

When is a Willful Breach 'Willful'?

The Link Between Definitions and Damages

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Liability for breach of contract is often described as a form of strict liability, in which the measure of damages is unaffected by the culpability of the breach. However, courts sometimes do award higher damages, under various legal doctrines, if the behavior of the breacher seems especially culpable.¹ When they do, they may describe the breacher's behavior using labels such as *willfully*, or *in bad faith*, or *fraudulently*, or *maliciously* – or, as Dickens once put it, 'otherwise evil-adverbiously.'²

Unfortunately, labels like these are not self-defining. Over fifty years ago, Corbin was scathingly critical of their use:

The word most commonly used is 'wilful' [*sic*]; and it is seldom accompanied by any discussion of its meaning or classification of the cases that should fall within it. Its use indicates a childlike faith in the existence of a plain and obvious line between the good and the bad, between unfortunate virtue and unforgivable sin.³

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1. For a survey of the relevant doctrines, see Patricia Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 Ariz. L. Rev. 733 (1982).

2. Charles Dickens, *A Tale of Two Cities* [1859] 93 (Viking Penguin ed., 1970).

3. Arthur Linton Corbin, 5 *Corbin on Contracts* 545 (1951). As this passage

In this paper, I make three claims. First, I argue that willful breaches cannot be defined merely by reference to the breacher's mental state, and that (as a result) the existing literature on willful breach lacks an adequate definition of 'willful'. Second, I argue that any definition of 'willful' we adopt will have important implications for just how high damages should be raised in those cases where a breach qualifies as willful, so that both of these issues – the definition of 'willful', and the measure of damages for willful breach – should be considered simultaneously. Third, I argue that these issues also require consideration of the fact-finding demands that each choice would place on courts.

I. Defining a 'willful' breach

I begin with the problem of defining 'willful'. One natural interpretation of that term links it to the defendant's mental state: willful breaches are knowing or intentional breaches.⁴

The problem is that adjectives like 'knowing' and 'intentional' (and their adverb forms, 'knowingly' and 'intentionally') are most easily applied to specific actions. A breach, by contrast, is not an action but a state of affairs. If I promise to deliver widgets to you by next Tuesday, then I am in breach if Tuesday arrives and you have no widgets, but your being widgetless on Tuesday is not itself an action. Your widgetless state may be the *result* of an action, of course; but typically it is the result of a whole sequence of actions:

demonstrates, we do not even have any consensus on spelling: 'willful' and 'wilful' are both common.

4. E.g., Marschall, *supra* note 1, at 733 (defining a willful breach as 'a knowing breach by a party not legally excused from performing, which is made for any primary purpose other than to confer a benefit on the aggrieved party'). For a similar definition, see William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 Duke L.J. 629, 651–52 (1999).

of all the things that were done (or not done) in the days leading up to Tuesday. Thus, before we can apply tests like ‘knowingly’ or ‘intentionally’, we need to know the individual actions in that sequence to which those terms should be applied.

To illustrate, consider two staples of the contracts curriculum: *Jacob & Youngs, Inc. v. Kent*,⁵ and *Peevyhouse v. Garland Coal & Mining Co.*⁶ In *Kent*, a builder promised to use a particular brand of pipe to build a house; in *Peevyhouse*, a mining company promised to make certain repairs to the land after they finished mining the coal. The builder in *Kent* used the wrong brand of pipe, apparently by accident; but the mining company in *Peevyhouse* decided the promised repairs would cost too much, so it simply refused to make the repairs. Described in this way, *Peevyhouse* sounds deliberate or willful, while the breach in *Kent* sounds accidental.⁷

However, *Kent* can be characterized as a willful breach if we focus on other events in the sequence. After all, as soon as the builder discovered his mistake, he could have torn the house down and started over, this time using the right brand of pipe. (Much of the pipe was in the interior walls and foundations, and so could not be replaced without demolishing the house.) The builder chose not to do this, for demolishing the house would have been extremely expensive, but there is no question that this choice – the choice not to demolish the house – was deliberate. Thus, if the intentionality of *this* part of the sequence is what matters,

5. 129 N.E. 889 (N.Y. 1921).

6. 382 P.2d 109 (Okla. 1962).

7. Consistent with this intuition, Marschall discusses *Peevyhouse* as a ‘willful’ breach, and appears to treat *Kent* as non-willful. Marschall, *supra* note 1, at 750–51 (discussing *Peevyhouse*), 743 (discussing *Kent*) (1982). *Peevyhouse* is also assumed to be a ‘deliberate’ breach in Lucian Arye Bebchuk & I.P.L. Png, *Damage Measures for Inadvertent Breach of Contract*, 19 Int’l Rev. L. & Econ. 319, 319–20 (1999).

Kent must be classified with *Peevyhouse* as a deliberate or willful breach.⁸ Granted, we can avoid this characterization of *Kent* if we focus instead on the builder's earlier, unintentional mistake about what brand of pipe was being installed. But why should the intentionality of *that* event control our characterization of the breach, rather than the intentionality of the subsequent decision not to tear down the house and start over?

Indeed, if we are free to pick and choose which decision to focus on, the breach in *Peevyhouse* was not necessarily willful. True, the coal company deliberately chose not to repair the land once they learned how much it would cost to do so. At least on one reading of the facts, though, the coal company originally thought there was sufficient coal sufficiently near the surface that the promised repairs would have been relatively easy. As it turned out, the coal was deeper and less plentiful, and this made the repairs more expensive than they might have been.⁹ Thus, if we focus on the coal company's mistake about the coal, that event in the sequence looks just as involuntary as the builder's mistake about the pipe. And if the answer is, 'the coal company should have known there was a risk it might be mistaken,' why not say that the builder should also have known there was a risk it might get the brand of pipe wrong?

The problem here is fundamental. In the vast majority of cases, the parties to a contract do not intend to breach at the time they signed it. Instead, they hope the contract will be performed as

8. The only commentator I have found who even mentions this similarity between *Peevyhouse* and *Kent* is Carol Chomsky, *Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts*, 75 Minn. L. Rev. 1445, 1449–50 (1991).

9. Judith L. Maute, *Peevyhouse v. Garland Coal & Mining Co. Revisited: The Ballad of Willie and Lucille*, 89 Nw. U. L. Rev. 1341, 1368–69, 1419–24 (1995).

planned, but then something else happens. Costs go up, or a better offer is found elsewhere, or work is performed incorrectly, and what originally looked like a good deal becomes less appealing to one party. Sometimes that party grits her teeth and performs anyway, but the litigated cases are those in which she decides she will not go through with the deal. If we look at the entire sequence of the defendant's decisions, there will almost always be some that were deliberate, thus potentially allowing us to classify the breach as willful. But there will also usually be some events that were not deliberate – the increase in costs, or the work that was done incorrectly, or the better offer that came along at the last minute – so if we focus on *that* event, we will classify the breach as resulting from an unintentional decision.

Indeed, even when breaches were in some sense intended from the beginning, we can always (if we try) find nondeliberate events that played a role. Consider a sleazy aluminum siding company that lures customers in by quoting a very low price, planning all along to take their down payment and disappear.¹⁰ While this sounds like the quintessential example of a deliberate breach, consider that even this company might have lived up to its contract if, after the contract was signed, an eccentric millionaire had unexpectedly offered it a reward for completing the job. Thus, even this breach can be described as resulting from a sequence of two events: an earlier event that was beyond the siding company's control (the failure of any millionaire to offer a reward); followed by a later, deliberate decision about how to respond to that event (the decision not to install the siding). Focusing on the second of

10. In recent work, Ayres and Klass refer to this as an 'insincere promise.' Ian Ayres & Gregory Klass, *Insincere Promises: The Law of Misrepresented Intent* (2005). See also George M. Cohen, *The Fault Lines in Contract Damages*, 80 Va. L. Rev. 1225, 1252–1256 (1994).

these events makes the breach seem deliberate – but if we focus instead on the first event, it is hard to distinguish this example in any formal way from cases like *Kent* or *Peevyhouse*.

Of course, quibbles like these do not stop most of us from condemning the siding company's breach as 'willful', even if we cannot articulate a formal definition of that term. Apparently, in some cases (like my aluminum siding example) we naturally select the breacher's deliberate decisions to focus on, and we see the resulting breach as willful. In other cases (*Kent?*), we decide to focus instead on the chance event or the mistake, and see the the breach as accidental. Often, these choices are made without our being consciously aware of them – though behavioral researchers are beginning to investigate these choices more systematically, as I discuss below in section I.B.

A. Analogies in criminal law

Viewed in these terms, the problem is not unique to contract law. A close analogy can be found in criminal law, in cases where it matters whether the defendant acted 'voluntarily,' and where the application of that label may depend on our choice to focus on earlier or later events in the sequence that led up to a crime. For example, a badly intoxicated driver may be literally unable to control her car, so if we focus entirely on her actions while she is behind the wheel, the resulting crash will seem involuntary. But if we look instead at her earlier decisions (made while she was sober) to drive to a party where she intended to drink, and to do so without making any arrangements for a designated driver, *those* decisions makes the accident seem more the result of a voluntary choice.¹¹

11. For a useful discussion of this issue in criminal law, see Mark Kelman,

Criminal law must also deal with the problem of conditional intentions, in cases where statutes impose longer sentences for crimes committed with a particular intent. For example, if a prison inmate takes a hostage and threatens to kill her *unless he is released from prison*, does this make the inmate guilty of assault ‘with intent to kill’? Or is he guilty only of ordinary assault, since he did not intend unconditionally to kill the hostage, and probably hoped he would not have to kill her?¹² This problem is at least somewhat similar to trying to decide whether a breach of contract was intentional if the contractor intended to perform *unless it turned out to be too expensive*, or if the aluminum siding company intended to breach *unless a millionaire offered to reward it for performing*. And while criminal law scholars have not agreed on any general solution to this problem, they do agree that characterizing a conditional intent is not simply a matter of discovering some fact about what the defendant was actually thinking.¹³

B. Lay assessments of culpability

Rather than looking for solutions in the theories of scholars, we

Interpretive Construction in the Substantive Criminal Law, 33 Stan. L. Rev. 591, 600–611 (1981). For an example of a closely analogous problem in contract law, compare *Commercial Discount Co. v. Town of Plainfield*, 180 A. 311, 313 (Conn. 1935) (decision by contractor to stop working, when the contractor was in severe financial difficulties and was simply unable to pay its workers, held not to be a ‘willful’ breach), with *Billingsmeier v. Concorde Marketing, Inc.*, 2001 WL 1,530,356 (Minn. App. 2001) (breach triggered by defendant’s financial difficulties held to be ‘willful’ when the financial difficulties themselves were caused by the defendant’s wrongful behavior).

12. Cf. *State v. Irwin*, 285 S.E.2d 345 (N.C. Ct. App. 1982) (reducing the charge to simple assault without intent to kill).

13. For a recent review of the controversy, see Gideon Yaffe, *Conditional Intent and Mens Rea*, 10 Leg. Theory 273 (2004).

might instead look to laypeople's intuitive judgments about which actions they characterize as 'intentional.' As I noted earlier, few observers would hesitate to condemn my aluminum siding company as a willful breacher, even after they understand that the company would have been perfectly willing to perform if only a millionaire had offered them a bribe. I can also report that my first-year contracts students regularly (and, in most years, nearly unanimously) consider the breach in *Peevyhouse* to be an intentional breach, but do not apply that label to the breach in *Kent*.

Behavioral researchers have recently begun to study laypeople's assessments of culpability when contracts are broken. While those studies have not focused specifically on terms like 'willful,' some of their findings are nevertheless of interest. For example, in one survey, lay subjects were asked to assess brief descriptions of hypothetical cases in which the breaching firm broke its contract either (a) to earn greater profits, when a better-paying opportunity arose elsewhere, or (b) to avoid suffering a loss, when the firm's costs of performance increased. Consistent with other work on heuristic distinctions between gains and losses, the subjects systematically tended to judge the first kind of breach as the more culpable.¹⁴ Other studies – though not focusing on breach of contract in particular – found that subjects' willingness to describe any given outcome as 'intentional' varied depending on whether they were judging the intentionality of normatively desirable behavior, where they might be concerned with assigning credit; or whether they were

14. Tess Wilkinson-Ryan & Jonathan Baron, *Moral Judgment and Moral Heuristics in Breach of Contract*, J. Empirical Legal Stud. (forthcoming). Interestingly, in describing their results the authors at one point use the term 'willful' to characterize the first kind of breach (breach to gain greater profits) but not the second kind (breach to avoid incurring losses). Id., mss at page 21.

judging the intentionality of normatively undesirable behavior, where they might be concerned with assigning blame.¹⁵

While this research is promising, it is subject to several limits. For one thing, the research is still at an early stage, so the patterns (if any) in lay judgments about breach are still unclear.¹⁶ Moreover, even if we could identify precisely which breaches most lay observers considered culpable, we would still have to decide whether those lay judgments about culpability ought to be endorsed and embodied in the law, or whether they should instead be considered ‘heuristic errors’ that the law should reject or try to overcome.¹⁷ Obviously, the answer will depend in part on why we want to single out willful breaches for extra punishment.

In this paper, though, I take no position on the question of *why* we might want to single out certain breaches for extra punishment. There are of course standard economic arguments for doing

15. For surveys of this literature, see Joshua Knobe, *The Concept of Intentional Action: A Case Study in the Uses of Folk Psychology*, 130 *Philosophical Studies* 203 (2006); Alfred R. Mele, *Intentional Action: Controversies, Data, and Core Hypotheses*, 16 *Philosophical Psychology* 325 (2003).

16. For another recent survey, also containing some intriguing results, see Steven Shavell, *Is Breach of Contract Immoral?* 56 *Emory L.J.* 439 (2006). An earlier survey, though one less useful for present purposes, can be found in David Baumer & Patricia Marschall, *Willful Breach of Contract for the Sale of Goods: Can the Bane of Business be an Economic Bonanza?* 65 *Temple L. Rev.* 159 (1992). Baumer and Marschall’s questionnaire explicitly told respondents that the hypothetical breach was ‘deliberate’ and ‘willful’ (id. at 184), so their survey sheds no light on the question of when respondents themselves would use those labels.

17. Wilkinson-Ryan and Baron (supra note 14) are properly cautious on this point. For varying views on the potential moral and legal relevance of lay heuristics generally, see, e.g., Cass Sunstein, *Moral Heuristics*, 28 *Behav. & Brain Sciences* 531 (2005); John Mikhail, *Moral Heuristics or Moral Competence? Reflections on Sunstein*, 28 *Behav. & Brain Sciences* 557 (2005).

so, based mostly on the need for additional deterrence if ordinary damages are too low;¹⁸ and there are also standard non-economic or moral arguments for extra punishment.¹⁹ Rather than engage in either of those debates, in this paper I simply posit that we have already decided (for some reason) that penalties ought to be higher for at least some breaches.

C. Two ways of defining ‘willful’

I do this in order to focus on the choice between two different *methods* of raising damages, involving two different definitions of ‘willful’. As I discuss below, these two methods correspond loosely to the difference between negligence and strict liability in tort law. The first method, corresponding to negligence, is one in which the only breaches that qualify as willful – and, hence, the only breaches that are subject to extra damages – are those where the breacher behaved inefficiently in some way. The second method, corresponding to strict liability, is one in which even breachers who behaved efficiently can be found to have committed a willful breach.

Obviously, the first method (the one corresponding to negligence) requires courts to be able to tell whether a breacher behaved inefficiently, so in that respect the first method is more demanding of courts. However, the second method (the one corresponding to strict liability) requires courts to calibrate the amount of the higher damages more precisely, so in that respect

18. E.g., Bruce Chapman & Michael Trebilcock, *Punitive Damages: Divergence in Search of a Rationale*, 40 Ala. L. Rev. 741, 805–08 (1989). For a more recent example, see Oren Bar-Gill & Omri Ben-Shahar, *An Information Theory of Willful Breach* [this volume].

19. E.g., Chapman & Trebilcock, *supra* note 18, at 779–86; Seana Valentine Shiffrin, *Why Breach of Contract may be Immoral* [this volume].

the second method is more demanding. Table 1 summarizes these differences.

Table 1: Demands placed on the courts

| Definition of 'willful' | Evaluate the breacher's efficiency | Calibrate the extra damages precisely |
|-------------------------|------------------------------------|---------------------------------------|
| Negligence | Yes | Less |
| Strict Liability | No | More |

II. The analogy to negligence

A. Defining a negligence regime

Consider first a legal regime in which the label 'willful' is applied, and higher damages are awarded, only when the breacher behaved inefficiently in some way. Under this regime, breachers who behaved efficiently would still be liable for ordinary contract damages, whatever ordinary damages are taken to be. In that respect, it differs from negligence regimes in tort law, where defendants who are not negligent pay no damages at all. But the regime I describe is still *analogous* to a negligence regime in torts, in that (1) it requires courts to evaluate the defendant's behavior, and (2) defendants whose behavior is found wanting are then subjected to harsher legal consequences. In this case, the harsher consequence is that defendants who are found to have behaved inefficiently must pay the *extra* measure of damages charged against willful breachers.

More specifically, a negligence regime (as I use the term here) depends on the law as it is actually applied, not on its black-letter doctrine. For example, even if the law were to explicitly define ‘willful’ to mean ‘resulting from inefficient behavior’, that would not qualify as a negligence regime unless it actually succeeded, in practice, in imposing extra damages only on those breachers who behaved inefficiently. As will become clear below, the economic effects of any definition depend on what courts actually *do*, not on what black-letter doctrine says they do.

I should also clarify that, when I speak of breachers behaving inefficiently, I intend to include more than just inefficient breach. In *Kent*, the builder’s final decision not to rebuild the house (once the mistake with the pipe was discovered) probably was not inefficient, as the value to the buyer of replacing the pipe was surely less than the high cost of doing so. But even if that decision was efficient, the builder might still have made an inefficient decision at an earlier stage – for example, when it decided how many precautions to take in checking each shipment of pipe. A regime that imposed extra damages on builders who made an inefficient decision at the precaution stage would still be a negligence regime, as I use that term.

Indeed, since most breaches result from an entire sequence of events, there are usually any number of decisions that might have been inefficient. In some cases, the charge might be that the breacher had failed to efficiently investigate the potential risks before agreeing to perform the contract.²⁰ In others, a breacher

20. For a mathematical model of the efficient level of investigation, see Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. Legal Stud. 401 (1988). For a prose analysis, asserting a different conclusion about the measure of damages that would create optimal incentives to investigate, see Cohen, *supra* note 10, at 1245–1246.

who had adequately investigated the risks might nevertheless be accused of failing to disclose those risks to its contracting partner, if circumstances would have made such disclosures efficient.²¹ If the risk of not being able to perform was sufficiently high (as in my aluminum siding example), and if that risk was not adequately disclosed to the other party, it might then be argued that it was inefficient for the breacher to offer the contract in the first place.²² Inefficiencies might also be alleged with respect to the breacher's litigation behavior, if (for example) the breacher raised frivolous legal claims whose likelihood of success was too low to justify the costs of litigating them.²³

In short, there are many possible ways in which any given breacher *might* have behaved inefficiently. A negligence regime, as I use that term, is one in which the only breaches that are deemed willful (in actual practice) are ones in which the breacher behaved inefficiently in one or more of these ways.

B. 'Willful' as a test for inefficiency?

It might seem unlikely that any test for willfulness could ever correspond (in actual practice) to a judgment about the inefficiency of the breacher's conduct. However, as long as the law has not resolved the definitional problems discussed in part 1, it is difficult to rule out *any* of the possible ways in which a willfulness test might be applied. For example, it would not be implausible if a breach like the one in *Kent* was especially likely to strike jurors

21. I discuss the potential costs and benefits of disclosing additional information in Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 Va. L. Rev. 565 (2006).

22. For a more detailed analysis, see Ayres & Klass, *supra* note 10, at 31-42.

23. Cf. the allegations of 'bad faith breach' in *Seaman's Direct Buying Serv. v. Standard Oil Co.*, 686 P.2d 1158, 1167 (1984).

as willful if the mistake with the pipe resulted from the builder's choice to take an inefficiently low level of precautions in inspecting each pipe delivery.²⁴ If jurors were less inclined to find willfulness in a case where the builder took efficient precautions and merely got unlucky, that tendency would move the law in the direction of a negligence regime.

On the other hand, even if a legal test for culpability were explicitly defined in terms of the inefficiency of the breacher's behavior, these same definitional problems might make it hard to know how that test was actually applied. Consider the following definition of 'opportunistic' breaches, from a Seventh Circuit case in which punitive damages had been sought:

Not all breaches of contract are involuntary or otherwise efficient. Some are opportunistic; the promisor wants the benefit of the bargain without bearing the agreed-upon cost, and exploits the inadequacies of purely compensatory remedies²⁵

24. The dissenting judge in *Kent*, who would have awarded higher damages, seems to have held something close to this view, for he described that breach as 'either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing' *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 892 (N.Y. 1921) (McLaughlin, J., dissenting). For a similar view, see Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract* [this volume]. Unfortunately, neither Judge McLaughlin nor Professor Scott discusses the costs or the likely benefits of additional precautions, and this makes it hard to judge whether a higher level of precautions would in fact have been efficient.

25. *Patton v. Mid-Continent Systems, Inc.*, 841 F.2d 742, 751 (7th Cir. 1988) (Posner, Circ. J.). A somewhat similar definition has been proposed in the draft of the Restatement (Third) of Restitution and Unjust Enrichment §39 (American Law Institute, 2008). However, that section does not contain any explicit suggestion that efficient breaches could not be opportunistic, and its proposed comment *i* strongly suggests the opposite.

This passage contrasts ‘opportunistic’ with ‘efficient’, suggesting (perhaps) that efficient breaches should never be labeled opportunistic. But the passage also says that opportunistic breaches exploit the inadequacies of normal contract damages, and the word ‘exploit’ is itself difficult to define. Suppose, for example, that ordinary contract damages are inadequate in a particular case; but suppose that the breacher behaved efficiently in every possible respect. Is this efficient breacher nevertheless ‘exploiting’ the inadequacy of ordinary damages, since she is getting away without paying the full costs of her breach? Or is she not really exploiting that inadequacy at all, because by behaving efficiently she has acted exactly as she would have acted even if ordinary damages had been adequate?²⁶

C. The demands that negligence makes of courts

Obviously, it will often be difficult for courts to evaluate the efficiency of the breacher’s decisions. Indeed, this difficulty is closely akin to the difficulty of evaluating a tortfeasor’s decisions in a typical negligence case, which is why I have borrowed the ‘negligence’ label.

At the same time, though, negligence regimes may be less demanding of courts with respect to the exact amount of the higher damages that are assessed, in those cases where the breacher is found to have behaved inefficiently and the breach is deemed willful. To be sure, the exact size of the award is not completely irrelevant under negligence, for it is important that

26. Note, too, that the quoted passage also contrasts opportunistic breaches with ‘involuntary’ breaches. Defining a *voluntary* breach raises the same problems already discussed in connection with tests like ‘intentional’ or ‘knowing’, since most breaches result from a sequence consisting of both voluntary and involuntary events.

the damages be high enough to deter the inefficient behavior. But as long as the damages exceed that minimum, they can (in theory) be raised to any arbitrarily high level—we can ‘throw the book at’ the inefficient breachers, as Richard Posner has suggested²⁷—without producing overdeterrence or any other adverse economic effects. This is because negligence rules, if they are accurately applied, offer a safe harbor for efficient breachers: as long as the breacher is confident that she has behaved efficiently in every respect, she should never have to worry about liability for extra damages. As a result, those extra damages can be set at any arbitrarily high level without inducing efficient breachers to further alter their behavior or their prices. While this feature of negligence rules has not been emphasized in the contracts literature, the same point has often been made in connection with tort law.²⁸

The catch, however, is that courts have to be able to identify efficient behavior *perfectly* in order to avoid any adverse effects from arbitrarily high damage awards. Moreover, it is not enough if courts are always able to make perfect decisions with hindsight, after a case has come to trial. To avoid adverse effects, potential defendants must be able to know in advance what kind of behavior will be judged inefficient by the courts, and hence subjected to larger penalties. Such certainty is difficult to achieve in the real world, especially if the legal criteria for higher damages are defined in such vague terms as willful.²⁹

27. Richard A. Posner, *The Economic Analysis of Law* 119 (7th ed 2007).

28. See especially Robert Cooter, *Prices and Sanctions*, 84 Colum. L. Rev. 1523 (1984). For discussions of the analogous point in connection with punitive damages, see Chapman & Trebilcock, *supra* note 18, at 806–808; Keith N. Hylton, *Punitive Damages and the Economic Theory of Penalties*, 87 Geo. L.J. 421 (1998).

29. For similar concerns, see Mark Gergen, *A Cautionary Tale About*

III. The analogy to strict liability

Accordingly, I turn now to regimes in which even breachers who behave efficiently still face some risk that their breaches will be deemed willful, and that they will be made to pay extra damages. As before, the key for my purposes is how such a regime is applied in practice, not what formal label the law adopts. Thus, I include here not just regimes that explicitly define ‘willful’ in a way that applies to efficient breachers, but also regimes that purport to adopt a narrower standard but whose judges or juries apply that standard inaccurately in some cases, so that efficient breachers are sometimes erroneously subjected to higher damages. In this sense, my classification is meant to be all-inclusive: any regime that does not qualify as a negligence regime (as defined in the previous section) will qualify as a strict liability regime.

Obviously, strict liability regimes reduce the demands on courts in one respect, since courts need no longer be accurate in evaluating the efficiency of the breacher’s behavior. Indeed, strict liability regimes can (in theory) dispense with the need for any evaluation whatsoever of the efficiency of the breacher’s behavior. To be sure, these regimes will still have to decide on some other grounds whether the breacher’s behavior was willful (since it is only willful breaches that are subjected to the extra damages), and what that entails will depend on what definition of ‘willful’ the law adopts. Still, as long as that definition does not require

Contractual Good Faith in Texas, 72 Tex. L. Rev. 1235, 1258 (1994), Nicholas J. Johnson, *The Boundaries of Extracompensatory Relief for Abusive Breach of Contract*, 33 Conn. L. Rev. 181, 197 (2000), Barry Perlstein, *Crossing the Contract-Tort Boundary: An Economic Argument for the Imposition of Extracompensatory Damages for Opportunistic Breach of Contract*, 58 Brook. L. Rev. 877, 889–990 (1992), Alan O. Sykes, ‘Bad Faith’ Breach of Contract by First-Party Insurers, 25 J. Legal Stud. 405, 438–39 (1996).

courts to evaluate the efficiency of the breacher's behavior (as I am assuming now), that will ease courts' task in one respect.

On the other hand, strict liability regimes increase the demands on courts with respect to the exact amount of the higher damage awards, for it now becomes important that the damage awards be neither too low *nor too high*. Damages that are too high are not a concern under negligence regimes, because efficient breachers would never have to pay those damages anyway.³⁰ But strict liability regimes (by definition) take away this safe harbor for breachers who behave efficiently, with the result that any increase in the higher damage awards will affect the behavior of even efficient breachers. To be sure, this effect on breachers might be good if the normal contract damages would otherwise be too low, and if the higher awards merely move the total damages closer to whatever level is optimal. But if the higher awards go *too high* – more precisely, if they go beyond the level of damages that is optimal, in a sense that I define below – then a strict liability regime must worry that the larger awards will cause breachers to modify their behavior excessively. This can lead to overdeterrence, higher prices, and other undesirable effects.

A. The cost of excessive awards under strict liability

This last point may require further explanation, for writers who are not trained in economics sometimes assume that the only economic argument against large damage remedies is that they would deter efficient breaches.³¹ Some writers then note (correctly) that the threat of large awards should not block an efficient breach if the parties can renegotiate, for if performance is truly inefficient

30. See the text *supra* preceding note 28.

31. See, e.g., E. Allan Farnsworth, 3 *Farnsworth on Contracts* 290 (2d ed. 1998); Marschall, *supra* note 1, at 736–38.

then the potential breacher should always be able to buy her way out of the contract. They conclude, as a result, that there should be no economic objection to higher damage awards as long as renegotiation costs are low.³²

What this analysis misses, however, is that the threat of higher damages will raise the price the potential breacher must pay in any subsequent renegotiation, and this can have further efficiency effects.³³ At a minimum, it makes such contracts less attractive to some parties – for example, builders will then face the risk of having to make a larger payment if and when they make a serious mistake, so they will probably have to raise the price of their houses to cover that increased liability risk. Builders may also take extra precautions to reduce the risk of making a mistake – for example, a builder may now find it worthwhile to instruct two employees rather than one to double-check every shipment of pipe – if a mistake will now put them in the position of having to make an even larger payment, because of the threat of larger damage awards.³⁴ To be sure, these may be good effects rather than bad ones, for there is some value (up to a point) in having builders take precautions. At some point, though, if the threatened payment becomes large enough, the builder will have an incentive to take too many precautions, so the legal rule will produce costs rather than benefits. In short, strict liability can produce good effects if damages are increased up to the optimal level, but no further.³⁵

32. E.g., Marschall, *supra* note 1, at 737–39; Dodge, *supra* note 4, at 663–87.

33. For a more detailed discussion of these effects, see Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 *So. Cal. L. Rev.* 629 (1988).

34. *Id.* at 646–650; Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 *Calif. L. Rev.* 1 (1985).

35. Cooter, *supra* note 28, at 1532–1537.

More precisely, in a strict liability regime it will not matter if damage awards are randomly too high or too low, so long as the average or expected value of those awards is at the optimal level.³⁶ But a regime of strict liability does require that the *expected* damage award be optimal, in order to give potential breachers just the right incentives to modify their behavior. Thus, when it comes to the exact measure of damages that is assessed against willful breachers, strict liability regimes make greater demands on courts than negligence regimes do.

B. Optimal damages under strict liability

In response, it is sometimes suggested that determining the optimal damage measure (under strict liability) must be easier than judging the efficiency of the breacher's behavior (under negligence).³⁷ After all, if the optimal damage award is exactly compensatory, we can calculate it by knowing only the *costs* inflicted by the breacher's behavior, but to evaluate the actual efficiency of the breacher's behavior, we usually need to know both its costs and its *benefits*. However, there are many cases in which the optimal damage award will *not* be exactly compensatory, so calculating the optimal award will require courts to know more than just the amount of the non-breacher's loss.

For example, if the non-breacher has more control over some aspects of the loss, either by mitigating damages after the breach or by taking precautions of his own beforehand, it could be better to award a smaller amount in order to improve the non-breacher's incentives to control those losses efficiently.³⁸ Smaller awards

36. Louis Kaplow & Steven Shavell, *Accuracy in Measuring Damages*, 39 J.L. & Econ. 191, 194 (1996).

37. See, e.g., Steven Shavell, *Economic Analysis of Accident Law* 9 (1987).

38. A similar point is made by Ayres & Klass, *supra* note 10, at 71–74 and

might also be more efficient if the non-breacher is less risk-averse than the breacher,³⁹ or if the loss is a non-monetary one that non-breaches prefer not to insure against,⁴⁰ or if the non-breaches differ in their susceptibility to damages in ways that the breacher cannot reflect by charging them a different price.⁴¹ In some cases, smaller awards might also be a more efficient way of optimizing various incentives at the precontractual stage,⁴² or of reducing problems caused by potentially judgment-proof defendants.⁴³ And if the size of the award affects the number of lawsuits that are brought (as seems likely), the resulting effect on litigation costs could also reduce the size of the optimal award.⁴⁴ Identifying the award that best balances all of these factors would challenge an expert economist, much less an ordinary judge or jury.

To complicate matters further, in some cases the optimal award might be *larger* than the above analysis might suggest, possibly even larger than strictly compensatory damages.⁴⁵ Among other possible justifications, if there is some chance

79–81. See also Saul Levmore, *Stipulated Damages, Super-Strict Liability, and Mitigation in Contract Law* [this volume], and Ariel Porat, *A Comparative Fault Defense in Contract Law* [this volume].

39. A. Mitchell Polinsky, *Risk Sharing Through Breach of Contract Remedies*, 12 J. Legal Stud. 427 (1983).

40. Samuel A. Rea, Jr., *Nonpecuniary Loss for Breach of Contract*, 11 J. Legal Stud. 35 (1982).

41. Gwyn D. Quillen, *Contract Damages and Cross-Subsidization*, 61 S. Cal. L. Rev. 1125 (1988).

42. Craswell, *supra* note 20.

43. James Boyd & Daniel E. Ingberman, *Do Punitive Damages Promote Deterrence?* 19 Int'l Rev. L. & Econ. 47 (1999).

44. A. Mitchell Polinsky & Daniel Rubinfeld, *The Welfare Implications of Costly Litigation for the Level of Liability*, 17 J. Legal Stud. 151 (1988).

45. Aaron S. Edlin & Alan Schwartz, *Optimal Penalties in Contracts*, 78 Chi.-Kent L. Rev. 33 (2003).

that a breacher might escape having to pay damages at all, that could reduce the deterrent effect of any given award. A common recommendation in these cases is to multiply whatever award would otherwise be optimal by one over the probability that the award will actually be assessed.⁴⁶ But this solution requires courts to be able to determine what that probability is, thus increasing the informational demands in one respect.⁴⁷

Moreover, in most cases the optimal solution will not involve a 'simple' correction like multiplying the damages by one over the probability of punishment. Though the point has not been widely recognized, that solution creates incentives for optimal decisions at the margin only under a few special circumstances that rarely hold in real legal institutions.⁴⁸ Specifically, that multiplier will be optimal only (1) if the probability of punishment is the same for all breachers, regardless of the severity of their breach, or (2) if the multiplier is adjusted individually case by case, to reflect the probability of punishment faced by each individual breacher. The first condition almost never holds, because more severe breachers usually cause greater damages and are more likely to be sued, and also more likely to be found to be in breach. And the second condition requires that the harshest penalties be imposed on those breachers who committed the *least* severe breaches (since those are the ones least likely to be held liable), which is exactly the opposite of how most punitive sanctions are used.

Instead, under more plausible assumptions about real-world

46. A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 Harv. L. Rev. 869 (1998).

47. Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies*, 100 Yale L.J. 369, 401-03 (1990).

48. I discuss this issue at more length in Richard Craswell, *Deterrence and Damages: The Multiplier Principle and its Alternatives*, 97 Mich. L. Rev. 2185 (1999).

enforcement, imperfect enforcement can lead either to underdeterrence or to overdeterrence, implying that the optimal adjustment may require either increasing *or decreasing* the size of the damage award.⁴⁹ As a result, it may be even harder for courts to identify the damage award that would be exactly optimal.

IV. Conclusion

In short, Corbin was right,⁵⁰ and defining ‘willful’ is harder than it might appear. In this paper, I have tried to expand on Corbin’s remarks in three ways. First, the existing literature has not yet developed *any* adequate definition of ‘willful’, mostly because it has not addressed the question of which event in the sequence leading up to the breach should be assessed for deliberateness or intentionality.

Second, the desirability of any particular definition cannot be judged without simultaneously considering the measure of damages that will be applied to those breaches picked out by the definition, because different definitions of ‘willful’ have different implications for the amount of extra damages that ought to be assessed. Specifically, definitions of ‘willful’ that reach only inefficient breachers can be paired with damage awards that are quite high, and do not need to be calibrated very precisely; but definitions of ‘willful’ that include efficient breachers as well will require damage awards that are more restrained. As a result, the

49. For a formal analysis of the factors that are likely to lead to overdeterrence or underdeterrence under conditions of uncertainty, see Steven Shavell, *Economic Analysis of Accident Law* 93–99 (1987); Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J. Law, Econ. & Org. 279 (1986).

50. See the passage quoted *supra* at note 3.

real task is to choose a *pair* of policies – that is, a combination of a definition of ‘willful’ and a measure of damages – rather than trying to choose a definition of ‘willful’ in isolation.

Third, and finally, each pair of policies that we might choose makes different demands on the courts. Some policies require courts to be good at evaluating the breacher’s behavior, while others require courts to be good at identifying the optimal level of damages. If the legal rules are chosen wisely, one or the other of these tasks can be de-emphasized, either by moving toward strict liability (thus sparing courts from having to evaluate the breacher’s behavior) or by moving toward negligence (thus freeing courts from having to calibrate the measure of damages precisely). But there is no way to free courts from both tasks simultaneously, so one or the other will have to be attended to.
