Professor Hillman has stated: "[d]espite its many dimensions, contract law is a credible, if not flawless, reflection of the values of the surrounding society. A highly abstract unitary theory illuminates contract law, but it cannot explain the entire sphere."¹¹² Despite differing views as to "Why?" most theorists agree that the protection of reasonable expectations is the fundamental goal of contract law; the award of damages is not the equivalent of meeting those expectations. The business community rejects efficiency as an excuse for willful breaches,¹¹³ and the legal community should also.

This Essay does not take the position that efficient breach theory is unsound for reasons of morality. The law does not enforce all promises. The breach of some unenforced promises may be more immoral than most of those for which the law grants a remedy.¹¹⁴ For better or for worse, the law has decided that certain kinds of promises create rights and has provided remedies for the protection of those rights. While there is continuous need to reexamine the criteria for enforceability of promises, a promise that at any moment is enforceable should not be subverted. Once the legal system decides

For an explication of a mixture of religious and Aristotelian foundations for contract law, see John Finnis, *Natural Law and Natural Rights* 178-83, 284-86 (Clarendon Press 1988). For an historical survey of natural law thinking about contract law, see Larry A. DiMatteo, *The History of Natural Law Theory: Transforming Embedded Influences into a Fuller Understanding of Modern Contract Law*, 60 U. Pitt. L. Rev. 839 (1999). A moral basis for contract performance is assumed in F.C. Sharp, *The Ethics of Breach of Contract*, 45 Int'l J. of Ethics 27 (1934), which discusses situations in which nonperformance may be ethical.

110. See Gordley, *supra* note 108, at §§ 20-39 (discussing nineteenth century will theory).

111. Merle Miller, *Plain Speaking: An Oral Biography of Harry S. Truman* 48 (1974) (quoting Harry S. Truman).

112. Hillman, *supra* note 107, at 6. *But see* Randy E. Barnett, *The Richness of Contract Theory*, 97 Mich. L. Rev. 1413, 1421 (1999) (book review) (criticizing Hillman's thesis). *Cf.* 2 Reinhold Niebuhr, *The Nature and Destiny of Man* 257 (1949) ("Usually the norms of law are compromises between the rational-moral . . . and the possibilities of the situation. . . .").

113. See David Baumer & Patricia Marschall, *Willful Breach of Contract for the Sale of Goods: Can the Bane of Business be an Economic Bonanza?*, 65 Temp. L. Rev. 159, 163-72 (1992) (analyzing efficient breach theory in the light of a survey of business executives).

114. See, e.g., *People v. Navaroli*, 521 N.E.2d 891, 895-96 (Ill. 1988) (holding that specific performance of a plea bargain agreement is "unnecessary to redress [defendant's] detrimental reliance"). Interestingly enough, *Navaroli* is the center piece of E. Allan Farnsworth, *Changing Your Mind: The Law of Regretted Decisions* (1998).

that a given kind of promise is enforceable, the promise takes on many of the attributes of property.¹¹⁵ This property is protected from interference by third persons¹¹⁶ and against impairment by the state.¹¹⁷ More often than not, it is also assignable.¹¹⁸ The promisee's property-like interest should strongly be protected from appropriation by the promisor.

CONCLUSION

This Essay makes several points. It seeks to clarify a frequently misunderstood statement by Holmes that many have taken to mean that performance of a contract is a mere option to the payment of damages. It notes that there is strong disagreement among academics that look at law from an economic perspective as to the validity of the theory of efficient breach. The main conclusion, however, is that, regardless of the soundness of efficient breach theory in economic science, it is not, and should not be, the basis of normative determinations in the legal system.

115. For example, in the case of a merger or acquisition by an asset purchase agreement, it is quite common to list the outstanding significant contracts of the acquired company and a value is placed on such contracts. Consider, too, the relatively free assignability of contract rights. See Calamari & Perillo, *supra* note 45, § 18.10, at 680 ("The modern view is emphatically to the effect that rights are ordinarily assignable."). Freedom of alienation of property is one of the earmarks of the shift from feudalism to capitalism. Free alienability of contract rights is perhaps the last step in that property reform.

116. It is perhaps anomalous that tort law sometimes protects unenforceable contracts. This anomaly perhaps can be explained by the fact that the victim of the tort may have sunk significant resources in the unenforceable deal. See Epstein, *Inducement*, *supra* note 89, at 23-24.

117. See U.S. Const. art. I, § 10, cl. 1.

118. See Calamari & Perillo, *supra* note 45, § 11.10, at 680.