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## FAULT IN AMERICAN CONTRACT LAW

Representing an unprecedented joint effort from top scholars in the field, this volume collects original contributions to examine the fundamental role of “fault” in contract law. Is it immoral to breach a contract? Should a breaching party be punished more harshly for willful breach? Does it matter if the victim of breach engaged in contributory fault? Is there room for a calculus of fault within the “efficient breach” framework?

For generations, contract liability has been viewed as a no-fault regime, in sharp contrast to tort liability. Is this dichotomy real? Is it justified? How do the American and European traditions compare? In exploring these and related issues, the essays in this volume bring together a variety of outlooks, including economic, psychological, philosophical, and comparative approaches to law.

Omri Ben-Shahar is the Frank and Bernice Greenberg Professor of Law at the University of Chicago. He has written extensively in the areas of contract law, products liability, and law and economics. Ben-Shahar is the editor of the *Journal of Legal Studies* and, recently, the book *Boilerplate: Foundation of Market Contracts*.

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# FAULT IN AMERICAN CONTRACT LAW

Edited by

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*To our parents,*

*Yael and Habash*

– O.B.S

*Adina and Haim*

– A.P.

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## PREFACE

### Introduction

The basic rule of liability in tort law is fault. The basic rule of liability in contract law is no fault. This is perhaps one of the most striking divides within private law, the most important difference between the law of voluntary and the law of nonvoluntary obligations. It is this *fault* line (speaking equivocally) that this book explores. Is it a real divide – two opposite branches of liability within private law – or is it merely a rhetorical myth? How can it be justified?

For law-and-economics scholars, this fault/no-fault divide between contract and tort is all the more puzzling. In law and economics, legal rules are understood as incentives, evaluated within a framework in which parties take actions to prevent different types of loss. Tortfeasors can take measures to avoid accidents; contracting parties can take measures to avoid loss from breach. The context of the loss can diverge between contract and tort – accidents to strangers versus harm to a known breached-against party – but the underlying framework of incentives is similar, if not identical. Robert Cooter famously described this underlying framework as a unified “model of precaution,”<sup>1</sup> and Richard Craswell showed how to think of the breach-or-perform decision as a problem of precaution, mirroring the framework of tort law.<sup>2</sup> Thus, to those who take the idea of a unified model seriously, a significant puzzle looms large: If these two branches of law share the same underlying framework, why do they follow different liability regimes?

<sup>1</sup> Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 Cal. L. Rev. 1 (1985).

<sup>2</sup> Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. Cal. L. Rev. 629 (1988); Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. Legal Stud. 401 (1988).

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To be sure, the unified model takes a very general view of tort and contract. But the divergence puzzle is all the more challenging when we increase the resolution of our view and compare some of the main tort and contract doctrines, only to find again a clear divide. For example, tort law has a substantial causation requirement, but causation is seldom an issue in contract. Tort law recognizes claims for punitive damages; contract law by and large does not. Contract law limits the magnitude of recovery through doctrines such as foreseeability and certainty; tort law mainly employs proximate cause and duty of care, which exclude different sets of harms. And the list continues: economic harm (common in contract but not in tort), nonpecuniary losses (common in tort but much less so in contract), comparative fault (applied as a defense in tort but not in contract), and mitigation of damages (more common in contract than in tort).

Any explanation of the puzzling interface between contract and tort would have to begin with an account of the limited role that fault plays in contract law. This breaks down into separate lines of inquiry: (1) Should lack of fault be a defense against breach? Should the breaching party be able to escape liability if he can show that he worked hard to avoid breach? (2) Should a high degree of fault be an aggravating factor multiplying damages? Should the breaching party be liable for more than normal damages if breach was “malicious?” (3) Should contract law take the aggrieved party’s fault into account? All of the contributions to this book deal with some aspects of these three fundamental questions.

### I. A Positive Account

The first thing that an account of “fault in contract law” needs to do is to separate myth from reality and identify the extent to which fault does, or does not, play a role in contract liability. Almost every chapter in this book contributes some descriptive nuance to the fault picture. At one end of the spectrum, Melvin Eisenberg argues that contract law is substantially a fault regime, manifested in areas like unconscionability, unexpected circumstances, interpretation, mistake, and nonperformance.<sup>3</sup> In all these areas, fault plays an important role, and liability depends to a large extent on the parties’ blameworthiness. Consistent with this descriptive line, Richard Epstein demonstrates that in many consensual relations, fault is built into the liability rule through a subtle definition of the content of the promise. Taking bailment

<sup>3</sup> Melvin Aron Eisenberg, *The Role of Fault in Contract Law: Unconscionability, Unexpected Circumstances, Interpretation, Mistake, and Nonperformance*, this volume.

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as the prototype, he shows that the generic understanding of a promise is to take due care, not to guarantee a result.<sup>4</sup> George Cohen argues in this book that fault plays an important role in contract interpretation, in evaluating the promisee's behavior that contributed to the breach, and in shaping the doctrine of contractual damages. He explains that the emphasis commonly made on strict liability fails to recognize the role of fault in contract law.<sup>5</sup>

At the other end, other contributors highlight the strict liability side of contract law. Robert Scott, for example, argues that case law is largely consistent with the idea that the promisor's liability does not vary with his degree of fault. Willfulness of breach, he claims, is not an aggravating factor, despite some famous statements to the contrary in case law.<sup>6</sup> Richard Posner argues that the Holmesian notion of an option to breach and pay damages, embedded in a contractual promise, necessarily implies that liability is strict.<sup>7</sup> "It wouldn't make any sense," he argues, "to excuse you just because the cost of performance would exceed the benefits, for that would make the option nugatory."<sup>8</sup>

Between these poles, other contributors highlight additional contours of the fault doctrine and how it infiltrates contract law. In support of the no-fault-as-defense prong, Eric Posner identifies a broad set of cases in which promisors who are able to show that breach occurred with no fault of their own would escape liability.<sup>9</sup> Ariel Porat and Fabrizio Cafaggi, in separate contributions, explore the presence of a comparative fault defense – cases in which promisors, who are able to show that harm could have been avoided efficiently by promisees before or after breach took place, escape liability either in full or in part.<sup>10</sup> Saul Levmore suggests that the law actually allows parties to vary the scope of the comparative fault component embodied in the mitigation defense. He argues that parties who draft liquidated damage clauses do more than fix the magnitude of recovery – they opt out of the fault-based mitigation duties.<sup>11</sup>

A glimpse into continental European legal systems makes the "fault in contract law" puzzle even more mysterious. Stefan Grundmann provides a

<sup>4</sup> Richard A. Epstein, *The Many Faces of Fault in Contract Law: Or How to Do Economics Right, Without Really Trying*, this volume.

<sup>5</sup> George M. Cohen, *How Fault Shapes Contract Law*, this volume.

<sup>6</sup> Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract*, this volume.

<sup>7</sup> Richard A. Posner, *Let Us Never Blame a Contract Breaker*, this volume.

<sup>8</sup> *Id.* at 1351.

<sup>9</sup> Eric A. Posner, *Fault in Contract Law*, this volume.

<sup>10</sup> Ariel Porat, *A Comparative Fault Defense in Contract Law*, this volume; Fabrizio Cafaggi, *Creditor's Fault: In Search of a Comparative Frame*, this volume.

<sup>11</sup> Saul Levmore, *Stipulated Damages, Superstrict Liability, and Mitigation in Contract Law*, this volume.

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doctrinal journey through the ways continental European law merges both fault and strict liability. His discussion demonstrates that although fault plays a role in contractual liability, this role varies significantly between common law and the civil law prevalent in continental Europe: In fact, fault is often a condition to any imposition of contractual liability in European law. Fault has also varied over time in European law, with more recent reforms aimed at bolstering its role.<sup>12</sup>

## II. Normative and Historical Accounts

The book provides a detailed depiction of the fault/no-fault divide and a distilled descriptive understanding of the role of fault in contract. But even after the many faces of fault in contract law are highlighted, it is all the more clear that the role of fault is limited. The primary ambition of this book, then, is to inquire into the reasons fault plays no more than a limited role and why it infiltrated some contract law doctrines, and perhaps to debate whether a bigger role for fault than it is currently accorded would be justified.

The first half of the book is organized along the normative positions toward fault in contract law. The first part – “The Case for Strict Liability” – includes three essays defending the traditional view that liability for breach of contract ought to be strict. Richard Posner and Robert Scott, in separate contributions, argue that fault should not be relevant to contractual liability, either as a no-fault defense or as a superfault damage booster. According to these writers, the Anglo-American contract law is efficient and should remain the way it is.<sup>13</sup> Richard Posner further argues against the interpretation of fault and “bad faith” doctrines in moral terms. Robert Scott offers two justifications for strict liability: reducing contracting costs, and supporting the parties’ reliance on informal and relational modes of contracting.<sup>14</sup> A third essay by Stefan Grundmann explains the prominence of strict liability in the law of market contracts as a mechanism that improves the comparability of offers.<sup>15</sup>

The second part – “The Case for Fault” – responds by defending the roles of fault doctrines in contract liability. George Cohen explains that fault is necessary to interpret contract intent, to understand how damages are assessed, and to curb promisees’ opportunism.<sup>16</sup> Eric Posner argues that negligence

<sup>12</sup> Stefan Grundmann, *The Fault Principle as the Chameleon of Contract Law: A Market Function Approach*, this volume.

<sup>13</sup> Posner, *supra* note 7; Scott, *supra* note 6.

<sup>14</sup> Scott, *supra* note 6.

<sup>15</sup> Grundmann, *supra* note 12.

<sup>16</sup> Cohen, *supra* note 5.

is superior to strict liability by eliminating the insurance element from the transaction. Under a strict liability rule, such insurance is forced on the victim, even though there is no reason for the victim to buy such insurance in the first place.<sup>17</sup> Melvin Eisenberg supports the role of strong moral norms in a contracting system that relies on legal remedies, reputation, and social norms for guidance of behavior.<sup>18</sup>

The third part – “Between Strict Liability and Fault” – provides various accounts of the division of labor between fault and strict liability in private law. The first two contributions here examine the more limited role of fault in contract, compared to its robust place in tort. They provide new insights into why English common law treated fault differently in tort and contract. Roy Kreitner argues that fault standards were historically considered to be socially imposed and thus inconsistent with the basic premise of contract law that the parties, not society, are the ones who create the content of the obligation. He also shows how the blurring of the contract/tort line in the area of products liability blurred the fault/no-fault distinction within each field.<sup>19</sup> Richard Epstein explores the origins of bailment law as a species of consensual obligation law and argues that the fault standard prevailed in it (and in other types of contractual arrangements) through the definition of the duty one party owed to another.<sup>20</sup> Taking a different perspective, but sharing Kreitner’s view of fault standards as socially imposed, Martha Ertman explores the role of fault in contract law as a vehicle for ex post equitable concerns. General notions of fault can conflict with ex ante concerns of rational planning, certainty, and parties’ autonomy, but particular recognition of the role of fault is necessary to fine-tune fair outcomes.<sup>21</sup>

### III. Explaining Legal Doctrine

#### A. *Willful Breach*

Part IV collects four separate contributions – by Richard Craswell, Steve Thel and Peter Siegelman, Oren Bar-Gill and Omri Ben-Shahar, and Barry Adler – all addressing willful breach, which is one of the more puzzling fault-based pockets in contract law. The four contributions provide justifications

<sup>17</sup> Posner, *supra* note 9.

<sup>18</sup> Eisenberg, *supra* note 3.

<sup>19</sup> Roy Kreitner, *Fault at the Contract-Tort Interface*, this volume.

<sup>20</sup> Epstein, *supra* note 4.

<sup>21</sup> Martha M. Ertman, *The Productive Tension Between Official and Unofficial Stories of Fault in Contract Law*, this volume.

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for the law's occasional harsher treatment of willful breach. They argue that what constitutes "willful" or "malicious" breach cannot be determined conceptually, but rather has to be the *conclusion* of the analysis that identifies situations in which normal damages are not high enough. There are occasions, these articles argue, in which normal damages do not suffice to create optimal deterrence and a damage booster is needed. These occasions have nothing to do with the mens rea of the promisor, the volition of his act, or its morality. They surely cannot be explained by reference to an infringement of the "sanctity of contract." Instead, the willful-breach cases have to do with incentives.

In the first of these four contributions, Craswell argues that the willful-breach add-on to damages can be explained in two ways. Higher damages are awarded when breach is clearly inefficient, or when normal damages are undercompensatory and do not provide enough incentive to perform.<sup>22</sup> Another willful-breach rationale is developed by Thel and Siegelman, who argue that higher damages are necessary when the social costs of avoiding breach are zero. They use the notorious example of breach in order to sell to a higher bidder as an example of a case in which there is no social cost to breach avoidance.<sup>23</sup>

A new theory of the role of willfulness is developed by Bar-Gill and Ben-Shahar. Unlike other theories, it offers an ex ante perspective. Willful breach, they argue, is often an indication of a systematic pattern of "nasty" but undetectable behavior, having to do with some failure by the promisor to make earlier investments in performance capacity. It is not the maliciousness of the observed infraction that is punished, but the revealed pattern of misconduct. The damage increase is needed to deter such propensities to shirk, and the subsequent mesh of subpar performance conduct that the underinvestment causes.<sup>24</sup>

Finally, Barry Adler argues that willfulness is not a device to increase damages for bad behavior, but rather a way to distinguish cases in which the true expectation remedy is higher.<sup>25</sup> These are cases in which the breached-against party's compensatory interest involves elements that are not measured by simple market-based damages. The added damages are paid in response not to the injurer's bad conduct but rather to the victim's true injury.

<sup>22</sup> Richard Craswell, *When Is a Willful Breach "Willful"? The Link Between Definitions and Damages*, this volume.

<sup>23</sup> Steve Thel & Peter Siegelman, *Willful Breach: An Efficient Screen for Efficient Breach*, this volume.

<sup>24</sup> Oren Bar-Gill & Omri Ben-Shahar, *An Information Theory of Willful Breach*, this volume.

<sup>25</sup> Barry E. Adler, *Contract Law and the Willfulness Diversion*, this volume.

Although these contributions are primarily normative, seeking justifications for the willful-breach rule, they also provide a more lucid picture of what types of conduct are considered willful under existing contract law. Collected here together, they provide the first attempt within law and economics to reconcile the perceived conflict between the notion of efficient breach and the doctrine of willful breach that has an eclectic appearance in case law.

### B. *Comparative Fault*

Part V of the book explores the justifications for comparative fault rules in contract law. Ariel Porat advocates a broad recognition of a comparative fault defense in contract law.<sup>26</sup> He argues that in cases in which promisees failed to take low-cost cooperation measures or tended to overrely on the promisor's performance, such defense should be generally available. Saul Levmore studies a more specific application of the mitigation-of-damages rule.<sup>27</sup> He argues that a mitigation defense is not available, and for good reasons, when the parties stipulate liquidated damages. By stipulating a damage clause, parties want to avoid the ex post adjudication over issues relating to fault. Finally, Fabrizio Cafaggi explains the greater role of comparative fault rules in European law, with emphasis in Continental contract law on cooperation and corrective justice, in distinction from American contract law's emphasis on risk allocation.<sup>28</sup>

## IV. The Morality of Breach

The final part tackles the fundamental question: Is it morally wrong to deliberately breach a contract? As opposed to those who argue that fault should not matter at all (like Richard Posner and Scott), and in contrast to the argument that no-fault breaches should (under certain conditions) be excused regardless of whether those breaches were deliberate or not (like Eric Posner), there is a position, recently made by Seana Shiffrin, that breach of a promise can be a moral wrong regardless of its efficiency. According to this position, parties who value performance as an end would not always permit willful breach, even if it were efficient.<sup>29</sup>

<sup>26</sup> Porat, *supra* note 10.

<sup>27</sup> Levmore, *supra* note 11.

<sup>28</sup> Cafaggi, *supra* note 10.

<sup>29</sup> Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 Mich. L. Rev. 1551 (2009).

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Continuing his previous dialogue with Shiffrin on the role of morality in contractual liability,<sup>30</sup> Steven Shavell argues that efficient breach merely mimics what a complete contract would have stipulated. When the contingency that eventuated and led to the breach of the contract was not explicitly addressed by the contract, the breach coupled with a payment of full-expectation damages is not a violation of a promise. In Shavell's view, the reason many individuals believe a breach is immoral is their mistaken perception that a contract is a simple set of promises, ignoring the fact that contracts are incomplete and it is the parties' intent that their contract be supplemented with a nuanced understanding of the obligations. The popular view that breach is immoral – so the argument goes – confuses the breach of a contract with the breaking of an explicit promise.<sup>31</sup>

In contrast to the argument made by some philosophers, that the law sanctions breach of contracts because the moral wrong is analogous to a breach of a promise, Dori Kimel offers a different view in this book. He argues that using state power to enforce contractual obligations is justified by the harm principle. According to that principle, the threshold for legitimate remedial responses to a breach of contract can only plausibly be harm. That explains why fault has a limited role in contract law: Because harm is the criterion for a remedial response, and because harm in contractual context is generally insensitive to fault, courts rightly tend to ignore fault.<sup>32</sup>

From a social-science experimental perspective, Tess Wilkinson-Ryan, in her contribution, explores people's moral sentiments toward breach. She surveys experimental research that documents people's opinion that promise breaking is wrong and that breach of contract is a form of promise breaking. Many people consider breach as a moral harm, even if it entailed no actual losses to the breached-against party. These sentiments affect people's decisions to breach, their willingness to settle after a breach takes place, and their predictions about legal rules of contract.<sup>33</sup>

## Conclusion

With fault having a variety of roles in contract law, is there truly a tort/contract dichotomy based on a fault/no-fault line? With products liability sitting

<sup>30</sup> Steven Shavell, *Is Breach of Contract Immoral?*, 56 Emory L.J. 439 (2006); Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 Harv. L. Rev. 708 (2007).

<sup>31</sup> Steven Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, this volume.

<sup>32</sup> Dori Kimel, *Fault and Harm in Breach of Contract*, this volume.

<sup>33</sup> Tess Wilkinson-Ryan, *Fault in Contracts: A Psychological Approach*, this volume.



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on the interface between tort and sales law, is there any room for separate doctrinal grounds for liability? In the end, was Cooter right – can the two fields be regarded as unified, not only in economic theory, but also in the basis for liability? Against two traditions that provide clear answers – a doctrinal tradition of clear but rigid distinctions between tort and contract, and a law-and-economics tradition of ignoring the differences between the two fields – we hope that the contribution of this book is in *blurring* the answers while portraying a more interesting picture.

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