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Virtue Ethics and Efficient Breach

Avery W. Katz
Columbia Law School, ak472@columbia.edu

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ABSTRACT

The concept of "efficient breach"—the idea that a contracting party should be encouraged to breach a contract and pay damages if doing so would be more efficient than performance—is probably the most influential concept in the economic analysis of contract law. It is certainly the most controversial. Efficient breach theory has been criticized from both within and without the economic approach, but its most prominent criticism is that it violates deontological ethics—that the beneficiary of a promise has a right to performance, so that breaching the promise wrongs the promisee.

This essay argues that this criticism is misplaced, and that efficient breach theory, properly understood, is not inconsistent with parties' complying with their deontological obligations. Instead, the intuitive resistance that most people experience to the concept may be better explained by aretaic concerns—specifically, that failing to complete a contractual relationship is not conducive to virtuous character or to the maintenance of a flourishing community. While efficient breach can be squared with deontological ethics, it cannot be squared with virtue ethics unless one is prepared to argue that seeking efficiency is a virtue, or at least that it is not a vice.

INTRODUCTION

Contracts scholars have been arguing over the concept of "efficient breach" for over thirty years. The issues at stake in this argument are well known, yet the debate fails to subside. Supporters of efficient breach contend that allowing a promisor to escape the obligation to perform by paying a money substitute both increases the potential gain from contractual exchange, and corresponds to the arrangement that most contracting parties would have wanted.[1] Critics of

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1. *See, e.g.*, RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 55-59 (1973); Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970); Robert L. Birmingham, *Legal and Moral Duty in Game Theory: Common Law Contract and Chinese Analogies*, 18 BUFF. L. REV. 99 (1969); Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73

the concept respond that allowing promisors to avoid performance without securing the promisee's formal ex post consent works an injustice in the individual case, and undermines the social practice of contracting more generally.[2]

These arguments are thoroughly familiar to anyone who teaches and writes about basic contract law, because they have been rehearsed again and again in the literature.[3] Indeed, the debate has proliferated in recent years.[4] Why do the leading writers in the discipline continue to revisit a debate in which the main positions have long been staked out? One possibility might be that they are contending for the hearts and minds of their students, who, each year, encounter the concept anew as they are introduced to the basic normative underpinnings of contract law. On this explanation, efficient breach remains a contested issue in contracts for the same reason that the fault principle remains a contested issue in torts; it is a locus for conflict between values that are inherently in tension, yet both deeply rooted in our political and moral culture, so that the issue will never go away. An alternate possibility, however, which I explore in this essay, is that the debate remains active because there are important normative concerns that have still not been adequately clarified by efficient breach's critics or addressed by its defenders.

The purpose of this essay is to suggest that the debate over efficient breach

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CALIF. L. REV. 1432 (1985); 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); Steven Shavell, *Contracts*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 436, 439 (Peter Newman ed., 1998) [hereinafter Shavell, *Contracts*]. It is generally acknowledged that Goetz and Scott coined the specific phrase "efficient breach" in their 1977 Columbia article; but the essence of the concept is plainly manifest in Birmingham's and Posner's formulations.

2. *See, e.g.*, CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 17 (1981) ("[T]he contract must be kept because a promise must be kept."); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989); Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947 (1982); Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007).

3. *See supra* notes 1-2 (providing examples of theory addressed in literature); *see also* Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629 (1988).

4. *See, e.g.*, Barry E. Adler, *Efficient Breach Theory Through the Looking Glass*, 83 N.Y.U. L. REV. 1679 (2008); Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568 (2006); Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CALIF. L. REV. 975 (2005); Gregory Klass, *To Perform or Pay Damages*, 98 VA. L. REV. 143 (2012); Jody S. Kraus, *A Critique of the Efficient Performance Hypothesis*, 116 YALE L.J. ONLINE 423 (2007); Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603 (2009); Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939 (2011); Steven Shavell, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439, 439 (2006) [hereinafter Shavell, *Is Breach of Contract Immoral?*]; Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 TEX. L. REV. 831, 867 (2006) [hereinafter Shavell, *Specific Performance Versus Damages*]; Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551 (2009); Seana Valentine Shiffrin, *Must I Mean What You Think I* Should *Have Said?*, 98 VA. L. REV. 159 (2012); Shiffrin, *supra* note 2; Steve Thel & Peter Siegelman, *Willfulness Versus Expectation: A Promisor-Based Defense of Willful Breach Doctrine*, 107 MICH. L. REV. 1517 (2009).

has focused on deontological concerns (specifically, whether contract breach is equivalent to promise-breaking, and whether promise-breaking in the contractual context is necessarily wrong) to the exclusion of aretaic ones (specifically, that failing to follow through on a contractual relationship is not conducive to virtuous character or to the maintenance of a flourishing community). It argues that the standard deontological objections to efficient breach do not substantially undermine its basic analysis, because they can generally be addressed by reinterpreting or revising the underlying contract so that paying a money substitute in lieu of specific performance is explicitly authorized. On such a reinterpretation, paying money when performance becomes inconvenient is neither a breach nor a wrong; it is just an alternate way of discharging one's contractual duties.[5] In this way, "efficient breach" (perhaps relabeled "efficient performance" or "efficient cancellation option" in the interest of more favorable marketing[6]) can easily be squared with deontological ethics.

The essay also suggests that the intuitive resistance that many people experience to the concept of efficient breach may be better explained by aretaic concerns—that is, by virtue ethics. The aretaic objection, unlike the deontological objection, cannot be disposed of by reinterpreting the promise so that paying money counts as performance rather than breach, because it is not fundamentally based on the morality of keeping promises. Rather, it is based on the morality of making promises in the first place. On this objection, a promise that can be satisfied with a cash substitute is a cheap and superficial one, and not the kind that we should valorize.

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5. A point recognized early on and reiterated with regularity. *See, e.g.*, David Simon & Gerald A. Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1436-37 (1979).

> As we see it, where both parties to a market transaction are market traders who are dealing with commodities of fluctuating value, the contract should be treated as equivalent to a bet which the parties are making against the future market price. Payment of market damages mounts to specific performance of the bet.

Id. at 1436.

> The view that a contract breach is the breaking of a promise overlooks the point that the contract that is breached is generally an incomplete contract, and that the breach is what the parties want and would have specified in a complete contract. In the example of the simple incomplete contract calling for a desk to be produced, the seller who finds that his production cost would be $2,000 will commit breach under the expectation measure. But in so doing, he will be acting precisely as would have been set out in a complete contract, and it is that contract which is best regarded as the promise between the parties that ought to be kept.

Shavell, *Contracts*, *supra* note 1, at 439.

6. *Compare* Brooks, *supra* note 4 (suggesting terminology of "efficient performance" as opposed to efficient breach), *with* Markovits & Schwartz, *supra* note 4 (suggesting terminology of "dual performance" as opposed to efficient breach).

While the concept of efficient breach can be squared with deontological ethics, accordingly, it cannot be squared with virtue ethics unless one is prepared to argue that seeking efficiency is a virtue, or at least that it is not a vice. The balance of this essay elaborates on these various claims.

THE CONSENSUAL BASIS FOR EFFICIENT BREACH

The practical problem that motivates the efficient breach debate is that circumstances change over time and so contracting parties' plans often must change too, even if those plans have been made the subject of a promise. For example, a farmer may promise to sell crops, but the crops may fail. A company that sells ice blocks for purposes of refrigeration may find itself unable to obtain supplies at a sustainable price due to an unexpectedly warm winter.[7] A coal company may promise to restore a parcel of land to its original condition after strip mining, but the cost of restoration turns out to be prohibitively expensive.[8] A consumer may promise to buy a boat, but then suffer health or financial reverses that make it unattractive to go through with the deal.[9] In each of these cases there are social gains to be achieved—or losses to be avoided—by adjusting the parties' plans.[10]

In the law and economics literature, this problem has generally been addressed from an ex post perspective. On this perspective, the contract has been formed, uncertainty about costs and benefits have been resolved, the parties are deciding what to do next, and the options are performance or breach (assuming that changed circumstances do not rise to the level of an excuse). At this point, performance is efficient if (and only if) the benefits of performance to the promise exceed the costs to the promisor.[11] If, conversely, the costs of

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7. Goebel v. Linn, 11 N.W. 284 (Mich. 1882).

8. Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Okla. 1962).

9. Neri v. Retail Marine Corp., 285 N.E.2d 311 (N.Y. 1972).

10. The news that motivates such adjustment does not have to be bad news; it could also be good news—for instance if a new buyer arrives who places a much higher value on the items being exchanged and is willing to pay a much higher price (or a new supplier emerges who can deliver at lower cost, and thus lower price).

11. The definition of efficiency used here, and in the law and economic literature, is potential Pareto superiority, also known as the Kaldor-Hicks criterion, also known as cost-benefit analysis. According to this criterion, an action (in this case breach of contract) is economically efficient when the gains resulting from the action, aggregated over all parties who are affected, exceed the losses. In this case it is possible in principle, and often in practice, to make all parties better off by arranging a side payment from the winners to the losers (in the case of breach of contract, a payment from the breacher to the aggrieved promisee in the amount of expectation damages). For a more extensive analysis and critique of the Kaldor-Hicks criterion, see JULES L. COLEMAN, *Efficiency, Utility, and Wealth Maximization*, *in* MARKETS, MORALS, AND THE LAW 95 (1988). This formal definition of efficiency should be contrasted with one common meaning of the term in informal discourse, where it is often used interchangeably with the term "advantageous." On this colloquial usage, an unscrupulous businessperson might say that it is efficient to dump industrial waste in a public waterway, because it is personally cheaper to do this than to pay the costs of ecologically secure disposal. This is not what economists mean by efficiency, however, because it excludes the costs suffered by the other users of the polluted water. The economist's view would be that dumping industrial waste could sometimes be efficient, but only if it is the cheapest alternative considering the interests of all parties put together. If the costs of

performance exceed the benefits, both parties can be made better off by canceling the performance and having the promisor compensate the disappointed promise by paying properly measured expectation damages. In this instance, the promisee is no worse off than if the promisor had specifically performed, and the promisor is better off (because paying damages is less costly than specifically performing). The resultant cost savings represent a net increase in social welfare.[12]

Presenting the issue from the ex post perspective might suggest that there is a conflict between economic efficiency and deontological justice, because the cost savings are apparently achieved at the expense of the promisee's rights. A stereotypical rights theorist would thus say that a promisor who breaches a contract in order to achieve a larger profit or avoid a larger loss has appropriated something that belongs to the promisee—the right to performance—and used it for his own personal ends. On this view, an efficient breacher is no better than a thief who steals and resells a car on the theory that he knows where to get a price that is higher than the owner's reservation value (that is, the maximum amount she would pay to retain the car). Both the thief and the breacher profit from converting something that is not their own, implying that any surplus thereby created is properly the entitlement of the rightholder (in the case of the car theft, the owner; and in the case of the broken contract, the promisee).[13]

But there is another way to look at the matter, an ex ante perspective that shifts our attention from the later point at which the parties are deciding whether to perform, to the earlier point where they are choosing to enter the contract and specifying their duties. At this initial point, the parties have the opportunity to decide who will hold the right to decide whether the promisor specifically performs. As a matter of principle if not of law, they could allocate that right to the promisee, by stipulating their advance consent to injunctive relief.[14] On the other hand, they could also allocate that right to the promisor

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ecologically secure disposal (or of abstaining from the activity that generates the industrial waste) are greater than the costs of pollution, only then would pollution be the efficient (least costly) alternative.

12. *See* POSNER, *supra* note 1, at 57.

> [I]n some cases a party would be tempted to breach the contract simply because his profit from breach would exceed the expected profit to the other party from completion of the contract, and if damages are limited to a loss of expected profit, there will be an incentive to commit breach. *There should be. . . . If [the potential breacher's loss from performance] is greater than the gain to the other party from completion, it is clear that commission of the breach would be value maximizing and should be encouraged.* And because the victim of the breach is made whole for his loss, he is indifferent; hence encouraging breaches in these circumstances will not deter people from entering into contracts in the future.

Id. (emphasis added).

13. *See, e.g.*, Friedmann, *supra* note 2.

14. In principle but not in law, because under common-law regimes, an equity court is not bound by the

by providing for an explicit option to pay, in lieu of specific performance, an amount of money representing the value of the promisee's expectation. One way to do this is through a liquidated damages clause; but if the parties do not or cannot agree on a liquidated amount, another method is to leave it up to a court or arbitrator after the fact.

This ex ante perspective prompts the question: When is it desirable to provide promisees with an option to buy their way out of a contractual promise at a court-determined price, and when is it not? The answer offered by the proponents of efficient breach is that providing such an option is typically value-increasing, and thus in the interest of both parties. From this answer it follows that the more efficient default rule in cases where the parties have left the matter silent is to imply the option.[15]

Here is a concrete example that illustrates the point: imagine a homeowner who wants her driveway repaved and is shopping for a contractor. The homeowner places some reservation value on the repaving work; this is the maximum she is willing to pay in order to have it done. Without loss of generality, suppose this reservation value equals $2000. It does not matter for our purposes whether the homeowner's reason for wanting a new driveway is commercial (i.e., it will increase the potential resale value of her home by $2000) or personal (it will be more pleasant to look at, and will make the driveway easier to shovel in winter). In either event, the homeowner does not wish to spend more than $2000 on the driveway; if the driveway were going to cost more than $2000, she would prefer to take the same amount of money and spend it on her next-best budget priority, for example her wine collection.

Suppose the homeowner looks in the Yellow Pages and finds three possible contractors. The first, which operates under the trade name of Reliable Contractors, promises to finish any job it undertakes, "no matter what." The second, Efficient Contractors, does not promise to finish any job it undertakes, but does promise to pay a sum equal to the customer's lost expectation interest if it does not finish. The third, Manhattan Contractors, does not promise to finish its jobs and does not even promise to pay the customer's lost expectation

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parties' agreement to specific performance. *See, e.g.*, Stokes v. Moore, 77 So. 2d 331 (Ala. 1955) (denying effect to parties' agreement, but the existence of the agreement can serve as evidence for the proposition that money damages are inadequate).

15. Note that ex ante agreement is not the only way to achieve the benefits of efficient nonperformance. The parties could alternatively wait for the new information to arrive and then agree on a mutually satisfactory modification ex post. Whether this alternative is preferable depends on whether the costs of ex ante agreement (primarily, errors in anticipating what allocation of rights is best, and the marginal transaction costs of negotiating an extra term that in most cases will never come into application) exceed the costs of ex post agreement (primarily, costs arising from haggling, delays, holdup, and bargaining failure). The advocates of efficient breach argue that in many, and perhaps, most cases, ex ante agreement on a cash buyout is preferable to waiting for an ex post modification; the main reasons are that waiting for an ex post modification imposes extra risk on the parties, and creates incentives for wasteful expenditure of resources in anticipation of hold-up. *See* Shavell, *Specific Performance Versus Damages*, *supra* note 4.

interest, but it does promise that it will give its full deliberation in deciding whether to show up to work, and to cheerfully refund any deposit if it does not show up. All three contractors have excellent Better Business Bureau ratings; they always keep their promises, or at least have so far.

It should be obvious that in a competitive market, the three contractors cannot charge the same price and all stay in business, because it is more costly to promise to finish a job, no matter what, than to promise to finish or pay expectation, whichever is cheaper; and it is more costly to promise to finish or pay expectation than it is to promise to show up to work if one feels like it. In particular, there is some possibility that the contractor will turn out to have performance costs of more than $2000 (either because the cost of labor and materials has risen, or because some other job comes along that would pay more than $2000 and it is not possible to undertake both).

The standard logic that implies that expectation damages lead to efficient breach also implies that the homeowner is strictly better off hiring Efficient Contractors than she is hiring Reliable Contractors. A full exposition of this logic is available elsewhere,[16] but the intuition is straightforward. If she hires Reliable Contractors, she gets her new driveway, and its $2000 value, with certainty. If she hires Efficient Contractors, she gets either the driveway, or enough cash to substitute for the anticipated appreciation in the value of her house (if she is buying the driveway as an investment) or (if she is buying the driveway for its consumption value) to buy a quantity of wine that will make her just as happy as she would be having the driveway (though perhaps happy in a different way). She gets $2000 worth of value either way, but Efficient Contractors charges a lower price and accordingly offers a better deal.[17]

Similarly, one can show that the homeowner is better off in expected terms hiring Efficient Contractors than she is hiring Manhattan Contractors. The

16. *See* Shavell, *Is Breach of Contract Immoral?*, *supra* note 4, at 444-45.

17. For example, suppose that the contractor's usual cost of performance is 1000, but one time out of ten it turns out to be 6000 (because materials and preparation costs are unexpectedly high due to unforeseeable ground conditions, or alternatively because an extremely lucrative job that would yield 6000 in extra revenue comes up at the last minute and it is not possible for the contractor to undertake both). In this case, the reliable contractor would have to charge at least 1500 in order to break even on the deal: 1500 = (90% x 1000) + (6000 x 10%). The homeowner would receive 2000 in benefits from entering into this agreement, and would enjoy a net surplus of 500 (=2000-1500).

The efficient contractor's costs are lower than this, however, because it does not have to incur 6000 in performance in the high-cost contingency; instead, it makes cash payment of 2000. Accordingly, to break even it only needs to charge 1100 (1100 = (90% x 1000) + (2000 x 10%)). The homeowner would again receive 2000 in benefits from entering into this agreement, but would now enjoy a net surplus of 900 (=2000-1100). Note that the 400 increase in consumer surplus corresponds to the avoidance of inefficiently costly performance, ten percent of the time. Inefficient performance wastes 4000 (the difference between the 6000 cost of performance and the 2000 benefit it produces for the homeowner); this 4000 discounted by the one in ten chance of incurring it equals 400. Note also that even if the homeowner attaches some subjective psychic value to performance, above and beyond its pecuniary value, the efficient contractor is still the more desirable partner so long as this psychic value is less than or equal to 400.

reason is that Manhattan Contractors will only perform if its cost of performance is less than the price it quotes, and will fail to perform otherwise. But there will sometimes arise circumstances in which Manhattan's cost is greater than the quoted price, but still less than the homeowner's $2000 value of completion, so that Manhattan inefficiently fails to complete.

It follows that if the homeowner has strictly instrumentalist motives for entering into the paving contract (that is, all she cares about is what she receives when the parties' interaction is complete), she should choose to do business with Efficient Contractors. Similarly, if she is not facing three different contractors, but one contractor offering to do business under three alternative contractual arrangements, differing only with respect to the availability of specific performance or the amount of money to be paid if it does not occur, she should prefer to do business under the efficient, expectation-protecting contract.

One might object that the homeowner, or at least some homeowners, would be willing to pay the price premium to hire the reliable contractor, in order to have the satisfaction of knowing that the job will be done no matter what. But the value of this satisfaction, if it exists, is properly incorporated in the homeowner's expectation interest. In the above example, for instance, such a preference simply means that the $2000 buyout payment does not fully compensate for the homeowner's losses when the contractor fails to perform. The payment thus needs to be increased by some additional amount sufficient to compensate for the disutility associated with the mental adjustment of receiving her utility in the form of wine instead of in the form of a new driveway; and this adjusted amount is the proper measure of expectation.

Accordingly, unless the homeowner places an infinite value on getting her driveway repaved as promised, there will be some amount of cash that will make her happier than the driveway. She will therefore be better off dealing with a contractor who promises to pay this amount of cash in lieu of the driveway, than with the reliable contractor who promises to specifically perform no matter what.[18]

If most promisees do not place an infinite value on having their promises enforced, then a rule of law that provides for expectation damages—including, we must stipulate, an appropriate premium for the mental and other costs of adjusting to the fact that the promise is being discharged by cash payment instead of the originally anticipated noncash performance—will make most promisees better off than a rule requiring specific performance. Expectation

18. Note that even the most reliable contractor will encounter situations in which it is physically or practically infeasible to perform, and the parties must specify, explicitly or implicitly, what amount of money is available as a substitute for performance in that instance. The ultimate contract price will depend on the amount that is chosen, just as it depends on the amount payable under contracts that do not require specific performance.

damages would therefore be justifiable as a default rule, providing the remedy that most parties would prefer, and that, in a world of costless and complete contracting, they would have explicitly chosen.[19] If these assumptions hold, awarding expectation damages is not only efficient, but maximally promotes party autonomy.[20]

Indeed, on this line of argument, the term "efficient breach" is actually a misnomer, because paying money in place of specific performance, if the promisor finds it advantageous to do so, is entirely consistent with the best understanding of the parties' agreement. Thus it is not a breach at all, but rather an alternate way of discharging one's duties under the contract. Instead of efficient breach, we might equivalently (and perhaps more clearly) speak of "efficient performance" or "efficient cancellation option" or "efficient rescission." And if there is no breach of promise, then there can be no promissory wrong.

To be clear, I am not claiming that all, or even most, actual contracts are consciously understood by the contracting parties as having this pay-or-perform nature. Nor am I claiming that the cost-saving features of pay-or-perform justify imposing it on parties who would prefer other remedies (or indeed, no remedy at all). The argument is simply that the efficiency properties of pay-or-perform make it a more useful term for most parties than perform-no-matter-what, that it is therefore reasonable to imply it as a default rule in ordinary contracts, and most importantly, that if parties include a pay-or-perform term in their contracts, whether explicitly or implicitly, it is not a breach of promise when it is exercised.

THREE TYPES OF OBJECTIONS TO THE ARGUMENT FOR EFFICIENT BREACH

Contributors to the literature on efficient breach have identified a number of straightforward and well-known objections to the argument laid out in the previous section. These overlapping objections include: (1) that the argument above depends on empirical presuppositions that are not borne out in practice, such as the assumption that expectation damages are routinely available at low

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19. *See* Shavell, *Contracts*, *supra* note 1.

> [T]he seller who finds that his production cost would be [greater than the buyer's reservation value] will commit breach under the expectation measure. But in so doing, he will be acting precisely as would have been set out in a complete contract, and it is that contract which is best regarded as the promise between the parties that ought to be kept.

Id. at 439.

20. Because it minimizes the number of occasions on which the state implies a term that the parties do not want, while leaving them free to contract around the implied term in the remaining cases. *See* Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989) (arguing that consent-based arguments have no purchase when choosing a default rule of interpretation).

cost and well measured by courts;[21] (2) that renegotiation ex post in the shadow of a specific performance remedy, or ex ante assessment of damages in the form of a liquidation clause, would more effectively protect parties' expectation interests and promote efficient performance than ex post assessment of money damages in an adversarial proceeding;[22] (3) that even if money damages protect the parties' expectation interests under the contract in question, they create a negative externality by undermining the certainty of future bargains by third parties;[23] (4) that ordinary contracting parties are boundedly rational and do not adequately consider the prospect of nonperformance when they enter into agreements, and thus do not bargain for the price adjustment that would properly correspond to that prospect under full information;[24] (5) that many, and perhaps most, contracting parties attach a distinct noninstrumental interest to performance that is incommensurable with money, so that damages can never be truly compensatory;[25] (6) that ordinary contracting parties do not in fact subjectively understand their agreements to contain an implicit buyout option, but in fact believe that they have agreed to specific performance;[26] (7) that the argument at most establishes hypothetical consent to a rule of money damages, but only actual consent is morally relevant.[27]

These objections are well known to scholars who follow the academic literature on contract law; and it is not the place of this essay to discuss or evaluate them in detail. Instead, I introduce them here in order to classify them according to the category of normative argument into which they fall; and for this purpose, three categories are relevant.

One type of normative argument arises from the consequentialist tradition, which assesses the morality of actions and institutions based on whether they

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21. *See, e.g.*, Eisenberg, *supra* note 4, at 989-97; Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1444 (1980); Macneil, *supra* note 2.

22. *See, e.g.*, Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979); Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341 (1984).

23. *See, e.g.*, Friedmann, *supra* note 2, at 7; Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 FORDHAM L. REV. 1085, 1092-93 (2000).

24. *See, e.g.*, Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 225-36 (1995); Tess Wilkinson-Ryan, *Do Liquidated Damages Encourage Breach? A Psychological Experiment*, 108 MICH. L. REV. 633 (2010).

25. *See, e.g.*, Yuval Feldman & Doron Teichman, *Are All "Legal Dollars" Created Equal?*, 102 NW. U. L. REV. 223, 256-57 (2008); Tess Wilkinson-Ryan & Jonathan Baron, *Moral Judgment and Moral Heuristics in Breach of Contract*, 6 J. EMPIRICAL LEGAL STUD. 405 (2009).

26. *See, e.g.*, Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1755 (2001). "As one transactor explained, '[y]ou want performance, not payment for nonperformance. [Payment] is not fulfilling your deal.' And, as another transactor put it, 'you do not just breach and pay. This is not done.'" *Id.*; Shiffrin, *Could Breach of Contract Be Immoral?*, *supra* note 4, at 1565-66.

27. *See, e.g.*, JULES L. COLEMAN, RISKS AND WRONGS 166-73 (1992); Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 (1992).

produce good or bad consequences.[28] This tradition includes both utilitarian theories of morality as well as the concept of economic efficiency itself; it is the normative mode in which contemporary economists are primarily schooled and acculturated.

For instance, objection (1), that courts do not actually award true expectation damages (because they are difficult to measure, or because some losses are excluded as a matter of legal doctrine, or because it is costly to bring suit, or because there is some chance the court will err or the aggrieved party will be unable to prove his claim), is a consequentialist objection. To the extent these concerns are empirically valid, the consequence of pay-or-perform will be that actual promisors will have an inadequate incentive to perform and an excessive incentive to breach. In this situation, attaching moral opprobrium to breach of contract might well be an effective way of increasing the sanction for nonperformance, leading to a more efficient outcome.

Similarly, objection (2), that the expectation interest is more cheaply and effectively promoted by ex post renegotiation, undertaken in the shadow of a legal right to specific performance, also provides a consequentialist objection to efficient breach. To the extent the claim is empirically valid, specific performance will provide an equally good incentive for efficient performance, at lower transaction costs and with a lower incidence of error.

Objections (3), (4), and perhaps (5) can also be framed in consequentialist terms. If pay-or-perform leads to third-party externalities or mistaken failures to perform, or if it is not properly priced into the other terms of the contract, then it will not have the efficiency consequences suggested above. For this reason, proponents of efficient breach would typically acknowledge and accept this set of objections.

A second type of objection arises from the deontological normative tradition, which assesses the morality of actions and institutions based on whether they respect rights, fulfill duties, and promote autonomy.[29] For a deontologist, the fact that an act leads to good consequences is irrelevant if it is wrongful. Wrongfulness depends instead on whether a choice conforms with a primary moral norm (for example, do not lie or kill, do not treat other persons as ends in themselves rather than means to an end). This is the mode of argument that most closely corresponds to the normative vocabulary of the law; and it is a mode of argument that most critics of efficient breach have deployed.

For instance, objection (6), that ordinary contracting parties do not in fact understand their agreements to contain an implicit buyout option, but in fact

28. *See* Walter Sinnott-Armstrong, *Consequentialism*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., Winter 2011), http://plato.stanford.edu/archives/win2011/entries/consequentialism/.

29. *See* Larry Alexander & Michael Moore, *Deontological Ethics*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., Fall 2008), http://plato.stanford.edu/archives/fall2008/entries/ethics-deontological/.

regard themselves as having agreed to specific performance, is primarily a deontological objection. Objection (7), that hypothetical consent does not properly substitute for actual consent, is also a deontological objection. Imposing upon the parties an agreement to which they have not agreed, even if it is more efficient, deprives them of autonomy and fails to respect their freedom to contract. Conversely, if the parties agreed to specific performance but the law only requires money damages, the legal system has countenanced a violation of the promisee's moral rights and the promisor's moral duties.

Objections (4) and perhaps (5) can also be framed in deontological terms. If parties do not understand what they are getting into when they agree to pay-or-perform, then they have not truly consented to the arrangement, and so the party who elects payment over performance is profiting at the other's expense and against her will. And most deontologists would insist that a payment of money, without more, does not rectify the harm caused by breaching the promisee's entitlement to performance.

Finally, a third set of objections can arise from a third normative tradition that today is commonly referred to as virtue ethics. This tradition assesses conduct based on whether it is grounded in or promotes the development of good moral character, and is commonly denoted as "aretaic," deriving from the ancient Greek word for virtue or excellence, *arete*.[30] The aretaic tradition is less commonly invoked in legal scholarly circles than either consequentialist or deontological arguments, but it has grown in influence in the philosophical literature in the last fifty years and has more recently begun to influence legal scholarship as well.[31]

While aretaic arguments have been much less prominent than consequentialist or deontological ones in the literature on efficient breach, some objections to pay-or-perform can be framed in such terms. For instance, objection (5), that money can never be full compensation for the incommensurable loss of nonperformance, suggests that there is a substantive value embedded in contractual relationships that is worth preserving, even if no person is harmed or wronged by their termination. Similarly, claims that efficient breach undermines the fiduciary nature of contractual relations also can be framed in aretaic terms.[32]

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30. *See* Rosalind Hursthouse, *Virtue Ethics*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., Summer 2012), http://plato.stanford.edu/entries/ethics-virtue/.

31. *See, e.g.*, ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION (1995); Lawrence B. Solum, *Virtue Jurisprudence: A Virtue-Centered Theory of Judging*, 34 METAPHILOSOPHY 178 (2003), *reprinted in* MORAL AND EPISTEMIC VIRTUES 163 (Michael Brady & Duncan Pritchard eds., 2004). For an application of virtue theory to contract law generally, that also touches on the primary argument of this essay, see Chapin F. Cimino, *Virtue and Contract Law*, 88 OR. L. REV. 703 (2009) (considering how aretaic legal theory better captures parties' dual intents in contract than current theoretical approaches).

32. *E.g.*, Markovits & Schwartz, *supra* note 4, at 2004-05. *See generally* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993) (outlining differences in scope and rigor

By distinguishing among these three modes of normative argument, I do not mean to suggest that they are mutually exclusive or that any particular objection to efficient breach must fall into a single category. On the contrary, several of the objections listed above could be classified in multiple ways. All three types of argument are embedded in our moral traditions, though perhaps not to the same extent at all times and places.[33]

Additionally, each of these modes of normative discourse is capable of incorporating the core values of the other two. For example, consequentialist theories all depend on some account of the good, but they vary depending on what this account consists of. One consequentialist might take the position that the good consists of human happiness but that happiness depends critically on the exercise of autonomy within clearly delineated boundaries—in which case the good is best promoted by articulating an intelligible set of rights and duties and by establishing institutions that protect their observance. Rule-utilitarianism is the classic statement of this position. A different sort of consequentialist might argue that true human happiness derives from the satisfaction of developing one's talents and capacities—that is, by pursuing excellence.

Similarly, all deontological theories depend on some account of rights, but they vary in what rights they consider fundamental. One deontologist might take the position that all persons have a right to certain basic goods (e.g., food, shelter, medical care, education) that enable them to formulate and pursue their diverse individual goals. Alternatively one might argue that the right to develop one's human potential is most important. These theories might overlap considerably in what specific rights they prescribe (for example, the rights to life and liberty would figure prominently under either of these theories) but their substantive groundings–and the rhetoric used to defend them—could be quite different. It is thus possible to reinterpret in deontological terms the concerns that I have here classified as aretaic.[34]

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of fiduciary and ordinary contractual obligations).

33. Hursthouse suggests that virtue ethics provided the dominant approach to Western moral philosophy up through the beginning of the Enlightenment, but was eclipsed by deontology and utilitarianism in the nineteenth and the first half of the twentieth centuries. *See* Hursthouse, *supra* note 30.

34. I am indebted to both Seana Shiffrin and Kent Greenawalt for helping me understand this point. The reinterpretation may be summarized as follows: while some moral duties are perfect, or categorically binding (for example, the duty to refrain from making promises one has no intention of keeping), others are imperfect, or binding to the extent it would be possible for everyone to fulfill them (for example, a duty to develop one's talents and character). The duty to keep one's promises is perfect because if people broke their promises whenever they were inclined to do so, no one would take promises seriously and the institution of promising could not exist. The duty to develop one's talents and character is imperfect, because it is possible to imagine a world where no one did this, but not rational to will that that world should be ours. On the distinction between perfect and imperfect duties, see Robert Johnson, *Kant's Moral Philosophy*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., Summer 2010), http://plato.stanford.edu/archives/sum2010/entries/kant-moral/. A deontologist thus could argue (indeed, I take this to be Shiffrin's position) that while it is logically possible to have a legal regime in which contractual promises are understood as containing an implicit

Because all three traditions are part of our common moral culture, and each of them has developed internal accounts of each other, few authors can be wholly pigeonholed within a single tradition. Daniel Friedmann, in what is generally considered to be the most prominent early attack on efficient breach theory, deploys both utilitarian and deontological arguments, though he presents the latter as more fundamental to his critique. Seana Shiffrin, perhaps the most vigorous critic of efficient breach theory in the recent legal literature, systematically combines deontological and aretaic rhetoric, sometimes even within the same sentences.[35] And even the early Richard Posner, who is identified more than any other legal commentator with the pursuit of economic efficiency, relies on aretaic values in defending his concept of wealth maximization against the rival consequentialist theories of utilitarianism and efficiency.[36]

Notwithstanding this theoretical overlap, in the remainder of this essay I will abstract from it and refer to these three kinds of arguments—consequentialist, deontological, and aretaic—as distinct ideal types. My motivation in doing so is that the essay is not intended to provide a full explication of these theories and the relationships among them. Rather, it aims to better understand the ways in which the major participants in the efficient breach debate have been talking past one another. For that reason, in what follows I use "deontological"

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condition of efficient breach, we should not want to live in such a regime because such a way of life would be disrespectful to the parties and their mutual relationship.

35. *See* Shiffrin, *supra* note 2, at 730-33.

> A virtuous agent can surely accept that there may be good aspects to wrongful breach on certain occasions. Yet, if such breach is indeed, all things considered, wrong, a virtuous agent cannot accept the economic benefits of breach as constituting a sufficient, or even a partial, contributory justification for the law's content. The challenge would be all the greater if the primary, positive justification for the law's content were the desirability of encouraging (and not merely making more likely) the wrongful conduct per se. In that case, the law (or its justification) would be suggesting a prescriptive recommendation to act wrongfully. It is hard to see how a virtuous agent could embrace that recommendation, whether explicit or implicit.

Id. at 732.

Ultimately, however, I read Shiffrin as drawing more on the aretaic than the deontological tradition.

36. RICHARD POSNER, THE ECONOMICS OF JUSTICE 68-69 (1983).

> To summarize, the wealth-maximization principle encourages and rewards the traditional "Calvinist" or "Protestant" virtues and capacities associated with economic progress. It may be doubted whether the happiness principle also implies the same constellation of virtues and capacities, especially given the degree of self-denial implicit in adherence to them. Utilitarians would have to give capacity for enjoyment, self-indulgence, and other hedonistic and epicurean values at least equal emphasis with diligence and honesty, which the utilitarian values only because they tend to increase wealth and hence *might* increase happiness.

Id.

to refer to the moral obligation to follow generally applicable rules, such as keeping promises, and "aretaic" to refer to the obligation to seek out ways of life that best promote human character. This terminology may not exactly correspond to the distinction between perfect and imperfect duty as it is understood by Kantians, but it is close enough for our purposes here.

One last distinction is in order before moving to the main argument: the distinction between efficient breach in particular, and arguments for expectation damages generally. I do not claim or believe that taking a deontological or aretaic position on ethics necessarily commits one to defending specific performance as the primary remedy for breach of contract, any more than taking a consequentialist or utilitarian position commits one to defending expectation damages. As we have seen, it is possible to favor specific performance on economic grounds, given the particular configuration of empirical factors at work; and conversely, one can hold a deontological view of contracting while still favoring the rule of expectation damages. Our honoree, Charles Fried, takes this very position in the book that is the subject of this symposium.[37] But in general, it is the case that those who have criticized efficient breach on moral grounds have tended also to argue in favor of specific performance, and have viewed expectation damages as, at most, a second-best remedy, perhaps tolerated for pragmatic reasons, but never to be condoned, and certainly not celebrated.[38]

THE ARETAIC ARGUMENT AGAINST EFFICIENT BREACH

To summarize the discussion thus far, the standard deontological objection to efficient breach is that it licenses wrongdoing, in the specific form of

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37. FRIED, *supra* note 2, at 17-21 ("What a Promise Is Worth"). Note that Fried does not offer any defense of expectation damages as opposed to specific performance; this is because his primary concern is to defend the promissory principle against reliance-based theories of contract such as those offered by Patrick Atiyah and Grant Gilmore. *Id.* at 18.

> The assault on the classical conception of contract, the concept I call contract as promise, has centered on the connection . . . between contract law and expectation damages. As the critics recognize and as I have just stated, to the extent that contract is grounded in promise, it seems natural to measure relief by the expectation, *that is, by the promise itself.* If that link can be threatened, then contract itself may be grounded elsewhere than in promise, elsewhere than in the will of the parties.

Id. (emphasis added).

38. *See, e.g.*, Daniel Friedmann, *Economic Aspects of Damages and Specific Performance Compared, in* CONTRACT DAMAGES: DOMESTIC AND INTERNATIONAL PERSPECTIVES 65 (Ralph Cunnington & Djakhongir Saidov eds., 2008) (conceding that specific performance may not be warranted in cases where the promisor's cost of performance exceeds the promisee's benefit, but insisting that in such cases breach is tolerated, but never condoned). Friedmann's theory of "tolerated" breach, however, would apply only to the case where the promisor's cost is an out-of-pocket cost as opposed to an opportunity cost. In cases where the promisor breaches in order to achieve a gain, Friedmann would view this gain as belonging to the promisee.

promise-breaking, in the service of consequential ends. The standard consequentialist response to this objection is that people enter into contractual promises not for the sake of the promises themselves, but in order to accomplish instrumental goals, most commonly economic ones: to exchange material commodities, to induce investment, to provide insurance against economic risk, and so on. Given such purposes, promises that can be escaped by paying a sufficient money substitute are more useful than those that cannot. Accordingly, agents who enter into contracts for instrumental purposes should agree that their contracts should be based on the former kind of promise, and not on the latter. Similarly, in cases where the parties have not explicitly stated what type of promise they are making, the default rule of interpretation should be that they have entered into the former kind of contract.

Even if paying money as an alternative to performance is not deontologically wrong, however, and even if it is consented to, it does not necessarily follow that it is a virtuous act. From the perspective of virtue ethics, the concept of efficient breach may be objectionable because it establishes and endorses a norm under which contracts are casually entered into and casually abandoned—in which contractual partners are treated instrumentally and superficially.[39]

To be precise, the objection is not that without a strong level of commitment, the contracting parties will lack sufficient incentive to invest in relationship-specific assets. That would be a purely consequentialist argument. From an efficiency perspective, sacrificing some degree of efficient reallocation of resources ex post could be economically worthwhile in order to achieve more efficient investment incentives ex ante; this is a consequentialist reason for commitment that might lead some or even most parties to prefer specific performance over expectation protection. But the argument I am unpacking here is a noninstrumental one: it is that a legal regime in which commitment is respected and valorized will better promote virtuous moral character, civic solidarity, and a flourishing community. We may call this the aretaic argument against efficient breach.[40]

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39. *Cf.* Markovits & Schwartz, *supra* note 4, at 1994-96.

> One of the basic, formal features of promising is that a promisor makes the promisee distinctive for her–she takes the promisee out of the general sea of humanity and becomes particularly attentive to the promisee's person. As Joseph Raz observed, promises establish a special relationship between promisors and promisees, and the value of this special relationship plausibly explains why it is not a sufficient reason for breaking a promise that doing so is best overall. Perhaps, then, the unilateralism associated with the expectation remedy wrongly eliminates such promissory solidarity, while other remedies (including, but not limited to, traditional specific performance) might make better room for it.

Id. at 1994 (footnote omitted).

40. This argument is closely related to that presented in Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1497-99 (2004), although Markovits does not explicitly draw the connection of his theory to virtue ethics.

To make the point concrete, consider an example drawn from social rather than commercial life. Imagine that a law student arranges to meet a group of friends for dinner, to be followed by a trip to the theater. At a late afternoon extracurricular event, lubricated by alcohol, the student meets a charming person and perceives the possibility of mutual romantic interest. On an impulse, the student abandons the dinner and theater plans and instead spends the evening with the charming new acquaintance. Indeed, the new acquaintance is so captivating that the student never even bothers to send a text message to the group of waiting friends. The friends are thus deprived of the pleasures of the student's company.

We can stipulate that there is no contractual liability entailed in standing up one's friends for dinner. Still, has the student behaved wrongly, to the extent that an apology is due? Most people would probably say yes; and their moral intuitions would be reinforced if we added in the factor that the friends delayed the beginning of dinner in hopes of the student's late arrival, leading them to rush through their meal and to arrive at the theater after the first act had started.

On the other hand, suppose that all the friends are young and unattached and all seeking romantic partners. Suppose that they have an agreed understanding (it could be explicit or implicit) that if the opportunity to spend the evening with a charming potential romantic partner comes along, it should be taken up without hesitation, with explanations to follow later. In their unanimous view, the potential disruption to the group plans is more than outweighed by the potential rewards of an exciting new paramour. All the other facts are the same; no text message is sent, the friends lose out on the student's company and suffer the delay of their evening plans. Now has the student behaved wrongly?

Some will alter their judgment in this situation and say no; but others will still say yes. To the extent that the student's behavior remains objectionable in this second situation, however, it is not because any promise has been broken. The friends have authorized the student's frolic, and consented in advance to be stood up. They may have suffered a loss by having to bolt their dinner and miss the beginning of the play, but they understood that this was a risk of their agreement and accepted that risk willingly and gladly in order to obtain similar opportunities for themselves.

> The prospect that an opportunity for efficient breach might arise, and the value associated with this prospect, therefore count among the benefits generated by the contract. And the parties may allocate this benefit, by means of the contract, just as they allocate any other. . . .
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> . . . The law's generally encouraging stance toward efficient breaches should be read . . . as establishing a principle of contract interpretation under which contracts that are silent are interpreted to exclude from a promisee's expectation the gains from possible efficient breaches (and in this way also rendering restitution for such gains unjustified on its own terms).

Id.

What is objectionable in the second case, accordingly—if there is something objectionable—is that this is no way to treat friends, and no way for friends to accept being treated. On such a view, the second group, even if they agree that these are the ground rules for their relationship, shares an impoverished view of friendship. In their willingness to subordinate their relationship to a casual fling, they exhibit their shallowness and lack of mutual commitment.[41]

Can a similar objection be leveled at ordinary contracts enforced by expectation damages? In formal terms, such an objection is easy to articulate. A contracting party who breaks off a relationship and offers money in compensation treats the parties' relationship as alienable and disposable. A counterparty who accepts this understanding as the price of doing business (or perhaps in exchange for a more favorable price) is collaborating in this alienability. The persuasiveness of the objection, however, does not depend on its mere form. It depends on whether we think that alienable relationships are substantively objectionable in the ordinary contractual setting.

ASSESSING THE ARETAIC OBJECTION

Aretaically grounded arguments have commonly been put forward in the property and constitutional law literature in furtherance of the claim that particular rights and duties should not be alienated, particularly in exchange for money.[42] They have been most influential, however, when applied to rights that are deemed fundamental to personal integrity: most particularly, those related to family formation and reproductive choice.[43] Do such arguments have any force in contracts generally? Do they apply when parties choose to trade away an entitlement to specific performance, explicitly or implicitly, by contracting ex ante into expectation damages?

One possible answer is that they do not, that market and nonmarket interactions represent separate spheres of human activity that involve separate ethical obligations. On such a view, human flourishing may require the existence of some thick relationships in which commitment and solidarity are constitutive elements, but it does not require all relationships to be similarly thick. Indeed, one might object that attempting to extend aspirations of solidarity to market relationships will, by spreading our emotional attention too

41. *Cf.* Ethan J. Leib, *Contracts and Friendships*, 59 EMORY L.J. 649 (2010); SEX AND THE CITY (New Line Cinema 2008) ("They say nothing lasts forever; dreams change, trends come and go, but friendships never go out of style.") (spoken by Sarah Jessica Parker as Carrie Bradshaw.). Aficionados of the *Sex and the City* television series will recognize the value conflict outlined in this paragraph as a running theme in the characters' dramatic and comedic interactions.

42. Most famously by Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849 (1987).

43. *See generally* ELIZABETH ANDERSON, VALUE IN ETHICS AND ECONOMICS (1995); MICHAEL TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT (1997); Frances E. Olsen, *The Family and the Market: A Study of Ideology and Legal Reform*, 96 HARV. L. REV. 1497 (1983).

thinly, undermine our ability to maintain our more intimate relationships with the same intensity.

On the other hand, the majority of citizens in modern capitalist societies, perhaps save retirees, students, and homemakers, spend the largest part of their social interactions in market-related activities. In both large and small-scale enterprise, productive activity is increasingly undertaken in teams. And as the relational contracts literature tells us, in all but the simplest exchanges, the parties' interactions depend on, and also reinforce, a web of social and cultural relations. To exclude aretaic considerations from our economic and work life may thus substantially impoverish our lives as a whole.[44]

Additionally, individual choices, as they are observed and interpreted by others, affect the development of social norms. Parties who behave according to the recommendations of efficient breach theory, and commentators who urge them to do so, do not just shape their own characters in an individualistic direction. They set a model of social behavior that others may be induced or even pressured to follow.[45] The model is further reinforced when it is embedded in our law and in our legal institutions.

Accordingly, those who are committed to the virtues of solidarity and trust, and concerned about their possible decline in modern society, may have reason to object to establishing a default rule of pay-or-perform, and to oppose a legal theory that promotes such a rule as socially desirable. This is so even if they would not be prepared to forbid contracting parties from agreeing ex ante to forego the remedy of specific performance. The reason is that default rules are not just a matter of head-counting of contracting parties' preferences. They establish a norm and put the stature of legal institutions and the legal community behind it.[46]

Note, by the way, that just as aretaic concerns can be in tension with

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44. This may be so even apart from the possibility that excluding norms of commitment and solidarity from market settings may undermine our ability to maintain them in other aspects of our lives. *Cf.* James Boyd White, *Economics and Law: Two Cultures in Tension*, 54 TENN. L. REV. 161 (1986) (suggesting that the wide application of economic analysis to legal problems threatens to undermine the distinctive moral values of the law).

45. This potential for spillover to social norms helps explain the otherwise puzzling argument that even if money damages fully protects the parties' expectation interests, breach of one contract creates a negative externality by undermining the certainty of future bargains by third parties. From a purely consequentialist perspective, this argument makes no sense; if expectation is fully protected even in the event of breach, there is no reason for third parties to be deterred from entering into their own contracts. Whether their counterparties breach or perform, they will still get their expected gains.

If on the other hand parties attach noninstrumental value to contractual performance, because they value solidarity for its own sake, then they do have reason to be concerned about other contractors' breaches. By exhibiting and modeling independent, impersonal economic behavior, and prioritizing material gains over personal connection, they may encourage others to adopt similar normative commitments, which will make it harder for people who do value contractual solidarity to find corresponding partners. Formally, this is an externality that operates through the mechanism of preference formation.

46. As Craswell, *supra* note 3, has argued, default rule arguments are not easily susceptible to deontological objections. But they are susceptible to aretaic objections, along the lines outlined here.

economic efficiency, they can also be in tension with deontological values such as liberty and autonomy. Inalienable commitment to a relationship, whether commercial or personal, necessarily limits one's ability to act independently. Impersonal trade can be alienating in one sense, but it is liberating in another, in that it frees people from the obligation of unwanted social relationships as the price of economic survival.[47]

Indeed, from an aretaic perspective, the rhetoric of efficient breach is at least as objectionable as its substance. I have suggested above that the concept would have generated less controversy had it been articulated in terms of efficient performance or efficient termination options. But the point of articulating the concept in terms of breach was at least in part deliberately transgressive.

In this way, the advocates of efficient breach have followed in the tradition of Oliver Wendell Holmes, who delighted in tweaking his more traditionally minded colleagues, and savored the thought that his legal positivist arguments would offend their ethical sensibilities.[48] Posner, Goetz, and Scott, and their cohort have actually taken Holmes one step further, by arguing not just that the law was indifferent to whether a person kept his contractual promise, but that promise-breaking was affirmatively desirable. Here is one reason why the label of "efficient breach" has been so controversial, but also so influential. The same theory presented under the name of efficient performance would probably not have created such a sensation.[49]

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47. *See* ADAM SMITH, THE WEALTH OF NATIONS 15 (Edwin Cannan ed., Modern Library 1994) (1776).

> Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. Nobody but a beggar chuses to depend chiefly upon the benevolence of his fellow-citizens.

Id.

48. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457 (1897).

> The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can.

Id. at 462.

49. Transgressive formulations of this sort are a standard rhetorical move in the economic analysis of law literature, where writers routinely talk of the efficient amount of crime, corruption, or pollution as opposed to the efficient amount to be spent on law enforcement or environmental. Even deontologists and virtue ethicists accept that it is not feasible to spend unlimited resources to combat such social ills, but it rankles to hear such ills described with the affirmative valence of efficiency or optimality—which is of course part of the point.

The defenders of efficient breach have not yet joined issue with the aretaic objection, in part because the nature of the objection has rarely been made explicit. This not does mean that no response can be made. An effective response, however, would have to defend an alternate account of virtue that competes with the relational account, in the same way that efficient breach theorists have defended an alternate account of consent that competes with the account offered by the deontologists.

Such an account can easily be imagined, although this essay does not attempt to develop it in detail. One way to do it would be to focus on more individualist virtues that are naturally compatible with the norm of efficiency, and with the positivist methodology of modern neoclassical economics.[50] The possible candidate virtues would include prudence, thrift, diligence, self-reliance, candor, and the like. These are admittedly unromantic virtues when compared with alternatives like solidarity and trust, and few of us would wish to aspire to them exclusively. But neither would we wish to disparage them, as it is more than plausible that they are an essential subset of that broader set of virtues comprised in practical wisdom.[51]

Alternatively, one might take the opposite tack and defend efficient breach in terms of relatively altruistic virtues. This approach would emphasize the ethical responsibilities of the promisee, for whom the relevant virtues would include clemency, magnanimity, and generosity. From this perspective, a promisee who insists on receiving full specific performance, when monetary compensation would fully protect his expectation interest (and when specific performance would impose an avoidable loss on, or obstruct a possible gain for, his counterparty), behaves vengefully and spitefully. Graciously accepting the substitute of expectation damages, conversely, could be a way of strengthening one's own magnanimous instincts, and of expressing sympathy for the other party's difficulties or happiness for the other party's good fortune. Such virtues would not merely be self-denying; they could also strengthen a partnership that would provide reciprocal opportunities for similar magnanimity in future dealings.

CONCLUSION

The ongoing debate over efficient breach theory is not just a debate between consequentialists and deontologists; it is also—and perhaps even primarily—a

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Another way of saying this is that it is a standard piece of economic (and law and economics) rhetoric to purport to make a virtue out of vice.

50. *Cf.* Avery W. Katz, *Positivism and the Separation of Law and Economics*, 94 MICH. L. REV. 2229 (1996) (defending practical virtues of positivism); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976) (contrasting norms of individualism and altruism).

51. As Hursthouse remarks, "It is part of practical wisdom to know how to secure real benefits effectively; those who have practical wisdom will not make the mistake of concealing the hurtful truth from the person who really needs to know it in the belief that they are benefiting him." Hursthouse, *supra* note 30.

debate between partisans of competing virtues. The aretaic arguments in the debate, however, have rarely been conducted openly, or explicitly distinguished from the deontological arguments. As a result, while the critics of efficient breach have been offering both deontological and aretaic objections (or deontological objections with an aretaic grounding), the defenders of efficient breach have only been recognizing and responding to the deontological elements of the criticism.

I conclude by returning to the focus of this symposium: Charles Fried's celebrated and influential *Contract as Promise*. The reader may be asking: What does efficient breach, or the connection between efficient breach and virtue ethics, have to do with Fried's book? The connection, I think, is as follows. Fried has famously argued that the law of contracts is best understood, and best morally justified, if we take its primary purpose to be the promotion and protection of promise-keeping. The debate over efficient breach, however, and the aretaic objection to efficient breach in particular, suggests that Fried's account is incomplete. It is not enough to keep one's promises; in addition, it is also important to make the right kind of promises—or perhaps in some circumstances, not to make promises at all.

The economic analysis of contracts, as a first cut, holds that promises that help to maximize exchange value are the right kind of promises, and promises that reduce exchange value are not. For virtue ethicists, promises that assist in the development of good moral character or that enact flourishing relationships are the right kind of promises, and promises that interfere with moral development or that enact dishonorable relationships are not. The law of contracts takes a stand on this issue by making it easier to enter into some contracts and harder to enter into others. Accordingly, those who care about the substantive content of promises, as well as whether they are kept, have reason to care about the law of contracts.