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Opportunistic Breach of Contract

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Abstract

Law and economics scholarship has traditionally analyzed efficient breach cases monolithically. By grouping efficient breach cases together, this literature treats the subjective motives and the distributive effects of the breach as immaterial. The *Restatement (Third) of Restitution and Unjust Enrichment* introduced a distinction based on the intent and the effects of the breach, allowing courts to use disgorgement remedies in cases of 'opportunistic' breach of contract (i.e., 'deliberate and profitable' breaches). In this article, we evaluate this approach, focusing on the effects of disgorgement remedies on allocative and productive efficiency, information-forcing and competitive effects, and restraint of breach-searching incentives. We show that, even from a purely consequentialist perspective, disgorgement remedies may be normatively warranted, especially when involving sellers' breach. Recent experimental evidence revealed that the preferences and reactions of ordinary people are in line with our evaluation of the effects of opportunistic breach.

Keywords: *contract law; efficient breach; opportunistic breach; contract damages; promissory theory of contract.*

1. Introduction

On the question of efficient breach, there exists a subtle tension between the consequentialist (economic) and the deontological (moralist) viewpoints. Both perspectives consider the failure to perform on a promise excusable in at least some subset of cases, yet they do not always agree on the boundary conditions when such breaches should be permitted and perhaps encouraged.[1] At one end of the spectrum, the standard economic analysis contends that if the promisor gains more than the promisee loses from a breach, then the right to breach (i.e., allowing nonperformance with payment of expectation damages) will be socially desirable. From an economic point of view, to the extent that expectation damages are fully compensatory, allowing an 'efficient breach'

1. See Craig S Warkol, "Resolving the Paradox Between Legal Theory and Legal Fact: The Judicial Rejection of the Theory of Efficient Breach" (1998) 20 Cardozo L Rev 321 at 321.

would not make either party worse off, and would increase joint welfare compared to actual performance.[2] At the other end of the spectrum, deontological philosophers of contract law take the moral duty to keep one's promises as a foundational principle of contracts, which should not be brushed aside based on cost-benefit analyses.[3] Lay intuitions about the excusableness of nonperformance are surprisingly nuanced and seem to track the consequentialist (economic) reasoning in some cases, while being deontological (moralist) in other cases. Survey-based studies and economic experiments conducted in recent years have shown that ordinary people have greater tolerance for contract breaches when the promisor seeks to avoid performance to mitigate unanticipated losses (hereinafter, 'loss-avoiding breaches') but are less willing to excuse performance when the promisor breaches to pursue a profit (hereinafter, 'gain-seeking breaches').[4]

U.S. state and federal court decisions, while constrained in the choice of remedies, have taken positions that fall across the wide consequentialist-deontological spectrum. Some courts reaffirmed the compensatory function of damages in contracts, refraining from imposing extra-compensatory liability to deter opportunistic breaches, while others expressed dissatisfaction with the limited judicial freedom to redress deliberate and profitable breaches of contract. Several courts have shown a readiness to strip the defaulting party of the profits obtained through an intentional breach, carrying out disgorgement of the profit under the veil of expectation damages. As Goff and Jones pointed out, there is ample evidence that judges have become impatient with such fictions and view damages as an instrument to induce performance, not an alternative to it.[5] In 2011, the *Restatement (Third) of Restitution and Unjust Enrichment* § 39 formally introduced a reconceptualization of the remedial approach to efficient breach, approximating the lay intuitions and the judicial opinions on this matter, allowing for the disgorgement of profits derived from breaches of contract that are both deliberate and

2. See Richard A Posner, *The Problematics of Moral and Legal Theory* (Belknap Press, 1999); Richard A Posner, "Let Us Never Blame a Contract Breaker" (2009) 107:8 Mich L Rev 1349; Steven M Shavell, "Is Breach of Contract Immoral?" (2006) 56 Emory LJ 439; Steven Shavell, "Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts" (2009) 107:8 Mich L Rev 1569 [Shavell, "May Not Be Immoral"].

3. See Dawinder S Sidhu, "The Immorality and Inefficiency of an Efficient Breach" (2006) 8 Tennessee J of Business Law 61; Henry Mather, *Contract Law and Morality* (Greenwood Press, 1999); Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press, 1981); Seana Shiffrin, "Could Breach of Contract be Immoral?" (2009) 107:8 Mich L Rev 1551; Seana Valentine Shiffrin, "Must I Mean What You Think I Should Have Said?" (2012) 98:1 Va L Rev 159.

4. See Jonathan Baron & Tess Wilkinson-Ryan, "Moral Judgment and Moral Heuristics in Breach of Contract" (2009) 6:2 J Empirical Leg Stud 405; Maria Bigoni et al, "Unbundling Efficient Breach: An Experiment" (2017) 14:3 J Empirical Leg Stud 527.

5. See Lord Goff of Chieveley & Gareth Jones, *The Law of Restitution*, 7th ed (Sweet & Maxwell, 2009).

profitable.[6] Several courts have in recent years relied on that *Restatement* section in granting disgorgement remedies.[7]

In this article, we analyze the distinction introduced by the *Restatement* between opportunistic and non-opportunistic breaches. Since our focus is on situations where the promisor deliberately chooses to breach a contract, the distinction between opportunistic and non-opportunistic breaches will hinge upon the breacher's motive for the breach. For brevity, we shall thus interchangeably refer to the non-opportunistic breaches as 'loss-avoiding' breaches and to the opportunistic breaches as 'gain-seeking' breaches. We will consider both categories of breach, with respect to different effects that they may have on (a) allocative and productive efficiency, (b) information-forcing and competitive effects, and (c) restraint of breach-searching incentives. We investigate whether any of these effects may support the dichotomous legal treatment of breach of contract cases introduced by the *Restatement*. Our analysis contributes to the existing literature, providing a more fine-grained consequentialist analysis that helps bridge the divide between economic and moral perspectives on opportunistic breach. We suggest that the established economic approach has ignored important differences, presenting a monolithic theory of efficient breach. The distinction between loss-avoiding and gain-seeking breaches is analytically important and both *Restatement* § 39 as well as subsequent caselaw have determined that not all efficient breach cases are equal—legal economists should soon embrace this realization.[8]

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6. *Restatement (Third) of Restitution and Unjust Enrichment* § 39 is a remedy rooted in restitution, enabling the injured party to disgorge the profit realized by the defaulting promisor by engaging in a deliberate profit-seeking breach. Disgorgement of profits is made available as an alternative to expectation damages. *Restatement (Third) of Restitution and Unjust Enrichment* § 39: Profit From Opportunistic Breach states:

(1) If a deliberate breach of contract results in profit to the defaulting promisor and the available damage remedy affords inadequate protection to the promisee's contractual entitlement, the promisee has a claim to restitution of the profit realized by the promisor as a result of the breach. Restitution by the rule of this section is an alternative to a remedy in damages.

(2) A case in which damages afford inadequate protection to the promisee's contractual entitlement is ordinarily one in which damages will not permit the promisee to acquire a full equivalent to the promised performance in a substitute transaction.

(3) Breach of contract is profitable when it results in gains to the defendant (net of potential liability in damages) greater than the defendant would have realized from performance of the contract. Profits from breach include saved expenditure and consequential gains that the defendant would not have realized but for the breach, as measured by the rules that apply in other cases of disgorgement.

Restatement (Third) of Restitution and Unjust Enrichment § 39 (2011) at 646 [*Restatement* § 39].

7. Farnsworth argued that the term "'disgorgement' is preferable to 'restitution'" because it conveys the idea that it is the transfer to the plaintiff of a benefit obtained by the defendant from the breach. E Allan Farnsworth, "Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract" (1985) 94:6 Yale LJ 1339 at 1342. In this article, we follow Farnsworth's suggested terminology.

8. Bigoni et al. carried out a novel incentivized laboratory experiment, showing that people's reactions differ with respect to gain-seeking and loss-avoiding breaches, consistent with the distinction introduced by *Restatement (Third) of Restitution and Unjust Enrichment* § 39. See Bigoni et al, *supra* note 4. Similarly, Roberts predicted that *Restatement* § 39 would inject a concept of "moral blameworthiness" into contractual legal obligations that would resonate

This article is structured as follows. In Section 2, we review the existing moral, legal, and economic literature, in search of the arguments put forth in favor or against a distinct legal treatment of opportunistic breach. We summarize the interesting experimental findings on ordinary people's reactions to opportunistic breach of contract, and judicial views on this matter. In Section 3, we provide support for the ordinary people's and judicial stances on efficient and opportunistic breach, discussing how different types of efficient breach produce distinct economic effects. We conclude that, even from a purely consequentialist perspective, disgorgement remedies may be warranted, especially when involving sellers' breach. In Section 4, we conclude with a brief discussion of the policy implications of the remedial protection for opportunistic breach.

2. Should Opportunistic Breach of Contract Be Discouraged?

Contract breaches can differ from one another, depending on the motives of the breach and the identity of the breaching party in the contract. Table 1 below illustrates the resulting four possible scenarios, distinguishing between non-opportunistic (loss-avoiding) and opportunistic (gain-seeking) breaches.[9]

As an illustration of Case 1, consider the following situation in which a change in circumstances increases the cost of performance:

> ***Case 1:*** *Seller's Loss-Avoiding Breach*. Seller undertakes to manufacture a machine for Buyer. Buyer pays 90, expected cost of performance is 80, and the value of the machine to Buyer is 100. In case of a breach by Seller, Seller compensates Buyer for 100. After contracting, due to an unexpected rise in the price of raw materials, Seller faces an increase in performance costs to $80 + x$. For all values $x > 20$, Seller would rationally choose to breach the contract, paying damages of 100. Performance of the original contract would create a deadweight loss equal to $x - 20$.

As an illustration of Case 2, consider a situation where a seller finds a higher valuing third party and has the opportunity to resell the good for a higher price:

> ***Case 2:*** *Seller's Gain-Seeking Breach*. Seller undertakes to manufacture a machine for Buyer. Buyer pays 90, expected cost of performance is 80, and the value of the machine to Buyer is 100. In case of a breach by Seller, Seller compensates Buyer for

with legal practitioners' moral inclinations. Caprice L Roberts, "Restitutionary Disgorgement as a Moral Compass for Breach of Contract" (2009) 77:3 U Cin L Rev 991 at 992. While this might not entirely undermine efficient breach theory, Roberts hypothesized that it would affect what courts deem to be a reasonable, "permissibly 'efficient' breach" in commercial dealings (*ibid* at 1023).

9. As previously discussed, we shall use these terms interchangeably, along the lines of the terminology introduced by the *Restatement*, characterizing opportunistic breaches as deliberate and profitable breaches. Other scholars have used different terms to refer to this distinction. For example, Cooter and Ulen introduced the distinction between "fortunate [or windfall] contingency" that make non-performance more profitable than performance, and "unfortunate [or accident] contingency" that imposes a larger cost for performance than for non-performance. Robert Cooter & Thomas Ulen, *Law and Economics*, 6th ed (Addison-Wesley, 2012) at 325.

Table 1. *Four Cases of 'Efficient' Breach*[10]

		Breaching Party	
		Seller	Buyer
Reason for Breach	**Loss-Avoiding**	Case 1 Expectation Damages	Case 3 Expectation Damages
	Gain-Seeking	Case 2 Expectation Damages vs. Disgorgement of Profits	Case 4 Expectation Damages vs. Disgorgement of Profits

100. After contracting, Seller finds a better buyer, offering a higher price $90 + w$. For all values $w > 10$ Seller would rationally choose to breach the contract, paying damages of 100. Performance of the original contract would create a deadweight loss equal to $w - 10$.

Next, consider the situation in Case 3, where a change in circumstances decreases the buyer's benefit of performance:

> ***Case 3:*** *Buyer's Loss-Avoiding Breach.* Seller undertakes to manufacture a machine for Buyer. Buyer pays 90, expected cost of performance is 80, and the value of the machine to Buyer is 100. In case of a breach by Buyer, Buyer compensates Seller for lost profit 10. After contracting, due to an unexpected change in circumstances, Buyer faces a decrease in the benefit of performance to $100 - x$. For all values $x > 20$, Buyer would rationally choose to breach the contract, paying 10 in lost profit to Seller. Performance of the original contract would create a deadweight loss equal to $x - 20$.

Consider now the last example in Case 4, where a change in circumstances provides the buyer with the opportunity to engage in a profitable breach:

> ***Case 4:*** *Buyer's Gain-Seeking Breach*. Seller undertakes to manufacture a machine for Buyer. Buyer pays 90, expected cost of performance is 80, and the value of the machine to Buyer is 100. After contracting, Buyer finds a better seller, offering a lower price $90 - w$. For all values $w > 10$, Buyer would rationally choose to breach the contract, paying lost profits of 10 to Seller. Performance of the original contract would create a deadweight loss equal to $w - 10$.

According to the monolithic view of efficient breach, the four cases discussed above are just four different cases of 'efficient' breach. In all these situations, under an expectation damages remedy, a rational promisor would deliberately choose to breach a contract. As discussed below, according to the monolithic perspective, disgorgement damages should not be part of the arsenal of remedies available under contract law. A disgorgement remedy would in fact discourage breaches in Cases 2 and 4, with a resulting social loss.

10. Table and scenarios adapted from Bigoni et al, *supra* note 4 at 532.

The other perspectives on efficient breach are more nuanced. A brief survey of these theoretical perspectives will be offered in Section 2.1. In Section 2.2, we review some empirical and experimental evidence showing differences in the human acceptance of efficient vs. opportunistic breaches. Judicial perspectives on this matter are strikingly diverse and will be reviewed in Section 2.3. The tensions that surface in these three arenas will motivate our consequentialist re-evaluation of opportunistic breach of contract, which we will carry out by highlighting some of the important factors that set our four cases of efficient breach apart.

2.1 Moral vs. Economic Views

Seana Shiffrin exemplifies the moral perspective on efficient breach.[11] Shiffrin argues that contracts create two distinct obligations: one legal and one moral. Both obligations are grounded in the 'promise principle'. In her view, the problem is that, by allowing parties to deviate from their legal promise via efficient breach, the law implicitly *encourages* the violation of their moral promise. Shiffrin brings to the fore the tension between the legal and moral norms, questioning the coherence of contract law that is simultaneously grounded upon and indifferent to promise-keeping. Along similar lines, Daniel Friedmann espoused a deontological view of breach of contract that runs against Oliver Wendell Holmes' well-known view on contract remedies.[12] Friedmann criticizes the contemporary constructs of efficient breach—according to which compensatory remedies provide a perfect substitute for the promised performance. Friedmann argues that damage remedies should be chosen deontologically and should be viewed as instruments to incentivize the promised performance, not to replace it.

This is not to say that all cases of non-performance are at odds with morality—as indicated by moral theorists' general acceptance of mistake, impracticability, and frustration of purpose defenses.[13] However, conditions leading to efficient breach, opportunistic and non-opportunistic alike, are likely to fall short of the stringent requirements of such defenses. For instance, in outlining the criteria for contractual discharge by frustration of purpose, the *Restatement (Second)*

11. See Seana Valentine Shiffrin, "The Divergence of Contract and Promise" (2007) 120:3 Harv L Rev 708.

12. See Daniel Friedmann, "The Efficient Breach Fallacy" (1989) 18:1 J Leg Stud 1. Holmes' well-known account of contract remedies is best expressed in *The Common Law*: "The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract if he chooses." Oliver Wendell Holmes Jr, *The Common Law* (Belknap Press, 2009) at 272.

13. For example, Shiffrin notes that "[t]he doctrines of mistake and impracticability presuppose notions of reasonable risk that represent our sense of which endeavors and which assumptions of risk are worth our affirmation and efforts. These characterizations refer back to public, legally normative values, but they are not in implicit or explicit tension with the view that the underlying moral promises are binding." Shiffrin, *supra* note 11 at 752. From a different perspective, Eisenberg observes that in some instances of mistake, moral and policy propositions relevant to resolving an issue may align or conflict. In the latter type of case, conflict may be resolved by deciding that one value trumps the other, or by balancing the goals of conflicting values. See Melvin A Eisenberg, "Mistake in Contract Law" (2003) 91:6 Cal L Rev 1573.

of Contracts asserts that the frustration must be "substantial," and "that the transaction has become less profitable for the affected party or even that he will sustain a loss" is not enough.[14] Likewise, for impracticability, the continuation of existing market conditions or parties' financial situations ordinarily do not qualify as "basic assumptions" whose non-occurrence can justify discharge of a contractual duty.[15]

Several law and economics scholars have responded to the moral arguments against efficient breach, attempting to make the economic argument more palatable for non-economists. Shavell observed that, while efficient breach *can* be immoral when the awarded damages are less than expectation damages, moral considerations should be tempered by the understanding that contracts are necessarily *incomplete* promises and that generally parties *would have* agreed to an expectation damages remedy if they had bothered to select a remedy *ex ante*.[16] Similar arguments arise in the work of other scholars suggesting that the cost-benefit analysis underlying the notion of efficient breach reflects the implicit will of the contracting parties.[17] The premise of many moral arguments against efficient breach is that payment of expectation damages in lieu of performance violates the promisee's rights. The contractual promise gave the promisee an absolute right to obtain performance, not the right to obtain performance or payment of damages at the promisor's election. However, as Craswell pointed out, this premise is inconsistent with what parties would have agreed upon in a hypothetical bargain over contract remedies.[18] If expectation damage remedies increase the aggregate welfare of the contracting parties, the parties likely would have chosen this remedy in their agreement—an efficient breach with payment of expectation damages could no longer be claimed to violate the promisee's absolute right to performance.[19] In this respect, Cooter suggests that the common law conception of breach remedies comes from the idea that contracting parties would generally prefer to adopt a pricing regime (rather than a sanctions regime) in contract breach situations.[20]

Moral theorists have not found these defenses of efficient breach convincing. The argument that, in a hypothetical complete contract, the parties would have included a right to breach in their agreement begs the fundamental question of

14. *Restatement (Second) of Contracts* § 265 (1979) cmt a at 335.
15. *Restatement (Second) of Contracts* § 261 (1979) cmt b.
16. See Shavell, "Is Breach of Contract Immoral?", *supra* note 2.
17. See Shavell, "May Not Be Immoral", *supra* note 2; Daniel Markovits & Alan Schwartz, "The Myth of Efficient Breach: New Defenses of the Expectation Interest" (2011) 97:8 Va L Rev 1939; Daniel Markovits & Alan Schwartz, "The Expectation Remedy Revisited" (2012) 98:5 Va L Rev 1093.
18. See Richard Craswell, "Contract Remedies, Renegotiation, and the Theory of Efficient Breach" (1988) 61:3 S Cal L Rev 629.
19. See, however, a case for extra-compensatory damages for breach of contract based on 'efficiency' considerations: "Allowing a party to breach a contract and pay damages is not as efficient as forcing that party, with the threat of punitive damages, to negotiate with the other party for a release from the contract." William S Dodge, "The Case for Punitive Damages in Contracts" (1999) 48:4 Duke LJ 629 at 663.
20. See Robert Cooter, "Prices and Sanctions" (1984) 84:6 Colum L Rev 1523.

whether default legal remedies should be chosen on deontological or utilitarian grounds. Furthermore, the choice of expectation damages as a majoritarian-default remedy seems inconsistent with at least some of the relevant facts.[21] If a right to breach truly reflects the contracting parties' preferences and natural expectations (so as to amount to the implied will of the majority of the parties), how do we explain the promisees' distaste for opportunistic breach of contract, even when full compensation is granted? As Macaulay points out, although one-shot contractual interactions could exhibit crude practices of efficient breach, when parties engage in a relational contract they are less likely to make use of efficient breach.[22] The Official Comments to the *Uniform Commercial Code* similarly embraces this view: "This section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit."[23]

A possible reason for objecting to economists' generalized endorsement of efficient breach is that expectation damages rarely make the promisee whole in practice. Several authors echo this complaint, and most scholars accept it as an uncontroversial fact in contract practice.[24] On normative grounds, Bar-Gill and Ben-Shahar observe that, when the losses caused by a breach are imperfectly detectable, super-compensatory damages may be necessary to align the promisor's incentives.[25] Otherwise, the threat of liability would be discounted by the detection error and would be insufficient to incentivize efficient performance. Super-compensatory damages would correct this problem and would only *appear* to conflict with the expectation principle, since they would bring the promisor's expected liability in line with the promisee's expectation interest.

If imperfect compensation drives the wedge between the economic and non-economic attitudes toward efficient breach, we should expect the promisee's disappointment about the breach to be a function of under-compensation; or at least, the observed distaste for efficient breach should be invariant with respect to the

21. It is important to note that as a matter of U.S. contract law doctrine, parties generally have no power to *exclude* a power to breach. Provisions in agreements in which the parties purport to agree to specific performance in case of breach are not binding on the courts. See Edward Yorio & Steve Thel, *Contract Enforcement: Specific Performance and Injunctions*, 2nd ed (Wolters Kluwer, 2022) at § 19.2. For discussion of one possible and limited exception, see Theresa Arnold et al, "'Lipstick on a Pig': Specific Performance Clauses in Action" (2021) 2021:2 Wis L Rev 359.

22. Macaulay observes that the presence of other factors is clearly reflected in the promisees' distaste for breach, even when full compensation is granted. See Stewart Macaulay, "Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian MacNeil and Lisa Bernstein" (2000) 94:3 Nw U L Rev 775.

23. UCC § 2-609 (1950) cmt 1.

24. See Charles J Goetz & Robert E Scott, "Enforcing Promises: An Examination of the Basis of Contract" (1980) 89:7 Yale LJ 1261; Timothy J Muris, "Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value" (1983) 12:2 J Leg Stud 379; Charles Fried, "The Convergence of Contract and Promise" (2007) 120:3 Harv L Rev Forum 1; Shavell, "May Not Be Immoral", *supra* note 2.

25. See Oren Bar-Gill & Omri Ben-Shahar, "An Information Theory of Willful Breach" (2009) 107:8 Mich L Rev 1479.

circumstances that led to the breach. However, empirical and experimental evidence—presented by Bernstein, Baron & Wilkinson-Ryan, and Bigoni et al.—suggests otherwise.[26] These problems and objections challenge the very core of the incomplete-contract and implied-consent defenses of efficient breach. In Section 3 of this article, we will return to this topic, considering these challenges seriously. In doing so, we will step away from the economic vs. non-economic dichotomy in search of factors that could generate a more nuanced evaluation of different types of efficient breach. We will proceed by identifying certain previously overlooked factors that play a role in efficient breach situations, and use them to show consistency between the layman's view and a more articulate economic understanding of the effects of efficient breach.

2.2 Ordinary People's Views

Empirical and experimental evidence provides interesting insights about contracting parties' preferences on the use of harsher remedies in response to opportunistic breaches of contract. The empirical evidence presented by Bernstein suggests that contracting parties believe that intentional breaches deserve harsher remedies than unintentional breaches.[27] Related survey-based evidence collected by Baron and Wilkinson-Ryan points in the same direction: circumstances of the breach matter.[28]

A laboratory experiment carried out by Bigoni et al. confirmed these earlier findings.[29] To test the views of ordinary people on the desirability of a right to carry out an opportunistic breach, Bigoni et al. designed an experiment in which the contract was subject to a specific performance remedy. If the parties managed to reach an agreement allowing the promisor to avoid performance in exchange for a compensatory payment to the aggrieved promisee, then the parties could cancel the contract. The authors studied how frequently parties successfully agreed upon cancellation, and whether the negotiated compensation level was higher in some circumstances than others. The authors considered four cases, corresponding to the four scenarios described in Table 1, above. In the first two cases, the seller wanted to cancel the original contract to avoid a loss (Case 1) or to pursue a gain (Case 2). Buyers were similarly placed in situations in which they sought cancellation of the original contract—either because the buyer's valuation of the good decreased or because the buyer had an opportunity to acquire the good elsewhere at a lower price. In the former case, the buyer wanted a cancellation of the original contract to avoid a loss (Case 3), while in the latter they wanted a cancellation to increase their gain (Case 4). In all four cases, cancellation of the original contract maximized the joint payoff of the contracting parties.

26. See Lisa Bernstein, "Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions" (2001) 99:7 Mich L Rev 1724; Baron & Wilkinson-Ryan, *supra* note 4; Bigoni et al, *supra* note 4.
27. See Bernstein, *supra* note 26.
28. See Baron & Wilkinson-Ryan, *supra* note 4.
29. See Bigoni et al, *supra* note 4.

However, given the requirement for a specific performance remedy, promisors needed to secure the promisee's consent in order to excuse their performance. Negotiations entailed persuading the promisee to accept some form of monetary compensation in lieu of performance.

The results of the experiment revealed a general disfavor of all breaches of contract—whether opportunistic or non-opportunistic. In all cases, the parties captured a lower realized (total) surplus through renegotiation than the respective theoretical benchmarks. Subjects were not always willing or able to cancel the original contract, notwithstanding the gains obtainable by avoiding its performance. In all cases, promisees' profits exceeded predicted levels, while the opposite held for promisors. When renegotiation was successful, subjects generally split the surplus in a manner more favorable to the promisee. Throughout the experiment, the surplus from renegotiation was kept constant and, in principle, 'rational' parties should have agreed to cancel the original contract, regardless of the subjective reasons for their wish not to perform.

Contrary to the theoretical prediction, the results of the experiment showed that the participants did not treat all cases of efficient breach alike, and they more strongly disfavored opportunistic breaches. The renegotiation of their no-longer-efficient contracts followed different paths in loss-avoiding and gain-seeking cases. First, promisees were willing to enter the renegotiation with their defaulting promisors more often in cases of loss-avoiding than gain-seeking breaches.[30] The motive underlying a promisor's desire to cancel the original contract impacted the parties' willingness to renegotiate the contract, even though (i) the cancellation was always efficient; (ii) the surplus generated by the breach was constant across all four cases; and (iii) there was no cost associated with the renegotiation. Second, when the parties reached an agreement to cancel the original contract, the promisee was able to obtain a larger share of the surplus as compensation in gain-seeking cases, compared to loss-avoiding cases, even though the total surplus obtainable through cancellation was constant across all cases.[31] Participants disfavored

30. The percentage of parties that refused to engage in renegotiation was over ten times higher when cancellation was sought for the pursuit of a gain (*ibid* at 538). Bigoni et al. further showed that, once parties accept the idea of engaging in renegotiation, they can carry out renegotiation successfully at the same rate, regardless of the reasons for the underlying breach.

31. The motivation behind the breach affected the way that the parties split the surplus. In the experiment, the compensation premium obtained by the promisee to allow cancellation was 60% higher for gain-seeking breaches than loss-avoiding breaches (*ibid* at 540). A relevant strand of the literature may provide an independent rationale for these behavioral differences. Insights from behavioral and experimental economics suggest that people tend to exhibit aversion toward highly unequal distributions of wealth. See Ernst Fehr & Klaus M Schmidt, "A Theory of Fairness, Competition, and Cooperation" (1999) 114:3 Quarterly J of Economics 817; Gary E Bolton & Axel Ockenfels, "ERC: A Theory of Equity, Reciprocity, and Competition" (2000) 90:1 American Economic Rev 166. See also Baron & Wilkinson-Ryan, *supra* note 4. In the dictator game, inequality-averse subjects are willing to sacrifice part of their payoff in order to reduce the distance between themselves and the recipient. In Bigoni et al.'s experiment, inequality aversion may have induced promisees to treat loss-avoiding breaches more favorably than gain-seeking breaches, but this only made a difference in their willingness to accept low offers in loss-avoiding cases. Inequality-averse subjects accepted low offers more often in cases of loss-avoiding breaches than gain-seeking breaches. The other results did not hinge upon the parties' attitudes toward inequality.

gain-seeking cancellations regardless of the role of the breaching party, whether buyer or seller.

2.3 Judicial Opinions

In U.S. caselaw, as well as in other jurisdictions, contract remedies have focused on protecting the expectations of contracting parties. Remedies, whether based on damages or on specific performance, have been instrumental to fulfilling such expectations and have never aimed to deter breach through punitive or extra-compensatory remedies. In the U.S., the *Restatement (Second) of Contracts* and caselaw preceding the 2011 *Restatement (Third) of Restitution and Unjust Enrichment*, reaffirmed the compensatory function of damages in contracts. U.S. contract law prohibits the use of punitive damages for breach of contract, thereby avoiding any form of extra-compensatory liability to deter or punish breaches of contract.[32] Farnsworth summarizes the conventional view:

> No matter how reprehensible the breach, damages are generally limited to those required to compensate the injured party for lost expectation, for it is a fundamental tenet of the law of contract remedies that an injured party should not be put in a better position than had the contract been performed.[33]

An Introductory Note in the *Restatement (Second) of Contracts* affirms:

> The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation of the promisee for the loss resulting from breach. "Willful" breaches have not been distinguished from other breaches, punitive damages have not been awarded for breach of contract. . . . In general, therefore, a party may find it advantageous to refuse to perform a contract if he will still have a net gain after he has fully compensated the injured party for the resulting loss.[34]

Cases affirming the purely compensatory and non-punitive nature of contract remedies include *Highland Inns Corp. v. American Landmark Corp.*, which declared that "the essential objective of a contract remedy is to compensate, not punish."[35] Similarly, in *Burger King Corp. v. Mason*, which involved allegations of both trademark infringement and breach of contract, the court insisted that disgorgement would be appropriate only for the first count—"disgorgement of profits earned is not the remedy for breach of contract," at least under Florida

32. *Restatement (Second) of Contracts* § 355 at 154 states that "[p]unitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable." There is one additional exception: in some states, insurance companies are subject to punitive (usually double or treble) damages for bad faith failure to settle a claim. See Alan O Sykes, "'Bad Faith' Breach of Contract by First-Party Insurers" (1996) 25 J Leg Stud 405.

33. E Allan Farnsworth, *Farnsworth on Contracts,* 4th ed (Aspen, 2004) at 760 [footnote omitted].

34. *Restatement (Second) of Contracts*, Ch 16 (1979) Introductory Note at 100.

35. 650 SW2d 667 at 674 (Mo Ct App 1983).

law.[36] *U.S. Naval Institute v. Charter Communications, Inc.* similarly involved allegations of both copyright infringement and breach of contract.[37] When the plaintiff sought disgorgement of the defendant's profits based on the breach of contract claim, the court responded:

> Since the purpose of damages for breach of contract is to compensate the injured party for the loss caused by the breach, those damages are generally measured by the plaintiff's actual loss. While on occasion the defendant's profits are used as the measure of damages, this generally occurs when those profits tend to define the plaintiff's loss, for an award of the defendant's profits where they greatly exceed the plaintiff's loss and there has been no tortious conduct on the part of the defendant would tend to be punitive, and punitive awards are not part of the law of contract damages.[38]

However, in several cases, American courts expressed views that fell across the wider consequentialist-deontological spectrum, expressing judicial impatience toward breachers who deliberately avoided their contractual obligations to pursue a profitable breach. As early as 1921, in a notable dictum in *Jacob & Youngs, Inc. v. Kent*, Cardozo supported the idea of using different remedies in willful vs. unintentional situations: "The willful transgressor must accept the penalty of his transgression. For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong."[39] As Bar-Gill and Ben-Shahar have shown, even courts that adhered to the purely compensatory function of contract damages have used their discretion to apply higher measures of liability in willful breach situations: "contract doctrine allows much flexibility in measuring expectation damages, and courts choose higher measures when they consider the breach willful or in bad faith."[40] These judicial opinions are in some ways consistent with the rationale inspiring efficient breach doctrine, which originally focused on the efficiency of breach in 'loss-avoiding' situations.

The Reporter's Note to Ch. 16 of the *Restatement (Second) of Contracts* states:

> According to economic theory, if available goods and resources are to be utilized in their most productive manner, each good must be consumed by the person who values it most highly. . . . A bargain from which both parties benefit results in a gain in "economic efficiency" by moving the exchanged assets to higher valued uses. . . . At the time the agreement is made, then, each party has a reasonable expectation that he will benefit from its performance.
>
> If one party later concludes that a contract that he originally thought would be profitable will be *unprofitable* for him . . . a breach of contract will result in a gain in

36. 710 F2d 1480 at 1494 (11th Cir 1983).
37. 936 F2d 692 (2nd Cir 1991).
38. *Ibid* at 696 [citations omitted].
39. 230 NY 239 at 244 (Ct App 1921) [citations omitted].
40. Bar-Gill & Ben-Shahar, *supra* note 25 at 1495.

> "economic efficiency" . . . if the party contemplating breach will gain enough from the breach to have a net benefit even though he compensates the other party for his resulting loss.[41]

The original focus of efficient breach doctrine on loss-avoiding situations also transpires from the rationale put forth in the literature for limiting contract damages to expectation damages: "a [damages] measure [any] larger than expectancy would discourage [parties] from making contracts because they would be wary of the extent of their liability for breach."[42] However, the undesirable effects of liability higher than expectation damages—discouraging parties from entering the contract—would not occur in the case of deliberate profit-seeking breaches, since the breacher could readily choose not to engage in a breach without facing unexpected losses.

In this respect, judicial opinions in cases dealing with 'gain-seeking' breaches indicate what may be a shift in judicial attitudes. For example, *EarthInfo, Inc. v. Hydrosphere Resource Consultants, Inc.* illustrates a court's readiness to strip the defaulting party of the profits obtained through an intentional breach and to carry out disgorgement of the profit.[43] In *EarthInfo*, the court held that the breach of contract sufficed for justifying rescission of the agreement and, because the breach had been "intentional or substantial," disgorgement of profits was appropriate.[44] Reflecting this trend, in 2011 the *Restatement (Third) of Restitution and Unjust Enrichment* § 39 reformed the remedial approach to efficient breach—embracing caselaw's occasional attempts to redress deliberate and profitable breaches of contract and enabling the injured party to disgorge the profit that the promisor realized as a result of a deliberate breach.[45] With respect to application, however, U.S. courts have, at times, struggled to reconcile the restitution remedy of *Restatement* § 39 with the deep-rooted contract principles prohibiting extra-compensatory remedies.[46]

U.S. federal courts have, in some cases, embraced the use of disgorgement damages in response to profit-seeking breaches of contract. In a 2015 case arising out of an agreement between two states, the U.S. Supreme Court, citing *Restatement* § 39, endorsed a partial disgorgement award against the breaching

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41. *Restatement (Second) of Contracts*, Ch 16 (1979) Reporter's Note at 101 [emphasis added].

42. Robert A Hillman, *Principles of Contract Law*, 4th ed (West Academic, 2023) at 158, citing *E I DuPont de Nemours & Co v Pressman*, 679 A2d 436 at 446 (Del 1996); Farnsworth, *supra* note 33 at 736-37.

43. 900 P2d 113 (Colo 1995) [*EarthInfo*].

44. *Ibid* at 119.

45. See *Restatement* § 39, *supra* note 6.

46. In part, courts' reluctance to adopt *Restatement* § 39 may stem from confusion over whether disgorgement qualifies as a legal or equitable remedy. Under the historic legal-equitable divide, this distinction would likely affect a plaintiff's ability to access the remedy. Roberts discusses the *Restatement's* somewhat convoluted framing of disgorgement as a legal remedy despite its use of language that traditionally would have described equitable remedies. Roberts urges courts to avoid becoming bogged down in questions about disgorgement's classification as legal or equitable, encouraging courts to focus instead on determining the appropriate boundaries between 'tolerable breaches' that do not merit disgorgement and breaches of contract on the 'ethical margins' that do deserve disgorgement. See Roberts, *supra* note 8.

state.[47] In justifying this decision, the Court explained the motivation to "stabilize a compact and deter future breaches, when a State has demonstrated reckless disregard of another, more vulnerable State's rights under that instrument."[48] Although the Court limited the reach of its decision in *Kansas v. Nebraska* by emphasizing the public nature of the dispute, other courts may expand (to private disputes) the premise that traditional contract remedies do not adequately address breaches where a party engages in conscious wrongdoing by proceeding with the contract in spite of a known risk of breach.[49]

At the same time, many courts still resist adopting the *Restatement of Restitution*'s disgorgement theory. For example, in *Phillips v. State Farm Fire and Casualty Company*,[50] the federal district court, applying Arizona law, rejected a claim based on *Restatement* § 39, commenting: "Plaintiffs fail to cite a single case in which an Arizona court has adopted this section of the Third Restatement. . . . 'The sheer novelty of this proposed remedy counsels against applying it here.'"[51]

Although generally embracing the idea that damages in contracts should aim to compensate promisees, not punish defaulting promisors, several European legal systems exhibit higher levels of hostility toward intentional and profit-seeking breaches. For example, Italian law draws a clear distinction between intentional and unintentional breaches when liquidating damages—intentional breaches give rise to an aggravated form of liability, which extends also to unforeseeable harm.[52] Similar principles appear in French and German law.[53] While German law does not recognize a general right to disgorgement damages for breach of contract, German courts have tended to grant a disgorgement remedy in a handful of categories of cases.[54] One such category—where "the seller of a non-fungible thing [who] breaches . . . by selling the thing to a third party" must turn over "the profits of the second contract"—corresponds to one of

47. See *Kansas v Nebraska*, 574 US 445 (2015) [*Kansas v Nebraska*].
48. *Ibid* at 1057.
49. Roberts presents a detailed discussion of the Supreme Court's reasoning in *Kansas v. Nebraska*, the limits of the decision, and its potential implications for future public and private opportunistic breach cases. See Caprice L Roberts, "Supreme Disgorgement" (2016) 68:5 Fla L Rev 1413.
50. 2019 WL 5789471 (D Ariz 2019).
51. *Ibid* at 4, citing *Kansas v Nebraska*, *supra* note 47 at 1069 (Thomas, J., concurring in part and dissenting in part). For an overview and critical discussion of *Restatement* § 39, see David Campbell, "A Relational Critique of the Third Restatement of Restitution § 39" (2011) 68:3 Wash & Lee L Rev 1063; but for more sympathetic views, see James Steven Rogers, "Restitution for Wrongs and the Restatement (Third) of the Law of Restitution and Unjust Enrichment" (2007) 42:1 Wake Forest L Rev 55 at 65-66; Kelsey A Hayward, "Disgorgement of Defendant's Gains from 'Opportunistic' Breach of Contract: Its Fit in Rhode Island" (2017) 22:3 Roger Williams U L Rev 614.
52. See art 1225, *Codice Civile.*
53. For a discussion of the different contract damages applicable in the event of intentional breach under French and German law, see James Gordley, *Foundations of Private Law: Property, Tort, Contract, Unjust Enrichment* (Oxford University Press, 2006) at 408-11.
54. See Mathias Siems, "Disgorgement of Profits for Breach of Contract: A Comparative Analysis" (2003) 7:1 Ed L Rev 27 at 35.

the efficient breach categories that we discuss in the present work as meriting disgorgement damages.[55]

Perhaps more similar to American jurisprudence, multiple Commonwealth courts have displayed varying degrees of amenability toward disgorgement remedies for breach of contract, specifically in response to conscious, unjust enrichment.[56] In *Attorney General v. Blake*, the UK House of Lords endorsed gain-based relief and disgorgement principles in a case where the defendant "earned his profit by doing the very thing he had promised not to do."[57] Courts in Canada and Ireland have indicated less definitively that a disgorgement remedy could exist in cases where a defendant has profited through intentional wrongdoing.[58] Overall, the United States is not alone in grappling with the question of how to address opportunistic breaches.

3. Efficient vs. Opportunistic Breach: A Consequentialist Analysis

According to the standard economic view of efficient breach, a right to breach is efficient because it avoids carrying out performance when performance is no longer efficient (i.e., the promisor gains more than the promisee loses from the breach). The payment of fully compensatory expectation damages would make the promisee as well off as they would have been had performance occurred, and this would lead to an overall increase in the parties' joint welfare.[59] Although Coase's wisdom suggests that, in a world with zero transaction costs, the efficient breach decision will materialize under all remedies (compensatory, over- or undercompensatory, or injunctive), most of the economic literature assumes Coasian equivalence away.[60] Of course, when overcompensatory and injunctive remedies are available, promisors might negotiate for the release of their obligation. Similarly, in undercompensatory remedy schemes, promisees might renegotiate and offer an extra payment to avoid an inefficient breach. But in both cases, renegotiations would involve bargaining and accounting for strategic costs that might impede the parties' capacity to reach an agreement.[61] In the following analysis, we will work within this framework to consider the (marginal) impact of alternative remedies when renegotiation costs apply. We will subsequently relax this assumption to consider the effects of contract remedies when renegotiation can be costlessly carried out.

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55. *Ibid* at 37 [footnote omitted].
56. See Caprice L Roberts, "A Commonwealth of Perspective on Restitutionary Disgorgement for Breach of Contract" (2008) 65:3 Wash & Lee L Rev 945.
57. *Attorney General v Blake and Another* (2000), [2001] 1 AC 268 (HL (Eng)). See also Roberts, *supra* note 56 at 954-55.
58. See e.g. Roberts, *supra* note 56 at 958-60.
59. See generally *supra* note 2.
60. See RH Coase, "The Problem of Social Cost" (1960) 3 JL & Econ 1
61. See Steven M Shavell, "Specific Performance Versus Damages for Breach of Contract: An Economic Analysis" (2006) 84:4 Tex L Rev 831.

Following the monolithic approach that informs this literature, the efficiency of compensatory damages applies to all four cases of breach in Table 1, above. In all four situations, an expectation damages remedy would lead a rational promisor to deliberately choose to breach a contract. In the following, we engage with the traditional law and economics analysis of efficient breach to consider other important—and thus far overlooked—effects of the right to breach in opportunistic and non-opportunistic situations. Specifically, we consider the economic consequences of a right to breach with respect to (a) allocative and productive efficiency; (b) information-forcing and competitive effects; and (c) restraint of breach-searching incentives. The consequentialist analysis that follows will allow us to formulate qualitative conclusions on the desirability (or lack thereof) of a right to breach in the four scenarios of breach that we consider. These qualitative considerations shed light on the lay intuitions that emerge from experimental evidence on efficient breach, and these considerations map out along the lines of the relevant consequentialist or deontological factors. To the extent that our analysis is persuasive, we will have helped to narrow the divide between the moral and economic viewpoints on opportunistic breach of contract.

3.1 Different Option Values of a Right to Breach: Buyers vs. Sellers

From a finance perspective, the right to breach a contract by paying compensatory damages is equivalent to an option. The option gives a prospective breacher (option holder) the choice between two alternative obligations: perform the contract or pay damages. Compared to the remedy of specific performance, the option to breach gives an advantage to the promisor and a disadvantage to the promisee: at the time performance is due, the promisor can unilaterally choose the cheaper of the two alternatives (performance or damages), whereas under specific performance the promisor must either perform or negotiate with the promisee for relief from the obligation to perform. Although the option to breach confers an advantage to the promisor and a disadvantage to the promisee, price adjustments can capture the distributive effects of alternative remedies. The aggregate value of an option to breach would determine the parties' choice of remedy: if the benefit of the option to the promisor exceeded the loss of the promisee, a damage remedy would be chosen.[62]

Looking more closely at the determinants of value of an option to breach, investment theory has well established that the value of an option increases with (i) the volatility of the market (i.e., the volatility of the future costs and benefits of the contract); (ii) the duration of the option (i.e., the time lag between the formation of the contract and the point at which or by which performance is due); and (iii) the existence of irreversible costs (or benefits) related to contract

62. This assumes a doctrinal context where such matters are in the parties' control. As indicated earlier, under American doctrinal law, parties generally do not have the power to *deny* themselves the power to breach, in that provisions agreeing to specific performance are not binding on the courts. See *supra* note 21.

performance.[63] While the elements of volatility and duration are relatively straightforward, understanding the irreversible costs that a right to breach will likely affect warrants special consideration in the context of contracts.

To illustrate the effects of an option to breach on irreversible deadweight losses, let us begin by considering two cases of seller breach, investigating whether the value of an option to breach differs based on the motivation behind the seller's breach. We suggest that the value of the option may differ between loss-avoiding and gain-seeking breaches. One reason for divergent valuations of the option to breach is that in loss-avoiding cases the performance of an inefficient contract is likely to generate larger irreversible deadweight losses than in gain-seeking cases. The right to breach avoids irreversible losses that would result from an inefficient performance. For example, consider the situation exemplified in Case 1, where a change in circumstances increases the cost of performance above the expectation value. In this situation, performance of the original contract may lead to an irreversible deadweight loss. Producing a good at a cost that exceeds its expectation value irreversibly generates a deadweight loss. This stands in contrast to the gain-seeking seller scenario, as in Case 2. Here, if the seller performs in accord with the terms of the original contract and sells to the low-valuing buyer, then that low-valuing buyer could conceivably resell the good to a higher-valuing buyer. While the original seller might end up with a lesser surplus than if they had breached and sold to the higher-valuing buyer, the resale could all but eliminate deadweight loss in the aggregate. Thus, the potential for resale implies that the secondary market can reverse the misallocation created by performance of the original, inefficient contract. This demonstrates that, with respect to gain-seeking behavior, refraining from breach does not irreversibly threaten efficiency, or at least does not threaten efficiency as much as in the loss-avoidance scenario.

Along similar lines, we explore the other two cases where a buyer breaches for loss-avoiding and gain-seeking motivations. The value of an option to breach for the buyer again varies due to different irreversible deadweight losses involved in loss-avoiding and gain-seeking cases, but in the opposite order as compared to the seller. Irreversible losses are likely to be larger with a buyer's gain-seeking breach than with a buyer's loss-avoiding breach. One reason for divergent valuations of the buyer's option to breach is that, in loss-avoiding cases, allocative inefficiency drives the inefficiency of performance (i.e., the buyer is no longer the high-valuing user). In some cases, the secondary market may correct this form of inefficiency—the low-valuing buyer can resell to a higher-valuing party after

63. See Robert L McDonald & Daniel R Siegel, "The Value of Waiting to Invest" (1986) 101:4 Quarterly J of Economics 707; Robert S Pindyck, "Irreversibility, Uncertainty, and Investment" (1991) 29 J Economic Literature 1110; Avinash K Dixit & Robert S Pindyck, *Investment under Uncertainty* (Princeton University Press, 1994). As Arrow and Fisher point out, the option may have a negative value when the irreversibilities on the benefit side exceed the irreversibilities on the cost side. Under those circumstances, the option value of a right to breach would be negative and we should not expect parties to include an efficient breach option in their agreement. See Kenneth J Arrow & Anthony C Fisher, "Environmental Preservation, Uncertainty, and Irreversibility" (1974) 88:2 Quarterly J of Economics 312

performance of the original contract (just like in the gain-seeking seller scenario). In contrast, in gain-seeking cases, a buyer's breach may instead avoid a productive inefficiency. If the buyer identifies a cheaper producer, performing the contract with the original seller means that the original, less-efficient party produces the good. An opportunistic breach in this case could avoid an irreversible loss, which could not be corrected through the secondary market, after performance of the original contract.

To illustrate, consider the situation depicted in Case 3, where a change in circumstances decreases the benefit of performance below the cost of production. In this situation, performance of the original contract may lead to a deadweight loss. Once a good is produced at a cost that exceeds its reduced value for the buyer, a deadweight loss exists. This loss will be irreversible if the performance cannot be effectively redeployed toward alternative uses with a value above production cost. A similar argument applies if the seller's cost of performance were to rise above the buyer's expectation value. The only difference between the two cases lies in the irreversibility of the loss. In Case 1, actual performance of the contract would lead to a productive inefficiency because the high-cost seller's inefficient production of the good creates a deadweight loss. The deadweight loss in this case would be irreversible because the seller would not have any means for recovering the lost value. In Case 3, actual performance of the contract would instead lead to an allocative inefficiency. Once the low-valuing buyer receives a performance that they valued less than production costs, a deadweight loss is created. In this case, however, possible redeployment of the performance to a higher-valuing buyer can reverse that allocative deadweight loss.

Consider now the last example, described in Case 4 above, involving a buyer's gain-seeking breach. As noted for Case 2, when gain-seeking opportunities drive the seller's breach, losses are often reversible. If a seller finds a better buyer, performance of the original contract may lead to allocative inefficiency. But the secondary market could reverse the resulting misallocation. In the case of a buyer's gain-seeking breach, by contrast, any deadweight loss (productive inefficiency) from inefficient performance of the original contract would be irreversible and not correctable by the secondary market.

The four examples discussed above illustrate an important consideration that sets apart the four cases of efficient breach. The option value of a right to breach depends on the magnitude of irreversible losses produced by inefficient performance of the contract. Reformulating these results in terms of option theory clearly suggests that the value of an option to breach may be greater for loss-avoiding cases than gain-seeking cases. Therefore, contracting parties might be more willing to include an option to carry out an efficient breach in loss-avoiding situations than an option to carry out an opportunistic breach in gain-seeking situations, when forming their contract.

An additional problem may arise in the contractual pricing of a right to breach in the four cases under consideration. When an option to breach is mutually desirable for the parties, the parties would include a right to breach in their agreement and adjust the contract price according to the valuation of that option. Such

valuation is more feasible for loss-avoiding breaches than for gain-seeking breaches. This is so because, in loss-avoiding situations, promisors' and promisees' incentives align. Neither party will act to increase the probability of loss-avoiding breaches. The promisor has an incentive to decrease, not to increase, the cost of performance, and the promisee has an incentive to increase, not decrease, the value of performance. Neither party has an incentive to seek loss-avoiding breach opportunities, because neither party would gain from such occurrences. However, in the presence of gain-seeking breach opportunities, parties *will* face misaligned incentives. If promisors enjoy the option to pay damages and walk away from their original contractual obligations whenever a more profitable opportunity arises, then they will have an incentive to search for such breach opportunities.

Incentive misalignment reduces the range of situations where parties would agree on an option to breach opportunistically. Unlike loss-avoiding situations, in gain-seeking cases, the likelihood of finding a more gainful contract opportunity depends on a promisor's search efforts (e.g., the seller's search for alternative buyers and/or their willingness to entertain better offers). The likelihood of an opportunistic breach is endogenously determined by the promisor, and the breach's expected value is private information.[64] A rational promisor will not reveal this private information to the promisee, but rather will underplay the risk of opportunistic behavior when negotiating the contract. Although the promisee is aware of these misaligned incentives, determining the level of effort that a promisor may dedicate to seeking a gainful breach opportunity is unrealistic for the promisee because such efforts are typically unverifiable and unobservable. Misalignment of incentives combined with asymmetry of information may hinder the parties' ability to agree on a price for the option to breach. In these situations, an adverse selection problem may arise.[65] At any given option price, informed promisors will engage in adverse selection—only those facing higher gainful breach probabilities will be willing to acquire the option at that price, and promisees would be likely to withdraw from negotiations. Trustworthy promisors (e.g., sellers who are less likely to find better sale opportunities and act opportunistically) will be offered an option to breach, but those promisors would have the lowest valuation for the option and would likely forego the right to engage in gain-seeking breaches. Hence, the range of cases where parties might agree upon an option ex ante would shrink. For all other situations, the parties may prefer an injunctive remedy, leaving the question of how to divide the surplus from better

64. In loss-avoiding cases, incentives are aligned, and breach situations are exogenously determined and will not be sought after by the contracting parties. A rational seller will try to maximize their profit. Thus, it is in the seller's interest to reduce, not to increase, their cost of performance and thereby avoid a loss-avoiding breach. When exogenous factors determine the occurrence of events that may lead to loss-avoiding breaches and the parties' incentives are aligned, the option to breach becomes less likely to lead to opportunistic behavior. The parties are thus more likely to agree to a mutually satisfactory price for the option to breach at the time of contract formation.

65. See for example Joseph E Stiglitz & Andrew Weiss, "Credit Rationing in Markets with Imperfect Information" (1981) 71:3 American Economic Rev 393.

sale opportunities to future negotiations. Alternatively, an overcompensatory but not fully disgorging remedy, which de facto liquidates the division of the surplus ex ante, could make opportunistic breaches desirable for both parties.

Parties would find it harder to agree on the value of the option to breach in gain-seeking rather than loss-avoiding cases. The differing incentives generated by loss-avoiding and gain-seeking situations and the resultingly greater probability that parties could agree on a right to breach in loss-avoiding situations reconciles the economic and deontological perspectives on efficient breach. In the following section, we illustrate the importance of the irreversibility argument as it applies to cases of allocative and productive inefficiency, spanning across the four breach scenarios introduced above.

3.2 Productive vs. Allocative Efficiency of a Right to Breach

As Shavell observed, in contracts to produce goods (Shavell's argument could similarly apply to contracts to provide services), parties tend to prefer the remedy of damages, essentially because of problems that would arise under specific performance if the cost of performance were to increase.[66] In Shavell's view, parties would favor the remedy of specific performance with respect to obligations to convey already existing property, because production would not need to increase when property already exists. We can recast Shavell's argument to say that in contracts to produce goods or to provide services, specific performance could lead to situations of productive inefficiency in instances where the cost of performance has increased. Problems of productive inefficiency would not generally arise for obligations to convey property that already exists. Performance of obligations to convey an existing good may only raise concerns of allocative efficiency. Shavell's analysis focuses on a subset of the breach scenarios considered in our previous discussion. In this section, we expand Shavell's analysis to consider the remedies that parties would tend to prefer in the other breach scenarios previously introduced, with an eye to the different allocative and productive efficiency concerns that apply in our four cases.

Let us dig into this issue by comparing the two cases involving allocative efficiency, beginning with the case of a seller's post-contractual effort to find a better buyer (Case 2). Two possible reasons can explain why a new buyer might be willing to pay a higher price for the same good or service. First, the difference in price may be due to a different division of the contract surplus between the buyer and seller. The seller might simply be able to extract a higher price from the new buyer. Alternatively, the second buyer may offer a higher price because they valued the good or service more than the first buyer. Although determining the subjective valuation of a buyer based on the price they agreed to pay may be difficult, some probabilistic inferences are possible. A buyer who offers a higher price is more likely to value the good more highly than a buyer who offers a lower

66. See Shavell, *supra* note 61.

price. Overall, this may make a gain-seeking breach by the original seller allocatively efficient—the right to breach creates a greater chance that the performance goes to the party who values it the most. However, we should keep in mind that the object of the contract performance is in some cases transferable. The secondary market could therefore enable allocative efficiency. For example, if a contract involves the sale of a good, the original buyer could resell the good to the higher-valuing third party. The results are similar when the buyer is the loss-avoiding promisor (Case 3). Suppose a buyer faces an unanticipated decrease in the benefit they receive from performance, such that they now expect a negative surplus from the performance of the contract. If the original contract involved the sale of a good, and performance of the original contract was carried out, the misallocation of the initial sale may be corrected by reselling the good to a higher-valuing third party. In sum, the allocative efficiency effects of the right to breach exist across the categories of loss/gain and seller/buyer breaches in our taxonomy.

A common characteristic of the sellers' gain-seeking breaches (Case 2) and buyers' loss-avoiding breaches (Case 3) is that in both cases, allocative efficiency could be restored through the secondary market. However, the role of secondary markets in correcting allocative inefficiencies is not without limits. Sometimes, secondary markets may be unable to correct the allocative inefficiency of the original performance (e.g., sale of non-resalable goods or non-transferable services). Further, transaction costs between the original buyer and the new prospective buyer may in some cases preclude a transfer (e.g., the identity of the new prospective buyer may only be known to the seller, and not to the original buyer). In all such situations, a right to breach would play a residual, yet important, role in promoting allocative efficiency.

The right to breach also plays an important role in promoting productive efficiency. Unlike with respect to allocative inefficiency, secondary markets play a more limited role in addressing productive inefficiency problems. For example, in some situations, the promisor could address an increase in production cost by resorting to the secondary market (e.g., by subcontracting to a cheaper producer). In these situations, the secondary market will dictate the actual cost of performance, with no need to invoke a right to breach (a right to subcontract may suffice to prevent productive inefficiency). In most situations, however, secondary market solutions are generally unavailable to mitigate productive inefficiency problems, and performance of the contract by the original promisor would therefore result in a deadweight loss. The right to breach provides the simplest and most direct way of avoiding productive inefficiency.

Let us proceed by considering the effects of a right to breach on productive efficiency, contrasting the cases of a seller's loss-avoiding breach (Case 1) and that of a buyer's gain-seeking breach (Case 4). In Case 1, the original promisor may no longer be the most efficient producer due to an increase in costs, and performance of the original contract may therefore lead to productive inefficiency. The resulting loss would be irreversible—once the less efficient seller produces the good, no subsequent transfer in the market can correct or mitigate the resulting loss in productive efficiency. Similarly, productive inefficiency may

lurk behind a buyer's gain-seeking breach (Case 4). Consider a case in which a buyer breaches because they find a cheaper seller. The new seller might charge a lower price for the same good or service, simply because they are willing to make a lower profit. For example, the buyer could leverage the original contract to solicit a better offer from another seller. In this case, the lower price would only reflect a different division of the surplus between buyer and seller, with no immediate efficiency implications. Alternatively, the lower price may reflect the fact that the new seller faces lower production costs. In this case, requiring the original promisor to perform the contract would lead to productive inefficiency, since performance of the contract would incur a greater production cost. Although determining whether a cheaper sale price stems from lower production cost or merely a different division of the surplus can be difficult, some probabilistic inferences are also possible in this case. A seller who charges a lower price likely faces lower production costs than a seller who charges a higher price. Overall, a buyer's gain-seeking breach may thus promote productive efficiency. The buyer's post-contractual search for a cheaper seller may result in a social gain in terms of productive efficiency. In sum, efficient breach may promote productive efficiency in both sellers' loss-avoiding breaches (Case 1) and in buyers' gain-seeking breaches (Case 4).

When invoking implied-consent theories to support efficient breach, it is important to keep in mind that the factors discussed above determine the value of a right to breach and will ultimately affect the likelihood that the contracting parties opt for including such a right to breach in their contract. As the preceding discussion shows, the effect of a right to breach on allocative and productive efficiency is highly contextual and the economic consequences cut across the 'why' and 'who' categories introduced in our taxonomy.

3.3 Information-Forcing Effects of a Right to Breach

We will next show that a right to breach creates valuable information-forcing effects and that such effects will be more significant in situations of loss-avoiding breach than gain-seeking breach. Bar-Gill and Ben-Shahar previously formulated an argument along these lines.[67] The authors argue that intentional and opportunistic breaches (in their words, "willful breaches"), reveal information about the true type of the breaching party.[68] Contracting parties that engage in opportunistic breaches are more likely than average to be acting dishonestly, and their self-serving breaches may have been caused by their ex ante choices to engage in socially undesirable patterns of behavior. In their view, such bad conduct, carried out in disregard of "sanctity of contract," warrants higher levels of liability for opportunistic breach.[69] In the following, we consider additional information-forcing effects of disgorgement damages in cases of opportunistic breach. We

67. See Bar-Gill & Ben-Shahar, *supra* note 25.
68. *Ibid* at 1480, citing *Restatement (Second) of Contract*s, Ch 16 (1981) Introductory Note at 100.
69. *Ibid* at 1482.

show that these effects emerge as a desirable byproduct of an otherwise undesirable problem and discuss how these effects may differ across the four (loss/gain and buyer/seller) cases in our taxonomy.

Mitigating problems of asymmetric information is an important function of contract law. Like information-forcing rules and penalty default rules, the right to breach may sometimes induce the revelation of private information that would not otherwise come to light in bargaining.[70] Consider the following scenario, corresponding to Case 1 in our taxonomy. A homeowner (promisee) enters into an agreement with a contractor (promisor) for repainting the exterior walls of a house. The homeowner possesses private information about the cost of performance, knowing that the exterior walls of the house were not properly sealed and absorb more paint than average. In the absence of a right to breach, the homeowner would not disclose this information to the promisor—divulging this information would likely increase the price that the homeowner would have to pay. Introducing a right to breach can curb the opportunistic behavior of a better-informed promisee. The risk of a breach leading to costly renegotiation or litigation would encourage the homeowner to reveal private information and consent to a higher contract price. A right to breach would thus serve as an information-forcing device, incentivizing the promisee to disclose relevant private information at the time of contract formation, so as to avoid the risk of a loss-avoiding breach by the promisor.

A similar information-forcing effect can be found in Case 3 of our taxonomy. Consider again an agreement between a homeowner and a contractor for repainting the exterior walls of a house. In this case, consider the mirror situation in which the promisor possesses private information about the promisee's benefit from performance. Specifically, imagine a scenario in which the contractor knows that the benefit from repainting the exterior of the house will be smaller than expected, because the city will soon require all homeowners to repaint their homes using a new, eco-friendly, insulating paint. If the homeowner has no right to breach, an inefficient performance of the contract might take place—even if the contractor (as the promisee to the homeowner's purchase) agrees to paint the house at a comparatively reduced price (that matches the homeowner's misinformed valuation), this may not accurately reflect the actual value of the painting job. By introducing a right to breach, an information-forcing effect would arise—giving a right to breach to the homeowner would incentivize the contractor to exhibit transparency in disclosing its information before the agreement.

In mitigating information asymmetries of this kind, the right to breach may even present a more effective tool than an affirmative duty to disclose, because the right to breach nudges the payoffs of the parties so that disclosure of relevant private information will tend to align with their own interests. Meanwhile, under a duty to disclose regime, parties remain better off concealing private information if their prior knowledge cannot be verified ex post. Given the evidentiary obstacle

70. See Goetz & Scott, *supra* note 24; Ian Ayres & Robert Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989) 99:1 Yale LJ 87.

of establishing whether a promisee had private information prior to conclusion of a contract, along with possible boundary problems about the specific information to which the duty to disclose applies, the right to breach appears to be a preferable tool for incentivizing disclosure.

Information-forcing effects are less conspicuous in gain-seeking cases. Gain-seeking opportunities arise due to the presence of third parties that intervene *after* the contract. These third parties intervene after a contract is formed, offering a better price, and enticing one of the contracting parties to breach. Importantly, gain-seeking opportunities are not known ex ante by the contracting parties when the contract is formed. Whether a right to breach exists or not, eventual gain-seeking parties would not generally have had an opportunity to reveal information that has not yet materialized to their contracting partners.

3.4 Competitive Effects of a Right to Breach

We now focus on the competitive effects of a right to engage in opportunistic breach. In the face of gain-seeking opportunities, the effects of a right to breach will manifest as competition rather than disclosure. The right to engage in opportunistic breach cultivates competition among the parties. When promisors possess the right to breach and pay damages, the gain-seeking behavior of sellers may abet competition among buyers prior to the agreement of a contract, just as gain-seeking behavior by buyers may trigger ex ante competition by sellers. We may better understand how ex post gain-seeking behavior triggers ex ante competitive effects by considering two examples.

The first example corresponds to Case 2 in our taxonomy: a homeowner enters into an agreement with a contractor for repainting the exterior walls of a house. In this case, however, the homeowner has information about the promisor's opportunity cost, knowing that other neighboring homeowners are willing to offer a higher price for the same service. If the contractor has no right to engage in opportunistic breach, the homeowner will try to secure the lowest possible price knowing that, once they reach an agreement, the contractor will carry out its performance and forego profitable opportunities with the other neighbors. A right to breach would alter this equilibrium. If the contractor has a right to engage in opportunistic breach, the homeowner will anticipate that the contractor might learn of the neighbors' willingness to pay and then breach to pursue better contractual opportunities. To avoid costly renegotiations and possible litigation, the homeowner would reasonably try to preempt the breach by offering a higher price for the contractor's services.

The second example corresponds to Case 4 of our taxonomy: a contractor knows that a competing contractor exists who may offer the same service at a lower price. The contractor anticipates gain-seeking behavior and opportunistic breach by the homeowner. If the homeowner has no right to engage in opportunistic breach, the contractor will try to secure the highest possible price knowing that, having reached an agreement, the homeowner will have no opportunity to engage in gain-seeking behavior. A right to engage in opportunistic breach would

similarly alter this equilibrium. The contractor would anticipate the homeowner's potential breach in pursuit of better, cheaper contractual opportunities. To avoid costly renegotiations and possible litigation, the contractor will reasonably try to preempt the breach by offering a lower price for their services.

In both Case 2 and Case 4, the right to engage in opportunistic breach nurtures competition between the contracting parties. Specifically, a right to breach for gain-seeking motivations would foster ex ante competitive behavior by promisee and promisor, incentivizing them to reveal their true benefits and costs through the contract price, so as to avoid the renegotiation and litigation costs associated with a breach by the other party.[71]

3.5 Searching for Breach Opportunities? The 'Restrained Incentives' Problem

Contract remedies can affect another important and often overlooked aspect of a contractual relationship. Traditional analyses of contract remedies begin their analysis at a point after the contract is signed and an opportunity for an 'efficient' breach arises. The analysis of the optimal allocation of the risk of non-performance proceeds to consider situations where parties' behavior can endogenously affect the risk of non-performance. The standard case of endogenous risk involves promisors who can affect the probability of performance by investing in performance effort. In this case, allocating the entire risk of non-performance on the promisor (e.g., with a fully compensatory remedy of expectation damages) will create optimal incentives.

The traditional focus on the impact of performance effort on the probability of performance overlooks the fact that promisors can affect the probability of breach not only by investing in performance efforts, but also by searching for gainful breach opportunities. Remedies have different effects on the probability that opportunistic breach situations may arise. In the face of a prospective loss-avoiding breach (e.g., an increase in performance costs), the parties' incentives are aligned—both parties would like to avoid such an 'unfortunate' occurrence, because neither can gain from it. Both parties will tend to avoid situations that could make performance more costly than non-performance.

Conversely, in the face of prospective gain-seeking breaches (e.g., finding a better selling opportunity), the parties' incentives are misaligned. A promisor has

71. As an additional incentive for preventing situations of opportunistic breach through ex ante competition, an award of expectation damages will rarely make the promisee indifferent between performance and breach, for the reasons mentioned earlier in the text. In addition to the costs caused by adjudicatory delays, legal fees, and court costs involved in litigation, expectation damages rarely equal the promisee's expectation. Reasons for under-compensation range from measurement difficulties associated with inadequate valuation of lost profits and idiosyncratic losses (see Muris, *supra* note 24) to limits imposed on damages based on the foreseeability of the loss (see Goetz & Scott, *supra* note 24; Ayres & Gertner, *supra* note 70), as well as costs that may be borne by the promisee due to court errors. As a result of these factors, in the event of a breach, the promisee is rarely made whole. See Shavell, "May Not Be Immoral", *supra* note 2.

reason to search for 'fortunate' contingencies that make breach more profitable than performance. A promisor's search for gain-seeking breach opportunities can impose a redistributive externality on the promisee (it eliminates the buyer's ability to resell to a better-paying buyer and capture the profit for themself). This may lead to a socially wasteful overinvestment in the search for opportunistic breach opportunities. In these contexts, contract remedies can play an important role in correcting the incentive-misalignment problem.

By accounting for the parties' behavior in the interval between the initial contract formation and the moment when an opportunistic breach opportunity arises, our normative conclusion departs from the conventional wisdom in the literature. Compensatory damages sufficiently incentivize performance efforts and discourage loss-avoiding breaches, but the use of overcompensatory damages would be necessary to also discourage the wasteful search for gain-seeking opportunities. Granting a right to engage in opportunistic breach with purely compensatory damages would encourage the promisor to seek more profitable opportunities after the contract, thereby failing to correct the above-mentioned incentive misalignment problem. Forcing promisors to share some of their gains from the breach with their promisees could mitigate the negative effects of their socially wasteful search for gainful breach opportunities. In this respect, we conclude that the use of disgorgement damages for opportunistic breaches of contract can foster better behavior by the contracting parties.

3.6 Renegotiation and Insurance Effects

According to the Coase theorem, in a world with zero or low transaction costs, the efficient breach decision will materialize, regardless of the chosen remedy.[72] A promisor would always decide to breach a contract when the cost of performance exceeded the benefits to all parties, and the breach decision would take place under all remedies: compensatory, over- or undercompensatory, or injunctive. Under a compensatory damage remedy, if a promisor's savings or gains from the breach exceed the loss to the promisee, the promisor would simply choose to breach and pay damages to the promisee. Under over- or undercompensatory damage remedies, rational parties would renegotiate their contract to avoid inefficient performance or inefficient breach. Under specific performance, parties would renegotiate to avoid inefficient performance and the promisor will obtain a waiver of their duty to perform in exchange for a payment at least as large as their valuation of the performance. In all cases, the decision to breach will occur if, and only if, it maximizes the contracting parties' joint payoffs.

Although costless renegotiation can always prevent inefficient breaches and allow efficient breaches to occur, the choice of contract remedies affects the parties' relative positions in the renegotiations process and has distributive effects. For example, under an expectation damages remedy, a promisor who decides to

72. See Coase, *supra* note 60.

break the contract will only need to pay compensatory damages to the promisee. Instead, if the remedy is injunctive or overcompensatory, a promisor may have to pay a larger amount to secure a release from the contract. The choice of default contract remedies, even if irrelevant to the promisor's breach decision, has consequences for the contracting parties.

The moral and deontological views on efficient breach are often said to favor injunctive and overcompensatory remedies, because these remedies put the 'victims' of a breach in a stronger renegotiating position vis-à-vis the 'perpetrating' breachers. This leads to a socially more desirable distribution of the gains/savings from the breach. Under a remedy of expectation damages, a breaching promisor retains the most savings (or gains) if the cost (or alternative use) of performance has increased in value. Under an injunctive or overcompensatory remedy, the promisee would instead capture a larger share of those savings (or gains).

Although the standard economic approach tends to disregard the distributive effects of legal remedies (alternative distributions of gains and losses do not affect the aggregate welfare of the parties, at least from a Kaldor-Hicks wealth maximization point of view), Craswell observed that, even from an economic point of view, the redistributive effects of alternative contract remedies should not be ignored.[73] A right to breach with compensatory damages benefits the promisor, and the contract price would reflect this advantage. More specifically, a promisor would willingly accept a lower price to avoid injunctive or overcompensatory remedies in the event of a breach.

If the promisor can indulge in efficient breach and avoid performance when a breach will enable realization of some savings (e.g., an increase in costs) or gains (e.g., receipt of a better offer), the contract price should capture those expected savings or gains. The promisor would be willing to accept a lower initial price in exchange for a chance to breach the contract if they only need to pay compensatory damages. Under overcompensatory damages, the promisor must ultimately pay more to exercise the option to breach. Under injunctive remedies, the promisor loses the option to breach and will need to charge a higher initial price in anticipation of the extra compensation that the promisee may extract when foregoing their right to specific performance (in the event that a breach becomes necessary). Therefore, adopting overcompensatory or injunctive remedies will generally result in higher initial contract prices.

Hence, the question: which configuration of remedies would the contracting parties select? Given the price adjustments that follow a change in contract remedies, the availability of injunctive or overcompensatory remedies does not truly 'give' promisees a greater share of the savings (or gains) from the breach; such remedies merely 'sell' that greater share to the promisees. With injunctive or overcompensatory remedies, promisees pay a higher contract price up front to capture a larger share of savings (or gains) from future breaches of contract.[74]

73. See Craswell, *supra* note 18.

74. Craswell persuasively articulated this point, albeit reaching a different normative conclusion from ours. See *ibid* at 636.

Among other considerations, the choice of remedies will give rise to insurance effects and parties will allocate the risk of breach based on their risk-aversion profiles.

Risk-neutral contracting parties will feel indifferent to alternative allocations of risk. Full compensation and no compensation will yield equal expected utility for the parties because the contract price would reflect the distributive effects of either rule. However, when parties are risk averse, the choice of breach remedy will play a different insurance function with respect to loss-avoiding and gain-seeking breaches. When promisors are risk neutral and promisees are risk averse, parties will allocate the entire risk of non-performance to the promisors. Fully compensatory remedies would, in fact, put the promisees on the same indifference curve that they would have been on in the case of performance, hence providing 'full insurance' coverage in the event of a breach. Expectation damages would fulfill this insurance function in both loss-avoiding and gain-seeking cases, without any need to augment damages for opportunistic breach. A risk-neutral promisor would, however, prefer to retain a right to breach with compensatory damages.

Whereas risk-neutral promisors may be willing to provide full insurance against breach to their promisees, risk-averse promisors would not. When both the promisor and promisee are risk averse, the parties may agree to share the risk of non-performance with undercompensatory damages, or to shift the risk entirely to the promisees with a waiver of liability in the event of non-performance (e.g., creating an obligation of means, rather than result). In this case, a tradeoff would arise between the insurance and incentive functions of the chosen remedy (i.e., undercompensatory damages or a waiver of liability would provide a partial or full insurance to risk-averse promisors but would unavoidably dilute their incentives to perform).[75]

While the insurance function of contract remedies can explain the use of compensatory and undercompensatory remedies, no configuration of the parties' risk-aversion would lead parties to adopt overcompensatory or injunctive remedies. These latter remedies would make promisees gain more than full compensation from a breach, but only risk-loving promisees would be willing to pay a premium for a chance to obtain overcompensatory payments from their breaching promisors. The insurance function of contract remedies is thus fully consistent with the conventional rule limiting compensation in contracts to compensatory damages. If, as seems sensible, contract remedies should not be designed to allow risk-loving parties to 'gamble' through contract remedies, the use of disgorgement

75. When both contracting parties are risk-averse, the optimal allocation of the risk would entail a sharing of the loss from non-performance, with a likely choice of undercompensatory liquidated damages. For a formal examination of these alternative allocations of the risk of non-performance, when both insurance and incentive effects are relevant, see Thomas J Miceli, *Economics of the Law: Torts, Contracts, Property, Litigation* (Oxford University Press, 1997); Francesco Parisi & Marta Cenini, "Allocazione del Rischio tra Clausola Penale e Autonomia Contrattuale (Italian)" (2009) 55 Rivista di Diritto Civile 309.

or injunctive remedies for opportunistic breach could not be justified on insurance grounds.

4. Conclusion

The above considerations support the view that not all cases of efficient breach are alike. Efficient breach of contract cannot be treated as a monolithic doctrinal category. When performance of the contract leads to allocative and productive inefficiencies, the degree to which resulting losses can be reversed will likely vary across different cases of breach. Similarly, the incentive, information-forcing, and competitive effects of a promisor's right to breach differ across loss-avoiding and gain-seeking breaches. To understand the differences between loss-avoiding and gain-seeking breaches in both seller and buyer breach cases, a more nuanced and complete account of the effects of a right to breach is necessary. In this article, we departed from the conventional dichotomy of moral vs. economics arguments on efficient breach, demonstrating that a more attentive understanding of the justificatory framework for efficient breach unveils previously overlooked similarities between the consequentialist and the deontological perspectives on breach.

Table 2, below, summarizes the economic effects of efficient breach for the four cases of breach introduced in Section 2. The presence and magnitude of the economic effects vary according to the market role of the promisor and whether the breach occurred in pursuit of a gain or in avoidance of a loss.

Table 2 thus offers an overview of the factors that play in favor or against the desirability of a right to breach. These factors provide a crude assessment of the different effects of a right to breach in the four cases under consideration. A comparison of the four types of breaches in Table 2 leads to several observations. The option to breach a contract in loss-avoiding cases (Cases 1 and 3) yields a larger number of desirable effects than an option to breach in gain-seeking cases (Cases 2 and 4). By examining the different effects of a right to breach in loss-avoiding and gain-seeking situations, we hypothesize that contracting parties might be more willing to include an option to breach in their contract for loss-avoiding breaches compared to gain-seeking breaches. This suggests that the majoritarian-default argument for the right to breach may be more compelling for loss-avoiding breaches than for gain-seeking breaches. This observation applies both to seller-breach and buyer-breach cases. A right to efficient breach in loss-avoiding cases would more likely be chosen than a right to opportunistic breach in gain-seeking cases. The right to breach produces different incentive effects for sellers and buyers, and a larger number of factors plays against a right to opportunistic breach carried out by sellers.

The varying effects of efficient breaches in various buyer/seller and gain-seeking/loss-aversion scenarios suggest that a gradient of remedies may be appropriate for different types of breach. At one end of the spectrum, extreme exogenous circumstances leading to impracticability or complete frustration of purpose

Table 2. *Effects of a Right to Breach*

	Hypothetical Contracted-For Remedy	Allocative and Productive Efficiencies	Information-Forcing and Competitive Effects	Insurance Function	Wasteful Search Incentives
Case 1: Seller Loss-Avoiding Breach	Yes	Productive Efficiency	Information-Forcing (for Buyer)	Yes	No
Case 2: Seller Gain-Seeking Breach	No	Allocative Efficiency	Buyers' Competition	No	Yes
Case 3: Buyer Loss-Avoiding Breach	Yes	Allocative Efficiency	Information-Forcing (for Seller)	Yes	No
Case 4: Buyer Gain-Seeking Breach	No	Productive Efficiency	Sellers' Competition	No	Yes

likely constitute conditions where the inability to breach would be most economically damaging to an affected party and nonperformance would likely be least morally objectionable. Such situations would likely continue to merit restitution or reliance damages.[76] In the middle, the economic effects of loss-avoiding breaches may favor applications of expectation damages. Finally, instances of gain-seeking breaches—which lead to fewer desirable economic effects than loss-avoiding breaches and may be considered more morally objectionable—may merit harsher remedies such as specific performance or disgorgement remedies.[77]

We have sought to investigate several issues in this article. First, we have tried to explain the disparity between economic analyses of efficient breach and certain moralist (deontological) positions in the philosophy of contracts. We examined the extent to which a more nuanced economic understanding of the different kinds of efficient breach reconciles much of the tension with moral theories of contracts. Our analysis looks at the differences between opportunistic (i.e., profit-seeking) and non-opportunistic (i.e., loss-avoiding) efficient breach cases, evaluating the merits of this distinction through several lenses. In most cases, we discovered that granting a right to breach yielded different results depending on the motives for the breach, suggesting that the monolithic treatment of efficient breach cases as a single homogeneous type is insufficiently subtle. Our analysis of efficient breach proved consistent with lay intuitions and the experimental evidence of how lay people would react to various breach scenarios.[78] Overall, our analysis supports the approach of the *Restatement (Third) of Restitution and Unjust Enrichment*, granting higher measures of compensation with partial or total disgorgement of the promisor's profits in gain-seeking breaches. Our policy conclusions align—albeit for different doctrinal reasons—with the contract remedies adopted in several Civil Law jurisdictions that grant specific performance for obligations 'to give' and damages for obligations 'to do'.[79] Overall, we

76. This is in line with existing standards established by the *Restatement (Second) of Contracts* §§ 347, 377.

77. This outcome aligns with the *Restatement (Third) of Restitution and Unjust Enrichment* § 39, as well as with the remedies adopted in several Civil law jurisdictions.

78. There are many reasons why we should care how lay people react to efficient breach. To the extent that the law is meant to incentivize socially desirable behavior, policymakers should, in principle, first understand how individuals perceive incentives and what expectations they form when agreeing to a contract. One should note the way that many judicial opinions track the intuitions of ordinary people regarding efficient breach in opportunistic cases. Our analysis may give courts grounds for greater clarity about the disgorgement remedies and how to best choose remedies in opportunistic breach cases.

79. See John P Dawson, "Specific Performance in France and Germany" (1959) 57:4 Mich L Rev 495; Konrad Zweigert & Hein Kötz, *An Introduction to Comparative Law*, 3rd ed, translated by Tony Weir (Oxford University Press, 1998). In all French-based and many other Civil Law jurisdictions, contract remedies vary according to the nature of the contractual obligation. Obligations 'to give' (e.g., conveyance of an existing property) are generally enforced using specific performance, while obligations 'to do' (e.g., produce a good or provide a service) are only granted compensatory damage remedies.

conclude that the differential characteristics and effects of distinct types of efficient breach warrant variable, nuanced approaches to remedies.

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