

A PRINCIPLE OF JUSTIFIED PROMISE-BREAKING AND ITS APPLICATION TO CONTRACT LAW

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INTRODUCTION

The theory of efficient breach states that it is socially useful to breach a contract whenever the breach would leave no party worse off, while leaving at least one party better off. This view, essentially a Kaldor-Hicks principle¹ applied to contract law, presupposes that the benefiting party will transfer enough of its breach-related gain to the losing party to make that party “whole” (that is, as well off as the losing party would have been had the contract been performed). The theory thus dictates that the legal system should not only refrain from penalizing economically efficient breaches, it should actually encourage them, on the assumption that such breaches produce a net benefit to society.

Traditionally the theory has been discussed in terms that are either amoral or immoral. Judge Richard Posner, one of the most distinguished proponents of efficient breach theory, points out that “many morally objectionable breaches of promise give rise to no cause of action . . . because the reach of law is limited by the costs of administering it. The costs of enforcing all promises would exceed the benefits.”² Posner includes promises that were efficiently

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1. A change in the state of the world is Kaldor-Hicks efficient if it makes at least one person subjectively better off and the gainer(s) could costlessly compensate the loser(s) so that no one would be subjectively worse off.

A project is (1) Pareto efficient relative to the status quo if at least one person actually prefers it to the status quo and no one prefers the status quo or (2) Kaldor-Hicks efficient relative to the status quo if there is a hypothetical costless redistribution from those who prefer the project to those who do not that would make the project Pareto efficient.

Matthew D. Adler & Eric A. Posner, *Implementing Cost-Benefit Analysis When Preferences Are Distorted*, 29 J. LEGAL STUD. 1105, 1105-06 (2000).

2. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 262 (4th ed. 1992).

breached in the set of promises that—on cost-benefit grounds—should not be enforced,³ even if breaking the contractual promise is morally objectionable. Although this view assumes that the law need not always dictate moral behavior, Posner's claim that "wealth maximization is instrumental to utility maximization"⁴ might imply that efficient breach is actually a moral theory. Nevertheless, his acknowledgment that some contractual breaches are morally objectionable—but legally permissible on cost-benefit grounds—suggests that he conceives of efficient breach as an economic theory that is amoral rather than one that is either moral or immoral. Posner's views aside, if contract law is amoral⁵ and efficient breach should be viewed as just a part of contract law, then efficient breach should be viewed as amoral.

Critics of efficient breach theory contend that it is immoral and therefore has no place in contract law.⁶ Some have argued that

3. Posner regards efficient breaches as economically analogous to contracts that are involuntarily broken because "performance is impossible at a reasonable cost." *Id.* at 118.

4. *Id.* at 16. See also RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* 115 (1983) (stating the same view more forcefully: "the criterion for judging whether acts and institutions are just or good is whether they maximize the wealth of society").

5. For the descriptive view that contract law is in fact amoral, see Geoffrey R. Watson, *In the Tribunal of Conscience: Mills v. Wyman Reconsidered*, 71 TUL. L. REV. 1749, 1804-05 (1997) (discussing cases and doctrines that exemplify the amorality of contract law and then contending that contract law should be modified to conform more to moral responsibility by binding promisors to perform sincerely made promises, including promises unsupported by consideration). See also Peter Linzer, *On the Amoral of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111 (1981) (examining the amoral stance reflected in RESTATEMENT (SECOND) OF CONTRACTS (1981)).

6. Patricia H. Marschall has argued that courts should not allow willful breachers to profit from their breaches: "Even if the theory of efficient breach were realistic, the values that support it are of less importance to society than the principle of good faith and fair dealing in the performance and enforcement of contracts . . . Courts ought to be putting more emphasis on the notion of sanctity of contract and the resulting moral obligation to honor one's promises." Patricia H. Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733, 734 (1982); see also Craig Warkol, Note, *Resolving the Paradox Between Legal Theory and Legal Fact: The Judicial Rejection of the Theory of Efficient Breach*, 20 CARDOZO L. REV. 321, 346-47 n.181 (1998) (citing the Israeli Supreme Court's open rejection of efficient breach theory "on moral grounds" and arguing that the theory implicitly endorses efficient theft and is therefore morally unacceptable); Frank Menetrez, *Consequentialism, Promissory Obligation, and the Theory of Efficient Breach*, 47 UCLA L. REV. 859, 882 ("the consequentialist nature of the theory of efficient breach renders it incapable of according any moral weight to promises, and thus unavoidably brings it into conflict with the morality of promis-

judges have been reluctant to apply efficient breach theory in actual cases “because it fails to consider the value of morality.”⁷ This article will propose a third alternative: efficient breach, when modified properly, is a moral theory that should be formally integrated into contract law⁸ because it enables judges to make decisions that promote economic efficiency without offending important moral principles.

The first two parts of this article are mainly theoretical. Section I.A. attempts to ground the concept of efficient breach within a larger moral theory by showing how the practice of efficient breach could be made compatible with utilitarian and even deontological ethics. Section I.B. develops a synthetic Principle of Justified Promise-Breaking, using a more complex measure of Kaldor-Hicks efficiency, and provides several examples to illustrate how the principle would work in practice and how the judgments it produces conform to basic moral intuitions. The article suggests that the principle’s conformity to basic moral intuitions and its presence in certain moral judgments weaken the claim that efficient breach is intrinsically immoral or amoral, even if the term is not normally used in moral, non-contractual discussions. Section II.A. examines how morally efficient and economically efficient breaches compare theoretically in terms of their compatibility with the autonomy-based, reliance-based, relational, and institutional theories of contract law. Section II.B. compares how efficient breach theory and the proposed Principle of Justified Promise-Breaking respond differently to the theoretical criticism that efficient breach is morally flawed because it implicitly endorses efficient theft.

The third part of this article is mainly practical. Section III.A. focuses on the different judgments that each approach to contractual breach produces when applied to a certain class of cases. The section illustrates how efficient breach theory recommends decisions that are morally less satisfying than those recommended by

sory obligation. If we wish to take seriously the moral force of contracts as promises, then efficient breaches should not be encouraged.”).

7. Warkol, *supra* note 6, at 343. Warkol also details how, “[w]ith a few notable exceptions, most judges do not explicitly adhere to the precepts of the theory of efficient breach in their decisions.” *Id.* at 334.

8. This article will not attempt to justify the view that a legal system should have moral aspirations or operate within a moral framework. The article assumes, instead, that when fashioning a legal system, laws that promote moral behavior should be preferred—all else being equal—over laws that do not. Thus, if economic efficiency is an important goal of the legal system and there are two possible legal rules that achieve the same efficient results but one is morally superior to the other, the morally superior rule should be preferred.

the Principle of Justified Promise-Breaking, particularly when breaking the contract yields a moral gain but a financial loss or a financial gain but a moral loss. Most of the cases discussed involve contracts whose breach affects some third party interest in a way that is not recognized by the standard theory of efficient breach and the conventional measure of Kaldor-Hicks efficiency. This non-recognition leads the two approaches to diverge in their judgments about whether a particular contract should be honored or breached. Section III.B recommends some changes in the judicial practice of efficient breach that would make the theory and practice of efficient breach more acceptable to judges, legal commentators, and litigants. Section III concludes by considering some of the practical problems that the recommended changes might produce.

I

THEORIES OF JUSTIFIED PROMISE-BREAKING

A. *Justified Promissory Breach Under Deontological and Utilitarian Ethics*

Any complete ethical system will supply enough principles to provide, explicitly or implicitly, the conditions that excuse or justify breaking a promise, even if such conditions almost never obtain.⁹ This section analyzes utilitarian and deontological ethics to determine when, under each, a breach would be permitted or required.¹⁰ In a utilitarian system of ethics, actions are judged by the consequences they produce.¹¹ In a deontological system of ethics, the consequences of an action are generally irrelevant to moral assessment;¹² rather, morality arises from a rational agent's recognition of his or her duties toward others.¹³

9. There might be a moral system that admits of no exceptions to the moral imperative to keep one's promises. However, it is hard to see how such a system could be considered rationally moral, as it would commit one to morally untenable decisions such as sacrificing one's mother in order to give some friends a promised ride to a tennis match.

10. These moral theories were chosen for discussion because they are probably the most influential, and because they provide tests that accurately capture essential moral judgments about promise-breaking. While a complete survey of the other moral theories of promises is beyond the scope of this article, Section II.A. of this article does discuss the major contract theories for enforcing promises.

11. See *infra* note 18.

12. W.D. ROSS, *THE RIGHT AND THE GOOD* 1, 17 (1930).

13. These duties can be grounded in different ways, from divine revelation to objective rational principles (such as Kant's "categorical imperative").

A Kantian or autonomy-based moral theory has as its fundamental principle the duty to treat people always as ends and never as means.¹⁴ Such a deontological theory grounds the duty to keep one's promises in an obligation to respect the promisee's autonomy. The obligation forbids one from using promises to manipulate the promisee in advancement of one's own ends and allows the promise to be broken only with the promisee's consent.¹⁵ It follows from these principles that the promisor is released from the promissory obligation whenever:

- (1) The promisor receives actual consent to the promise being broken, because the promisee either no longer wants the promise to be performed, or is willing to release the promisor from the obligation. For example, Pierre promises Diane a trip to Spain next summer but, when the summer arrives, she asks him not to perform because her demanding jet-setting job has made her unwilling to spend her leisure time traveling.
- (2) The promisor constructively receives the promisee's ex ante implied consent to the promise being broken. Promisees cannot efficiently list all of the circumstances in which they would prefer that the promise not be kept, even though these circumstances actually exist. Thus, if the promisor reasonably believes that the promisee would have requested an exception to the promise at the time it was made had he or she considered the circumstances in which the promise must now be performed, the promisor constructively receives ex ante implied consent.¹⁶ This

14. "The practical imperative will . . . be . . . [to act in such a way] that you use humanity, whether in your own person or in the person of any other, always at the same time as an end, never merely as a means." IMMANUEL KANT, *GROUNDING FOR THE METAPHYSICS OF MORALS* 36 (James W. Ellington trans., 1981).

15. [T]he man who tends to make a false promise . . . [makes] use of another man merely as a means to an end For, the man whom I want to use for my own purposes by such a promise cannot possibly concur with my way of acting toward him, and hence cannot himself hold the end of this action.

Id. para. 37.

16. Compare this notion of ex ante implied consent with Richard Posner's claim that ex ante consent is implicitly given to a loss whenever it was compensated ex ante (as with a losing lottery ticket's high expected return): "[s]ince the entrepreneur's expected return includes a premium to cover the risk of losses due to competition, he was compensated for the loss ex ante." POSNER, *supra* note 4, at 88-94. However, it seems difficult to extend this notion of compensation as consent to efficient breaches. Whereas entrepreneurs knowingly assume the general risks of being in business in order to achieve expected gains that will compensate

sort of consent requires that the promisor have enough knowledge about the promisee's values and goals to be able to infer how they relate to the circumstances in which the promise must be kept. For example, Pierre promises Diane a trip to Spain next summer, but just before the summer arrives Diane happily accepts a promising new job that will require her full-time presence in New York for the duration of the summer. Had Diane thought of this possible circumstance when Pierre originally made the promise to her, she would have mentioned it as a condition that would release him from delivering her the promised trip to Spain. Thus, he implicitly is released from his duty.¹⁷

- (3) The promisor constructively receives the promisee's ex post implied consent to the promise being broken. With this kind of consent, the promisee would not have included, at the time that the promise was made, any exception to performance that covers the actual cause for non-performance. However, because circumstances have subsequently changed in such a way that the promisee would now prefer to include this exception to the promise, the promisee would now release the promisor from the duty to perform if given the opportunity. This sort of consent involves an actual change in the promisee's values or goals that was not known to either party at the time of the promise but becomes known to both by the time for performance. For example, at the time that Pierre promised

their potential losses, they enter contracts precisely to lower these risks. However, Posner's notion of implied consent for institutions (such as the tort system of negligence liability) is essentially the same as the proposed notion of implied consent to a broken promise: "implied . . . consent . . . can be ascertained by asking . . . whether, if transaction costs were zero, the affected parties would agree." *Id.* at 96.

17. All conditions that excuse the performance of a promise (including legal defenses to breach of contract) arguably belong to the set of circumstances under which the promisee has given ex ante implied consent. For example, suppose Pierre promises to take Diane hang-gliding but subsequently becomes paralyzed. He has her ex ante implied consent not to fulfill the promise if, at the time of the promise, she believed (as moral philosophers do) that "ought" implies "can," so that if he cannot possibly take her hang-gliding later, he is no longer obligated to do so. In effect, this value (or moral judgment) that potentially relates to the promise and that both people shared before the promise was made becomes an ex ante implied term of the promise. Similarly, the legal defenses to breach of contract might be seen to derive from some ex ante implicit moral consensus about when a promisor is released from a duty to perform a contract. For example, if Pierre made a contract with Diane to take her hang-gliding, but subsequently became paralyzed, he could assert the defense of impossibility.

Diane a trip abroad next summer, Diane preferred Spain over all other countries, but as the summer approaches she discovers Biblical archeology and would now much rather have a trip to Israel. Although Diane never explicitly tells Pierre of her new “performance preference,” he intuitively knows of it because of their close relationship. Pierre gives her a trip to Israel instead.

In each of these cases, the promisee is treated as an end rather than as a means. The promisee’s autonomy is actually respected more than it would be if the promisor rigidly adhered to the original promise because the non-performance of the promise is what the promisee actually wants, even if this actual preference is never expressly communicated (as in the last two cases). Where the promisee’s consent to breach is implied but not express, the promisee’s autonomy is nevertheless respected because two conditions are satisfied:

- (1) the promisee would have consented to the breach, and
- (2) the breach was motivated by the promisee’s interests.

Arguably both conditions must be satisfied, since condition (1), alone, means the promisee’s wishes are only coincidentally respected and condition (2), alone, affords too great an opportunity for a promisor paternalistically or even selfishly to assert what is in the promisee’s best interests.

Utilitarianism, another major moral theory, has its philosophical roots in the writings of Jeremy Bentham. The central goal of utilitarianism is to maximize happiness and minimize suffering.¹⁸ A later variant of utilitarianism, act utilitarianism, is based on “the view that the rightness or wrongness of an action is to be judged by the consequences, good or bad, of the action itself.”¹⁹ Thus, act utilitarianism grounds the duty to keep one’s promises in the general obligation to achieve the greatest good for the greatest number of people. The duty to maximize the good implies that a promise should be broken whenever doing so will produce more good (or less harm) than keeping the promise will produce. This article measures the good (or harm) produced by an action in terms of

18. See JEREMY BENTHAM, *An Introduction to the Principles of Morals and Legislation*, reprinted in *THE WORKS OF JEREMY BENTHAM* 1 (John Bowring ed., 1962) (1789).

19. J.J.C. Smart, *An Outline of a System of Utilitarian Ethics*, in *UTILITARIANISM: FOR AND AGAINST* 3, 9 (J.J.C. Smart & Bernard Williams eds., 1973); for another defense of act utilitarianism see DEREK PARFIT, *REASONS AND PERSONS*, 3-114 (1984).

Kaldor-Hicks efficiency, but distinguishes between two versions of such efficiency:

(a) the standard version, which measures welfare only in terms of wealth effects, and

(b) “complex-Kaldor-Hicks” (hereinafter “c-Kaldor-Hicks”) efficiency, which measures welfare in broader terms that include wealth effects and all of the other morally significant effects directly attributable to an action, including those that the market cannot easily monetize. Such non-monetizable effects include environmental destruction (or repair), pain and suffering (or healing), tortious harms (or their avoidance), and death (or its prevention).

B. Proposal for a Aynthetic Principle of Justified Promise-Breaking

The proposed Principle of Justified Promise-Breaking synthesizes the autonomy-based and act utilitarian theories²⁰ by providing that a promisor should break a promise when, and only when, the promisor reasonably believes that:

- (1) breaking the promise will produce more good (or less harm) than keeping the promise would produce, as measured by c-Kaldor-Hicks efficiency, *and*
- (2) the promisee consents to the promise being broken *or* a denial of such consent would be morally unreasonable under the circumstances in which the promise must be kept.²¹

Under this principle, the virtues of Kantian ethics are preserved but without indifference to the moral consequences of respecting the promisee’s autonomy.²² Thus, if no reasonable and

20. Comprehensively demonstrating how this particular moral theory is superior to all of the alternatives is well beyond the scope of this article – and possibly anything shorter than a tome. For the purposes of this article, the aim of which is to place efficient breach within an acceptable moral framework, it will suffice to offer a workable moral theory that produces judgments in conformity with basic moral intuitions and in light of which efficient breach theory may be critically evaluated and constructively modified.

21. One might object that this principle effectively weakens the practice of promising by encouraging promisors to seek utilitarian justifications for promissory breach. However, the principle requires would-be promise-breakers to include in their utilitarian calculus the harms that will be done both to the general institutions of promises and trust, and to the promise-breaker’s personal credibility, if the promise-breaker relies on specious utilitarian claims in order to be released from a promise. Thus, a good-faith application of the principle will yield relatively few cases in which a promise should be broken.

22. Immanuel Kant, perhaps the most absolutist of deontologists, apparently rejected the possibility that it could ever be right to lie, no matter how terrible the consequences of telling the truth. See IMMANUEL KANT, *On a Supposed Right to Lie*

moral person in the promisee's circumstances would insist that the promise be kept (given the harmful consequences of keeping the promise), the promisor should break the promise, even if the promisee denies consent to the promise-breaking. However, the promisor should not break the promise in order to achieve some greater general good without the promisee's express or implied consent if a moral and reasonable person could deny consent under the circumstances. Any promise broken pursuant to this Principle of Justified Promise-Breaking will be termed a "morally efficient breach" and any promise broken in violation of this principle will be termed a "morally inefficient breach." Accordingly, broken promises that are efficient (under either the complex or the standard version of Kaldor-Hicks efficiency) but contrary to the promisee's morally reasonable wishes are morally inefficient breaches.

To observe the principle in practice, it is helpful to see how it applies to legally unenforceable promises made between friends, since these promises tend to induce more reliance and greater expectations than such promises among non-friends. Consider the following six examples in which Ari breaks a promise to have dinner with his friend, Sam:²³

- (1) On the way to dinner Ari unexpectedly meets a real estate broker who can obtain for Sam the kind of apartment that Ari knows Sam values much more than a dinner with Ari. He takes the broker out to dinner instead of dining with Sam, and, as a result, Sam gets the apartment he wanted. This example most clearly involves a morally efficient breach: the promisor reasonably believed both that breaking the promise would produce a net c-Kaldor-Hicks gain and that the promisee would have consented to the breach. Further, the promisor's beliefs were correct.
- (2) Same facts as in (1), but Ari is ultimately unsuccessful in getting Sam the apartment. This example similarly involves a morally efficient breach. Even though the promisor's belief about producing a net c-Kaldor-Hicks gain turned out to be false, as long as that belief and his belief

from Altruistic Motives, in CRITIQUE OF PRACTICAL REASON AND OTHER WRITINGS IN MORAL PHILOSOPHY 346, 347-348 (Lewis White Beck trans. and ed., 1949).

23. While these hypotheticals would never be litigated in court, they are offered to illustrate how the principle of justified promise-breaking works in practice and how it generally conforms to everyday moral judgments and intuitions.

about the promisee's ex ante consent were reasonable,²⁴ his breach was morally efficient under the Principle of Justified Promise-Breaking.

- (3) Same facts as in (1), but Ari uses the new contact with the broker to help another friend, Tal (who is not a friend of Sam's), rather than to help Sam. The apartment would make Tal slightly happier than it would make Sam happy. This example illustrates a morally inefficient breach. While Tal's greater happiness from the apartment might bring enough of a c-Kaldor-Hicks gain to Tal to outweigh the harm of the broken promise to Sam, it is unreasonable for Ari to believe that Sam would consent ex ante or ex post to the broken dinner promise, and Sam's refusal to consent would not be morally unreasonable.
- (4) On the way to dinner Ari unexpectedly encounters a child who was injured by a hit-and-run driver and needs urgent medical help. Ari rushes the child to a nearby hospital instead of meeting Sam for dinner. This example illustrates a morally efficient breach because helping the injured child clearly produces enough of a c-Kaldor-Hicks gain to outweigh the harm of the broken promise to Sam, and it would be reasonable to believe that Sam would give ex ante consent to breaking a dinner promise in order to save a child's life (assuming Sam is a morally reasonable person). Since refusal of such consent would be morally unreasonable, Ari would be justified in breaking the promise without Sam's implied ex ante consent.²⁵ Notice that if Sam is a morally reasonable person, his ex ante consent is virtually guaranteed by the overwhelmingly greater good that the broken promise produces. In addition, if Ari chooses to ignore the bleeding child so that he can keep his dinner promise, and Sam discovers this later on, Sam

24. A more Kantian theory of morally efficient breach might involve a strict liability rule requiring accurate implied consent, so that even if the promisor reasonably believed both that breaking the promise would produce a net gain and that the promisee would have consented (ex ante or ex post), the breach would be morally inefficient if the promisee would have actually denied consent ex ante or ex post (as evidenced, for example, by the promisee's later statements).

25. Kent Greenawalt makes a similar point: "If I break an important promise in order to save a life, I may have a social duty to offer some kind of apology to the harmed promisee, but my failure to fulfill the promise was my moral duty and therefore justifiable." Kent Greenawalt, *The Perplexing Borders of Justification and Excuse*, 84 COLUM. L. REV. 1897, 1921 n.74 (1984).

might actually incur a net loss because of his guilt for having been the reason that Ari failed to save a child's life.

- (5) On the way to dinner Ari unexpectedly encounters Seinfeld, who is so impressed by Ari's neurotic wit that he decides to interview Ari for the position of executive writer-producer of his television show right there and then. Seinfeld's impulsive enthusiasm and the fact that the show is severely behind its production schedule mean that Ari cannot obtain another interview time. Consequently, Ari misses his dinner date with Sam but gets the job of his dreams at ten times his previous salary. This example involves a breach that is arguably also morally efficient, assuming Ari reasonably believed that participating in Seinfeld's spontaneous job interview was likely to produce enough happiness to outweigh the harm of breaking his dinner promise to Sam. He could also reasonably believe that Sam would have impliedly consented, assuming the two friends share the moral view that finding one's dream job at ten times one's previous salary is more important than keeping a dinner date. While breaking the dinner promise is clearly c-Kaldor-Hicks efficient, if Sam would deny ex ante or ex post consent to the broken promise so that Ari could obtain his dream job, such a denial would not be as clearly morally unreasonable as denial would be in the example of the injured child. Nevertheless, the closer the two are as friends, the more they share in each other's success and happiness, and the more likely it is that Sam's implied consent would be virtually guaranteed by the happiness that Ari's unexpected fortune would bring to Sam. Here, too, Sam might even experience a net loss if he somehow discovers that but for Ari's decision to keep his dinner promise to Sam, Ari would have vastly improved his career.
- (6) On the way to dinner Ari unexpectedly notices that his favorite episode of the *Twilight Zone* is starting on the television and, while he could record the show and watch it after his dinner with Sam, he decides on a whim to stay home and watch the show instead of meeting Sam for dinner. This example clearly illustrates a morally inefficient breach: even if watching the *Twilight Zone* episode brings Ari so much pleasure that it outweighs the harm of his broken promise to Sam, it is unreasonable to believe that Sam would have consented to such a broken promise (assum-

ing that Sam is not similarly moved to break the dinner promise in order to watch the same episode). If Sam refuses to give consent, such refusal would not be unreasonable. Thus Ari would not be justified in breaking his promise, and Sam would rightly conclude that it had been broken for an utterly trivial and selfish reason.

Examples (5) and (6) demonstrate a principle relevant to repeat-interaction business partners: how trivial and selfish a friend's excuse for promise-breaking can be without offending the promisee will depend on how close their friendship is and on how great the promisor's net gain was.²⁶ The closer the two friends are, the more easily a gain for one can be "transferred" as an "efficient overall gain" to the other; similarly, the longer two companies have been doing business with each other, the less likely they are to sue each other over minor contractual breaches—especially if those breaches lead to a long-term gain for the disappointed promisee. For example, suppose company P pays subcontractor M \$5,000 to complete a market research study by January 1. Unexpectedly, a lender offers M a capital investment loan of \$100,000 for the purpose of improving M's research equipment. Meeting the lender's requirements would mean devoting all of M's energies to researching and investing in new equipment, and would thus require a breach of the January 1 deadline. However, since the resulting improvements will ultimately enable P to gain at least \$50,000 in improved research results and faster deliveries of future studies undertaken by M for P, the breach is, over the long-run, efficient for P. Thus, P chooses not to sue M for breach of the contractual performance deadline.

Examples (1) through (4), discussed above, highlight another principle: Where the motive for the breach is the reasonable belief that breaching will maximize the net benefits to the promisee (as in examples (1) and (2)), it is likely that the promisee would impliedly consent to the breach. However, where the motive is to benefit some third party (examples (3) and (4)), the conditions for implied consent are less likely to be satisfied because of the possibly divergent values that the promisor and the promisee place on this

26. For a discussion of how contractual relations reflect the closeness of the contracting parties, see generally Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691 (1974), showing how relational norms aim at protecting the relationship between parties, and Ian R. MacNeil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340 (1983), in which MacNeil argues that contracts serve to govern the relations of economic actors in the process of projecting exchanges into the future.

third party's interests. While this divergence will be minimal where two friends share similar moral values and/or have a very strong friendship, it is more likely to pose a problem between single-transaction business associates—where the potential losses are higher and moral agreement is less likely to exist. Moreover, there is presently no legal principle of contract law that can override a promisee's morally unreasonable objection to a breach that produces tremendous gains to third parties at comparatively little cost to the promisee (as in the example of breaking a dinner promise to help the injured child).²⁷

II

COMPARING THEORETICAL ACCEPTABILITY: EFFICIENT BREACH THEORY VERSUS THE PRINCIPLE OF JUSTIFIED PROMISE-BREAKING

A. *Comparing Compatibility With Each Major Contract Theory: Efficient Breach Theory Versus The Principle of Justified Promise-Breaking*

The preceding section has tried to develop the Principle of Justified Promise-Breaking by synthesizing essential aspects of utilitarian and deontological theories of promise-keeping and by illustrating the application of the proposed principle to various cases. The elaboration and illustration of this principle should make it clear that the standard and the proposed versions of efficient breach clearly overlap in important ways. The two agree that breaking a promise can produce a c-Kaldor-Hicks improvement,²⁸ and they sometimes share the view that this improvement ought to be achieved by breaking the promise. The substantial overlap between the Principle of Justified Promise-Breaking and the standard efficient breach theory, coupled with the presence of morally efficient breaches in moral, non-legal judgments (for example, breaching a dinner promise to benefit the promisee even more, or to save a child) weakens the claim that the standard theory of efficient

27. See *infra* Section III.A.

28. A standard Kaldor-Hicks improvement will qualify as a c-Kaldor-Hicks improvement whenever it results in a net financial gain without enough of a non-monetizable "moral loss" (such as pain and suffering or environmental destruction) to offset the financial gain.

breach can have no basis in moral reasoning, or that the theory is intrinsically immoral or amoral.²⁹

On the other hand, the economic theory of efficient breach clearly lacks some essential moral features inherent in the Principle of Justified Promise-Breaking: specifically, the view that net social gains should be achieved without the promisee's consent only if the promisee's denial of consent is morally unreasonable, and the view that the Kaldor-Hicks efficiency computation must include non-monetary consequences,³⁰ and not only wealth consequences. These substantial differences ultimately mean that not every morally efficient contractual breach is economically efficient, and not every economically efficient contractual breach is morally efficient.³¹

In this section, the theoretical differences between morally and economically efficient breaches become more conspicuous when the two are evaluated in terms of how they would be received by the major theories of contract law: the autonomy-based, reliance-based, relational, and institutional theories of contract.³² The autonomy-based view of contract theory has been vigorously and famously defended by Charles Fried:

An individual is morally bound to keep his promises because he has intentionally invoked a convention whose function it is to give grounds—moral grounds—for another to expect the promised performance In both speech and promising there is an invitation to the other to trust, to make himself vul-

29. See *supra* note 4 for the view that maximizing wealth by breaching efficiently amounts to a moral action.

30. While the inclusion of non-monetary effects makes the Principle of Justified Promise-Breaking morally more attractive in theory, it also makes it much harder to apply in practice. A proposal for how actually to compute the losses associated with non-monetary consequences like pain and suffering, environmental damage, and death—with enough precision to make the right cost-benefit judgment in any given case—is beyond the scope of this article. It may be easy to conclude that an entrepreneur should never breach a contractual promise when doing so will harm her business and paralyze someone (for example, a promise to abide by occupational safety procedures). However, it is more difficult to conclude that she should *breach* a contractual promise when doing so will harm her business but avoid a paralysis (e.g. stalling billion dollar deliveries to get an injured man the medical care that will prevent his paralysis).

31. See *infra* Section III.A.

32. See F. H. Buckley, *Paradox Lost*, 72 MINN. L. REV. 775 (1988), for a clear and comprehensive discussion of these and other contract theories.

nerable; the liar and the promise-breaker then abuse that trust.³³

If the promisee's expectations involve only monetary gain, and the breaching promisor compensates the promisee enough so that the promisee receives that expected gain³⁴ and recovers any costs associated with the breach (for example, the cost of finding cover³⁵), then an economically efficient breach is perfectly compatible with the autonomy-based view of contract law. Indeed, Fried explicitly endorses the promisee's expectation interest as the proper measure of damages: "If I make a promise to you, I should do as I promise; and if I fail to keep my promise, it is fair that I should be made to hand over the equivalent of the promised performance."³⁶

However, insofar as efficient breach allows one to disappoint the expectations of the promisee, it should be rejected by Fried's autonomy-based contract theory. While Fried never expressly ac-

33. CHARLES FRIED, *CONTRACT AS PROMISE; A THEORY OF CONTRACTUAL OBLIGATION* 16 (1981).

34. While the standard theory of efficient breach seeks merely to restore the contractual expectations of disappointed promisees, there is a good argument for requiring a more equitable distribution of the surplus created by efficient breaches. Consider the following scenarios in which A has a contract to buy a rare stamp from B for \$100, and C values the same stamp at \$600: (1) B breaches with A, sells the stamp to C for \$600, and compensates A with \$100; (2) B sells the stamp to A for the agreed upon \$100, and then A sells the stamp to C for \$600. In each case the stamp ends up with the party that values it most, but the \$500 surplus created by shifting the good to this party is distributed differently. In case (1), B retains the surplus only by breaching the agreement with A, while in case (2), A retains the surplus only because B honors an apparently unwise agreement. There is no compelling reason why either A or B should end up with the entire surplus of \$500. On the one hand, it was ultimately B who created the value in the first place by agreeing to sell the stamp at all (whether to C or to A). On the other hand, A played the economically important role of establishing a floor price for the stamp and prompting the surplus-creation process that led to C's bid of \$600; without A's initial offer of \$100, C would have offered only B's lowest acceptable price of \$100 (assuming perfect rationality and no other buyers). Hence, there may be good reason to divide the surplus more equitably, if not equally, among the original parties to the contract that was efficiently breached.

35. In commercial law, to "cover" is:

to find a source of supply of similar goods through purchases on the open market after a seller of goods has breached a contract of sale by failing to deliver the goods as agreed. Under UCC § 2-712, after a seller breaches and the buyer "covers," the buyer can recover the difference between the cost of the substitute goods and the original contract price . . . provided the buyer has acted in good faith and without unreasonable delay in effecting such "cover."

BARRON'S LAW DICTIONARY 117 (4th ed. 1993).

36. Fried, *supra* note 32, at 17.

cepts efficient breach, his acceptance is implicit in his argument that expectation damages are the appropriate remedy for breach. Such a remedy seems inadequate for his Kantian, duty-based approach to contractual obligations. If one is duty-bound to keep one's promise, then a promisor has committed a wrong by breaking the promise, such that the most appropriate remedy is arguably specific performance, and the next best remedy is the promisee's expectation interest plus some punitive damages for the wrong committed (although the expectation interest might inadequately measure the very expectations that Fried is so concerned with protecting).³⁷ Awarding the promisee only her expectation interest passes no judgment on the party in breach³⁸ and reduces the promisor's decision whether to keep the promise to a mere cost-benefit analysis (i.e. will breaching and paying the promisee her expectation interest produce more value for the promisor than performing?).

Mark Tunick makes a related point:

[From] the economics approach, promises are treated as commercial transactions, and promisors as economic actors who consider the costs and benefits of fulfilling their promises. Fried would find this to be an inappropriate assumption to make inasmuch as when one promises that means that one is not supposed to make the sort of calculation of costs and benefits in deciding whether to keep one's word—after all, one *promised*.³⁹

Tunick does not discuss the apparent inconsistency between Fried's Kantian view of contracts and Fried's forgiving remedies for breach, but his observation points in the same direction. While awarding specific performance or punitive damages would not alter an efficient breacher's cost-benefit approach to promises (such remedies would simply raise the costs of breaching), such remedies

37. See Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977) (arguing that the prohibition of liquidated damages undercompensates promisees whenever they place a non-provable, idiosyncratic value on performance).

38. Moral philosopher T. M. Scanlon explicitly rejects the idea that compensating the promisee's expectations is morally just as good as keeping the promise: "the obligation one undertakes when one makes a promise is an obligation to do the thing promised, not simply to do it or to compensate the promisee accordingly." T.M. SCANLON, WHAT WE OWE TO EACH OTHER 301 (1998).

39. MARK TUNICK, PRACTICES AND PRINCIPLES: APPROACHES TO ETHICAL AND LEGAL JUDGMENT 127 (1998) (*italics in original*).

could nevertheless symbolically pass moral judgment on decisions to breach.

While there appears to be a good argument that an autonomy-based contract theory is incompatible with an economically efficient breach, no such incompatibility exists with a morally efficient breach. Because consent comprises the second step of the two-step analysis required by the Principle of Justified Promise-Breaking, there is no possibility that a morally efficient breach will violate the promisee's autonomy through deception or disappointed expectations. In the rare cases when a morally efficient breach effectively ignores the will of the promisee, it is only because the promisee is asserting his or her autonomy in a way that calls into question the person's ability to will in a morally reasonable way (for example, by insisting that keeping a dinner promise is more important than saving a life).⁴⁰

An interesting problem arises when performance would produce c-Kaldor-Hicks efficiency, the promisee wants performance, but the promisor prefers breach after concluding that the contract is immoral. In such a case, the standard theory of efficient breach would allow breach, while the Principle of Justified Promise-Breaking might not reach the same result. For example, suppose that because John is terminally ill, perpetually depressed, and in constant physical suffering, he hires Mary to terminate his life. If she later concludes that she should breach this contract because it is immoral, a pure theory of efficient breach would permit her breach provided Mary pays John the value of the contract as compensation (although in practice the contract would be void as against public policy). The outcome is less clear under the Principle of Justified Promise-Breaking because of the principle's required consent to breach and its c-Kaldor-Hicks measurement that includes both death and physical suffering in the utilitarian calculus. On the one hand, it would seem that a c-Kaldor-Hicks improvement cannot pro-

40. An absolutist proponent of the autonomy-based theory of contracts might object that any promisor who chooses to breach a contractual obligation without the promisee's consent has compromised the promisee's autonomy. While such an objection is technically correct, it is not particularly damaging to a synthetic theory that aims only to incorporate the more useful insights of Kantian and utilitarian ethics without succumbing to the extreme forms of either philosophy. Moreover, such an objection appears to compel the untenable conclusion that one should honor a contract to paint a wall by noon instead of breaching it to extinguish a small fire across the street that could, if ignored, consume an entire building of people; in such a case, the "autonomy value" of those saved in the building should outweigh the "autonomy value" of the promisee expecting to have a wall painted by noon.

duce a death, because the dead person would be a “loser” who cannot be compensated even in theory. On the other hand, if euthanasia would end the constant physical agony of a terminally ill patient while respecting his or her wishes, it would apparently improve the welfare of the world without producing any “losers.” This conclusion seems confirmed by the possibility that nothing short of specific performance can compensate the promisee in the euthanasia example.

Assuming that performance would yield a c-Kaldor-Hicks improvement, the Principle of Justified Promise-Breaking does not require the promisee’s consent to performance (and presumably it does not need to, since such consent is implied by the fact that the promisee has not terminated the contract), and thus there is no opportunity to invoke any moral consensus that might override the promisee’s wishes. However, Mary could try to alter the c-Kaldor-Hicks calculus by claiming that performance will cause her a lifetime of unbearable remorse that outweighs John’s remaining months of misery. Assuming her claim is credible, there would then be an opportunity to invoke a moral consensus in order to determine whether John’s will can be overridden. Nevertheless, in controversial cases like euthanasia, there may be no moral consensus that could permit Mary’s violation of John’s will. This outcome may be an ethical limitation of the principle, depending on one’s views of paternalism and how to deal with difficult issues like euthanasia.

Another major contract theory bases the obligation to fulfill one’s promise on the detrimental reliance that the promise induces in the promisee. An economically efficient breach poses no problem for this theory, since a breach that is efficient implies that the promisee is awarded his expectation of pecuniary gain and thus loses no more than would have been lost had the promise been performed. Morally efficient breaches, however, could potentially leave promisees worse off than they would have been with performance. If the c-Kaldor-Hicks improvements gained from the morally efficient breach are not monetizable or not legally collectible by the promisees, the promisees will remain uncompensated for their detrimental reliance.⁴¹

A more sociological, less popular contract theory grounds the duty to keep one’s promise on the importance of long term-rela-

41. See *infra* Section III.A, case (7), in which a corporate whistleblower breaches a confidentiality agreement for the public good.

tions among economic actors.⁴² This theory, which appears to rest on a utilitarian calculus applied to socio-psychological realities, is more compatible with morally efficient breaches than with economically efficient breaches because the former are more likely to preserve good relations among parties to a contract. As efficient breach currently is conceived and implemented, too little attention is paid to whether the promisee agrees with the outcome recommended by efficient breach. Even if the promisee is adequately compensated (which is in itself a rarity),⁴³ he would still probably be more inclined to trust the promisor in breach, and to enter into future contracts with the promisor, if the promisor promptly tries to negotiate a contractual release from the promisee—as morally efficient breaches require. Thus, another advantage of the Principle of Justified Promise-Breaking is that it promotes a more diplomatic way of breaching that is less likely to leave the promisee resentful.

Finally, the institutional theory of promises holds that promises are binding on promisors because they have accepted benefits from the institution of promising, and hence it is only fair that they should be bound by the rules of that institution. The philosopher most associated with this view is John Rawls.⁴⁴ Rawls states that the:

principle of fairness has two parts, one which states how we acquire obligations, namely, by doing various things voluntarily, and another which lays down the condition that the institution in question be just The purpose of this second clause is to insure that obligations arise only if certain background conditions are satisfied. Acquiescence in, or even consent to, clearly unjust institutions does not give rise to obligations. It is generally agreed that extorted promises are void *ab initio*.⁴⁵

Thus, every institution has rules (express or implied) about when the institution is just or not, and it is implicit in the institution of promising that it would be unjust to oblige promisors to keep promises under certain conditions (e.g., duress). Thus, while promisors are not excused from keeping their promises just because they no longer feel like performing them, they can be excused under the right conditions. Since Rawls is interested in preserving the institution of promising for the benefits it provides

42. See Macneil, *supra* note 26.

43. See *infra* note 62.

44. See JOHN RAWLS, A THEORY OF JUSTICE 342-50 (1971).

45. *Id.* at 343.

in terms of trust and cooperation,⁴⁶ he is likely to admit of few cases in which promise-breaking is allowed, and these will almost always involve a promisor being deceived, coerced, or not sufficiently alert. Thus, the standard theory of efficient breach is probably too permissive in allowing promises to be broken, since these allowances are based on maximizing wealth rather than avoiding some unfairness to the coerced promisor. Whether the Principle of Justified Promise-Breaking is restrictive enough for the Rawlsian view is unclear, although the fact that a would be promise-breaker must almost always obtain the consent of the promisee should still preserve the trust and cooperation that Rawls seeks to promote through the institution of promising.⁴⁷

B. Comparing How the Theoretical Critique of Efficient Theft is Addressed: Efficient Breach Theory Versus the Principle of Justified Promise-Breaking

This section concludes the theoretical discussion of efficient breach by comparing how the moral and the economic versions of efficient breach each respond to the serious criticism that efficient breach is morally flawed because it implicitly condones efficient theft.⁴⁸ Craig S. Warkol provides the following example of an efficient theft:

46. Rawls maintains that the "role of promises is analogous to that which Hobbes attributed to the sovereign. Just as the sovereign maintains and stabilizes the system of social cooperation by publicly maintaining an effective schedule of penalties, so men in the absence of coercive arrangements establish and stabilize their private ventures by giving one another their word." *Id.*

47. In the rare event that consent is not obtained, it is only because the breach was to produce such a great good that no morally reasonable person would have denied consent (as in the example of breaching a contract to paint a wall by noon in order to prevent the adjacent building full of people from catching fire). The great majority of such cases will probably involve some kind of altruistic protection of third-party interests, so that there should be room within the Rawlsian system for a justification or an exception that covers such cases of promise-breaking; indeed, this uncommon form of promissory breach should only reinforce the very social trust and cooperation that Rawlsian institutions intend to advance.

48. The legal doctrine of adverse possession seems to suggest that the law is not opposed—at least in principle—to condoning efficient theft. The justification for the doctrine of adverse possession is that it encourages the efficient use of scarce resources by awarding property rights to those who value the property more (as evidenced by their possession and use of it) over those who value it less (as evidenced by their disuse or inadequate protection of the property). However, the doctrine's goal of promoting efficiency is balanced by the doctrine's other goals—protecting the true owner's interests, safeguarding the adverse possessor's reliance interests, and preventing stale claims—and hence is unavailable to takers of property for many years. Thus, those seeking to justify efficient theft by analogy to the

Suppose that Robin purchased a vase for \$50,000. One afternoon Barbara saw Robin's vase and decided that she would spend up to \$75,000 to purchase a similar vase Floyd, the efficient economic actor . . . fashioned a solution. Floyd broke into Robin's house and stole the vase. He then sold the vase to Barbara for \$75,000 and returned \$50,000 to Robin. In economic terms, the merchandise moved to its highest valued user, and Floyd efficiently redistributed societal resources.⁴⁹

This particular example would be strengthened by supposing that Robin actually valued the vase at \$80,000 but was lucky enough to buy it through a one-of-a-kind deal for only \$50,000. This additional detail illustrates how the theft results in a net wealth loss of \$5,000 and how giving Robin the \$50,000 of compensation required by efficient breach theory fails to leave her whole because it will be impossible for her to find the same vase for the one-time bargain price of \$50,000. Alternatively, if the same bargain price can be found, but only after 100 hours of searching, then, once again, the theory fails to compensate Robin adequately because efficient breach theory does not traditionally include search costs in the compensatory damages awarded to the promisee.⁵⁰ Moreover, if—after the purchase—Robin grew sentimentally attached to the particular vase she bought, such that no other vase of the same kind could replace the subjective value of the original vase, then a damages award based on the original purchase price of \$50,000 would be similarly inadequate.⁵¹

The typical critique of the efficient theft argument focuses on the inefficiency of theft itself.⁵² Richard Posner reasons that theft

property rule of adverse possession must account for those goals of the doctrine that make it unavailable to efficient thieves of land for many years.

49. Warkol, *supra* note 6, at 346. For other presentations of the efficient theft argument, see Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 963 (1982), and Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 4 (1989).

50. Warkol notes how both the time and the emotional costs of breach are not compensated: "[V]arious costs . . . often are not recoverable. One such cost is the time and frustration involved in negotiating a second deal." Warkol, *supra* note 6, at 349.

51. See *supra* note 30.

52. See, e.g., David D. Haddock, Fred S. McChesney, & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CAL. L. REV. 1 (1990) (arguing that an efficient legal system will penalize theft enough to eliminate the advantages of theft over negotiations, because remedies that only make the plaintiff whole do not sufficiently deter actors from choosing theft over negotiation, and such a choice discourages investment in the stolen asset while encouraging the deadweight loss of investments in protecting the asset from theft).

“is inefficient because it violates the principle that where market transaction costs are low, people should be required to use the market if they can and to desist [from enjoying the good they wish to steal] if they can’t.”⁵³ He also points out that the owner and the thief will have invested money “in trying respectively to prevent and to accomplish the transfer of the good. The sum is wasted from a social standpoint; this waste is the economic objection to theft.”⁵⁴

Richard Hasen and Richard McAdams take a similar approach but start by showing that,

theft is a more efficient method of exchange than the market whenever (i) the thief values the good at some amount greater than the owner does, (ii) the indirect costs of the theft are less than the transaction costs of a sale, and (iii) the theft avoids the transaction costs.⁵⁵

Professors Hasen and McAdams define the indirect costs of the theft as “the investment thieves make in theft (e.g., time and resources spent acquiring technology and skills for stealing) and the defensive measures taken by owners (e.g., deadbolt locks, burglar alarms, and guard dogs).”⁵⁶ They conclude that the indirect costs of theft are never less than the transaction costs of a sale because “the structure of market interactions works to reduce transaction costs, whereas the structure of theft interactions works . . . to increase the thieves’ investment and owners’ defensive measures in response to each other.”⁵⁷ Professors Hasen and McAdams also point out that whenever a thief tries to resell a stolen object, efficiency is lost because “society incurs both the indirect costs of the theft—any futile defensive measures plus the thief’s investment costs—and the transaction costs of the thief’s subsequent sale.”⁵⁸

An additional argument can be made in support of the conclusion that theft is never efficient; theft undermines the tremendous utility of certain intangible benefits associated with a theft-free society, such as: the ability to rely on the future presence of one’s pos-

53. POSNER, *supra* note 2, at 208.

54. *Id.*; see also David D. Friedman, *Should the Characteristics of Victims and Criminals Count?*: Payne v. Tennessee and Two Views of Efficient Punishment, 34 B.C. L. REV. 731, 732 n.5 (1993) (“If your television set is worth more to me there is no need for me to steal it; I can buy it instead. My gain from stealing it is only the money I save by not buying it from you. But that is equal to your loss, so after including the associated costs the theft is inefficient.”).

55. Richard L. Hasen & Richard H. McAdams, *The Surprisingly Complex Case Against Theft*, 17 INT’L REV. L. & ECON. 367, 370 (1997).

56. *Id.* at 371.

57. *Id.*

58. *Id.* at 372 (emphasis in original).

sessions; the ability to trust strangers not to steal one's personal property; and the ability to enjoy the privacy of a domicile that will not be invaded by thieves. The utility of these intangible goods is not fully captured by investment in counter-theft measures because such measures cannot secure these intangible benefits, even though owners might be willing to pay for them. For example, if Alice asks Bob, a stranger, to watch her coat while she runs out to make a quick phone call, there is no anti-theft investment that she can make to prevent Bob from stealing the very property he agreed to safeguard. There is also no anti-theft purchase she can make to assure herself that a particularly crafty thief will not be able to overcome the latest lock that she fixed to her door. Even if, in fact, no thief has yet developed the ability to bypass Alice's new lock, she can never be sure that this is the case. Therefore, she can never enjoy the same peace of mind as someone who has the same kind of lock as Alice has but who lives in a society where theft rarely occurs because it is effectively discouraged by the legal rules in effect. Finally, investments in anti-theft devices fail to capture the owner's search costs of replacing the goods that were stolen or the difference between the high price of some substitute good and the lower value of the property being replaced.

Professors Hasen and McAdams claim that the "important effect [of theft] . . . is not the temporary deprivation of one's property but the resources wasted incurring both indirect costs and transaction costs."⁵⁹ This conclusion seems weakened by the above observation about the intangible benefits of a theft-free world and by the fact that if people cannot accurately state what is in their possession, their very net worth is called into question—at least as far as lenders are concerned. For example, if Alice owns jewels worth \$10,000, she could not plan to use them as collateral for a loan as long as they are unpredictably out of her possession or likely to be stolen at any moment.

While these arguments probably suffice to overcome the criticism that efficient breach theory implicitly endorses efficient theft, the Principle of Justified Promise-Breaking is even more effective in rebutting the efficient theft objection. Because none of the above arguments consider wealth effects, they fail to consider one highly theoretical case in which theft could be efficient. Suppose that whenever a theft occurred the thief always came from the poorest 1% of the country, the victim always came from the wealthiest 1%, the theft never amounted to more than \$10, and the theft was al-

59. *Id.* at 374.

ways carried out on the street. This kind of limited theft would leave everyone feeling safe in their homes and 99% of the people feeling safe on the streets such that the intangible benefits of a theft-free world would effectively be preserved. The gains to the poorest 1%, as compared to the losses of the wealthiest 1%, could be so great that the thefts would produce c-Kaldor-Hicks improvements despite the investments that the richest 1% might make in bodyguards, weapons, or other anti-theft devices.

While this kind of limited “Robin Hood” theft would probably have to be accepted by efficient breach theorists, it would probably not have to be endorsed by those following the Principle of Justified Promise-Breaking. A morally efficient breach requires consent from the promisee before a promisor can breach for the sake of achieving a c-Kaldor-Hicks improvement, unless no reasonable and moral person could deny consent under the circumstances. At first blush, permitting a promissory breach that causes a loss of \$1,000 to a billionaire so that a homeless man who has \$1 to his name can receive a \$1,000 benefit appears to be something that no reasonable and moral billionaire could deny.⁶⁰ However, even putting aside the standard criticisms of redistribution schemes, the billionaire could reasonably and morally deny this kind of promissory breach on the ground that there is potentially no end to the number of such breaches that she would have to permit in a given day. The parallel to this situation is the billionaire who must spend all of her time being a victim of theft or avoiding theft until she has lost enough money to homeless thieves that wealth effects no longer render such thefts c-Kaldor-Hicks efficient. On the other hand, a billionaire’s refusal to consent might violate the standard of the “reasonable and moral” billionaire if the promissory breach occurred infrequently enough, and refusal would certainly violate this standard if it meant the death of the homeless man whom the breach would have saved.⁶¹

60. Even though a \$1,000 promissory breach would cost the billionaire only .0001% of his or her wealth, it would increase the wealth of the homeless man by 100,000%. Stated differently, \$1,000 would mean a lot more to a homeless man than to a billionaire in terms of the marginal life improvements that such a sum can afford each person. Because the law of diminishing marginal returns applies as much to money as to any other scarce good, the \$1,000 loss should effectively have no impact on the billionaire’s quality of life. On the other hand, the \$1,000 gain should make a substantial difference to the homeless man’s quality of life.

61. The standard theory of efficient breach would also not penalize a petty theft that saves the thief’s life; such a theft would be excused under the doctrine of necessity (provided that transaction costs are too high for the thief to obtain the object legally). See POSNER, *supra* note 2, at 242.

III
MORALLY EFFICIENT AND ECONOMICALLY
EFFICIENT BREACHES COMPARED
IN PRACTICE

A. *Where the Principle of Justified Promise-Breaking and Efficient
Breach Theory Diverge in Their Judgments of Contractual
Breach*

When applied in practice, the Principle of Justified Promise-Breaking and the classical theory of efficient breach agree in their judgments of promissory breach whenever breaking the contract yields both a c-Kaldor-Hicks gain (that is, a “moral gain”) and a financial gain (that is, the standard Kaldor-Hicks gain) for all parties to the broken and more efficient contracts. In other words, the two approaches agree whenever the breach is both morally and economically efficient.⁶² Section III.A of this article will examine the class of “asymmetric breaches” in which the two approaches diverge in their judgments: whenever breaking the contract yields a moral gain but a financial loss, or a financial gain but a moral loss. This class of cases can be reduced to four types:

62. Note that an economically efficient breach cannot be morally efficient, under the principle of justified promise breaking, unless the disappointed promisee is in fact adequately compensated. For a good summary of the undercompensation problem, including cases and other articles discussing the problem, see Warkol, *supra* note 6, at 348-51 (discussing how efficient breach promisees often receive inadequate compensation for their search costs, attorney’s fees, and lost interest); see also Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 637 (1988) (remarking that damages in the American contract regime “often fall short of a truly compensatory measure due to the exclusion of such items as attorneys’ fees, unmeasurable subjective losses, and ‘unforeseeable’ damages”); Goetz & Scott, *supra* note 37 (noting that an efficiently breaching party must know how much to compensate the promisee, and how this requirement is often best met with liquidated damages clauses rather than the expectation measure that courts use); Macneil, *supra* note 49, at 958 (arguing that the efficiency of particular remedies can be ascertained only by examining their pertinent transaction costs and externalities, and thus the standard damage award based on expectations is often simplistic and inadequate); John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. REV. 1565, 1571-84 (1986) (detailing how expectation measures fall short of the full compensation ideal). See generally Daniel Friedmann, *supra* note 49 (taking issue with the standard analysis of the efficient breach question). Note that because civil law systems tend to protect contractual entitlements with property rules, they generally allow the promisee to choose specific performance and to enforce penalty clauses. See RUDOLPH B. SCHLESINGER ET AL., *COMPARATIVE LAW: CASES - TEXT - MATERIALS*, 663-84 (5th ed. 1988); Ugo Mattei, *The Comparative Law and Economics of Penalty Clauses in Contracts*, 43 AM. J. COMP. L. 427, 434-38, 441 (1995).

- (A) An unexpected opportunity to achieve greater financial benefits to third parties that can be realized only by breaking a contract that would have yielded moral benefits;
- (B) An unexpected opportunity to achieve greater moral benefits to third parties that can be realized only by breaking a contract that would have yielded financial benefits;
- (C) An unexpected factual revelation leads the promisor to conclude that breaching the contract is morally justified, independent of any other financial or moral opportunities that breaking the contract enables the promisor to realize;
- (D) An unexpected moral epiphany leads the promisor to conclude that breaching the contract is morally justified, independent of any other financial or moral opportunities that breaking the contract enables the promisor to realize.

Breaches in these types of cases are now illustrated with various hypothetical situations.⁶³ Each situation is then analyzed under the Principle of Justified Promise-Breaking and the classical theory of efficient breach to highlight the ways in which the two approaches produce different judgments.

Type A

An unexpected opportunity to achieve greater financial benefits can be realized only by breaking a contract that would have yielded moral benefits to third parties.

- (1) A, a non-profit relief organization, hires company B to build a hospital in Cambodia. B is later offered another deal to build a hospital in Hong Kong for three times the profit (and thus enough to compensate A's expectation interest). B cannot complete both contracts simultaneously, and an economically efficient breach with A will mean that 400 Cambodians will die because of the delays in getting them proper hospital care. B knows that Cambodia severely lacks hospitals but Hong Kong does not. Because Hong Kong has plenty of medical facilities, and its patients can often afford to fly elsewhere for medical care, no one there will die if B rejects the Hong Kong offer and builds

63. These cases had to be invented since there appear to be no reported cases with similar facts; this absence of real cases might indicate that the legal rules regarding contractual breach discourage morally efficient breaches that are not also economically efficient. The one notable exception is case (7), which resembles the various corporate whistle-blower cases that have arisen in the context of employee confidentiality agreements.

the hospital in Cambodia. B breaches in order to build a hospital in Hong Kong.

- (2) Same facts as in case (1), but this time B is offered another deal, for ten times the profit, to build the military command buildings for a nuclear missile site. B breaches in order to build the military buildings.

The standard theory of efficient breach would unflinchingly view both breaches as efficient. The Principle of Justified Promise-Breaking probably would not. In the first case, a different third party class (Hong Kong patients) is benefited much less than the original third party class (Cambodian patients) so that the breach produces a c-Kaldor-Hicks loss, even though this loss is belied by the fact that monetary wealth is maximized by building in Hong Kong. In the second case, if constructing a military command building for a nuclear missile site is viewed as a c-Kaldor-Hicks loss or waste (because its main purpose is to enable mass destruction), then the wealth that is maximized by the breach similarly belies the fact that the breach is morally inefficient (because the breach fails to produce a c-Kaldor-Hicks improvement). If B's breach in these two cases fails to produce a c-Kaldor-Hicks gain, then the Principle of Justified Promise-Breaking requires no inquiry into the promisee's consent to the breach. The breach is deemed morally inefficient.

The kind of judgments implicit in the above c-Kaldor-Hicks analyses are admittedly far more complicated in reality. In the first hypothetical, the system that determines who gets access to medical care in Cambodia might be so corrupt that any new hospital will benefit only those who need it least. In the second case, the construction of the missile site might deter an enemy from starting a nuclear war, thereby saving millions of lives. These possibilities suggest that, in theory at least, there is never enough information to reach any moral conclusions. Nevertheless, moral judgments must be made in practice,⁶⁴ and thus the c-Kaldor-Hicks analysis should be performed in good faith, using whatever reliable information is available at the time.

64. A philanthropist with little time to research the most morally worthy beneficiary will probably rely on a general statistical heuristic and donate to hospital construction before nuclear missile site construction, even though enough research might lead to a different decision in any particular case. This observation might be explained by the fact weapons are good only if they are used for good purposes, but medical care is generally regarded as almost always intrinsically good. While most would agree that arming known criminals is morally wrong, few would contend that giving them medical care is morally wrong.

Type B

An unexpected opportunity to achieve greater moral benefits to third parties can be realized only by breaking a contract that would have yielded financial benefits.

- (3) B breaches a contract to build a hospital in Hong Kong in order to build a hospital in Cambodia. B expects no more profit from the hospital deal in Cambodia than from the original Hong Kong deal, such that B will be unable to compensate the original promisee's expectation. However, B expects the new contract to produce far greater third party gains because of how badly Cambodia needs hospitals.
- (4) Same facts as in case (3), but B's original contract was to build the military command structure for a nuclear missile site.

Unlike in the first two cases, these cases involve contractual breaches that produce c-Kaldor-Hicks improvements. Thus, it becomes necessary to inquire into whether the promisee would consent to the breach. Such consent would naturally exist in the unusual event that the promisee and promisor shared sufficiently interdependent goals (as in the market research subcontractor example)⁶⁵ or were equally loyal to the same third party beneficiaries (for example, the Cambodian government has the original contract with B to build the nuclear missile command structure, but decides that B's decision to breach and build a hospital in Cambodia instead is acceptable). However, in most cases, the promisee will not consent to the morally-motivated breach, and breaching the contract to achieve the c-Kaldor-Hicks improvement will not be justified unless no moral and reasonable promisee would deny consent under the circumstances. Whereas in cases (1) and (2), a promisor wanting to breach would have to conclude only that the breach produced a c-Kaldor-Hicks improvement, in cases (3) and (4), such a promisor would have the additional difficulty of concluding that the c-Kaldor-Hicks improvement is so great that no moral and reasonable promisee would deny consent to the breach. Thus, it is less clear in cases (3) and (4) that the breaches would qualify as morally efficient. The Principle of Justified Promise-Breaking places great weight on the promisee's autonomy, making it difficult for a promisor to breach for third party interests whose protection is not clearly mandated by morality.

65. See *supra* Part I.B.

An example of when breaching to protect a third party interest is clearly mandated by morality is more easily found in those cases where a party must choose between rescuing a third party's life and performing a relatively unimportant contract.⁶⁶ Neither the law nor the standard theory of efficient breach gives the rescuer of a third party any protection from a potential lawsuit by the disappointed promisee. The law thus views moral duties to third parties as legally subordinate to the obligations of contract law. This apparent preference might be explained by the fact that, in general, the tort regime of common law countries recognizes no legal duty to rescue a stranger.⁶⁷

In theory, however, the problem has nothing to do with the judicial recognition of third party interests because such recognition effectively occurs whenever an efficient breach is granted so that some third party valuing the contract more than the original promisee can exploit that contract. In effect, the problem amounts to protecting interests that are ignored by tort law and that have not been specifically safeguarded by the original contract or a more efficient replacement contract. Moreover, because these third-party "rescue interests" are not addressed by the contract, they are effectively not monetized adequately, making it all the more difficult for courts to consider them. To illustrate this point, consider the following case:

- (5) Adam is contractually bound to deliver groceries to Greg's house by 5:00 P.M. Adam expects to gain \$5 from the \$15 contract, because it costs him \$10 to perform it; Greg values performance by 5:00 P.M. at \$20 and pays \$15 for the service. So Adam and Greg each expect to gain \$5 from the contract. On the way to the supermarket, Adam encounters a woman who has been badly wounded by a hit-and-run driver. If he helps the woman his delivery will be late. He ignores the injured woman to avoid being liable to Greg for breach of contract.

While the Principle of Justified Promise-Breaking would deem such a decision to be morally inefficient, the standard theory of efficient

66. If the promisor must choose between saving the promisee's life and providing the bargain that the promisee contracted to obtain, then the promisor probably risks no legal problems for doing the morally right thing. Indeed, it would be interesting to see what courts would do in those rare cases where the saved person is so ungrateful as to sue the rescuer for failing to perform the contract.

67. See, e.g., James L. Isham, Annotation, *Liability of Otherwise Uninvolved Person for Harm Resulting from Refusal to Telephone, or to Allow Another to Telephone, for Emergency or Police Help*, 37 A.L.R.4th 1196, 1197-98 (1985).

breach—and American law generally—would judge Adam to have behaved acceptably. Because the injured woman has not entered into a contract with Adam or Greg that is more efficient than the contract being broken, contract law cannot protect her interests.⁶⁸ Thus contract law gives Adam every incentive to ignore the injured woman so that the groceries will get to Greg's house by 5:00 P.M. However, if the injured woman contractually promised to pay Adam at least \$10, she is no longer an irrelevant stranger to the original contract. The standard theory of efficient breach now has no difficulty in accepting Adam's breach as efficient, as long as he compensates Greg for the \$5 net gain that Greg expected from his contract with Adam. But short of a specific offer that monetizes the value of the breach, that breach will be considered inefficient by the standard theory of efficient breach. This morally disturbing outcome is avoided by the Principle of Justified Promise-Breaking because there is no requirement that the third-party interest "prove its value" contractually; that interest—which need not be monetizable—is included automatically when determining whether the breach is c-Kaldor-Hicks efficient.⁶⁹

The closest contract law presently comes to recognizing third party interests that are never voluntarily negotiated into a contract (and thereby monetized) is the doctrine of quantum meruit. For example, in the famous 1907 case of *Cotnam v. Wisdom*, a doctor rendered medical service to save an unconscious accident victim and was later able to recover his ordinary doctor's fee from the patient under a theory of restitution, even though the patient never assented to the service before it was given.⁷⁰ Applying a similar theory to the original grocery hypothetical, Adam could choose to help the injured woman, and while he would still be liable to Greg for his expected \$5 net gain, he could recover from her the fair market

68. Tort law also cannot protect the injured woman's interests because Adam has no duty to help a stranger under the American regime; under European tort law, however, such a duty would exist. For a full discussion of this contrast, see Jennifer L. Groninger, *No Duty to Rescue: Can Americans Really Leave a Victim Lying in the Street? What Is Left of the American Rule, and Will It Survive Unabated?*, 26 PEPP. L. REV. 353 (1999).

69. Note, however, that the principle does not imply that a contract must always be broken to save a third party's life. When the contract itself represents the survival of many lives, then a more complicated cost-benefit analysis will be required, taking into account the number of people likely to be saved by any given action. If, for example, Adam contracted to deliver to a hospital an urgent supply of blood, the timely delivery of which will save 100 lives, then breaching this contract to save the injured woman in the street clearly would not be justified.

70. *Cotnam v. Wisdom*, 104 S.W. 164 (Ark. 1907).

value of whatever services he rendered her. However, if Adam cannot prove that his services had a fair market value of more than \$5, he would still incur a net loss and be economically discouraged from helping the injured woman.⁷¹ Awarding damages to Greg based on his reasonable reliance or his restitutionary interest seems fair enough (after all, he did nothing to cause the woman's injury), but awarding him damages based on his lost expectations (the \$5 net gain) seems a bit harsh. In effect, Greg's expectation interest represents his profit, and it seems wrong to allow a promisee to profit from a promisor's morally motivated and profitless breach. Awarding the promisee's reliance or restitutionary interest, on the other hand, simply restores the promisee to his or her pre-contractual position.

Type C

An unexpected factual revelation leads the promisor to conclude that breaching the contract is morally justified, independent of any other financial or moral opportunities that breaking the contract enables the promisor to realize.

- (6) A hires B to drill off-shore for oil. One month before B is supposed to commence drilling, several reputable studies indicate that the drilling will produce environmental damage worth far more than the contract between A and B. However, the lax regulatory scheme in place ensures that A and B will still profit handsomely by performing the contract. Out of a moral concern for the environment, B breaches the contract upon learning how ecologically devastating performance of the contract would be.

Case (6) is similar to case (5) in that both involve gaps in the tort law that effectively sanction a harmful omission (failing to rescue a third party in mortal danger) or a harmful commission (polluting the environment). The main difference between the two cases, when applying the Principle of Justified Promise-Breaking, is that there might be less moral consensus about the morality of polluting the environment, where the consequences to human health

71. The *Cotnam* case and the grocery hypothetical also highlight a strange moral paradox in the law: the different forms of assistance that Adam and the doctor rendered to the injured woman might have been equally critical to her survival, but because only the doctor's services have a readily ascertainable fair market value, only the doctor's assistance will be compensated. A compromise approach that avoids this paradox would be to award rescuers the fair market value of either the services they rendered or their time spent in rendering these services, whichever is greater.

are relatively remote. If no moral and reasonable person would allow the kind of pollution in question for the sake of individual profit, then the Principle of Justified Promise-Breaking would recognize the breach as morally efficient; otherwise, the principle would yield the same outcome as the standard theory of efficient breach. However, even under the standard theory of efficient breach, a breach to prevent the pollution would be efficient if, for example, environmental conservation groups collected enough money to pay the original parties the amount needed for them to realize their expected monetary gains in exchange for the non-performance of the contract. This possibility is analogous to the woman offering the grocery deliverer \$10 to breach the delivery contract and help her instead.

To the extent that the environmental damage might lead to some kind of future tort liability, a stronger case for breach emerges under the standard theory of efficient breach. In case (6), for example, if B discovers after signing the contract that his drilling might release toxic chemicals into certain drinking water sources and may eventually lead to tort suits against his company, then B's breach is more likely to be considered economically efficient by efficient breach theory. Thus there seems to be a stronger case within the American legal system for excusing a breach that avoids a potentially actionable tort than for excusing a breach that enables altruistic assistance. The contracting party exposed to tort liability may no longer receive the net gain originally bargained for, assuming the harm was too costly or difficult to foresee before entering into the contract. However, if the breaching party perceives the foreseeable harm too late—because of inadequate due diligence or foresight (perhaps analogous to the kind that leads parties to make losing contracts)—then the promisee should not be made to pay (especially if the party in breach could have obtained insurance against possible tort liability). If, however, no reasonable amount of due diligence could have uncovered the risk of future tort suits, awarding expectation damages would unfairly allow the non-breaching party to profit from a mistake that does not benefit the party in breach.

Moreover, there could be an argument based on public policy that courts should not enforce contracts that are likely to produce tortious harms to a substantial number of people. A court certainly would not enforce a contract to commit an intentional tort; such

contracts are void as against public policy.⁷² Courts also do not enforce contracts in violation of health and sanitary codes⁷³ or public morals,⁷⁴ and will generally treat as unenforceable any contract whose formation or performance violates a statute.⁷⁵ But extending this principle to contracts that may produce unintentional torts not violating any explicit regulation is riddled with problems in any case where the causal link between the contract and the harm is somewhat indirect. For example, should a contract that a steel supplier enters into with a car manufacturer not be enforced because of the many tort claims arising from automobile accidents? In deciding whether enforcing the contract is in the public interest, courts would have the costly and perhaps impossible task of weighing the likely costs against the likely benefits of the subject matter involved in the contract that was breached.

Nevertheless, certain Type C breaches involve avoiding harm that is definitely foreseeable and of far greater moral (and sometimes financial) importance than the original contract. Consider, for example, the following hypothetical:

- (7) Bella signs a confidentiality agreement as a condition for employment with a pharmaceutical company, promising never to reveal anything about the internal affairs of the company, the ingredients of its products, or the results of product testing that the company has not made public, even after her employment ends. One year after she leaves the company, Bella learns that a class action suit has been filed against the company, alleging that the company sold to the public a beneficial but potentially dangerous drug without disclosing certain harmful side-effects of which it was aware. The members of the class action were all seriously harmed by the undisclosed side-effects and

72. See RESTATEMENT (SECOND) OF CONTRACTS § 192 (1981); see also 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 5.2, at 12 (2nd ed. 1998) ("A promise that involves committing a tort or a breach of a fiduciary duty is . . . unenforceable as against public policy.") (citing *United States v. King*, 840 F.2d 1276 (6th Cir. 1988), *Corti v. Fleisher*, 417 N.E.2d 764 (Ill. App. 1981), *Sayres v. Decker Auto Co.*, 145 N.E. 744 (N.Y. 1924)).

73. See, e.g., *Chesterfield Farms, Inc. v. Loftus*, 20 N.Y.S.2d 966 (N.Y. Mun. Ct. 1940) (refusing to uphold a contract designed to circumvent New York City's sanitary code regulating the sale of milk).

74. *Ernst v. Crosby*, 35 N.E. 603 (N.Y. 1893) (denying recovery of rent to innocent grantee of a parcel of realty in New York City under a lease, subject to which the property had been conveyed to him, because his grantor knew when he made the lease that the lessee intended to use the premises for prostitution purposes).

75. 2 RESTATEMENT (SECOND) OF CONTRACTS § 178 cmt. a, illus. 1 & cmt. b, § 179 cmt. b (1981).

desperately need some former employees who can testify as to when the company knew about the undisclosed risks. Bella can provide the needed testimony, and decides to breach the confidentiality agreement in order to testify.⁷⁶

Applying the Principle of Justified Promise-Breaking, Bella's breach produces a c-Kaldor-Hicks improvement because it strengthens public confidence in the legal system, improves corporate responsibility and consumer safety, and helps the judicial system correct a wrong. Unless the promisee (who is here the employer being sued) recognizes his wrong, he will not consent to Bella's breach of the employee confidentiality agreement. However, such a self-serving refusal of consent is still subject to the analysis of whether a reasonable and moral person in the promisee's position would refuse consent. While presumably a moral and reasonable promisee would not be in the company's position to begin with, she would certainly grant consent based on the moral benefit provided by Bella's testimony.

The standard theory of efficient breach would not likely characterize Bella's breach as efficient. From the promisee's perspective, the breach is economically inefficient because it may lead to a lawsuit that is far more expensive than the contract value of Bella's confidentiality agreement. From Bella's perspective, the breach is economically efficient as long as the plaintiff class contractually promises to indemnify Bella against any liability she might have for breach of contract. However, the pharmaceutical company would be inadequately compensated for its breach-related losses since they would presumably far exceed the damages it could expect to collect from Bella for her breach of the confidentiality agreement.⁷⁷ As a result, efficient breach theory would regard Bella's breach as inefficient.

It is unclear how current law would treat case (7). Carol Bast notes how one court has recognized public policy limits to confidentiality agreements:

76. See Marie Brenner, *The Man Who Knew Too Much*, VANITY FAIR, May 1996, at 170 (reporting on a story based upon similar facts to the example listed above, which also inspired the 1999 Michael Mann film *The Insider*). The article details how a scientist for the Brown & Williamson tobacco company breached his confidentiality agreement to expose the company's wrongdoing.

77. Even if the pharmaceutical company successfully argues that the millions of dollars in lost goodwill, future profits, and shareholder value were all damages that were foreseeable and proximately caused by Bella's breach, such that she should be liable for the sum of these damages, the company is unlikely actually to recover such damages (unless Bella is very wealthy).

In *Khair v. Campbell Soup Co.*, [893 F. Supp. 316 (D. N. J. 1995)] the question was raised whether the employee could blow the whistle to the EEOC where the employer's counterclaim alleged that the disclosure violated a confidentiality agreement The court noted, "[T]here is a serious issue as to whether under New Jersey law a confidentiality agreement or common law duty may frustrate the right of an employee to report his employer's illegal conduct to the appropriate government agency."⁷⁸

Bast observes that "it was less costly, at least in the short run, to stifle whistleblowing" that otherwise might have avoided the tortious harms produced by the Ford Pinto, the Love Canal, and Three Mile Island.⁷⁹ She concludes that "[u]se of confidentiality agreements in an analogous situation may conceal a practice contrary to public policy."⁸⁰ Arguing for a public policy exception to the enforceability of confidentiality agreements, Bast contends that when such agreements are used to "suppress information posing a substantial and imminent health or safety danger to third parties," they endanger the public, and when they are used to hide "information of illegality or statutory violation" they encourage "non-compliance with the criminal justice system" or thwart "the purpose[s] of the statutes."⁸¹

Type D

An unexpected moral epiphany leads the promisor to conclude that breaching the contract is morally justified, independent of any other financial or moral opportunities that breaking the contract enables the promisor to realize.

- (8) J was hired by the American government to advise it on developing a more advanced nuclear bomb. J had never assisted in such a project and had not given much thought to the morality of such assistance at the time that she contractually promised to provide it. Once J starts working on the project, she gives it some more thought and concludes that she is doing something morally wrong. J breaches the contract, even though she is not certain that she will be able to find alternative employment quickly.

78. Carol M. Bast, *At What Price Silence: Are Confidentiality Agreements Enforceable?*, 25 WM. MITCHELL L. REV. 627, 644 n.83 (1999).

79. *Id.* at 700.

80. *Id.*

81. *Id.* at 701.

In Type D breaches, there is no post-contractual revelation of some morally significant fact that was not clear when the contract was made (like the environmental harms in case (6)). Rather, Type D breaches involve a post-contractual transformation in the promisor's moral values, and can include the breach of any contract to perform some act that is illegal as against public morals, such as late-term abortions,⁸² prostitution,⁸³ or euthanasia.⁸⁴ In the euthanasia example, the promisor in breach had all of the morally relevant information at the time she made the promise, but some time after the promise was made, she experienced "an ethical change of heart" that made her unable to commit the euthanasia she contracted to perform.

A strict application of efficient breach theory should consider Type D breaches to be inefficient whenever performance would have produced more wealth than non-performance would have produced. Whether the wealth of the world is increased by creating a more advanced nuclear bomb or granting someone the wish to die are difficult theoretical questions, but efficient breach proponents typically avoid them by using "willingness to pay" as the best measure of the wealth that the contract would have produced. Thus, staunch efficient breach theorists would award the promisee his or her expectation damages, based on the value of the contract.⁸⁵ However, given that the promisor has breached for reasons that are purely moral, it seems unfair to allow the promisee to profit from the promisor's good-faith moral transformation. The Principle of Justified Promise-Breaking, on the other hand, is more nuanced with respect to Type D breaches, and would probably award damages to promisees based only on their reasonable reliance or restitutionary interest. The case for preferring more forgiving remedies in Type D breaches is strengthened when the breach produces a c-Kaldor-Hicks gain that is substantial but not so great that it should morally override the promisee's will (as might be the case in the nuclear bomb example, assuming an inadequate moral consensus on the subject).

82. *See, e.g.,* Summit Med. Assoc. v. Pryor, 180 F.3d 1326, 1330 n.4 (11th Cir. 1999); Woman's Med. Prof'l Corp. v. Taft, 114 F.Supp 2d 664, 706 (S.D. Ohio 2000).

83. *See, e.g.,* Iowa Supreme Court Board of Prof'l Ethics and Conduct v. Lyzenga, 619 N.W. 2d 327 (Iowa 2000); People v. Zampa, 191 N.E.2d 390 (Ill. App. Ct. 1963).

84. *See* discussion of the euthanasia case *supra* Part II.A; *see, e.g.,* Vacco v. Quill, 521 U.S. 793, 797 (1997).

85. A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 31-32 (2nd ed. 1989).

The legal system is also more nuanced in its treatment of such breaches. If the judiciary or the legislature has not expressly deemed the subject matter of the contract to be illegal as against public policy (as in assisting the American government to build a more advanced nuclear bomb), then judges may treat the broken contract as an ordinary breach, awarding whatever damages are appropriate to the case. If, on the other hand, the legal system has expressly deemed the subject matter of the broken contract to be illegal as against public policy (as with euthanasia⁸⁶ or a late-term abortion in some states⁸⁷), then a breach of such a contract would only advance that policy and courts would probably allow the breach without penalty.

Consider the following two moral epiphany breaches brought about by a post-contractual religious conversion in the promisor:

- (9) M enters into a contract to deliver alcohol to a chain of liquor stores. Sometime after he signs the contract, M converts to orthodox Islam and breaches the contract, claiming that his new religious convictions make him certain that delivering the alcohol would be immoral.
- (10) P, an agnostic Native American who inherits Native American burial land, enters into a contract to sell the land to a hospital developer. Sometime after the contract is signed, P rediscovers his native religion and has a moral epiphany against the sale. P breaches.

Under efficient breach theory, the broken contract in case (9) would entitle the aggrieved party to an award equal to its expectation interests. Under contract law, the disappointed party would be entitled to whatever reliance, restitutionary, or expectation damages are appropriate because there is no recognized defense of “moral or religious impossibility.”⁸⁸ Under the Principle of Justi-

86. *See supra* note 84.

87. *See supra* note 82.

88. If there were such a defense, it would be interesting to ask whether promisees should be able to protect themselves from the possibility of the promisor's moral or religious conversion by contractually including an acknowledgment of fair warning (e.g., “I acknowledge that the subject matter of this contract is morally controversial and prohibited by certain religions.”), and requiring attestations of moral acceptability (e.g., “I attest that I have thoroughly and adequately considered the morality of the subject matter, and that I have no moral or religious qualms with performing the contract. In the event that I undergo a religious or moral conversion that affects my ability to perform, I shall be liable for the full value of performance.”). Such a protective liquidated damages clause might be analogous to one inserted by a hang-gliding instructor who, in order to reassure future customers who place some idiosyncratic value on performance, promises to

fied Promise-Breaking, it is unlikely that the pain caused to the promisor would outweigh the harm of the breach; even if it did outweigh the harm, and the promisee denied consent to a breach, a moral and reasonable promisee could deny consent. Thus, the principle would deem the breach to be morally inefficient. Nevertheless, if the breach was in fact motivated only by a moral conversion rather than financial opportunism, then awarding damages based only on restitution or reasonable reliance seems to be the most appropriate remedy. Granting expectation damages would unfairly enable the promisee to profit from a good-faith, but profitless, change in the promisor's ethics.

In case (10), contract law would grant the hospital developer specific performance.⁸⁹ The standard efficient breach theory would apply the gentler remedy of awarding expectation damages to the developer. The Principle of Justified Promise-Breaking would probably reach the same result as it reaches in case (9).

This section has compared how efficient breach theory and the Principle of Justified Promise-Breaking diverge with respect to asymmetric breaches (that is, cases in which breaching produces wealth losses and moral gains, or wealth gains and moral losses). These differing judgments were compared to those produced by the legal system, when this additional comparison highlighted the differences between the two approaches or indicated an unsettled or problematic area of the law. To conclude this section, it is worth mentioning one class of cases where the two theoretical approaches roughly agree in their divergence from the current legal regime of contracts: those contracts that current law would encourage be breached but that a legal system aimed at promoting either kind of Kaldor-Hicks efficiency would enforce.⁹⁰ For example, current law would encourage the breach of any contract for the sale of marijuana, because the subject matter of the contract is illegal. How-

pay liquidated damages, in the event that he is paralyzed by a hang-gliding accident prior to the time for performance.

89. See *First Nat'l State Bank of N.J. v. Commonwealth Fed. Sav. and Loan Ass'n of Norristown*, 455 F. Supp. 464, 469 (D.N.J. 1978). See also 2 E. ALLAN FARNSWORTH, *FARNSWORTH ON CONTRACTS* § 12.6 (2nd ed. 1998) (stating that traditionally, if vendor breaks promise to convey land, specific performance will be granted); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties, and the Just Compensation Principle*, 77 COLUM. L. REV. 554, 569-70 (1977) (claiming that where a party holds subjective values that are not reflected in any established market, it would be more efficient to award specific performance in favor of that party, since monetary damages are unascertainable).

90. A thorough discussion of legal prohibitions that are Kaldor-Hicks inefficient is beyond the scope of this article.

ever, if empirical evidence were to show that the activity promotes both kinds of Kaldor-Hicks efficiency, then breaching the contract without the promisee's consent would be morally and economically inefficient. Similarly, if empirical evidence were to show that the sale of alcoholic beverages produces both kinds of Kaldor-Hicks losses, then breaching a contract for the sale of alcohol without the promisee's consent could be accepted as morally and economically efficient (even though present law would reject such a breach as inefficient).

*B. Using The Principle of Justified Promise-Breaking To Improve the
Morality and Efficiency of Efficient Breach In Practice
(and Theory)*

The classical theory of efficient breach has been subject to much criticism,⁹¹ despite its foundation on a valuable insight from act utilitarian ethics. Adapting the practical implementation of efficient breach theory so that it more closely conforms to the Principle of Justified Promise-Breaking outlined above⁹² could bring the doctrine much greater acceptance among legal commentators, judges, and litigants.

Currently, some judges⁹³ apply efficient breach in the way that the theory prescribes, considering only whether the breach was Kaldor-Hicks efficient in terms of wealth maximization without continuing through the rest of the analysis comprising the Principle of Justified Promise-Breaking. Putting aside the moral reasons to use the more complex version of Kaldor-Hicks efficiency that includes non-monetary effects,⁹⁴ once judges determine that the breach was monetarily efficient, they should determine whether the breaching party obtained consent to the breach from the promisee.⁹⁵ If the

91. See *supra* notes 6, 49, and 62.

92. See *supra* Part I.B.

93. The most renowned is Judge Posner. See, e.g., *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 750 (7th Cir. 1988) (Posner, J.) (stating that the law does not want to deter breach when the promisor's performance is worth more to a third party than it is to the promisee); see also *Allapattah Servs. v. Exxon Corp.*, 61 F. Supp. 2d 1326, 1329 (S.D. Fla. 1999) (stating that the "acceptance of intentional, efficient breaches has been uniformly adopted among the jurisdictions," and listing cases); 3 E. ALLAN FARNSWORTH, *CONTRACTS* § 12.8, at 194-95 (2d ed. 1990) (stating that "most courts have not infringed on the freedom to keep or to break a contract traditionally afforded a party by the common law and endorsed by the notion of efficient breach," and listing cases).

94. See *supra* Part III.A for examples of how such non-monetary effects can enter the moral calculus involved in deciding whether to breach a contract.

95. See *supra* Part I.A; see also Macneil, *supra* note 49, at 958-60 (arguing that the legal regime governing efficient breaches should "require joint decision mak-

promisee denied consent to breach, the judges should then determine whether the denial was unreasonable, using the tests summarized below,⁹⁶ and decide the case accordingly.

If the consent came from a mutual post-contractual termination of the contract or is implied from an exception to the contractual promise that the promisor reserved expressly, then there is no breach at all. If consent was implied *ex ante*⁹⁷ because the promisor delivered something which, *ex ante*, the promisee valued more than the promised benefit, then the promisee's case should be dismissed as ungrateful overreaching. However, *ex ante* consent might still present a problem where the promisor correctly assumed that the promisee would have preferred the alternative benefit actually delivered by the promisor over the one originally promised, but an *ex post* change in the promisee's circumstances makes the promisee prefer the originally promised benefit over the one actually delivered. In such a rare case, the judge might have to decide the consent issue by determining which party was more negligent in failing to inform the other about the new performance being delivered or the new circumstances affecting performance preferences.

A similar analysis applies to *ex post* implied consent to breach:⁹⁸ if the promisor delivers something that the promisee would have valued less than the originally promised performance, but because of post-contractual changes in circumstance the promisee should now prefer the delivered performance, the promisee's lawsuit for breach should be dismissed as ungrateful overreaching. The other instances where implied consent *ex post* could occur include all of the cases covered by the doctrines of impossibility and frustration of purpose,⁹⁹ insofar as they involve some post-contractual change in law or fact that renders performance inefficient or impossible and releases the promisor of the obligation to perform.

In the vast majority of efficient breaches—especially those involving benefits to third parties—implied consent to a contractual breach will almost never be available as a defense because the contracting parties will not have a close enough relationship to enable the promisor to infer accurately the circumstances under which the

ing concerning termination of the first contract" in order to avoid "negative transaction costs and externalities").

96. For the theoretical framework underpinning such tests, *see supra* Part I.B.

97. *See supra* Part I.A.

98. *See supra* Part I.A.

99. To the extent that these doctrines also reflect moral values that were shared by both parties before the contract was entered into, the implied consent produced by such doctrines is also *ex ante*. *See supra* note 17.

promisee would impliedly consent to a breach (and because, if the parties have such a close relationship, they will rarely choose to litigate the case in the first place). In particular, the promisor will usually lack sufficient knowledge of the promisee's specific goals, alliances, or moral values to know when the promisee would prefer breach to performance. Moreover, where the contracting parties are involved in a one-time transaction, a gain to the promisor in breach will not transfer naturally to the promisee over the long-run.¹⁰⁰

Thus, in most cases the promisor will need to obtain the promisee's express consent to the breach, in the form of a negotiated release. If the breaching promisor fails to get an express release within, for example, one month¹⁰¹ of the breach, the non-breaching promisee would be entitled to summary judgment for breach of contract, and would be awarded damages based on the promisee's expectation interest, reasonable attorney's fees, and any costs that the promisee can prove are likely to be incurred in obtaining cover (including the value of the time the promisee will probably spend in finding cover or the promisee's cost of paying another firm to conduct the search). To protect the promisor from a recalcitrant or overreaching promisee who refuses to negotiate a release, the deadline could be extended for as long as the promisee spurns the promisor's good-faith efforts to enter into negotiations for a release. The deadline could also be extended for as long as the promisee rejects reasonable compensation offers from the promisor in breach, where a "reasonable compensation offer" is that level of compensation that a court would have awarded (based on the rules described in this section).¹⁰² Thus, if during the first three months after the breach the promisee refuses to negotiate with the promisor or consistently rejects reasonable compensation

100. See discussion of the market research subcontractor example *supra* Part I.B.

101. Actual deadlines for negotiating an express release should probably be determined by judicial experience and other research. The deadline could also be made to vary according to the type of contract being breached and could in all cases be extended by a negotiated deadline agreement with the promisee.

102. One can imagine a frustrated class of promisees who place such a high subjective value on the time required to find cover and negotiate the proper level of compensation that no level of compensation could induce them to spend any of their time even negotiating (much less granting a release to the party in breach). While such a refusal is not the kind of exploitative holdout that the proposed rules are intended to avoid, it would have to be treated as such because of the practical impossibility of assessing the subjective value that a party places on its own time (in excess of the provable economic value of its time).

offers, the promisor's month for negotiating a release would not begin until the fourth month after the breach. This default deadline would provide an incentive to promisors to begin good-faith negotiations for a release as soon as possible after their breach.¹⁰³

The proposed rules governing an express release should adequately, if not completely, bolster the standard theory of efficient breach against the moral critique that promisee autonomy is compromised and against the moral and economic critique that promisees are consistently undercompensated in practice.¹⁰⁴ Promisors in breach must pay the promisees' search costs for cover—if the breach is to be truly efficient and if they are to obtain a consent to the breach. Thus, parties in breach will be encouraged promptly to inform the affected promisees about the breach and to help the promisees mitigate the costs for cover (including search costs). Finally, the summary judgment option will also lessen the burden of efficient breach litigation on judicial resources.

If an express release could not be obtained through good-faith negotiations, a judge following the Principle of Justified Promise-Breaking must determine whether no reasonable and moral person in the promisee's circumstances would deny consent to breach. This step provides a crucial safeguard against the holdout problem, in which the promisee tries to extract an inefficiently high level of compensation for breach. To facilitate judicial determination of this issue, promisors could submit as evidence each offer they made but the promisees rejected, thereby enabling judges to assess whether the promisees were opportunistically holding out or merely rejecting offers that were inefficiently low. If the promisee was holding out, the judge would award the promisee an efficient level of compensation minus that portion of the promisor's reasonable attorney's fees that was caused by the holdout. If, on the other hand, the promisee was not holding out and was justified in denying consent, the promisee's compensation would not be reduced by any of the promisor's attorney's fees. An efficient level of compensation would amount to the same package awarded when the promisee wins on summary judgment (discussed above). If the

103. This incentive directly addresses a problem discussed by Macneil:

[The standard theory of efficient breach promotes] individual, uncooperative behavior as opposed to behavior requiring the cooperation of the parties. The whole thrust of the Posner analysis is breach first, talk afterwards. Indeed, this may be an overstatement of the level of cooperation, since Posner pays singularly little attention to talking afterwards.

Macneil, *supra* note 49, at 968.

104. See *supra* note 62.

promisor's offers were consistently inefficient during the stipulated or default negotiation period, then after the deadline expires the promisor would lose on summary judgment.

Judges seeking to apply the "morally improved" version of efficient breach to the greatest extent possible will have the most difficulty with asymmetric breaches. Such breaches will require judges to weigh wealth effects against c-Kaldor-Hicks changes that cannot be adequately monetized but clearly have moral import. These breaches¹⁰⁵ will be encouraged by efficient breach theory but disallowed by the Principle of Justified Promise-Breaking. If breaching despite a monetary loss and the promisee's denial of consent nevertheless produces a complex Kaldor-Hicks improvement, judges will also have to consider whether the improvement is so great that no moral and reasonable person in the promisee's position would deny consent. This question will often involve controversial subjects (as in breaching a contract to improve America's nuclear bomb, in case (8)). These difficulties probably mean that the Principle of Justified Promise-Breaking can often be implemented only in a weaker, non-obligatory form: promisors *may* break their promises when doing so is morally justified.

Nevertheless, the principle should be applied with all of its normative force (that is, promisors *should* break their promises when, and only when, doing so is morally justified) whenever justice and public safety are clearly at stake.¹⁰⁶ There is also a strong moral argument for applying the obligatory form of the principle when the survival of human life conflicts with a relatively trivial contract (for example, breaching a grocery delivery contract to save a severely injured person). Applying the principle in this manner could create a new tort-based duty to strangers since, if one should break a minor contract to perform a rescue, then surely the same obligation should exist when no contract conflicts with the rescue.

The modifications to contract law recommended above nevertheless risk producing at least two serious problems:

- (1) a flood of litigation from third parties claiming an injury from some contract that they contend was morally inefficient under the circumstances and should have been

105. See *supra* Part III.A.

106. See discussion of case (7) *supra* Part III.A (offering a rationale for imposing liability for refusing to break a confidentiality agreement despite the overwhelming harm that such a refusal would cause to the interests of justice). Enforcement of this liability scheme could come in the form of civil penalties paid to the harmed plaintiffs, or even criminal sanctions from the state (under a theory of obstruction of justice).

breached. Nevertheless, such suits could be limited by narrowly defining the circumstances under which there is a duty to break morally inefficient contracts.

- (2) more inefficient breaches might result from parties presenting their breach motive as a concern for third-party interests, when the value of these interests is in fact smaller than the contractual interest at stake. However, such breaches could be limited by a stricter application of the Principle of Justified Promise-Breaking.¹⁰⁷

CONCLUSION

At the very least, the proposed Principle of Justified Promise-Breaking provides a theoretical framework for considering facts that are morally relevant to judging a breach of contract, and illustrates how the theory of efficient breach can be made morally acceptable, with some significant modifications. The principle also defends as moral the basic act utilitarian rationale behind the standard theory of efficient breach, while highlighting some of the moral shortcomings of efficient breach theory.

Even a conservative application of the Principle of Justified Promise-Breaking to the standard theory of efficient breach (that is, one that recognizes as efficient only those breaches that maximize the monetary wealth of all the parties to the broken and the more efficient contracts) still yields a version of efficient breach that is much more likely to prompt would-be breachers to seek consent from promisees and to leave disappointed promisees adequately compensated. These improvements tip the scale of moral and economic considerations in favor of the legal system's formal adoption of the morally improved version of efficient breach theory.

107. See discussion of Type B breaches *supra* Part III.A.