

ESSAY

IS BREACH OF CONTRACT IMMORAL?

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ABSTRACT

The view that there is something wrong with a person's breaching a contract is widely held. I argue here that this view is misleading—essentially because the particular contingency that led to a breach will often not have been explicitly addressed in a contract. If so, we will not know if the breach should be considered immoral, for we will not know whether the parties would have required performance had they addressed the contingency that arose. However, we can make an important inference if expectation damages must be paid for a breach: The breach probably was not immoral, since the breaching party's willingness to pay expectation damages suggests that performance would not have been required in a contract providing explicitly for the contingency that occurred. This conclusion is related to breach and damages in practice, to a survey that I conducted about the morality of breach, and to the opinions of commentators on the morality of breach and on the "efficiency" of breach.

INTRODUCTION

The question posed here is when, and why, it might be thought immoral to commit a breach of contract. The view that there is something wrong with a person's breaking a contract, or, equivalently, that a person ought to meet his or her contractual obligations, is widely recognized. The Restatement of Contracts, for instance, refers to the "sanctity of contract and the resulting

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moral obligation to honor one's promises,"¹ and a well-known commentator avers in a typical statement that a "contract must be kept because a promise must be kept."²

Yet it is manifest that contracts are often disobeyed and that the law permits this without imposition of rigorous sanctions—the party in breach generally is obligated to pay only damages to the victim of the breach; the party is not usually compelled to perform.³ The ability to commit breach and pay damages stands in apparent opposition to, or at least raises questions about, the moral duty to perform. The Restatement and commentators seem to be of the opinion that breach and payment of damages generally are tolerable, and sometimes even desirable, for practical, economic reasons.⁴ Some authorities have seemed almost to celebrate the option to commit breach despite its negative moral aspect, notably Holmes, who wrote:

The duty to keep a contract . . . means a prediction that you must pay damages if you do not keep it,—and nothing else But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can.⁵

Against this background, I ask in Part I of the Essay whether it is immoral to break a contract. To consider the question, one must, of course, state what constitutes moral behavior in the contractual context, and I employ a simple and natural definition: Performance is morally required in a contingency if and only if the parties did specify, or would have specified, performance in that particular contingency.

¹ RESTATEMENT (SECOND) OF CONTRACTS, *Introductory Note to ch. 16*, at 100 (1981).

² CHARLES FRIED, *CONTRACTS AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* 17 (1981).

³ RESTATEMENT (SECOND) OF CONTRACTS, *Introductory Note to ch. 16*, at 100 (1981).

The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation of the promisee for the loss resulting from breach [P]unitive damages have not been awarded for breach of contract, and specific performance has not been granted where compensation in damages is an adequate substitute for the injured party.

Id.; see also JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 16.1 (4th ed. 1998) ("The primary relief that the Anglo-American legal systems offer is substitutionary relief, normally damages Specific performance is an extraordinary remedy . . .").

⁴ RESTATEMENT (SECOND) OF CONTRACTS, *Introductory Note to ch. 16*, at 100 (1981) (observing that circumstances may change, leading a party to want to breach to avoid losses, and that this economic reason for breach is consistent with traditional common law decisions); see also E. ALLAN FARNSWORTH, *CONTRACTS* §§ 12.1–3 (3d ed. 1999).

⁵ Oliver W. Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897). Although this oft-cited quotation suggests that Holmes found breach and payment of damages morally unobjectionable, I note below that that is not a proper interpretation of his meaning. See *infra* Part IV.

Given this definition, the first point that I discuss is that a breach usually cannot be said to be immoral in an automatic sense. The reason is that when a breach occurs, it is typically true that the particular contingency that obtained will not have been explicitly addressed in the contract⁶—meaning that one will not know directly from the contract whether the parties would have wanted performance in the contingency, and thus, whether the breach should be considered wrongful. When, for instance, a seller breaches a contract to clear snow in the contingency that his equipment was stolen or in the contingency that the snow was so deep that it was difficult to transport his equipment to the buyer's site, and these contingencies were not explicitly addressed in the contract, one will not know whether the breach should be considered immoral.

Yet if the party in breach must pay damages, we can make an important inference: This party would not have been willing to commit breach unless the cost of performing (or the benefit of not performing) in the contingency exceeded the burden of damages. In particular, under the expectation measure of damages, we can reason that the cost of performing must have exceeded the expectation. However, if the cost of performing was this high, it can be shown that had the parties explicitly addressed the contingency in question, they would rationally have agreed that there would be no obligation to perform in that contingency. In sum, we can deduce from the fact that the party in breach was willing to pay the expectation measure of damages that the breach was probably not immoral because the parties likely would not have stipulated performance had they addressed the contingency that arose.

This inference that a breach that occurs under the expectation measure of damages is probably not immoral cannot be made, however, if the measure of damages is less than the expectation. If that is so, the fact of breach does not imply that rational parties would have agreed to nonperformance in the contingency. They may or may not have agreed.

In Part II of this Essay, I ask whether breach in reality is likely to be immoral, given the analysis in Part I and my definition of immoral breach. The main conclusion that I reach flows from the observation that, in practice, damages for breach are likely to be less than fully compensatory and perhaps substantially so. Therefore, the willingness of a party to commit breach does not imply that nonperformance would have been agreed to had the contracting

⁶ A reader who views this statement skeptically is probably not interpreting an explicit provision for a contingency in the manner that I do, and such a reader should reserve judgment until he or she has considered Part I below, especially Part I.C, *The Observed Incompleteness of Contracts*.

parties considered the contingency that occurred, and breach might thus be immoral. It is necessary to consider how strong the reason for breach was to know if a breach was immoral.

In Part III, I report on a survey that I conducted about individuals' attitudes toward breach of contract. The survey shows that if individuals are asked the general question whether breach is unethical, they usually respond that it is. If, though, individuals are told that the breach occurred in a contingency that was not explicitly provided for in the contract and that had the contingency been addressed, the contracting parties know that performance would not have been stipulated, individuals no longer tend to view breach as wrongful.

In Part IV, I review the literature considering the morality of breach and also the literature on so-called efficient breach because it addresses the economic desirability of breach. These literatures do not consider the point stressed here: contracts often do not mention explicitly the contingencies that arise, and when so, contracts do not exemplify the kind of promise to which a moral duty of performance would necessarily attach.⁷ Relatedly, literature concerned with the morality of breach does not recognize the inference that can be drawn from the willingness of a party to commit breach and pay expectation damages. Because of these omissions, that literature accords the moral duty to obey contracts different weight from the weight that is suggested by the logic of this Essay.

I conclude with remarks on the implications of this Essay for the moral and legal advice that commentators on contracts sometimes offer.

I. THE MORALITY OF BREACH: IN PRINCIPLE

Here I develop the main analytical argument outlined above. Namely, I define moral behavior by reference to contractual provisions for specific contingencies, explain why contracts tend to omit explicit mention of many contingencies, and analyze breach in unprovided-for contingencies given that expectation or lesser damages must be paid.

⁷ However, two of my own writings emphasize that under the expectation measure, breach occurs in contingencies when parties would not have specified performance in a completely detailed manner. See Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 467-69 (1980); see also LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 155-221 (2002).

A. Definition of Moral Behavior in a Contingency

I assume that if a contract provides explicitly for a particular contingency, then the moral duty of a party is unambiguous should that contingency arise: The party is obligated to perform a given act if and only if the contractual provision addressing the contingency states that the act is to be performed. Consider a contract under which a seller is supposed to clear a person's driveway if it snows and the contingency that the seller's snow-clearing equipment is stolen. If the contract mentions this possibility and specifies that if it occurs, the seller still has an obligation to clear snow (perhaps because he can rent snow-clearing equipment), then the seller is assumed to have a moral duty to clear snow even if his equipment is stolen.⁸ However, if the contract says that the seller is excused from having to clear snow if his equipment is stolen, then the seller would not have a moral duty to perform if his equipment is stolen.

Likewise, I assume that if a contract does not address a contingency, then the moral duty of a party if the contingency arises is determined by what the contract would have said had it provided explicitly for the contingency, supposing that what the contract would have said is known to the parties.⁹ Thus, if the contract for clearing a driveway of snow does not address the contingency that the seller's snow-clearing equipment is stolen, but had the contract included a clause covering theft of the equipment, the parties know that that clause would have stated the seller still has an obligation to clear snow, the seller would have a moral duty to clear snow if his equipment is stolen, and so forth.

The assumption that I am making—that a person has a moral duty to perform an act given the occurrence of a contingency if and only if the contract explicitly did state, or would have stated in an explicit provision, that the person was to perform the act in the contingency—derives from the view that a

⁸ By a particular contingency, I mean a fully described contingency, or at least one leaving out no aspects of possible relevance to contracting parties. Hence, the statement that snow-clearing equipment is stolen might not be considered fully described, for it does not say whether or not the seller can, for instance, rent snow-clearing equipment. However, for expository simplicity, I will assume that the statement that snow-clearing equipment is stolen is a full description of the contingency. On the notion of a completely specified contingency (or "state of the world"), a notion that is basic to the theory of probability and of expected utility, see the classic discussion in LEONARD J. SAVAGE, *THE FOUNDATIONS OF STATISTICS* 8–17 (2d rev. ed. 1972).

⁹ In reality, what a contract would have said about a particular contingency might not be known with confidence by the parties, implying that they might not know their moral duties with confidence.

contract is a species of a promise for which there are well-known grounds for finding moral obligations.¹⁰ For my purposes, however, it is not necessary to discuss the grounds rationalizing the morality of promise keeping. It is enough to suppose that if a person makes a promise to do something in a given contingency, he has imposed upon himself a moral obligation to do that thing if the named contingency arises.

B. The Nature of Obligations to Perform in Completely Detailed Contracts

Given the assumption that a person's moral duty to perform an act in a contingency rests on whether the contract did or would have required the act to be performed in the contingency, it is of interest to identify the character of the contingencies under which contracting parties would be likely to specify that an act is to be performed.

Let us focus on a contract to produce something or to provide a service.¹¹ It will now be argued that we would expect *the buyer and the seller to agree to a contractual provision to undertake a task in a particular contingency if and only if the cost would be less than the value of performance to the buyer*. In particular, if the cost would exceed the value to the buyer in the contingency,

¹⁰ See, e.g., DAVID HUME, A TREATISE OF HUMAN NATURE bk. 3, pt. 2, § 5, at 331 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2000) (1739); IMMANUEL KANT, GROUNDWORK OF THE METAPHYSICS OF MORALS 15, 32, 38 (Mary J. Gregor ed. & trans., Cambridge Univ. Press 1998) (1785); W.D. ROSS, THE RIGHT AND THE GOOD 16–47 (1930); John Rawls, *Two Concepts of Rules*, 64 PHIL. REV. 3 (1955); Thomas Scanlon, *Promises and Practices*, 19 PHIL. & PUB. AFF. 199 (1990); John Searle, *How to Derive "Ought" from "Is,"* 73 PHIL. REV. 43 (1964). A different and perhaps appealing definition of moral contractual behavior is that contractual behavior is moral as long as it was anticipated by both parties—so that breach would be moral in a contingency as long as breach was expected to occur by both parties (even if performance would have been agreed to had the parties provided explicitly for the contingency). If one employs this definition of moral contractual behavior, the thrust of the present Essay would not be altered, namely, that what is facially a breach of a contract might not be immoral. That in turn would be so because (as will be discussed) contingencies are usually not explicitly provided for in a contract, meaning that what is anticipated in a particular contingency cannot be read directly from the contract.

¹¹ There are other important types of contracts, such as contracts to convey property. The analysis of other types of contract would be similar in its general structure: (1) one would examine the nature of a completely detailed contract, ascertaining when performance and when nonperformance would be provided for; and then (2) one would compare the contingencies in which incomplete contracts are breached to the contingencies in which nonperformance would be allowed in a completely detailed contract. If this analysis were undertaken for contracts to convey property, the particular conclusions reached would be somewhat different from those obtained here. The main reason is that the parties would not have a strong affirmative reason to allow for nonperformance. See generally Steven Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q.J. ECON. 121 (1984), and Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 TEX. L. REV., 831, 833–35, 846–53 (2006), for analysis of the nature of completely detailed contracts to convey property. A full discussion of the morality of breach of contracts to convey property would be distracting for the purposes of this Essay.

we would expect the contractual provision to excuse the seller from having to perform. Suppose, for instance, that the value to a person of having his driveway cleared of snow is \$200 (in terms of time saved and convenience) and that in a normal contingency, the cost to the seller of clearing the driveway would be \$50, whereas in an unusual contingency in which the seller's snow-clearing equipment is stolen, the cost of clearing the driveway would be \$500 (the cost to the seller of renting equipment). We would predict that the outcome of bargaining would be a clause addressing the normal cost contingency that requires the seller to clear the driveway and a clause addressing the unusual cost contingency that excuses the seller from having to clear the driveway. That this outcome would result is apparent if we imagine that the parties bargain about a separate price for each contingency. Clearly, for the contingency with the \$50 cost, any price for clearing the driveway between \$50 and \$200, such as \$100, would be satisfactory to the two parties. The buyer and the seller would each prefer a provision requiring the driveway to be cleared for a \$100 price, to a provision not requiring the driveway to be cleared and with no payment being made (if the price is \$100, the buyer would obtain a net gain of \$100 and the seller would obtain a profit of \$50). However, for the contingency with the \$500 cost, there is no price for clearing the driveway that would be satisfactory to both parties. The buyer would be willing to pay at most \$200 for the provision requiring the driveway to be cleared, but the seller would demand at least \$500 for the provision. Consequently, the provision would not require the seller to clear the driveway.¹²

¹² Similar but somewhat more complicated logic leads to the same conclusion—that the provision for the \$50 cost contingency will specify clearing of the driveway, but the provision for the \$500 cost contingency will not—if we assume that there is a single contract price rather than a different contract price for each cost contingency (as in the text). Suppose, for instance, that the parties are considering a contract in which the contract price would be paid at the outset, and they are bargaining over this price and the two contingent provisions. Imagine that they initially discuss a contract price of \$100 and provisions that require the driveway to be cleared whether the cost is \$50 or \$500. Assume that the likelihood of the \$50 cost is 90% and that the likelihood of the \$500 cost is 10% (we need to be explicit about the likelihoods in this note). Then the value of the contract to the buyer would be $\$200 - \$100 = \$100$, since the buyer would be guaranteed performance. The expected value of the contract to the seller would be $\$100 - (90\% \times \$50 + 10\% \times \$500) = \5 . Suppose the seller proposes to the buyer that the candidate provision requiring that he perform in the high-cost contingency be altered so as to excuse the seller from having to perform and that the seller offers to lower the price from \$100 to \$70 to induce the buyer to agree to the change. The expected value of the new proposed contract to the buyer would be $90\% \times \$200 - \$70 = \$110$, so the buyer would be better off (by \$10). The expected value of the new contract to the seller would be $\$70 - 90\% \times \$50 = \$25$, so the seller too would be better off (by \$20). Since both would be better off under the proposed contract with the seller not having to perform in the high-cost contingency, they would be likely to decide to switch to the proposed contract. More generally, it can be shown that for any contract in which the seller does not perform if and only if the cost is

The general qualitative point, then, is that in a contractual provision devoted to a particular contingency, the seller would have a duty to perform if it would not be too hard to perform. However, the seller would not have a duty to perform if it would be sufficiently difficult to do so because the buyer would not be willing to pay enough to induce the seller to agree to perform in such a problematic contingency.

C. *The Observed Incompleteness of Contracts*

In reality, contracts are far from completely detailed. It is evident that they usually mention relatively few contingencies explicitly out of the multitude of events of possible relevance.¹³ A contract for removing snow from a person's driveway might mention several conditions, such as whether clearing is to be done if it snows on a holiday, but not a practically endless number of events that could matter to the seller—theft of his snow-clearing equipment, illness of his crew, snow so deep that it makes roads impassable for the trucks transporting the snow-clearing equipment.¹⁴ Likewise, a contract might not mention events that could matter to the buyer, such as unexpected travel out of town over the winter, sale of home, and inheritance of snow-clearing equipment.¹⁵ Although contracts that are the product of substantial legal effort will address numerous contingencies of potential significance, they will still not provide expressly for many that could be of consequence.¹⁶

An issue concerning the definition of an incomplete contract is very important to mention for clarity. Suppose that a contract states that "snow is to be cleared from the buyer's driveway if the snow is over five inches deep," and that the contract mentions no other conditions. This contract does not provide *explicitly* for the contingency that the seller's snow-clearing equipment is stolen. But the contract *implicitly* covers that contingency, for in a formal

less than the value of performance, there exists a substitute contract (generally with a different price) in which the seller is required to perform if and only if the cost is less than the value of performance, such that *both* parties prefer this substitute contract. This is why it is said that parties will tend to elect contractual provisions of the claimed nature if they are making a completely detailed contract. For a proof, see Shavell, *supra* note 7, at 475–76.

¹³ Of course, if the contract is verbal, the number of contingencies that can be included is small, given the limited ability of individuals to remember what was said and difficulties of proof.

¹⁴ These are all examples of contingencies affecting the cost of performance for the seller. Also of possible importance are contingencies in which the seller might be offered a high price to clear snow for someone else.

¹⁵ These are examples of contingencies that lower the value of performance to the buyer and thus might lead him not to want performance.

¹⁶ See, for example, the cases mentioned in FARNSWORTH, *supra* note 4, § 17.6.

sense the contract covers *all* contingencies. It divides them into two general categories: those in which the snow is up to five inches deep (whatever else happens) and those in which the snow is over five inches deep (whatever else happens).

For our purposes, then, one must keep in mind that what is meant by contractual incompleteness in regard to a contingency is not that a contract fails to cover the contingency in an implicit sense through the use of clauses depending on general events, but rather that the contract fails to address the contingency in an explicit sense. The reason that I stress this point is that in reality, many (and I would say, on reflection, most) conditions mentioned in contracts are not single contingencies; they are events, agglomerations of individual contingencies. Hence, when a particular contingency does occur, it may well not have been explicitly addressed in the contract, meaning that we will not truly know what the parties would have specified in a provision for the actual contingency at issue.

D. Explanation for the Incompleteness of Contracts

A number of explanations have been offered for the observed incompleteness of contracts.¹⁷ Most obviously, it takes time to discuss and to include contingent provisions in contracts. If a contingency is unlikely, this effort may not be worthwhile in view of the low probability that a provision for it would prove useful.¹⁸

Second, many contingencies would be hard for a court to verify. Consider a provision excusing the seller from having to clear snow if he had back pain. If it would be infeasible or expensive for a court to verify that an individual experienced back pain, then the provision would be problematic because it could allow the seller to claim the excuse of back pain opportunistically.

¹⁷ On why contracts are incomplete, see, e.g., STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW, 299–301 (2004); Oliver Hart, *Incomplete Contracts*, in THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 752, 752–58 (John Eatwell, Murray Milgate & Peter Newman eds., 1987); Alan Schwartz, *Incomplete Contracts*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 277, 277–79 (Peter Newman ed., 1998).

¹⁸ Suppose that including a contingent provision would take up fifteen minutes of time for each of two lawyers negotiating a contract and that each charges \$250 an hour. The legal cost of the provision would then be \$125. Suppose, too, that including the provision would save the parties \$1,000 if the contingency were to occur. Then if the likelihood of the contingency is below 12.5%, the expected value of the provision would be less than \$125, so it would not be worthwhile including. More generally, if c is the cost of a contingent provision and b is the benefit of including it, the provision will not be worthwhile including if its likelihood is below c/b .

Hence, provisions for contingencies might not be advantageous to include in contracts when the courts would encounter difficulty in confirming their occurrence.

A third reason why we would expect only limited use of contingent provisions is that our legal regime, under which parties usually are able to commit breach and pay damages, serves as an implicit substitute for contingent provisions. As will shortly be discussed, under this regime, a party will be motivated to perform if the cost of so doing is not high in order to avoid paying damages; whereas, he will be led to commit breach if the cost of performing is high because paying damages will be less expensive than performing. This behavior—performing when the cost is below a threshold and not performing when the cost would exceed a threshold—is in at least qualitative alignment with the performance obligations that would be set out in a contract that is completely detailed about cost contingencies, reducing the need to have such a contract.

Still another reason why it may be rational for parties not to take pains to include many contingent provisions in a contract concerns the general possibility of renegotiation of their contract. The parties can anticipate that if they do not provide for a troublesome contingency and it occurs, they will often be able to renegotiate and resolve their problem. If, for instance, the seller finds that it would be unexpectedly costly to perform when the contract requires performance, he might be able to obtain a release from his obligation by paying the buyer some bargained-for sum. Of course, the outcome of such renegotiation may be uncertain and it may introduce an added risk into contracts, but the possibility of successful renegotiation lessens the consequences of failure to make contingent contractual provisions.

In all, then, we see that there are important and plausible reasons explaining the observation that contracts are substantially incomplete.

E. The Morality of Breach When Contracts Are Incomplete

To ascertain under our definition whether a breach in a contingency that was not explicitly provided for is moral or immoral, one needs to determine whether performance would have been required had the contingency been expressly addressed and whether the parties to the incomplete contract know this. For an onlooker to characterize a breach as immoral when the contract does not address the particular contingency that occurred is for the onlooker to fail to recognize that, but for the practical reasons for incompleteness that have

been discussed, the contract would have included an explicit provision and that it might have allowed nonperformance. I now consider the questions of what the content of a contractual provision that was not actually made would have been if it had been made and whether the parties have reason to know it. These questions are answered first under the assumption that damages for breach equal the expectation measure and then under the assumption that damages do not equal the expectation measure.

F. The Morality of Breach When Contracts Are Incomplete and Damages Equal the Expectation Measure

When sellers have to pay damages for breach, they will be motivated to obey the contract if the cost of performance is less than the damages they would have to pay for a breach. If, though, the cost of performance exceeds the damages they would owe for a breach, they will have a financial reason to commit breach. Hence, they will tend to commit breach if and only if the cost of performance exceeds the measure of damages.¹⁹

It follows that when the measure of damages equals the expectation measure, sellers will be led to commit breach if and only if the cost of performance exceeds the value of performance to buyers. But this is exactly when a seller would have been excused from performing in an explicit complete contract, as was explained above. In other words, *under the expectation measure of damages for breach, the seller will fail to perform in the same contingencies as the seller would be permitted not to perform in a complete contract.* Accordingly, *breach should not be characterized as immoral* under our assumptions.²⁰ Note, too, that at least in principle, the seller knows this. That is, the seller knows in what contingencies breach would and would not be required in a complete contract, presuming that the seller knows the expectation measure of damages, for the seller compares his

¹⁹ For simplicity, I set aside litigation expenses, reputation concerns, and other factors apart from damage payments that may affect the decision to commit breach.

²⁰ This conclusion raises a question, namely, what if a party breaches an explicit contingent provision of a contract and pays expectation damages? Such a breach should be immoral since the contingent provision is explicit, yet the conclusion that I have reached is that payment of expectation damages makes the breach moral. The resolution of the apparent conflict is that it cannot happen that a party would be willing to pay expectation damages to breach a truly explicit contingent provision. Recall that I showed that if an explicit provision calls for performance, it must be that the cost of performance is less than the expectation. Hence, in such a contingency, the seller will not find it worthwhile to commit breach. The reasons that in reality we do see breach of explicit contingent provisions lie mainly in two factors: that damages are really less than the expectation (see the discussion in Part II below) or that an apparently explicit provision is not really explicit (see the discussion above in Part I.C).

costs of performance to the expectation measure of damages.²¹ Furthermore, we as onlookers know that when breach occurs, it must be moral, for we can infer that the cost of performance must have been higher than the value of performance from the willingness of the seller to commit breach.

In the contract concerning snow removal, if the seller commits breach after his equipment is stolen and pays expectation damages of \$200, the cost to him of performance must have exceeded \$200. This means that had the parties discussed the theft contingency, the seller knows (and we know) that he and the buyer would have agreed that there would be no duty to perform in the contingency. Thus, the failure to clear snow is not immoral.

G. The Morality of Breach When Contracts Are Incomplete and Damages Are Undercompensatory

Now assume that damages are less than the amount necessary to make the victim of breach whole. Since breach will tend to occur whenever the cost of performance exceeds the level of damages, breach will occur more often than nonperformance would have been permitted in a completely specified contract—thus breach might be immoral. In our example, if the measure of damages is \$125 instead of the expectation measure of \$200, breach will occur whenever the cost of performance exceeds \$125. Consequently, if breach occurs when the cost is between \$125 and \$200, for instance when it is \$150, the complete contract would have insisted on performance. Such breach would be immoral, if the seller realizes that the true expectation is \$200.

II. THE MORALITY OF BREACH: IN PRACTICE

Given the conclusions reached in the prior section, what can be said about whether the breach that we see in practice is moral or immoral? If damages tend to be fully compensatory, we could say that breach tends to be moral, as breach should occur if and only if contracting parties would have allowed nonperformance had they addressed in their contracts the contingencies that engendered breach. But if damages are not really compensatory, breach might be immoral.

²¹ That the seller knows the measure of damages is a natural analytical assumption. If the seller does not know the measure of damages, then the conclusions obviously change; the seller would commit breach based on his probabilistic views of damages, and whether breach would be immoral would be, in his opinion, a matter of probability.

Are damages fully compensatory in reality? The expectation measure is, of course, the general damages remedy employed for breach of contract, where the expectation measure is defined as the amount that would restore the victim of a breach to the position that he would have enjoyed had there been performance.²²

Yet, as many observers have noted, the expectation measure as it is actually applied tends not to be fully compensatory and may leave the victim of a breach substantially worse off than he would have been had there been performance.²³ The reasons given for believing the expectation measure often to be undercompensatory include the following: First, courts are reluctant to credit hard-to-measure components of loss as damages.²⁴ Hence, lost profits and idiosyncratic losses due to breach are likely to be inadequately compensated or neglected.²⁵ Second, courts are inclined to limit damages to those that could have been reasonably foreseen at the time the contract was made; courts frequently do not redress consequential losses and other hard-to-anticipate losses.²⁶ Third, damages tend not to reflect the considerable delays that victims of breach may suffer. Fourth, legal costs are not compensated.²⁷

Not only do expectation damages appear to be significantly undercompensatory in a general sense,²⁸ but damages for breach are probably effectively nonexistent unless the breach victim's losses exceed the costs of bringing suit, which is to say, a threshold of several thousand dollars. Losses must be greater than the cost of bringing suit for the breach victim to have a credible threat to litigate, and the minimum costs of bringing suit are arguably at least a few thousand dollars.²⁹

²² RESTATEMENT (SECOND) OF CONTRACTS §§ 346–47 (1981); CALAMARI & PERILLO, *supra* note 3, § 14.4.

²³ A good account of why damages are undercompensatory is given in Melvin A. Eisenberg, *Actual and Virtual Specific Performance*, 93 CAL. L. REV. 975, 989–96 (2005); *see also* Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 276 (1979). What follows is a summary of reasons offered by these authors.

²⁴ *See* Eisenberg, *supra* note 23, at 991–92; *see also* Schwartz, *supra* note 23, at 275.

²⁵ *See* Eisenberg, *supra* note 23, at 993.

²⁶ *See id.*

²⁷ *Id.* at 989.

²⁸ *Id.*

²⁹ If, for example, a lawyer's hourly fee is \$250 and only twenty hours of his or her time are required to litigate, the legal costs of litigation would be \$5,000, implying that the expected gain from suit would have to exceed this amount for a threat to litigate to be credible. I abstract here from many complicating issues, such as the reputational concerns of the party in breach (making the threat of suit more likely) and the value of the breach victim's time (making the threat of suit less likely).

In view of the foregoing, the practical reality is that breach could be immoral or moral. To know which is the case, we have to inspect the reasons for breach and the knowledge of the party committing breach. In a rough sense, the likelihood that breach is immoral is higher the lower damages are in relation to the true expectancy. Hence, the chances are greatest that breach is immoral when damages are effectively zero—that is, when breach-caused losses are below the threshold that would make suit worthwhile. If damages surpass this threshold but are significantly below the value of performance, the breaching party must obtain a relatively large benefit from breach—one that substantially exceeds the damages he would have to pay—for the breach to be moral.³⁰ If, though, expectation damages are near the value of performance, breach is quite likely to be moral, and the reason for breach does not need to be examined to infer that that is so.

III. THE MORALITY OF BREACH: IN THE OPINIONS OF INDIVIDUALS

To this point, we have made use of the definition of breach that I assumed, of which the salient feature is that nonperformance in a contingency is morally permissible if the parties know that they would have agreed to nonperformance had they discussed the contingency. Is this definition of the morality of breach of contract consistent with the actual expression of moral opinions about contract breach? Or do individuals tend to disregard the question about hypothetical contractual terms and instead describe a breach as immoral because it is facially a violation of a promise? If it is made clear that breach would be accompanied by payment of compensatory damages, do attitudes toward breach change? To gain an understanding of these issues, I conducted a small-scale survey.³¹

³⁰ Consider a contract to paint a house that is to be put up for sale and thus will likely command a higher price if freshly painted. Assume, too, that the owner would find delay costly because the owner has signed a purchase and sale agreement on another home, set a closing date, and must sell his or her present house soon in order to secure funds to close on the new home. In particular, assume that the owner's expected cost from a delay in painting would be \$25,000 due to having to sell the home when it is in real need of a paint job and that the painter has an appreciation of this fact. But suppose that the damages the owner would obtain for delay would be only \$3,000, owing to the speculative nature of the price the owner could have obtained had the painting been done. Then the painter would be led to breach if he could obtain more than \$3,000 in profit for doing a different job, yet if the painter's profit from a breach is less than \$25,000, the breach would be immoral; only if his reason for breach makes more than a \$25,000 difference would the breach be moral.

³¹ The number of respondents was forty-one. The survey was designed with Michael Simkovic (survey results on file with author).

The survey consisted of four questions, each of which asked about the morality of breach and could be answered as follows: (1) definitely unethical; (2) somewhat unethical; (3) neither ethical nor unethical; (4) somewhat ethical; (5) definitely ethical. I assigned a score of one to definitely unethical, a score of two to somewhat unethical, and so forth. Hence, the lower the score, the less ethical a respondent felt breach would be.

The first question was designed to ascertain whether respondents believe that breach in general is unethical. It was as follows:

Suppose that a Renovator has made a contract to do a kitchen renovation for a Homeowner. The Renovator then discovers that the job would cost him a lot more than he had anticipated because the price of kitchen equipment has risen sharply—so the Renovator would lose money on the job. Is it unethical for the Renovator to break his contract with the Homeowner?³²

Note that the question does not mention whether damages would be paid. The average answer score was 2.41, meaning about midway between somewhat unethical and neither ethical nor unethical.³³ Also, 38 of the 41 respondents found breach unethical or ethically neutral; only 3 of the respondents answered that the breach would be somewhat ethical, and no respondent answered that breach would be definitely ethical.³⁴

The second question differed from the first in that respondents were told that had the parties to the contract discussed the rise in prices, performance would not have been required:

Suppose that a kitchen Renovator has made a contract with a Homeowner and finds that his costs have risen sharply due to an increase in the price of kitchen equipment. Suppose too that *the Renovator and the Homeowner did not discuss this unlikely possibility when they made their contract*. However, the Renovator knows what they *would have* agreed to if they had discussed this possible large cost increase in advance: *They would have agreed that the contract would be canceled if there was a large cost increase—the Renovator would be excused from the contract*. Under these assumptions, is it unethical for the Renovator to break his contract?³⁵

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

The average answer score was 3.0, meaning ethically neutral.³⁶ Also, 17 of the respondents found breach more ethical in this question than they had in the first question; none of the respondents found breach less ethical than in the first question.³⁷

In the third question, the assumption that the respondents were told to make was changed. They were told that had the contracting parties discussed the contingency concerning the rise in prices, the parties would still have wanted performance:

Suppose that a kitchen Renovator has made a contract with a Homeowner and finds that his costs have risen sharply due to an increase in the price of kitchen equipment. Suppose too that *the Renovator and the Homeowner did not discuss this unlikely possibility when they made their contract*. However, the Renovator knows what they *would have* agreed to if they had discussed this possible large cost increase in advance: *They would have agreed that the contract would remain in force despite a large price increase—the Renovator would still have to do the job.*³⁸

The average answer score for this question was 1.56, which is to say, midway between definitely unethical and somewhat unethical.³⁹ All but 3 of the respondents found breach to be somewhat or definitely unethical, and the other 3 considered it ethically neutral.⁴⁰ Further, 31 of the respondents found breach to be less ethical than in the prior question in which the hypothesis was that the parties would have agreed to nonperformance.⁴¹

The fourth question was like the first, except that respondents were told that compensatory damages would be paid for breach:

Suppose that a kitchen Renovator has made a contract with a Homeowner and finds that his costs have risen sharply due to an increase in the price of kitchen equipment. If the kitchen Renovator breaks his contract with the Homeowner, suppose that (as contract law says is required) *he compensates the Homeowner for his losses—*for delay, inconvenience, having to hire another renovator, and so forth. Is it unethical for the Renovator to breach his contract?⁴²

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

The average answer score for this question was 3.56, which is about midway between ethically neutral and somewhat ethical.⁴³

In summary, the individuals participating in the survey found the simple, unqualified fact of breach to be unethical on average (2.41 was the average for the first question).⁴⁴ In other words, the felt reaction to the fact of breach was that it is an unethical act.⁴⁵ However, when individuals were *prompted* by being told what contracting parties would have agreed to had they discussed the particular contingency that arose, individuals tended to change their evaluation of the morality of breach, finding it better or worse in the expected way.⁴⁶ When informed that if the problematic contingency had been discussed, the contracting parties would have agreed that there was no duty to perform, individuals found breach ethically neutral (3.0 was the average for the second question).⁴⁷ When apprised that if the problematic contingency had been discussed, the contracting parties would have said that there was still a duty to perform, individuals found breach to be quite unethical (1.56 was the average score for the third question).⁴⁸ And when told that breach would be accompanied by full damages payments, individuals again changed their opinion of breach, finding it to be somewhat ethical (3.56 was the average score for the fourth question).⁴⁹

IV. THE MORALITY OF BREACH: IN THE VIEWS OF COMMENTATORS

As I noted at the outset, most sources on contract law and legal commentators who have addressed the issue of the morality of breach have considered it to have a generally unethical dimension, or at least have described it as having that character in the opinion of others. These sources include the Restatement of Contracts, authors of hornbooks such as Farnsworth, and prominent contracts scholars such as Atiyah, Barnett, Craswell, Eisenberg, and Fried.⁵⁰ Eisenberg's statement in a recent article is

⁴³ *Id.*

⁴⁴ See *supra* text accompanying notes 33–34.

⁴⁵ Note that this was so even though in the question posed, the circumstance of the Renovator might have evoked some sympathy since the reason for breach was that costs rose (rather than that he decided to take another job). See *supra* text accompanying note 32.

⁴⁶ See *supra* text accompanying notes 35–43.

⁴⁷ See *supra* text accompanying note 36.

⁴⁸ See *supra* text accompanying note 39.

⁴⁹ See *supra* text accompanying note 43.

⁵⁰ See P.S. ATIYAH, PROMISES, MORALS, AND LAW 137 (1981); FARNSWORTH, *supra* note 4, § 12.3 (discussing economic analysis of remedies and commenting that it “leaves no place for notions of the sanctity

representative: "The moral meaning of making a [contractual] promise is to commit yourself to take a given action in the future even if, when the action is due to be taken, all things considered you no longer wish to take it."⁵¹ That is, he believes that a contractual promise has moral valence, so that a breach might be immoral.

These writings do not devote attention to the main point developed here: Because contracts frequently do not provide for the specific contingencies that lead to breach, one usually cannot truly say that an explicit promissory duty was violated when a breach occurred. It is evident that the view of commentators about the morality of breach is similar to the opinion of individuals in general, as represented by the survey results reviewed above.⁵² Namely, the breach of a contract is seen as what it appears to be: a violation of a promise and thus having a morally inappropriate aspect. Perhaps, though, commentators would alter their opinions if they considered the incomplete nature of contracts and that breach tends to occur when an express contractual promise would have allowed nonperformance, just as the surveyed individuals changed their opinions when they were asked about the morality of breach against this background.⁵³

In any event, I will now comment on the views about breach held by Holmes and by law and economics scholars concerned with "efficient breach." Holmes's ideas about breach are often characterized as adumbrating those of economic analysts⁵⁴ because he emphasized the point that when a person without morals, a "bad man," is contemplating breach, his decision would be determined primarily by the prospect of having to pay damages for that act.⁵⁵

of contract and the moral obligation to honor one's promises"); FRIED, *supra* note 2, at 17; Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 296 (1986); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 489-91 (1989); Eisenberg, *supra* note 23, at 1011-13.

⁵¹ Eisenberg, *supra* note 23, at 1012.

⁵² Compare *supra* text accompanying notes 44-49 (summarizing survey results), with *supra* text accompanying notes 50-51 (explaining various commentators' views of morality and breach).

⁵³ See *supra* text accompanying notes 44-49 (summarizing survey results).

⁵⁴ See, e.g., Albert W. Alschuler, *The Descending Trail: Holmes' Path of the Law One Hundred Years Later*, 49 FLA. L. REV. 353, 419 (1997).

⁵⁵ Holmes, *supra* note 5, at 459-60, 462. In particular, he says:

If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.

Id. at 459.

Yet Holmes hardly believed that individuals generally do act without morals, and although he did not squarely address whether breach might be immoral, we have no reason to think that he would not consider it so.⁵⁶ That Holmes asserted that the law gives individuals an option to perform or to pay damages does not imply that he thought breach was an ethically neutral act; he sought to describe the law,⁵⁷ not to evaluate behavior.

Many economically oriented writers on breach of contract have focused on what is called the theory of efficient breach.⁵⁸ An efficient breach is a breach that fosters a utilitarian, aggregate measure of social welfare because the breach would lead to the avoidance of unduly costly performance or would allow the sale of a good to a third party willing to pay more than the promisee.⁵⁹ Writers on efficient breach have observed that breach will tend to be efficient under the expectation measure (since a party contemplating breach will commit it if and only if his benefit would exceed the value of performance to the other side).⁶⁰ These writers often further recommend that as a matter of

⁵⁶ It is clear that Holmes discusses the motivations of the bad man to draw out the direct effect of legal sanctions on behavior. *See id.* As the ending phrase in the quotation of the last note shows, Holmes does this not because he thinks that good men fail to exist. Further, he even states that he does not want a wrong meaning to be taken from his address: "I take it for granted that no hearer of mine will misinterpret what I have to say as the language of cynicism. The law is the witness and external deposit of our moral life The practice of it . . . tends to make good citizens and good men." *Id.*

⁵⁷ Although Holmes's characterization of the law may seem basically sound, some have criticized it. An interesting example is Sir Frederick Pollock, who suggested in a letter to Holmes that the law was not indifferent between breach and performance. Letter from Pollock to Holmes (Sept. 17, 1897), in 1 HOLMES-POLLOCK LETTERS 79-80 (Mark De Wolfe Howe ed., 1941). In Pollock's eyes, why else would the law sanction an individual for inducing another to commit breach? Pollock also pointed out that in the German civil code, specific performance, not damages, is generally the favored remedy for breach, as is true today. *Id.*; *see infra* note 67.

⁵⁸ Robert L. Birmingham introduced this theory in *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284-85 (1970). The theory has been developed and explicated by, among others, Charles J. Goetz and Robert E. Scott in *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), and by Richard Posner in the various editions of his textbook, the latest being *ECONOMIC ANALYSIS OF LAW* 118-26 (6th ed. 2003). The theory is now widely recognized (but usually at most partially endorsed) within the legal community, as is evidenced, for example, by its mention in *RESTATEMENT (SECOND) OF CONTRACTS, Introductory Note to ch. 16* (1981). One should note, however, that most economic analysis of contracts published in economics journals asks not about the social desirability of damage measures, but rather about the desirability of damage measures for the contracting parties themselves. *See, for example*, Shavell, *supra* note 7, and much of the literature discussed in PATRICK BOLTON & MATHIAS DEWATRIPONT, *CONTRACT THEORY* chs. 11-13 (2005).

⁵⁹ *See, e.g.*, POSNER, *supra* note 58, at 118-26.

⁶⁰ *Id.*

actual policy, breach should be encouraged when it is efficient, even though the role of morality is not analyzed by them.⁶¹

How does the theory of efficient breach relate to what has been said in this Essay? Two points should be made: First, because damages are likely to be less than the true expectation, as stressed here, it is not clear that breach will in fact tend to be efficient. Thus, it is not evident that contracting parties should be encouraged to commit breach whenever they are willing to pay damages, according to the social welfare criterion of efficient breach theory.

Second, when efficient breach does occur, it coincides with the terms of completely detailed contractual promises and thus should not be seen as immoral (given my definition of moral behavior). This conclusion has nothing directly to do with promoting a utilitarian measure of social welfare, though, and thus might be regarded as a kind of coincidence. As the reader recalls, the conclusion flows from the logic explaining the nature of the contract that the parties themselves would want (they might not give two straws for social welfare).⁶² I will remark in the Conclusion, however, on the efficient breach theorists' normative recommendations about breach behavior, assuming that the damage measure is equal to the expectation. My analysis so far does not allow me to do this, for I have not discussed social welfare.⁶³

CONCLUSION

I would like to comment on the implications of this Essay for the general normative thrust of the writing of both efficient breach theorists and traditional commentators concerned with the morality of breach. I will assume that the social objective is to promote a measure of social welfare based on individuals' utilities. In particular, then, our moral feelings will have a direct effect on

⁶¹ See, e.g., Birmingham, *supra* note 58, at 284 ("Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered."); see also RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 57 (1st ed. 1972) ("If his profit from breach would also exceed the expected profit to the other party from completion of the contract, and if damages are limited to loss of expected profit, there will be an incentive to commit a breach. There should be.").

⁶² The argument in Part I leading to the conclusion that performance would be specified in a contingency if and only if the cost of performance is less than the value of performance, rested on how much the buyer would pay and on how much the seller would demand for a provision requiring performance.

⁶³ Although the subject of this Essay has been the morality of breach, which concerns normative statements (such as "you ought not to commit breach because that would be wrong"), and I have defined and considered a definition of moral behavior, I have not said how the morality of behavior enters into social welfare, which is by definition the criterion to be employed for social evaluation.

social welfare because they are themselves components of individuals' utilities,⁶⁴ and they will also exert an indirect influence on social welfare because they provide incentives toward socially desirable behavior.

An important normative aspect of many commentators' writings on breach is their moral advice. Their writing often suggests that individuals ought to feel a general ethical duty to obey contracts, that is, a desire to obey contracts above and beyond that due only to having to pay damages for breach. If we could influence individuals' moral feelings, would we want individuals to put a thumb on the scale in favor of contract performance? The answer suggested by the analysis here is that we would not want individuals *always* to do so, but we would want that done *when necessary*, to make up for the slack due to inadequate damages. In other words, according to a perfectly calibrated and flexible moral system, the moral sentiments would come into play if and only if they are needed to correct the too-great incentive of a "bad man" to commit breach when the personal benefit from breach would exceed damages but not the true value of the expectancy. Note that this ideal moral system is consistent with the spirit of traditional commentators' advice, whereas it is inconsistent with the spirit of efficient breach theory, in that morality has a useful role to play. Still, the ideal moral system is inconsistent with the advice of traditional commentators and is consonant with efficient breach theory, in the sense that ideal moral forces would not discourage breach when breach would be efficient.

The actual moral system, however, is not as flexible as the ideal one. Moral impulses probably cannot be freely tailored to turn on for this kind of contract breach and to turn off for that one.⁶⁵ If so, the price that we have to pay for having the fairly general and socially valuable moral idea that breaking contracts is undesirable is that that view will be applied by us in some circumstances where breach is efficient. This in turn will mean that some desirable breaches will not be committed owing to the moral discomfort that they would entail and that other desirable breaches will be committed despite the discomfort that they will entail (this discomfort will, unfortunately, lower social welfare). Further, the implications for moral advice about breach

⁶⁴ For example, an individual's utility will decrease if he or she experiences guilt for violating a moral duty.

⁶⁵ Many have argued thus, as well as that moral views ought not to be too qualified (lest they be subverted by opportunistic interpretation). See, e.g., RICHARD B. BRANDT, *A THEORY OF THE GOOD AND THE RIGHT* chs. 9, 11 (1979); Jonathan Baron, *Normative, Descriptive and Prescriptive Responses*, 17 *BEHAV. & BRAIN SCI.* 32, 32-33 (1994); R. M. Hare, *Principles*, 73 *PROC. OF THE ARISTOTELIAN SOC'Y* 1, 10 (1973).

become complicated, for when giving moral advice, we have to consider the degree to which the advice will be understood as special to the circumstances of the breach or as having a more general effect, and thus entailing the implicit disadvantages just mentioned.

Closely related to their moral advice to contracting parties is commentators' advice about the law, namely, that the moral desirability of satisfying contractual promises argues for legal policy that fosters performance. Some have said, for example, that the scope of specific performance should be expanded for moral reasons among others.⁶⁶ A striking instance of such thinking is that underlying the approach of the German Civil Code to contract performance, according to which the general remedy for breach is supposed to be specific performance.⁶⁷ Of course, the theme of this Essay has been that contracts are to an important extent incomplete promises and that the morality of promise keeping does not imply that performance should always occur. Yet, I have noted that damages seem to be systematically less than the true expectation measure. The import of these observations for legal policy is not clear. Damages are inadequate because it is time consuming and expensive for the legal system to resolve what would often be contentious proceedings about subjective elements of loss from breach. It may be that our legal system works better avoiding the costs of ascertaining these problematic elements of loss, by relying on moral forces, such as they are, to fill the gap in inducing appropriate performance. In any event, the belief that there is a clear and overarching moral reason to alter contract law to enhance the keeping of contracts appears to be the product of an oversimplified view of moral sentiments and of a related failure to take into account the importance of the incompleteness of contracts.

⁶⁶ See, e.g., Randy E. Barnett, *Contract Remedies and Inalienable Rights*, 4 SOC. PHIL. & POL'Y 179, 195-201 (1986).

⁶⁷ See, e.g., KONRAD ZWIEGERT & HEIN KÖTZ, *AN INTRODUCTION TO COMPARATIVE LAW* 472-74, 483-85 (Tony Weir trans., 3d rev. ed. 1998). As this reference makes clear, however, specific performance is more aspirational than real in Germany since, in fact, victims of breach can elect damages and usually do so.