WILLFULNESS VERSUS EXPECTATION: A PROMISOR-BASED DEFENSE OF WILLFUL BREACH DOCTRINE

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Willful breach doctrine should be a major embarrassment to contract law. If the default remedy for breach is expectation damages designed to put the injured promisee in the position she would have been in if the contract had been performed, then the promisor's behavior—the reason for the breach—looks to be irrelevant in assessing damages. And yet the cases are full of references to "willful" breaches, which seem often to be treated more harshly than ordinary ones based on the promisor's bad/willful conduct. Our explanation is that willful breaches are best understood as those that should be prevented or deterred because the parties have implicitly agreed that the promisor would not breach in those circumstances. When willfulness, so understood, is present, courts rightly award remedies that serve to deprive the promisor of any incentive to breach and to assure the promisee of getting her full expectation.

INTRODUCTION

Almost every contracts student learns on the first day of class that the default remedy for breach is expectation damages, which are designed to put the injured promisee in the position she would have been in had the contract been performed. At the same time, the cases often refer to "willful breach," by which courts seem to mean especially bad, deliberate conduct by the promisor. Almost by definition, however, the willfulness of a breach can have little to do with the promisee's expectation interest; that interest should only be measured with reference to the harm suffered by the injured victim. Whatever the *promisor* did or failed to do to cause the harm would seem to be of no relevance in calculating the promisee's expectation. Commentators have typically sought to explain this tension by suggesting that while the promisee's expectation is not affected by the willfulness of the breach, expectation can often be measured or interpreted in many ways, and when a breach is found to be willful, the defendant's

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bad behavior grants license to pick the most generous definition of the plaintiff's expectation.[1]

We offer an alternative understanding that is cleaner and, we think, more compelling. Willfulness matters not because it screens for a more generous expectation measure, but because it identifies those breaches that should be prevented or deterred—that is, all breaches that could have been avoided at little or no cost to the promisor. When willfulness, so understood, is present, courts rightly award remedies that serve to deprive the promisor of any incentive to breach and to assure the promisee of getting full expectation.

The special treatment of willful breach has been difficult to square with contract doctrine, and not just because it is sometimes unclear what courts mean when they say a breach is willful. According to conventional wisdom, courts do and should award the victims of breach of contract their expectation—the amount necessary to put them in the position they would have been in had their promisors kept their promises—with the breaching promisor free to keep anything left over. However, in reality, courts frequently award promisees more than their expectation when they find that a breach is willful, and thus act to deprive willful breachers of any gains from breach.

Although some commentators are quite upset by willful breaches,[2] contract law generally does not concern itself with the morality of breach in any direct way. In the context of bargains, this approach has much to recommend it. People enter into contracts in hopes that the promises made to them will be kept, and when a promise is broken, the promisee's injury is typically the same whatever the reason for the breach. A disappointed promisee ought to be satisfied with full expectation, regardless of what motivated the breach. Moreover, the ex ante price of a promise is in part a function of the remedies that will be available upon breach, and promisees who bargain for nothing more than the benefit of their bargains will not want to pay a premium for the right to receive more than expectation in case of any breach, willful or otherwise.

Nonetheless, courts often talk about the willfulness of breach, and a number of doctrines seem to turn on willfulness. In this article we examine and defend these doctrines. The special treatment of willful breach can be justified without any recourse to particular concern for fairness or the morality of promise keeping. Indeed, our rationale for willful breach doctrines is not promisee centered at all. Instead, we argue, the willful

1. *See, e.g.*, 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.17a (2d ed. 1998) (listing various circumstances in which courts take willfulness into account). Robert Hillman suggests that "in construction contracts, the degree of willfulness of a contractor's breach helps courts determine whether to grant expectancy damages measured by the cost of repair or the diminution in value caused by the breach, the latter often a smaller measure." Robert A. Hillman, *Contract Lore*, 27 J. CORP. L. 505, 509 (2002).

2. *See, e.g.*, William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629 (1999); Nicholas J. Johnson, *The Boundaries of Extracompensatory Relief for Abusive Breach of Contract*, 33 CONN. L. REV. 181 (2000).

breach rules provide a mechanism by which promisors can bind themselves in a manner that promising parties would and do adopt ex ante. We show that courts appropriately give special treatment to breaches that contracting parties, at the time they enter into their contract, expect the promisor to be able to avoid at little or no cost to the parties as a whole—that is, willful breaches. We also show that the remedies awarded on a finding of willful breach effectively and appropriately bind the promisor not to commit such a breach, even if those remedies sometimes overcompensate the promisee's expectation.

We accept—and indeed, embrace—the proposition that promisees want nothing more than to have the promises made to them kept, and thus will not bargain for anything more than a right to expectation, regardless of the reason why breach has occurred.[3] The problem, however, is that promisees (and promisors) know that courts seldom award a disappointed promisee full expectation.[4] In this situation, promisors cannot credibly commit to efficient performance, because the ex post damages courts actually award will likely leave promisees undercompensated. That, in turn, leaves promisors with too much incentive to breach. As a result, promisors will get more for their promises at the time when contracts are negotiated if they can credibly commit not to breach. The level of commitment and the price paid depend on the cost to the promisor of avoiding breach: the more costly it is to avoid breach, the more a promisor will charge to accept liability for such breach.

While contracting parties will agree upon different levels of commitment in different situations, they will almost always agree that some breaches are out of bounds. When the parties know at the time of contract that a breach will damage the promisee and can be avoided by the promisor at no net cost to the two parties taken together, they will not want to permit it.[5] Since a commitment not to breach in these circumstances will be of value to the promisee, the promisor will receive more for her promise when she makes that commitment. Moreover, the promisor will get that premium at little or no cost, since she can, by definition, get that premium (and avoid enhanced liability) simply by not breaching willfully.

The various willful breach doctrines screen for those opportunistic breaches that produce no net benefit for the parties—this is the best definition of willful breach, and often turns out to be what concerns courts. The doctrines enable promisors to commit credibly to perform their promises without requiring the parties to negotiate a premium to reflect the added

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3. Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369 (1990).

4. *See* Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1444–45 (1980); Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 275 (1979). Among the factors frequently leading to undercompensatory expectation awards are doctrines limiting recovery for damages not proven with certainty, consequential damages, and attorneys' fees.

5. *See* Steven Shavell, *Damage measures for breach of contract*, 11 BELL J. ECON. 466, 467–69 (1980).

cost to the promisor of not breaching willfully. Moreover, if a promisor for some reason *wants* to preserve the right to commit a cost-free breach, she is free to do so by opting out of the rules, but only at the cost of revealing that she is willing to commit such a breach and foregoing what the promisee would pay for the commitment.

The efficiency of the willful breach rules is enhanced by the sanction for their violation—a sort of promisor-centered expectation, in which the breaching *promisor* is put in the position she would have been in if she had kept her promise. At the same time, the remedy also effectively assures the *promisee* of getting at least her expectation as well, because the promisor's cost will always be greater than the promisee's expectation, inasmuch as the promisee can use that cost to perform. Granted, when this remedy is actually awarded, the promisee will sometimes receive more than her expectation. The point, however, is not to compensate the promisee for some special harm imposed by willful breach, but instead to destroy the promisor's incentive to breach willfully. Indeed the remedy would work just as well if it were paid to a third party, and the beauty of the doctrines is that if they work, there are no breaches.[6]

Moreover, by defining the remedy in terms of the *promisor's* expectation, the willful breach doctrines avoid untoward incentives. The promisor is not punished for a willful breach, but simply denied any benefit therefrom. The disgorgement remedy does not lead the promisor to take inefficient precautions, since it only applies to willful breaches, which can be avoided with no precautions at all. The remedy does not distort the promisee's incentives either. Inasmuch as the promisee's compensation is not dependent on his actions, the prospect of an enhanced remedy for willful breach will not lead the promisee to rely excessively on the promise. Similarly, the willful breach rules do not undercut the effectiveness of rules that depend on permitting undercompensation in some cases. For example, since a promisee cannot expect a willful breach at the time he enters a contract, the prospect of receiving a supercompensatory remedy in case of willful breach does not at all undermine his incentive to disclose his circumstances to avoid the rule limiting consequential damages.[7]

We use two sets of cases to show that willful breach doctrines require those who commit breaches that could be avoided without cost to the parties as a whole to surrender the profits they gain from breach. One group is the cases, such as *Allied Canners & Packers, Inc. v. Victor Packing Co.*[8] and *KGM Harvesting Co. v. Fresh Network*,[9] in which the question is whether to award the difference between contract and market price when the buyer would not have realized that amount had the contract been performed, and has in fact suffered much smaller losses. The other is the cost-

6. *See* Robert Cooter & Ariel Porat, *Anti-insurance*, 31 J. LEGAL STUD. 203 (2002).

7. *See, e.g.*, Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules,* 99 YALE L.J. 87, 101–04 (1989).

8. 209 Cal. Rptr. 60 (Ct. App. 1984).

9. 42 Cal. Rptr. 2d 286 (Ct. App. 1995).

of-completion/diminution-in-value cases, such as *Peevyhouse v. Garland Coal & Mining Co.*,[10] *Groves v. John Wunder Co.*[11] and *Jacob & Youngs v. Kent*,[12] in which promisors save expenses by breaching. In both sets of cases, the choice is between awarding the promisee the promisor's expectation or her own, and the choice almost always turns on willfulness.

I. CONTRACT-MARKET DAMAGES AND THE EXPECTATION CAP

Courts have taken varied approaches to the challenging problem that arises when market prices change dramatically after a middleman simultaneously contracts to buy goods from an original supplier and to resell them at a markup to an end user. If the original supplier breaches, but the middleman is not liable to the ultimate buyer when he fails to deliver (e.g., because the downstream buyer has become insolvent), the breach by the original supplier poses a difficult problem. The middleman seeks the contract-market price differential provided by section 2-713 of the U.C.C., but the seller insists that the buyer is entitled only to his expectation, the (smaller) markup he would have realized if the contract had been performed. Courts have split on this question, awarding contract-market differential when the breaching party sells the goods to someone else, but limiting recovery to the markup when the seller was unable to deliver and did not sell the goods to someone else.

Commentators differ on whether this result is defensible. Some see this bifurcated treatment as a workable solution to the problem,[13] while others argue that the middleman should always be able to recover the contract-market price differential,[14] and others that he should always be limited to his markup.[15] We do not undertake here to defend the approach taken by the courts and, in fact, are generally sympathetic to the view that the middleman should always get the contract-market price differential. We simply argue that—as the courts have recognized—the cases are fundamentally different, and the case for the contract-market price differential remedy is even stronger when the breach is willful than when it is not.

Consider first the case of willful breach, in which the seller breaches and sells the goods to someone else at the enhanced market price. This breach is willful in the sense that it does not save any real resources and the seller could avoid the breach at no net cost to the parties. Put another way, selling

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10. 382 P.2d 109 (Okla. 1962).

11. 286 N.W. 235 (Minn. 1939).

12. 129 N.E. 889 (N.Y. 1921).

13. *See, e.g.*, E. ALLAN FARNSWORTH, CONTRACTS § 12.12, at 813–14 (3d ed. 1999).

14. *See* VICTOR GOLDBERG, FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE 225–32 (2006); David Simon & Gerald A. Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395, 1436–38 (1979).

15. *See* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 128, at 854–56 (4th ed. 2001); Roy Ryden Anderson, *Of Hidden Agendas, Naked Emperors, and a Few Good Soldiers: The Conference's Breach of Promise . . . Regarding Article 2 Damage Remedies*, 54 SMU L. REV. 795, 833 n.206 (2001).

to someone other than the promisee at the market price and forcing the promisee to cover at the market price is a pure transfer from the promisee to the promisor, with no net gain to the two parties taken together, since the benefit to the breaching promisor is identical to the added cost incurred by the injured promisee.

In this situation, courts have awarded the middleman the contract-price differential, often referring to the breach as willful.[16] The problem here, as everyone recognizes, is that the award of the contract-market price differential leaves the middleman in a better position than he would have occupied if the contract had been performed (in which case he would have realized only his markup).[17] Importantly, however, awarding the middleman his markup would not fully compensate him for his expectation. Even if he does not have to pay damages to the ultimate buyer, his relationship with that buyer will be damaged, and the award of his markup will not compensate him for this loss. Put another way, if the middleman and the ultimate buyer had considered the possibility when they entered the contract, as it seems entirely likely that they would, they presumably would not have agreed that the seller should be able to breach and realize all the increase in market price, because the increased price would be lost to both the middleman and the ultimate buyer.[18]

Breach is also not efficient here. While the seller gains more from breach than the middleman loses, once the loss to the ultimate buyer is factored in, the gains from breach exactly equal the losses—indeed, in one of the reported cases, the breaching seller actually sold the goods to the ultimate buyer (skipping the middleman) for market price.[19] For the same reason, this breach is also one that can be avoided at no net cost to the con-

16. *See, e.g.*, TexPar Energy, Inc. v. Murphy Oil USA, Inc., 45 F.3d 1111, 1113–14 (7th Cir. 1995); KGM Harvesting Co. v. Fresh Network, 42 Cal. Rptr. 2d 286, 289–93 (Ct. App. 1995); Tongish v. Thomas, 840 P.2d 471, 475–76 (Kan. 1992).

17. The market-contract price remedy has been criticized in other contexts as excessive. *See, e.g.*, GOLDBERG, *supra* note 14, at 233 (lost-volume retail seller); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 6-4, at 412–14 (5th ed. 2006); David W. Carroll, *A Little Essay in Partial Defense of the Contract-Market Differential as a Remedy for Buyers*, 57 S. CAL. L. REV. 667, 667 (1984) ("Theoretical discussions are in unanimous support of [the] criticism" that "contract-market differential measure of damages in sale-of-goods cases is inaccurate and inconsistent with the compensation principle of contract damages." (footnotes omitted)); Robert Childres, *Buyer's Remedies: The Danger of Section 2–713*, 72 NW. U. L. REV. 837, 837 (1978) ("Section 2–713 of the Uniform Commercial Code [the market damage rule] should not have been enacted and should be repealed. Given the small chance of repeal, the observer should be made aware that the Code's scheme for buyer's remedies is sensible only if section 2–713 is ignored. This is so, for section 2–713 fails because it is a hypothetical remedy; it lacks any relevant relation to damages actually suffered.").

18. This insight leads Victor Goldberg to the conclusion that the contract-market price remedy should be available in all such cases. *See* GOLDBERG, *supra* note 14, at 225–32. Several commentators suggested to us that a breach by the seller *does* create a net gain for the seller/middleman, since the middleman could pass on the higher market price to the ultimate buyer. But that seems to us to ignore the reality that the downstream contract between the middleman and the buyer would likely incorporate some form of liability for the middleman if he failed to deliver and forced the downstream buyer to cover, or if he simply bought at the same price at which the buyer could have purchased.

19. *See TexPar Energy*, 45 F.3d at 1113.

tracting parties. To be sure, the seller realizes an extra profit by breaching, but this profit is fully lost to the middleman and his customer. The breach is motivated not by the transfer of the goods to a higher-value user or savings to be realized by not producing the goods, but instead merely by the seller's hoping to take advantage of a quirk in the relationship between the middleman and the ultimate buyer. Accordingly, this seems to be a case in which even the acknowledged champion of efficient breach, Judge Posner, would have the courts "throw the book" at the breaching seller.[20]

While courts do self-consciously award the middleman more than his expectation, the contract-market price differential remedy they adopt is not punitive in any conventional sense. For one thing, the alternative award of the markup is clearly *less* than the middleman's expectation, inasmuch as it does not compensate him for his damaged reputation. Thus the court is left with two choices: one of which, the markup, undercompensates the middleman, and the other, the contract-market differential, overcompensates him for his expectation (inasmuch as had the contract been performed he would not have realized the benefit of the increase in market price). The markup remedy, however, leaves the breaching seller with substantial profit from his breach, and thus creates an incentive to breach. The contract-market differential remedy, on the other hand, does not punish the seller beyond requiring her to disgorge her gains from breach—she is no worse off than she would have been had she performed. Thus while the remedy in this case exceeds the middleman's expectation interest, it exactly matches the breaching promisor's. What the contract-market differential does is to deprive the seller of any profits from her breach. Thus a seller who faces this rule has no incentive to breach willfully by selling to a third party. The awarded remedy in these middleman cases can be justified without importing moral disapproval of breach into contract law. Instead, it is simply the result the parties would have agreed upon if they had considered the situation when they entered into the contract.[21]

At the time they entered into their contract, both parties would have recognized that if the middleman were to recover only his markup in case of breach, he would not receive his expectation. Accordingly, the seller would have received less for her promise than she would have if she had been able to commit to performing *even if she subsequently received a better offer*. By making that commitment—and agreeing to give up any profits realized from a resale to a third party—she would get more for her promise. Moreover, she would incur no costs in making this promise, beyond the loss of any future profits that would result from potential breaches she agreed to forego. She would not have to make any investment to avoid selling to a third party, since she could hardly do so inadvertently. She would be sacrificing the ability to take advantage of a rising market, but this is exactly the purpose of the contract. The present value of expected future price changes was probably zero at

20. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.10, at 119 (7th ed. 2007).

21. *Cf. id.* (suggesting that the sanction for opportunistic breach should be calculated to deter and not to punish breach).

the time the contract was made in any case, and if she had wanted to gamble on price changes, she would not have entered into the contract in the first place. Thus, by committing to pay the contract-market price differential in case she sold to a third party at a higher price, the seller-promisor benefitted. Although the remedy is supercompensatory, the parties would choose it because the *promisor* preferred it.

Now consider the case in which the seller breaches not to sell the goods to someone else at a higher price, but because she *cannot* perform, for example, because the goods are destroyed before she delivers. In this case the courts typically award the middleman only his markup, and the seller is not required to disgorge the amount she earned by breach.[22] In other words, the middleman receives something less than expectation, and the seller is better off than she would have been if she had performed by buying and delivering substitute goods or making them at substantial expense.

This is a case of non-willful breach, since the seller would have had to expend real resources to avoid being unable to perform. The breach is probably also efficient, even when the interests of the ultimate buyer are considered. The efficiency of the breach depends on whether the seller could have procured or produced the goods for less than the ultimate buyer paid for them. If it would cost the seller more to produce substitute goods than the market price of those goods at the time of breach, the breach is efficient. If the seller would have had to procure substitute goods in the market at the price the ultimate buyer paid, the breach is a wash in terms of efficiency.[23]

If the middleman is entitled to the contract-market price remedy when the seller breaches because her goods are destroyed, he has bought protection against accidental damage to the seller's property; by contrast, the middleman who buys protection against willful breach has insured himself only against the seller's changing her mind. The middleman might want to buy protection against such destruction of property, but that protection will cost more than protection against willful breach (i.e., the seller's breaching and selling to a third party), since the seller will have to expend real resources to avoid the inadvertent breach.[24] Even if the seller is in the best

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22. *See, e.g.*, H-W-H Cattle Co. v. Schroeder, 767 F.2d 437, 438 (8th Cir. 1985) (seller unable to deliver); Allied Canners & Packers, Inc. v. Victor Packing Co., 209 Cal. Rptr. 60, 61–62 (Ct. App. 1984) (seller unable to deliver). *But see* Sun Maid Raisin Growers v. Victor Packing Co., 194 Cal. Rptr. 612, 613 (Ct. App. 1983), which involved the same seller and a similar claim that " 'disastrous' rains" made it impossible for the seller to perform. In this case, however, the seller opportunistically breached his obligation to supply the raisins remaining on an *old* contract, apparently believing that he could cover from the new year's raisin crop, which would be cheaper. *Id.* at 615–16. *After* the seller breached, rain destroyed the bulk of the crop, almost doubling the price of raisins. The published opinion is incomplete and does not describe the trial court's reasoning in detail. *Id.* at 616. However, it appears that in using the higher December (post-rain) price, the trial court was motivated by an effort to deprive the breaching seller of its gains from breach.

23. The breach might be inefficient if the seller breached because her cost of producing a replacement was more than the contract price but less than market price at time of breach. However, there is no evidence that this is the case, inasmuch as the seller did not produce substitute goods and sell them to someone else at the new, higher market price.

24. The seller will of course have her own reasons to protect her property, but to the extent this is so the middleman has no incentive to pay extra for the contract-market price remedy.

position to protect her property, the middleman will be hesitant to pay for this protection, inasmuch as his goal in entering the contract is only to get his expectation, and much of the contract-market price remedy will be in excess of that in this circumstance.[25] Moreover, the seller will not always be the lowest-cost provider of insurance against the destruction of her property, especially with respect to destruction not caused by her negligence, so even if the middleman wants to be protected against destruction of the goods, he might not want to buy that protection (in the form of entitlement to the contract-market price remedy) from the seller. Accordingly, while at the time of entering a contract the parties will almost always agree that the seller will not profit from selling to a third party, they will not always agree that the seller will perform regardless of her real costs of performance.[26] The middleman cases—which award contract-market price damages if, but only if, the seller breaches willfully—can be seen, then, as an approximation of the remedies contracting parties would choose rather than a reflexive reaction to immoral breach.

II. COST OF CORRECTION VERSUS DIMINUTION IN VALUE

When a promisor fails to perform in order to save expenses, rather than to take advantage of a more profitable transaction, the computation of expectation damages presents some of the most famous issues of contract law. Allan Farnsworth offers a useful hypothetical for analyzing promisors who benefit from breach by avoiding expenses they have agreed to undertake:

> Suppose that [we] contract to build a house for you according to your plans for $150,000. [We] then find that by substituting cheaper materials [we] can do the job for $25,000 less than if [we] follow the plans. [We] make the switch, but you do not discover this until the house is built and you have paid [us] the $150,000. The price at which you can sell your house on the market is diminished by $10,000, and it would now cost $60,000 to replace the materials to conform to the plans, largely because of the cost of undoing and redoing the work.[27]

Courts typically award one of two remedies in this situation. The first is the diminution in value to the promisee, here represented by the $10,000 by which the house's market value has been impaired because of the breach. The second is the cost of correction, or the $60,000 it would take to tender a conforming house. The rationale for adopting the larger measure is often said to turn on the willfulness of the promisor's breach, with especially

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25. Indeed, the effect of a perfect willful breach rule is to prevent such breaches, so that no such damages are ever actually paid. By contrast, a rule entitling the middleman to the contract-market price remedy in the event of nonwillful breach will not prevent this type of breach, and will in fact result in windfall awards.

26. Shavell proves that the optimal complete contract will entail performance only when the cost of performance is lower than the buyer's valuation. Shavell, *supra* note 5, at 467–69.

27. E. Allan Farnsworth, *Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract,* 94 YALE L.J. 1339, 1382 (1985).

blameworthy breaches singled out for higher damages.[28] That is, a promisor who saves costs by breaching deliberately is much more likely to be required to pay the cost of correcting his breach than one who saves expenses by an accidental breach.[29] Again, our claim is that what willfulness is really doing here is screening for those breaches that parties would want to forbid ex ante. Willfulness itself is largely epiphenomenal, serving as a kind of indicator that a promisor's actions are contrary to what the contract expressly or implicitly called for.

A. *Three Variants on* Jacob & Youngs

1. *Inadvertent Breach*

Farnsworth's hypothetical suggests a variation on the famous case of *Jacob & Youngs v. Kent*,[30] and the application of willful breach doctrine can be illuminated by considering several variants on that case. In *Jacob & Youngs*, the builder contracted to supply Reading pipe, but—apparently inadvertently—substituted identical-quality Cohoes pipe instead, without realizing any cost savings at all.[31] This appears to be a classic example of an inadvertent breach.[32] The pipe substitution could have been avoided with sufficient precautions, for example, by hiring someone to match the materials ordered against the contractual specifications.[33] Given that the parties

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28. Although the $60,000 cost of correction can be thought of as protecting the buyer's expectation interest, it often overcompensates that interest. The diminution in market value will not fully compensate a promisee who places idiosyncratic value on the completed project. However, the award of the cost of correction will overcompensate that idiosyncratic value if the promisee values performance more than the market does but not as much as the cost of correction. A promisee who receives the cost of completion will have enough to get exactly what she bargained for, but need not choose to spend the money on completion.

29. *Compare* Kangas v. Trust, 441 N.E.2d 1271, 1275–76 (Ill. Ct. App. 1982) (emphasizing deliberateness), *and* City School Dist. v. McLane Constr. Co., 445 N.Y.S.2d 258 (App. Div. 1981) (same), *with* H.P. Droher & Sons v. Toushin, 85 N.W.2d 273 (Minn. 1957) (emphasizing good faith). *See also* George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225 (1994); Hillman, *supra* note 1, at 509 ("[I]n construction contracts, the degree of willfulness of a contractor's breach helps courts determine whether to grant expectancy damages measured by the cost of repair or the diminution in value caused by the breach, the latter often a smaller measure."); Patricia H. Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733 (1982).

30. 129 N.E. 889 (N.Y. 1921).

31. *See id.* at 890. The breach was only discovered after the pipe had been installed, which made the cost of correction vastly greater than would have been the case if the correct pipe had been used in the first place. *See id.*

32. Richard Craswell effectively deconstructs the distinction between "deliberate" and "accidental" breaches in his contribution to this Symposium, and after reading his paper, we acknowledge that the distinction is much more difficult to sustain than has previously been recognized. Richard Craswell, *When is a Willful Breach "Willful"? The Link Between Definitions and Damages*, 107 MICH. L. REV. 1501 (2009).

33. Analogously, having a bargee on duty could have prevented the unmooring of the ship in *United States v. Carroll Towing*. 159 F.2d 169, 172 (2d Cir. 1947). While the text below offers an example of willful breach, one that could be avoided without cost, the analysis suggests that breaches should be treated as willful even if they are costly to prevent, so long as the cost of prevention is

might not want to invest resources in avoiding the breach, however, the appropriate stance is not to prevent or deter such a breach unless the parties contract for a particular level of precautions (as they are free to do). The law takes this approach by limiting the promisee to any diminution in value and not classifying the breach as willful.

2. *Deliberate Breach that Transfers Wealth Between the Parties*

Now, imagine a variant (call it *Jacob & Olds v. Kent*) in which the contract calls for Reading pipe, but the builder deliberately substitutes Cohoes, which is cheaper (but just as good), with the intent of keeping the savings. Should this be treated as a willful breach? We suggest that it should be.[34]

True, the breach looks to be efficient: assuming the owner really did not care which pipe was used (since the two brands are of identical quality),[35] both builder and owner could be made better off by a breach that substitutes cheaper Cohoes for more-expensive Reading and splits the savings between the two parties. Of course, our breaching contractor did not share the savings. But he could have, and it is entirely possible that the parties might have agreed ex ante to permit the builder to substitute identical materials at lower cost and keep any savings so realized. That would provide the appropriate party with incentives to look for cheaper materials, and would result in lower contract price. Consequently, such a rule could be justified in a way that it could not in the middleman cases.

The problem, of course, is that a builder will have an incentive to substitute not just cheaper but functionally identical materials, but also cheaper *inferior* ones. This is especially true in a construction contract, where such substitute materials are easy to find and substitutions are often difficult to detect. In the face of this problem, treating the breach as willful and awarding the owner the cost-of-correction measure provides the appropriate incentives for the builder to inform the owner of the opportunity for savings, and to negotiate for consent to deviate from the contract. We recognize that this might lead to inefficient performance, for example, by reducing the

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less than the benefit of performance to the promisee. Defining a willful breach as one that can be avoided at *no* net cost to the parties suggests a negligence limitation to willful breach doctrine.

34. "There is no general license," Cardozo wrote in *Jacob & Youngs*, "to install whatever, in the builder's judgment, may be regarded as 'just as good.' " 129 N.E. at 891 (quoting Easthampton Lumber & Coal Co. v. Worthington, 79 N.E. 323, 325 (N.Y. 1906)); *see also id.* ("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." (citations omitted)); O.W. Grun Roofing & Constr. Co. v. Cope, 529 S.W.2d 258, 261 (Tex. Civ. App. 1975) ("The [substantial performance] doctrine does not bestow on a contractor a license to install whatever is, in his judgment, 'just as good.' ").

35. This case also shows that promisor-centric willfulness rules do not create perverse promisee incentives. Suppose that you are a member of the Reading family and so value living with Reading pipe that you will indeed correct the situation. Notwithstanding your real injury, however, under the consequential damage rules, you will not be able to recover your special loss if you did not inform us of your unique concern at the time we entered the contract. The fact that you might nonetheless recover the cost of correction if we breach does not undermine the information-forcing effect of the consequential damage rules, however, since you can neither predict nor cause our willful breach.

builder's incentive to seek out cheaper sources of pipe, or by creating bargaining costs over division of the savings if cheaper pipe *is* found. Since the parties could have adopted a "cheaper substitute" rule, however, and chose not to do so, it makes sense to read the contractual specification as a requirement and treat the conscious choice to use something else as willful.

In fact, this may be the best explanation for the use of the phrase "Reading Pipe" in the contract—it might not have been a shorthand for a particular quality or kind of pipe,[36] but a way for the owner to be safe, since he presumably was not in a position to know of all deviations or whether Cohoes pipe really was just as good as the pipe called for in the contract. When the builder accidentally substitutes Cohoes pipe and realizes no cost savings, there is no particular reason to assume that the substituted materials will turn out to be of lower quality than what the contract called for (and, as noted above, awarding cost-of-correction in that case would lead to expensive and inefficient precautions). But when the substitution is deliberate, and *does* save money, the builder's motives are questionable and the homeowner would be poorly positioned to judge whether the substitution was permissible or not. Hence, he (and, from an ex ante perspective, the builder) might be well served by a "Reading-only" rule that obviated the risk of harm if Cohoes was not really "just as good."

3. *Deliberate Breach that Is Costless to Prevent*

Consider a final variant, *Jacob & Juveniles v. Kent*, in which the builder substitutes Cohoes pipe (still identical in quality and cost), but does so just as a joke. This is a strong case for willfulness. Such a breach would not save money, and it would have been costless to prevent because all the builder needed to do was decide that the joke was not really all that funny. Put another way, there would be no real resource costs involved in performing, since this is not a case where "precautions" to prevent breach are necessary, or even meaningful. This should therefore be considered a willful breach, and awarding the cost-of-completion remedy seems appropriate.[37]

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36. This was the conclusion of Richard Danzig, who noted the building contract provided that " '[w]here any particular brand of manufactured article is specified, it is to be considered as a standard.' " RICHARD DANZIG, THE CAPABILITY PROBLEM IN CONTRACT LAW: FURTHER READINGS ON WELL-KNOWN CASES 111 (1978) (quoting specification twenty-two of the contract).

37. We are aware that joke breaches are rarely, if ever, seen. This is not, we suspect, because breaches can never be funny. Rather, it likely reflects the fact that since joke breaches are willful, the Jacob & Juveniles of the world know that they would be on the hook for cost-of-completion damages if they did breach. Only a very funny joke indeed would be worth the substantial sum it would cost to rip down the walls and replace Cohoes with Reading pipe. The cost-of-completion measure does its job when it deters joke breaches, as indeed it usually does.

For a recent example of an actual joke breach, however, consider the case of the construction worker who buried a Red Sox jersey in the foundation of the new Yankee Stadium as it was being built in order to bring bad luck on the Pinstripers. *See Yankees will donate once-buried Red Sox jersey to Boston-area charity*, ESPN.COM, Apr. 14, 2008, http://sports.espn.go.com/mlb/news/story?id=3344825 (providing details on and photographs of the burial and exhumation). The remedy in this case—though not legally ordered—turned out to be the cost-of-performance measure (removal of the jersey), rather than the diminution in value of Yankee Stadium from having a shirt buried in its foundation, which would presumably have been zero. As Seana Shiffrin nicely pointed out to us, the

B. *Treatment by the Courts*

Now consider two of the best-known cases from the contracts classroom that are also suggested by Farnsworth's hypothetical, *Peevyhouse v. Garland Coal Mining Co.*,[38] which suggests that you are entitled to the $10,000 diminution in value, and *Groves v. John Wunder Co.*,[39] which suggests that you get the $60,000 cost of correction. Both cases involved leases to extract valuable materials from land, with an obligation to return the land in its original condition. Restoring the land turned out to cost much more than the difference in value between the degraded and restored land.

Peevyhouse and *Groves* are typically taken as presenting two answers to the question of what it takes to protect the promisee's expectation interest.[40] In choosing between these measures, which is notoriously difficult, both courts relied on willfulness to some extent. But the fundamental question is why the promisor's willfulness should have any bearing on that analysis at all. The court in *Groves* explained that "[d]efendant's breach . . . was wilful. There was nothing of good faith about it. Hence, that the decision below handsomely rewards bad faith and deliberate breach of contract is obvious. That is not allowable."[41] And although the *Peevyhouse* majority did not mention willfulness (or discuss the defendant's motives at all), the dissent did suggest that the failure to return the land in its specified condition was "wilful," which it took as an argument for awarding the cost of completion.[42]

Our take on these cases is that they are both wrongly decided. Neither breach should be seen as willful, in our understanding, since both would have been costly to avoid. Promisees who did not expressly negotiate for the cost-of-correction measure ex ante probably would not want such protection, so, in

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cost of *preventing* this breach would not be zero if the contractor had to incur expenses to supervise the construction workers on the project. But if we suppose that the shirt was inserted by the CEO of the construction company (rather than a day laborer), our zero-cost characterization remains apposite.

38. 382 P.2d 109 (Okla. 1962); *see also* Eastern S.S. Lines, Inc. v. United States, 112 F. Supp. 167 (Ct. Cl. 1953) (restoration of ship); City of Anderson v. Salling Concrete Corp., 411 N.E.2d 728 (Ind. Ct. App. 1980) (landfill not brought to level specified in lease).

39. 286 N.W. 235 (Minn. 1939); *see also* Am. Standard, Inc. v. Schectman, 439 N.Y.S.2d 529 (App. Div. 1981); Joyner v. Weeks, (1891) 2 Q.B. 31 (U.K.).

40. *See* Timothy J. Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379 (1983).

41. *Groves*, 286 N.W. at 236. Of course, the term "wilful" could just be a makeweight or place maker that a court uses to justify the remedy it prefers for other reasons.

42. The dissent noted:

> Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations. Therefore, in my opinion defendant's breach of the contract was wilful and not in good faith.

Peevyhouse, 382 P.2d at 115 (Irwin, J., dissenting).

There is evidence of a conflict of interest (or possibly even outright corruption) on the part of several justices involved in the *Peevyhouse* majority. *See* Judith L. Maute, Peevyhouse v. Garland Coal & Mining Co. *Revisted: The Ballad of Willie and Lucille*, 89 NW. U. L. REV. 1341 (1995). That fact makes it especially difficult to interpret the majority's lack of reference to the willfulness of the breach.

the general case, there is no reason why a failure to return the leased land in restored condition should be treated as willful, triggering a remedy that entitles the promisee to correct the breach. On this analysis, *Groves* presents a poor case for willfulness and the cost-of-correction measure. Although the majority characterizes the breach as willful, no justification at all is offered for this label, nor can we see one.

If the breach in *Groves* was not willful, it is hard to see how the breach in *Peevyhouse* was any more so. But we suggest that the award of diminution in market value in *Peevyhouse* was nevertheless incorrect because, as many commentators have pointed out, there was good evidence that the Peevyhouses actually did want the land repaired.[43]

Put another way, the cost-of-correction remedy serves two separate purposes: first, it works to compensate those promisees who have high idiosyncratic value (and really do want the land cleaned up). This is an ordinary expectation theory for awarding the cost of performance, and in the case of the Peevyhouses, the history of the negotiation between the parties makes it entirely compelling, although not, apparently, to the Oklahoma Supreme Court.[44]

Second, the cost-of-correction remedy can also serve to *prevent* breaches that the parties would not have wanted to excuse ex ante, by forcing the breaching promisor to surrender all of the expenses saved from such breaches.[45] Neither *Groves* nor *Peevyhouse* fits this description, however, because both promisors might very well have wanted to preserve their ability not to perform when cleanup of the land turned out to be very expensive and the effects of failing to clean up minimal. Hence, these are not the kind of breaches that the willfulness designation is calculated to prevent. Where the promisor does wish to bind himself ex ante not to breach, however, this rationale should hold, even if the promisee in fact suffered little or no idiosyncratic harm from the breach.

Selling to another buyer, or deliberately substituting a cheaper input, can never happen by accident, and if a seller takes either of these actions, it is virtually certain that he did so in a way that undermines the interests the

43. Indeed, they negotiated for nonstandard contractual language, waiving the right to the usual payment of $3000 for surface damage in exchange for a promise to return the land to its original condition.

44. That said, an award of the cost of correction may overcompensate even a promisee who places idiosyncratic value on completion, if she values correction more than the market does but less than the cost of correction. Nonetheless, courts typically restrict themselves to either diminution in value or cost of correction, perhaps because determining idiosyncratic value is difficult. For an unusual case in which the court estimates the buyer's loss of subjective value and compensates that directly, rather than awarding either diminution in value or cost of correction, see Ruxley Electronics & Construction Ltd. v. Forsyth, [1996] 1 A.C. 344 (H.L.) (appeal taken from Eng.) (U.K.) (approving award of £2500 for "loss of amenity" for a swimming pool built to a maximum depth of 6 feet instead of contractually specified 7 feet 6 inches, rather than either the £21,560 cost to rebuild or the £0 diminution in market value).

45. Moreover, the prospect of this remedy assures the promisee that she will get her expectation if she wants it, since she is free to go ahead with correction.

contract was formed to promote and protect.[46] Breaches that merely *happen* to save money, but clearly occur for other reasons (as when a factory burns down and is not rebuilt in time to perform), are not expressly in derogation of the contract, in the sense that the parties did not—and probably would not—allocate such savings to the promisee. Breaches that save costs by nonperformance (as in *Peevyhouse* and *Groves*) are in some sense an intermediate case, and in these cases, the expectations of the promisee should determine whether the costs saved by nonperformance should remain with the breaching promisor or be delivered to the promisee, regardless of the willfulness of the breach.

CONCLUSION

Not all intentional breaches are willful, and willful breaches are not those that are especially injurious to promisees. Instead, they are breaches that promisors would want to commit themselves ex ante not to undertake. It follows that the remedy for such breaches is and should be the surrender of any gains they engender for the breaching promisor, not compensation of the promisee. This remedy sustains promisors' credible commitments not to breach in those circumstances where such commitments are valuable. Accordingly, the availability of this remedy for willful breach furthers the interests of all contracting parties, and particularly promisors, even when it exceeds promisee expectation.

46. As Andrew Kull nicely observed, "Skimped performance [indicates] opportunism, because we can see that the performance being withheld . . . is one that was specifically bargained for. To the extent that the defendant can cheat on a promised performance and get away with it, the bargain has been undermined." Andrew Kull, *Disgorgement for Breach, the "Restitution Interest," and the Restatement of Contracts*, 79 TEX. L. REV. 2021, 2050 (2001).