
ARTICLES

A THEORY OF SELF-HELP REMEDIES IN CONTRACT

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INTRODUCTION

Teaching and scholarship about contract remedies tend to focus on damages and injunctions, the two principal remedies courts provide. Little attention is paid to “self-help remedies,” by which I mean actions a party may take to obtain redress for breach of contract without going to court.¹ This is

* Professor, Berkeley Law School. This article had a long gestation. A draft was presented at a Berkeley Law School retreat in September 2008. An earlier version was presented at a faculty workshop at Harvard Law School in Fall 2007. Parts I-III grew out of a paper presented at the International Conference on Comparative Remedies for Breach of Contract at the Buchmann Faculty of Law, Tel Aviv University in June 2002. That paper appears as Mark P. Gergen, *The Law's Response to Exit and Loyalty in Contract Disputes*, in *COMPARATIVE REMEDIES FOR BREACH OF CONTRACT* 75 (Nili Cohen & Ewan McKendrick eds., 2005). A key point in Part III is made in Mark P. Gergen, *Restitution as a Bridge over Troubled Contractual Waters*, 71 *FORDHAM L. REV.* 709, 719-25 (2002) [hereinafter Gergen, *Restitution*]. I owe a special debt to Douglas Laycock, Andrew Kull, Alan Rau, and Melvin Eisenberg for talking through these issues with me and commenting on drafts. The views expressed here are decidedly my own.

¹ Self-help remedies have been defined as “legally permissible conduct that individuals undertake absent the compulsion of law and without the assistance of a government official in efforts to prevent or remedy a civil wrong.” Douglas I. Brandon et al., *Self-Help: Extrajudicial Rights, Privileges and Remedies in Contemporary American Society*, 37

unfortunate. Self-help remedies are of obvious practical significance in their own right. As for theory, the academic obsession with the damage remedy and neglect of self-help has contributed to pervasive under-estimation both of the strength of contract rights in American law and of the weight placed on remedial simplicity. Putting to the side repossession, the principal self-help remedy in contract is the power to withhold performance in response to breach. Often this power is exercised in tandem with the power to refuse non-conforming performance. In addition, a party may threaten to withhold performance in order to extract concessions. The exercise of these powers is regulated after the fact by a dauntingly long list of rules that are scattered across the fields of contract, restitution, and equity.² These rules determine when an actor has the power to withhold or refuse performance in response to breach, as well as the power to threaten to do so to extract concessions, and the legal consequences of an actor's decision whether or not to exercise these powers.

VAND. L. REV. 845, 850 (1984). Brandon et al. include as instances of self-help remedies in commercial transactions liquidated damage terms, self-help repossession, and arbitration. *Id.* at 911-13. This list illustrates some of the difficulties of defining the category. If liquidated damage terms are classified as self-help remedies, then so might any contract term that is designed to simplify litigation or to make the outcome more predictable. This might include, for example, merger provisions that exclude parol evidence. Readers interested in pursuing the topic of designing contracts in anticipation of litigation should look generally at Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814 (2006). My principal focus is on self-help remedies that do not anticipate or require that a party go to court to make the remedy effective. I will say a fair bit about the power to obtain substitute performance (or cover) and collect the cost and the power to complete performance and collect the contract price. These have been described as forms of self-help specific performance. The power to refuse future dealings with a defaulter has been described as a self-help remedy, as have reputational sanctions more generally. I will not explore these sanctions here. While reputational sanctions are important, they are largely unregulated by courts.

The only article I know of that examines the rules on material breach and substantial performance under this heading is Celia R. Taylor, *Self-Help in Contract: An Exploration and Proposal*, 33 WAKE FOREST L. REV. 839 (1998). There is, however, a substantial literature on many of the individual rules. I will refer to this literature when it is relevant, but I will not discuss the law on repossession. For an introduction to, and critical analysis of, this body of law, see Edward L. Rubin, *The Code, the Consumer, and the Institutional Structure of the Common Law*, 75 WASH. U. L.Q. 11, 36-41 (1997). A fair amount has been written on the subject of self-help remedies in the area of property rights. Readers interested in pursuing this topic might start with Symposium, *Property Rights on the Frontier: The Economics of Self-Help and Self-Defense in Cyberspace*, 1 J.L. ECON. & POL'Y 1 (2005).

² The list includes rules on mitigation, material breach, substantial performance, conditions, voluntary payment, waiver, equitable estoppel, election of remedies, restitution as a remedy for breach, restitution to a defaulter, accord and satisfaction, good faith, and duress. To these can be added rules that apply in subfields of contract, such as sales law rules on rejection, revocation, and cure.

This article offers a positive and normative account of this body of law. The positive account centers on two general observations. One observation is that the law permits a party to withhold or refuse performance in response to breach to avoid suffering a loss that damages may not adequately compensate even if the response inflicts a disproportionate loss on the defaulter.³ When it comes to self-help remedies, there is no “option” to breach a contract even if breach would be efficient.⁴ My other observation is that when there is an honest dispute about the performance owed under a contract, and nonperformance will not cause a significant loss, the law prods parties to resolve the dispute without going to court. The law does this by permitting a party who is under a disputed performance obligation to use a threat of nonperformance to extract a settlement and by presuming that whatever performance is rendered and accepted settles any dispute over whether less or more was due. When

³ See *infra* Parts I, II. Parts of the argument parallel and support the argument in Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CAL. L. REV. 975 (2005). In particular, Professor Eisenberg argues for a right to cover in “good faith” – meaning the choice of cover has “some basis in reason.” *Id.* at 1043 (quoting *Sam Wong & Son v. N.Y. Mercantile Exch.*, 735 F.2d 653, 655 (2d Cir. 1984) (Friendly, J.)). He lauds cover as a form of self-help specific performance, arguing that the standard for permissible cover should be more generous than the standard for specific performance because of problems posed by the latter, “including the nature of the enforcement process and problems of mitigation, opportunism, and jury trial.” *Id.* at 1042.

The same thing may be said for specific performance when equitable enforcement is a simple and effective way to put the plaintiff in the promised position. Courts routinely specifically enforce contracts to deliver property when the property is in the defendant’s possession. See DOUGLAS LAYCOCK, *THE DEATH OF THE IRREPARABLE INJURY RULE 100-01* (1991). Economists have come around to the view that this is the best background rule for such cases. See Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 TEX. L. REV. 831, 831-32 (2006).

⁴ Misunderstanding of this point is pervasive. It ties into the widely held view that contract rights are weaker than property rights. So Carol Rose observes: “[I]n contract law, liability rules, not property rules, do indeed constitute the background default rule: The parties are supposed to perform, but except in particular circumstances (mostly real estate!) they have the option of defaulting and paying damages instead of performing.” Carol M. Rose, *The Shadow of The Cathedral*, 106 YALE L.J. 2175, 2187 (1997). Richard Brooks pithily summarizes the supposed differences between the two types of rules: “Property rules protect entitlements by using the state’s police powers to prohibit nonconsensual appropriations, whereas liability rules use court-determined monetary compensation to discourage nonconsensual appropriations.” Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568, 575 (2006). It also ties into the widely held view that contract rights have a lower stature in American contract law than they do in civil law systems and in other common law systems. Ronald J. Scalise, Jr., *Why No Efficient Breach in Civil Law? A Comparative Assessment of the Doctrine of Efficient Breach*, 55 AM. J. COMP. L. 721, 763 (2007) (using the example of efficient breach to show that “the difference [in contract law] appears to be one between American common law and the law of the rest of the world”).

nonperformance will cause a significant loss, the law prods parties to perform and accept performance and then resolve their dispute in court.⁵ In the law of self-help, uncertain contract rights, unlike indisputable contract rights, sometimes do give way in the interest of efficient performance, but in a way that preserves the power of a party to go to court and have a rights claim resolved.

My normative account of these rules is fairly straightforward as it is fairly easy to show these rules are consistent with norms of both economy and autonomy. I use the normative account of the rules as a springboard to respond to recent economics-minded scholarship that mounts a formidable challenge to the turn against rule formalism in American contract law in the last century. I respond in particular to recent work of Robert Scott.⁶ My observation that the law of self-help tolerates a great deal of waste, and even some windfall, to avoid even a modest risk of short-changing contract rights undercuts the theory of efficient breach. This might seem to render economic theories of contract descriptively inaccurate and instead support what I will call autonomy theories.⁷ But current economic thinking about contract remedies is dismissive of the possibility and desirability of calibrating damages to ensure efficient decisions in contracting, reliance, and performance. Instead, current thinking favors simple and reliable mechanisms to protect parties from nonperformance

⁵ See *infra* Part III.

⁶ Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847 (2000) [hereinafter Scott, *Formalism*], makes many of the key points. The article combines theoretical, empirical, and historical arguments to justify a formalist approach in contract law and criticize what is described as a contextualist approach. The theoretical argument is that courts are unlikely to do better than sophisticated actors in designing terms when relevant information is unknown or the design of terms involves difficult tradeoffs. *Id.* at 862-66. The empirical argument is that the world is complex – in Scott’s words, it is “a thick environment of many heterogeneous parties.” *Id.* at 865. These points lead to the conclusion that efficient terms are likely to be individualized, meaning they cannot be set by courts on a wholesale basis. The historical argument, which Scott calls the failure of Karl Llewellyn’s project, is that courts have not derived individualized rules from trade norms, which might have been a solution to the problem of competence and heterogeneity. *Id.* at 866-69. The upshot is that Scott touts the old-time virtues of remedial simplicity. He advocates literal interpretation of contracts without regard to context. *Id.* at 866. This presumably means a return to the plain-meaning and four-corners rules and, perhaps, a return to the rule barring enforcement of indefinite terms. See *id.* at 860, 877 (suggesting some indecision on the last point). He nods sympathetically to the “doctrines of perfect tender, mistake, and excuse [and] the sharply defined rules regarding expectation damages” that “assign risks on an all-or-nothing, binary basis.” *Id.* at 852-53. In Robert E. Scott, *The Death of Contract Law*, 54 U. TORONTO L.J. 369 (2004) [hereinafter Scott, *Death*], Scott argues that the shift of courts from a formalist to a contextualist approach is partly responsible for the flight from relying on the legal system to enforce contracts to relying on self-enforcement, particularly in contracts that require flexible commitments.

⁷ In using the term, I follow Melvin A. Eisenberg, *The Theory of Contracts*, in *THE THEORY OF CONTRACT LAW* 206, 223-35 (Peter Benson ed., 2001).

when the adequacy of performance or damages is difficult to verify.⁸ The power to withhold and refuse performance in response to breach in order to avoid the risk of suffering an uncompensated loss is such a mechanism.

I part ways with current economic thinking about contract remedies on a different point that is an aspect of the general question of the legal status of informal agreements. Economic and autonomy theories of contract tend to cut in different directions on this question. In a recent article, Professor Scott argues that courts ought to refuse to enforce avoidably indefinite agreements, reasoning that a practice of enforcing indefinite agreements crowds out self-enforcement through reciprocal norms of fairness.⁹ While it is difficult to justify the doctrine of indefiniteness in these terms, Scott's larger point may be valid. American contract law is much more open than it used to be to enforcing claims based on uncertain agreements, in particular agreements whose existence or content is uncertain because of the agreement's informality. It is quite plausible that the specter of litigation has made people less willing to use informal agreements to order their affairs. Scott and economic theorists tend to favor blunt rules making some uncertain agreements unenforceable.¹⁰ I argue that the rules that regulate withholding and refusing performance in a case in which there is an honest dispute about rights offer a more attractive solution to the problem of determining when courts should resolve an uncertain rights claim. The rules prod, but do not compel, parties to resolve their disputes outside of court. Their non-compulsory nature makes the rules fairly easy to defend on economic grounds and inoffensive on autonomy grounds.

I. THE DUTY TO MITIGATE DOES NOT REQUIRE SACRIFICING A RIGHT

I show in this Part that the duty to mitigate does not require a party to act in a way that would subject the party to a risk of a loss that may not be adequately compensated in damages even if the action would avoid a significantly greater loss to a defaulter. To make my point, I use a familiar case, *Parker v. Twentieth Century-Fox Film Corp.*,¹¹ and a familiar problem that often is

⁸ See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 618-19 (2003); Alan Schwartz & Joel Watson, *The Law and Economics of Costly Contracting*, 20 J.L. ECON. & ORG. 2, 4-5 (2004); Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369, 406-07 (1990).

⁹ Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1692-93 (2003).

¹⁰ See, e.g., Scott, *Death*, *supra* note 6, at 370.

¹¹ 474 P.2d 689 (Cal. 1970). As often happens to cases in the canon, *Parker* has been used to make a variety of points. See Mary Joe Frug, *Re-Reading Contracts: A Feminist Analysis of a Contracts Casebook*, 34 AM. U. L. REV. 1065, 1114-25 (1985) (discussing feminist issues raised by the case); Victor P. Goldberg, *Bloomer Girl Revisited or How to Frame an Unmade Picture*, 1998 WIS. L. REV. 1051, 1052-53 (explaining that the decision should have been rested on the ground that base price in the contract was paid by the studio to have an option on Parker's time); William J. Woodward, Jr., *Clearing the Underbrush for*

illustrated by *Rockingham County v. Luten Bridge Co.*¹² The mitigation doctrine may seem unrelated to the topic of self-help remedies because the doctrine typically bears on the amount of damages recovered for breach. *Parker* directly implicates the power to refuse non-conforming performance because the mitigation doctrine was invoked by the defendant in the case to hold the plaintiff at fault for refusing an offer of substitute performance.¹³ More generally, both in *Parker* and in the situation of *Luten Bridge*, once the mitigation issue is resolved in the plaintiff's favor, the plaintiff is entitled to the contract price.¹⁴ While the remedy is not self-enforcing – the plaintiff may have to sue to collect the money owed – a judgment for the price follows mechanically and a trial to establish the fact and amount of the liability is unnecessary. In both situations, the mitigation doctrine works to simplify or avoid litigation. This also is a key characteristic of the rules we will look at in Parts II and III.

Shirley MacLaine Parker had a contract with Twentieth Century Fox to play the female lead in *Bloomer Girl*, a musical about gender and racial conflict in the antebellum South with a precociously progressive female lead character.¹⁵ The studio cancelled plans for *Bloomer Girl* and offered MacLaine as a substitute the female lead in *Big Country, Big Man*, a dramatic Western, with the same guaranteed compensation of \$750,000 for fourteen weeks' work.¹⁶ MacLaine turned down the offered role and sued for the guaranteed compensation.¹⁷ In its defense, the studio argued that MacLaine failed to mitigate damages by not taking the offered role.¹⁸ The trial court rejected this defense on a motion for summary judgment.¹⁹ The fighting issue in the case on appeal was whether the question of the comparability of the roles (framed as whether the second role was "different and inferior" to the first) should go to the jury.²⁰ The California Supreme Court said no, affirming the trial court.²¹

Real-Life Contracting, 24 LAW & SOC. INQUIRY 99, 105 (1999) (explaining that the case is a good vehicle for exploring the difference between book law and real life). I discuss Goldberg's account of the case in Part IV. See *infra* notes 159-74 and accompanying text.

¹² 35 F.2d 301 (4th Cir. 1929).

¹³ *Parker*, 474 P.2d at 692-93.

¹⁴ *Luten Bridge*, 35 F.2d at 307-08; *Parker*, 474 P.2d at 693-94.

¹⁵ *Parker*, 474 P.2d at 690-91.

¹⁶ *Id.*

¹⁷ *Id.* at 691.

¹⁸ *Id.* at 692.

¹⁹ *Id.* at 693-94.

²⁰ *Id.*

²¹ *Id.* *Parker* seems to be representative of employment cases more generally. A survey of recent contract and Title VII cases concludes that courts require that two positions be "virtually identical" before they will require a terminated employee to take another position to mitigate damages. Richard J. Gonzales, *Satisfying the Duty to Mitigate in Employment Cases: A Survey and a Guide*, 69 MISS. L.J. 749, 760-62 (1999). The author adds that courts have been more willing to require an employee to relocate when his line of work and

The conduct countenanced in *Parker* might be quite wasteful. MacLaine did no work for fourteen weeks at a time when she “was one of the biggest female stars in Hollywood.”²² If the studio was serious in its proposal to produce the Western with her as the female lead (which is not clear), then her refusal denied her fans the pleasure of seeing her in the role. Apparently, MacLaine did no other work during the fourteen-week period, for the studio did not seek an offset against damages. While MacLaine’s rights were vindicated, it is at best rough justice. MacLaine received fourteen weeks of pay for which she did no work, which is a windfall if MacLaine values leisure more than whatever satisfaction (apart from the fee) she would have derived from performing in the musical.

The interest in remedial simplicity explains why the law tolerates waste and windfall in this situation. There is reason to believe that MacLaine genuinely preferred the role in *Bloomer Girl* to the role in *Big Country, Big Man*. To protect MacLaine from a loss in performing the less desired role, while avoiding waste, the law might require her to take the role in the Western while giving her damages for her loss. This the law does not do. Had MacLaine taken the role, she would have been denied damages for her artistic, political, or reputational loss, as any estimate of the loss would be speculative. The only way MacLaine could avoid suffering an uncompensated loss was to do what she did, which was to reject the role in *Big Country, Big Man* and get a judgment for the contract price.

Parker illustrates several respects in which the duty to mitigate is unlike the duty of care in negligence. First, whether an action is proper is determined by a subjective standard: taking an actor with all of his or her peculiar preferences when an action is of a type that plausibly implicates subjective preferences.²³

past behavior indicated he was not averse to relocating. *Id.* at 767-68. In Title VII cases (but not breach of contract claims), an employee may be denied full back wages for an extended period of time on the theory that he should have taken less desirable and lower paying work to mitigate damages. *Id.* at 769-71.

²² Goldberg, *supra* note 11, at 1052. I take the facts not found in the opinion from Goldberg’s excellent article. Goldberg argues that there was an alternative basis for decision because the contract had a “pay-or-play” provision that required the studio to pay MacLaine if it cancelled the project. *Id.* at 1053. Goldberg argues this was an easier basis. I think it was an easy mitigation case as well.

²³ This also is true when courts determine whether damages are an adequate remedy to preclude an order of specific performance. *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 83 (3d Cir. 1948), is a classic statement of the principle.

The caveat about subjective preferences is to acknowledge that courts sometimes apply an objective standard in assessing whether an action taken in response to breach is appropriate. Melvin Eisenberg makes a similar point when he argues that an objective standard should be used to evaluate a buyer’s search for cover while a subjective good faith standard should be used to evaluate a buyer’s choice of cover. Eisenberg, *supra* note 3, at 1042-49. Professor Eisenberg finds mixed support in the case law on the use of a subjective standard to evaluate choice of cover. *Id.* at 1046-47.

Second, when it comes to mitigation, “[o]ne is not obligated to exalt the interests of the defaulter to his own probable detriment.”²⁴ The point I just made about *Parker* is really no more than a gloss on these two familiar propositions. Thus, when a party has subjective preferences in the promised performance that might be harmed by taking a substitute, she may reject the substitute to satisfy those preferences and avoid an uncompensated loss even if that loss might seem a relatively small sacrifice in comparison to the burden imposed on the defaulter. Third, a court will take the question of whether a choice was unreasonable away from the jury if the choice could have been reasonable. Contrast this deferential rule with the rule in negligence under which the issue of whether conduct is unreasonable is taken away from the jury only if no reasonable person could think the conduct unreasonable. *Parker* is direct authority for precisely this last point, for the fighting issue in the case was whether the question of the comparability of the roles should have gone to the jury.²⁵ Maxims such as “uncertainty is resolved against a wrongdoer”²⁶ or a party “should not be faulted for choosing one of several reasonable alternatives”²⁷ tie all of this together and warn against hindsight judgment.

*Rockingham County v. Luten Bridge Co.*²⁸ is often paired with *Parker* in casebooks.²⁹ I expect this is done to show the mitigation doctrine has teeth. This is unfortunate, for the case has misled generations of students and even some teachers. The result in *Luten Bridge* is the exception and not the rule when a plaintiff completes performance after repudiation and sues for the contract price. Usually, when a party completes performance of a contract after repudiation, the party has a reason to do so in addition to collecting the contract price. So long as this reason is non-trivial the party will collect the contract price.

Luten Bridge Company had just begun work on a bridge for Rockingham County when a rump group of Rockingham County commissioners voted to relocate the road and to cancel the bridge contract.³⁰ Other commissioners who claimed to speak for the county told the company to continue the work.³¹ The company completed the bridge.³² The fighting issues in the case (which

²⁴ *In re Kellett Aircraft Corp.*, 186 F.2d 197, 199 (3d Cir. 1950).

²⁵ *Parker*, 474 P.2d at 694.

²⁶ DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 97 (3d ed. 2002).

²⁷ *S.J. Groves & Sons Co. v. Warner Co.*, 576 F.2d 524, 530 (3d Cir. 1978).

²⁸ 35 F.2d 301 (4th Cir. 1929).

²⁹ See, e.g., RANDY E. BARNETT, CONTRACTS: CASES AND DOCTRINES 131, 142 (4th ed. 2008); JOHN P. DAWSON ET AL., CONTRACTS: CASES AND COMMENTS 60, 66 (9th ed. 2008); E. ALLAN FARNSWORTH ET AL., CONTRACTS: CASES AND MATERIALS 492, 500 (6th ed. 2001); LON L. FULLER & MELVIN A. EISENBERG, BASIC CONTRACT LAW 167, 171 (8th ed. 2006).

³⁰ *Luten Bridge*, 35 F.2d at 302-03.

³¹ *Id.* at 303.

³² *Id.*

are edited out in most casebooks) are who spoke for the County in the litigation and in the cancellation decision.³³ The court held that the rump group did.³⁴ The opinion goes on to hold that the company could recover only its costs up to the time of the cancellation plus its lost profits, though it spent much more to finish the bridge.³⁵ This seems a straightforward application of the mitigation doctrine. Even an inattentive student can see that the company ought to stop because it is wasteful to build a bridge in the middle of nowhere. I expect students are not told that the outcome hinged on the unusual fact that the company did not try to justify its decision to complete the bridge.³⁶ Had the company given the court a plausible reason why it had to complete the bridge to avoid a loss that damages would not adequately compensate, the case likely would have come out the other way.

*Clark v. Marsiglia*³⁷ is the leading case requiring a party to stop performance to mitigate damages. The defendant delivered paintings to the plaintiff to clean and repair.³⁸ After the plaintiff began work, the defendant told him to stop.³⁹ The plaintiff completed the work and sued for the agreed fee.⁴⁰ The plaintiff's theory of the case, which the trial court accepted, was that once the paintings were in his possession, the defendant had no right to take them back and he had the right to complete the work and recover the promised fee.⁴¹ A terse per curiam decision reversing the trial court emphasized the desirability of encouraging a person in the defendant's position to stop work he has ordered when he no longer wants the work done and the unfairness of requiring the defendant to pay for work done after the stop order.⁴² This is the mitigation principle pure and simple.

The treatment of *Luten Bridge* in the casebooks suggests that most teachers do not appreciate that the rule the case stands for is so riddled with exceptions

³³ Barak D. Richman, *The King of Rockingham County and the Original Bridge to Nowhere*, in *CONTRACTS STORIES* 304-34 (Douglas G. Baird ed., 2007), tells the story behind the case. Professor Richman notes that from the perspective of the parties and the courts, "the case only tangentially involved a dispute over contract law." *Id.* at 305.

³⁴ *Luten Bridge*, 35 F.2d at 305-06.

³⁵ *Id.* at 307-08.

³⁶ Richman, *supra* note 33, at 328 ("[N]either party proffered an argument challenging the lower court's calculation of damages."). Richman suggests two possible explanations. One is that a supporter of the bridge had promised to indemnify Luten Bridge Company. *Id.* at 316. The other is the company was advised to complete the bridge by its attorneys as the safest course given the uncertainty as to who spoke for the County. *Id.*

³⁷ 1 Denio 317 (N.Y. 1845).

³⁸ *Id.* at 317.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 318.

⁴² *Id.*

that the outcome in the case actually is the exception and not the rule.⁴³ While *Clark* was widely embraced in the United States,⁴⁴ it is not followed if the plaintiff has an interest in completing performance that damages cannot adequately compensate.⁴⁵ *Bomberger v. McKelvey*⁴⁶ canvasses the exceptions

⁴³ For example, FARNSWORTH ET AL., *supra* note 29, at 494, presents it as unexceptional “that the injured party cannot recover for cost that could have been avoided by simply *stopping performance*” and poses as the difficult case where avoiding loss requires “taking *affirmative steps*.” IAN AYRES & RICHARD SPIEDEL, *STUDIES IN CONTRACT LAW* 953 (7th ed. 2008), preface analysis of damages for breach of a construction contract with the statement “any performance by Contractor after the breach is normally out of the question (the work is being done on Owner’s land) and, in any event, would probably run afoul of the mitigation principle.” It is not clear that an owner’s right to exclude trumps a contractor’s right to complete work to avoid a loss. In *Bomberger v. McKelvey*, 220 P.2d 729, 735-37 (Cal. 1950), the trial court permitted a contractor to go on an owner’s land to demolish a building the contractor had been hired to demolish though the owner had countermanded the demolition order and asked the trial court to enjoin the entry.

⁴⁴ The rule was not universally embraced even in the United States. *John A. Roebling’s Sons Co. v. Lock-Stitch Fence Co.*, 22 N.E. 518, 518 (Ill. 1889), holds, to the contrary, that a contractor has a right to complete performance. In many cases that are cited as authority for the rule, the plaintiff did not complete performance and the rule is invoked to deflect the defendant’s argument that the plaintiff has no right to damages because of the failure to complete. *See, e.g., Davis v. Bronson*, 50 N.W. 836, 839 (N.D. 1892) (criticizing a line of cases that would seem to hold that the contract-defaulter would be obliged to pay in full should the other side nonetheless fully perform, and concluding “the weight of reason and authority is against it”).

English law is nominally more protective of the plaintiff in these cases because there is a right to complete performance and recover the contract price unless, perhaps, the plaintiff has no legitimate interest in performing the contract. *See White & Carter (Councils) Ltd. v. McGregor*, [1962] A.C. 413, 413 (H.L. 1961) (describing a case where defendants cancelled a contract to have plaintiffs place advertisements on its litterbins on the day the contract was made, plaintiffs went ahead and placed the advertisements for the three-year period of the contract, and plaintiffs were able to recover the contract price). ANDREW BURROWS, *REMEDIES FOR TORTS AND BREACH OF CONTRACT* 317-22 (2d ed. 1994), surveys the inroads on the rule. Burrows concludes that continued performance is not allowed if it requires the cooperation of the other party or if it runs up damages a great deal and is unnecessary to protect the plaintiff’s interests under the contract. This ends up being very close to the American position.

⁴⁵ *S. Cotton-Oil Co. v. Heflin*, 99 F. 339, 347-48 (5th Cir. 1900) (holding that manufacturer of cotton seed who contracted to sell manufacturing by-products to defendant could continue production after stop order and recover difference between contract price and market price); *N. Helix Co. v. United States*, 524 F.2d 707, 726 (Ct. Cl. 1975) (holding that manufacturer could continue to produce and deliver helium under long-term contract where production was interrelated with other operations, manufacturer had no storage facilities, and there were no other buyers); *O’Hare v. Peacock Dairies, Inc.*, 79 P.2d 433, 442 (Cal. 1938) (holding that a farmer could continue to produce and deliver milk to buyer under long-term contract on the reasoning that the farmer is not obliged to sell his herd to stop production); *Dougan Co. v. Klamath County*, 193 P. 645, 657 (Or. 1920) (holding a

to the rule and notes the common theme.⁴⁷ The facts of the case are a striking illustration that a plaintiff may complete performance to avoid a loss that may not be adequately compensated in damages even though completion inflicts a much greater loss on the defaulter. McKelvey bought a lot from Bomberger and agreed to pay Bomberger \$3500 to demolish a building on the lot, with Bomberger being allowed to salvage what he could from the existing building.⁴⁸ The parties understood that Bomberger would contract with the existing tenant to build a replacement building and that the existing tenant would vacate once that building was complete.⁴⁹ McKelvey agreed to buy out

contractor had a right to complete construction of courthouse after a stop order where work had to be completed for the contractor to collect from a special fund established for that purpose and the contractor otherwise would have had a claim only against general revenues of the county).

Chief Justice Oliver Wendell Holmes, Jr. wrote in a case refusing to apply the rule:

We assume that these decisions [citing *Clark v. Marsiglia*] are right in cases where the continuance of work by the plaintiff would be merely a useless enhancement of damages. . . . [But a clear repudiation] would not have ended the right of the plaintiffs to go on under the contract in a case like the present, where there was a common interest in the performance, and where what had been done and what remained to do probably were to a large extent interdependent.

Martin v. Meles, 60 N.E. 397, 399 (Mass. 1901). “Common interest” appears to mean that the plaintiff has an interest in completing performance other than receiving the contract profit.

⁴⁶ 220 P.2d 729 (Cal. 1950).

⁴⁷ The relevant passage follows. I quote it at length because it is a good statement of the exceptions to the rule and the rationale for both the rule and the exceptions.

The reason for this rule is twofold: Ordinarily a plaintiff is interested only in the profit he will make from his contract, and if he receives this he obtains the full benefit of his bargain; on the other hand, performance by the plaintiff might be useless to the defendant, although he would have to pay the entire contract price if the plaintiff were permitted to perform, and this would inflict damage on the defendant without benefit to the plaintiff. . . . If these reasons are not present, the rule is not applied. For example, where the plaintiff is not interested solely in profit from the agreement but must proceed with the work in order to fulfill contract obligations to others, or where refraining from performance might involve closing a factory, damages may be inadequate and the plaintiff may have a right to continue performance. . . . It has likewise been held that where a contractor has started work and has reached a point where it would be impracticable to attempt to make a reasonable estimate of damages, or where to complete the work will diminish damages or at least not enhance them, the contractor may go forward and complete performance. . . .

The general rule is also subject to the jurisdiction of equity to order specific performance of the contract, and, apparently in recognition of this principle, it has been held that in cases where damages will not afford adequate compensation and where specific performance will lie, the plaintiff may continue to perform, in spite of a notice to stop, and thereafter recover on the basis of his continued performance. . . .

Id. at 733-34.

⁴⁸ *Id.* at 731.

⁴⁹ *Id.*

the balance of the existing tenant's lease at that time.⁵⁰ After the lot was conveyed, McKelvey delayed construction of its planned store because it could not obtain needed materials due to wartime shortages.⁵¹ McKelvey ordered Bomberger not to proceed with the demolition.⁵² Bomberger ignored the order and demolished the building, claiming he needed skylights salvaged from the building to complete construction of the replacement building, which was well under way.⁵³ The case holds Bomberger was entitled to the \$3500 he was promised for the demolition work plus the \$2500 he was promised to buy out the existing tenant's lease.⁵⁴ The court reached this result despite the facts that the demolished building was worth around \$26,000, it was generating \$300 monthly rent, and the materials needed could be replaced at a cost of only \$540 with approximately a three month delay.⁵⁵

The power to complete performance in response to repudiation and to collect the contract price is not absolute. English law starts from the premise that a party has a right to perform and collect the contract price in response to repudiation. English courts have struggled to define when this right gives way. One judge summed it up this way: "How one defines that point is obviously a matter of some difficulty; for it involves drawing a line between conduct which is merely unreasonable . . . and conduct which is *wholly* unreasonable."⁵⁶ This delightfully cryptic standard seems to me a fairly apt description of the balance the Court struck in *Bomberger*. While Bomberger's decision to tear down the building clearly was unreasonable from McKelvey's perspective, and it probably was unreasonable from society's perspective, the decision was reasonable from Bomberger's perspective to avoid a three-month delay in securing payment for work he had already completed on another contract. The result in the case was not foreordained. I expect the California Supreme Court would have affirmed the trial court had it decided the mitigation issue in favor of McKelvey. In this respect, the case is unlike *Parker*, where a majority of the California Supreme Court held the reasonableness of MacLaine's choice could not be second-guessed. While this is an important qualification on the power recognized in *Bomberger*, the difference between *Parker* and *Bomberger* is one of degree and not of kind. The common theme is that the duty to mitigate does not require a party to respond to breach in a way that will

⁵⁰ *Id.*

⁵¹ *Id.* at 732.

⁵² In an interesting twist, McKelvey went to court and tried to get a preliminary injunction prohibiting Bomberger from demolishing the building, asserting its right as owner to exclude Bomberger from the property. The trial court denied the request. *Id.* at 729.

⁵³ *Id.* at 732.

⁵⁴ *Id.* at 736-37.

⁵⁵ *Id.* at 732-33.

⁵⁶ *Clea Shipping Corp. v. Bulk Oil Int'l Ltd.*, [1984] 1 All E.R. 129, 136-37 (Q.B. 1983).

expose the party to a risk of a loss that may not be adequately compensated in damages even if the response would avoid a much larger loss to the defaulter.

II. THE POWER TO WITHHOLD AND REFUSE PERFORMANCE WHEN THE RIGHTFUL POSITION IS CERTAIN AND DAMAGES MAY BE AN INADEQUATE REMEDY TO VINDICATE THE RIGHT

In American law, the doctrine of material breach and the related doctrines of total breach and substantial performance usually define when a party has the power to withhold or refuse performance in response to breach in the absence of an express condition.⁵⁷ The mitigation doctrine performs a similar function

⁵⁷ The occurrence of a material breach or a total breach triggers several possible legal responses. These include the power to suspend performance, the power to abandon a contract and make substitute arrangements (e.g., cover or resale), and the power to recover in restitution for the reasonable value of any performance rendered. The Restatement (Second) of Contracts distinguishes between material and total breach on the basis of whether the harm from the breach is curable. Under the Restatement, a material breach that is curable justifies suspending performance. See RESTATEMENT (SECOND) OF CONTRACTS § 242 cmt. a (1981). A total breach – meaning an incurable material breach – discharges the non-defaulting party, justifying his withdrawal from the contract. *Id.* §§ 236, 243(1)-(2). It also justifies the optional restitution remedy. *Id.* § 373.

The concept of substantial performance is associated with a claim to be paid for defective work. State laws differ in some details. In most states, a party who substantially performs has a right to recover the contract price less damages caused by his breach (the contract remedy), while a party whose work falls short of substantial performance but whose work nevertheless confers an incontrovertible benefit on the defendant has a right to recover in restitution. See, e.g., *Reynolds v. Armstead*, 443 P.2d 990, 992 (Colo. 1968) (holding that a contractor in material breach nonetheless could recover the value his work had added to the house); *Levan v. Richter*, 504 N.E.2d 1373, 1381 (Ill. 1987) (ruling that a contractor who constructed an in-ground swimming pool so shoddily that it could not hold water was entitled to nothing as it had no value at all); *Plante v. Jacobs*, 103 N.W.2d 296, 298-99 (Wis. 1960) (holding that a builder who did not entirely complete construction of a house was entitled to contract price minus damages). In a few states, a party who substantially performs has a right to recover in restitution, while a party whose work falls short of this forfeits compensation. *J.A. Sullivan Corp. v. Commonwealth*, 494 N.E.2d 374, 378-79 (Mass. 1986) (finding that a contractor who built a college gym was entitled to payment for the work he had completed, despite contract allowing payment only if every item finished). The New York rule on construction contracts is a variant. A contractor who substantially performs is paid on the contract (less damages) but there is no claim in restitution if the work falls short of this. *Steel Storage & Elevator Constr. Co. v. Stock*, 121 N.E. 786, 787 (N.Y. 1919) (holding that an elevator fabricator failed to show cause for any award because the elevator had not met every essential requirement). New York law has softened outside the construction context. *Hadden v. Consolidated Edison Co. of New York*, 312 N.E.2d 445, 449 (N.Y. 1974), states that willfulness of default is only one factor to consider in deciding if an employee substantially performed his job and holds that an employee who had taken bribes from contractors might not forfeit his pension. The New York Court of Appeals ultimately concluded forfeiture of the pension was appropriate on a technical ground. *Hadden v. Consol. Edison Co. of N.Y., Inc.* 382 N.E.2d 1136, 1139 (N.Y. 1978).

when called upon, as it was by the studio in *Parker*, to try to hold a plaintiff at fault for not accepting an offer of substitute performance.⁵⁸ My major point in this Part is that the lesson of *Parker* can be generalized. A party may withhold performance in response to a clear breach, and may refuse non-conforming performance, to avoid suffering a loss that may not be adequately compensated by damages, even if withholding or refusing performance inflicts a disproportionate loss on the defaulter. The power to withhold performance in response to breach and the power to refuse non-conforming performance sometimes are limited to avoid forfeiture and unjust enrichment, but are not limited to avoid what has come to be called economic waste. There is no need to discuss conditions; it is well known that the law may excuse default of a condition to avoid forfeiture but that the law does not excuse default on the ground that fulfilling a condition imposes an unreasonable burden.⁵⁹

The Restatement (Second) of Contracts states five factors that bear on the determination of material breach.⁶⁰ They are similar to the five factors that

⁵⁸ Robert A. Hillman, *Keeping the Deal Together After Material Breach – Common Law Mitigation Rules, the UCC, and the Restatement (Second) of Contracts*, 47 COLO. L. REV. 553 (1976), remains a good treatment of the topic. Hillman challenges the many cases that state in categorical terms that there is no obligation to do further business with a defaulter. *Id.* The most famous of these cases is *Canadian Industrial Alcohol Co. v. Dunabbar Molasses Co.*, 179 N.E. 383 (N.Y. 1932). It held that

the plaintiff replied in substance that it had no longer any faith in the defendant's readiness or ability to live up to its engagements, and did not wish to add another contract to the one already broken. The law did not charge it with a duty to make such an experiment again.

Id. at 385; see also *W-V Enters., Inc. v. Fed. Sav. & Loan Ins. Corp.* 673 P.2d 1112, 1122 (Kan. 1983) (“[T]here is no obligation to mitigate damages if the mitigation involves dealing with the breaching party.”).

⁵⁹ For a discussion of excuse to avoid forfeiture, see E. ALLAN FARNSWORTH, *CONTRACTS* 595-600 (2d ed. 1990).

⁶⁰ RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981). The factors are:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of the benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Id.

Some cases offer a somewhat higher standard to justify termination, requiring “a material breach which destroys the entire purpose of entering into the contract.” *Ervin Constr. Co. v. Van Orden*, 874 P.2d 506, 511 (Idaho 1993); see also, e.g., *Peters v. Blagden Homes Inc.*, 151 A.2d 183, 184 (D.C. 1959) (finding for a homebuilder whose guaranteed damp-proof basement flooded before it could be finished, prompting purchaser to breach before

bear on the determination of “fundamental breach” under the UNIDROIT principles.⁶¹ With no loss of substance, these two lists of five can be reduced to three factors: (1) whether the aggrieved party needs to withhold or refuse performance to avoid suffering a loss that will not be adequately compensated in damages;⁶² (2) the burden imposed on the defaulter by withholding or refusing performance;⁶³ and (3) whether the default was willful or in bad faith.⁶⁴

allowing the builder to finish all necessary work). Another version of the standard asks if “the contract would not have been made if default in that particular had been expected or contemplated.” *Huffman v. Saul Holdings Ltd. P’ship*, 194 F.3d 1072, 1081 (8th Cir. 1999) (quoting *Berland’s, Inc. of Tulsa v. Northside Vill. Shopping Ctr., Inc.*, 378 P.2d 860, 865 (Okla. 1963)).

⁶¹ UNIDROIT PRINCIPLES OF INT’L COMMERCIAL CONTRACTS art. 7.3.1(2) (2004):

In determining whether a failure to perform an obligation amounts to a fundamental non-performance regard shall be had, in particular, to whether: (a) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result; (b) strict compliance with the obligation which has not been performed is of essence under the contract; (c) the non-performance is intentional or reckless; (d) the non-performance gives the aggrieved party reason to believe that it cannot rely on the other party’s future performance; (e) the non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated.

The UNIDROIT Principles are a product of an effort to state global principles of commercial law incorporating both common law and civil law.

⁶² RESTATEMENT (SECOND) OF CONTRACTS § 241(a)-(b), (d) (1981); UNIDROIT PRINCIPLES OF INT’L COMMERCIAL CONTRACTS art. 7.3.1(2)(a)-(b), (d) (2004).

⁶³ RESTATEMENT (SECOND) OF CONTRACTS § 241(c) (1981) states the principle against forfeiture. UNIDROIT PRINCIPLES OF INT’L COMMERCIAL CONTRACTS art. 7.3.1(2)(e) (2004) speaks of avoiding a “disproportionate loss” to the defaulter. These are much the same thing. The Restatement (Second) of Contracts defines forfeiture as “the denial of compensation that results when the obligee loses his right to the agreed exchange after he has relied substantially.” RESTATEMENT (SECOND) OF CONTRACTS § 227 cmt. b (1981). The Restatement’s definition of forfeiture suggests two baselines for measuring forfeiture. The references to “reliance” and “the denial of compensation” suggest a baseline of the defaulter’s pre-contractual position. The reference to the defaulter’s “right to the agreed exchange” suggests a baseline of the defaulter’s position if the contract was fully performed by both sides. I think the latter view is more in accord with the law. Countless insurance cases invoke the principle opposing forfeiture to protect the right of an insured to collect on what is in effect a winning bet notwithstanding his default on a technical term of the bet using tools such as construction to protect reasonable expectation, interpretation, waiver, estoppel, and impracticability. See *Clark v. West*, 86 N.E. 1, 5 (N.Y. 1908) (“The cases which present the most familiar phases of the doctrine of waiver are those which have arisen out of litigation over insurance policies where the defendants have claimed a forfeiture because of the breach of some condition in the contract . . .”). *Aetna Casualty & Surety Co. v. Murphy*, 538 A.2d 219, 221-22 (Conn. 1988), is striking because the court dispensed with these tools and applied a rule requiring an insurer to show actual prejudice from an

insured's failure to give timely notice of a claim, relying on RESTATEMENT (SECOND) OF CONTRACTS § 229 (1981). Sales cases that prevent a buyer from rejecting goods because of a minor defect to get out of a losing bargain are similar. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 355-57 (3d ed. 1988) (concluding that "relatively little is left" of the UCC perfect tender rule, U.C.C. §2-601, because courts have used a variety of devices to prevent sellers from rejecting goods in bad faith to escape a disadvantageous bargain).

⁶⁴ RESTATEMENT (SECOND) OF CONTRACTS § 241(e) (1981); UNIDROIT PRINCIPLES OF INT'L COMMERCIAL CONTRACTS art. 7.3.1(2)(c) (2004). I will come back to this element in the next Part, for it may be invoked to excuse a refusal to perform when the obligation to perform is uncertain.

A related rule in the law of substantial performance and in the law of restitution denies a contractor who knowingly deviates from a contract any recovery for the value of the work done. Many cases state the rule though there seem to be few occasions to apply it. Tolstoy Constr. Co. v. Minter, 143 Cal. Rptr. 570, 573 (Ct. App. 1978); Moore's Builder & Contractor, Inc. v. Hoffman, 409 N.W.2d 191, 195 (Iowa Ct. App. 1987); Peabody N.E., Inc. v. Town of Marshfield, 689 N.E.2d 774, 779-80 (Mass. 1998); Sear-Brown Assocs., P.C. v. Blackwatch Dev. Corp., 492 N.Y.S.2d 266, 266 (App. Div. 1985) (applying the rule to deny recovery due to intentional deviation); Merrill Iron & Steel, Inc. v. Minn-Dak Seeds, Ltd., 334 N.W.2d 652, 656-57 (N.D. 1983); Ahlers Bldg. Supply, Inc. v. Larsen, 535 N.W.2d 431, 435 (S.D. 1995); Uhlir v. Golden Triangle Dev. Corp., 763 S.W.2d 512, 514, 516-17 (Tex. Civ. App. 1988) (referencing the rule but not finding it applicable in that case). There have been some inroads on this rule. *Hayeck Building & Realty Co. v. Turcotte*, 282 N.E.2d 907, 910 (Mass. 1972), requires only that a contractor act in good faith and countenances a switch to less costly method of doing work. *Mathis v. Thunderbird Village*, 389 P.2d 343, 351 (Or. 1964), which is the basis for RESTATEMENT (SECOND) OF CONTRACTS § 241 illus. 7 (1981), excuses a builder's intentional failure to complete work in a minor respect because it was prompted by the owner's failure to pay. *Vincenzi v. Cerro*, 442 A.2d 1352, 1354 (Conn. 1982), excuses allegedly willful failure to complete work in a timely fashion because the failure was minimal.

A parallel rule holds that in a case in which a contractor willfully deviates from contract specifications, a plaintiff is entitled to recover remedial cost, no matter how disproportionate this amount may be to the apparent loss. *Kangas v. Trust*, 441 N.E.2d 1271, 1276 (Ill. 1982); *Roudis v. Hubbard*, 574 N.Y.S.2d 95, 96 (App. Div. 1991); *Fid. & Deposit Co. v. Stool*, 607 S.W.2d 17, 20-21 (Tex. Civ. App. 1980). *Contra* Grossman Holdings, Ltd. v. Hourihan, 414 So. 2d 1037, 1039-40 (Fla. 1982) (denying remedial cost though contractor built house facing in wrong direction over repeated protests of owner).

A plausible explanation for the traditional rules is that they discourage a party from unilaterally modifying a contract by denying him compensation for a knowing deviation. See Andrew Kull, *Restitution's Outlaws*, 78 CHI.-KENT L. REV. 17, 18 (2003) (making the general point that restitution punishes wrongdoers by withholding a claim that it would otherwise allow to prevent unjust enrichment). The Restatement (Third) of Restitution and Unjust Enrichment concurs by stating that restitution to the builder who knowingly deviates from plans should be qualified or denied in order to avoid subjecting the owner to a forced exchange. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 36(b) (Council Draft No. 5, Nov. 24, 2003); *id.* cmt. b. This analogizes the builder who deviates from plans to the knowing trespasser who builds an improvement. *Id.* Even property rights can give way if an infringement is minor and enjoying the infringement would inflict an

The Restatement (Second) of Contracts is conspicuously silent about the relative weight assigned to these factors when they cut in different directions.⁶⁵ As discussed above, a party may refuse non-conforming performance, or may withhold performance in response to breach, to avoid suffering a loss that may not be adequately compensated by damages, even if the response inflicts a disproportionate loss on the defaulter.⁶⁶ The power to revoke acceptance in sales law provides a telling example. The standard for rejection – a buyer may reject a one-off delivery of goods for any imperfection – is famously pro-buyer.⁶⁷ Revocation is more troublesome than rejection because the seller is likely to incur a loss when it must recover and resell goods that have been used by the buyer. Under the Uniform Commercial Code, a buyer may revoke acceptance for a hidden defect only if the defect “substantially impairs” the value of the goods to him.⁶⁸ Commentators who have looked closely at the

undue hardship on the infringer. *Mannillo v. Gorski*, 255 A.2d 258, 264 (N.J. 1969) (innocent encroacher is only made to pay the market value of what he has taken). Typically, the doctrine of undue hardship protects only innocent infringers. *Ariola v. Nigro*, 156 N.E.2d 536, 543 (Ill. 1959) (relying on rule that an intentional encroachment will always be enjoined).

There are some situations in which it is well established that intentional breach will not bar recovery for the value of part performance. One is where a defaulter renders part performance and then abandons a contract. Two staples of the Contracts course, *Britton v. Turner*, 6 N.H. 481 (1834), and *Vines v. Orchard Hills, Inc.*, 435 A.2d 1022 (Conn. 1980), are in this mold. In *Britton*, a worker abandoned a contract for a year’s employment after working nine and one-half months. *Britton*, 6 N.H. at 482. In *Vines*, a condominium buyer backed out of the contract after paying a hefty deposit. *Vines*, 435 A.2d at 1025. Both cases allow the defaulter to recover for the value of his part performance less whatever holdback is necessary to put the other party in the promised position. Construction contracts are no different. A builder who abandons a job may recover the contract price less the other party’s cost of completing the work. RESTATEMENT (SECOND) OF CONTRACTS § 348 illus. 2 (1981). This is true even in New York, which usually is stern towards a builder who knowingly deviates from a contract. *Mirisiv v. Renda*, 441 N.Y.S.2d 138, 139 (App. Div. 1981). That the aggrieved party is generally indifferent to who completes performance so long as he pays no more than the contract price for what he buys or receives no less than the contract price for what he sells might explain why forfeiture is unjustified in these situation. In these cases, default does not expose the aggrieved party to risk of uncompensated loss.

⁶⁵ RESTATEMENT (SECOND) OF CONTRACTS § 241 cmt. (a) (1981) (“This Section therefore states circumstances, not rules, which are to be considered in determining whether a particular failure is material.”); *id.* § 241 cmt. b (“[N]o simple rule based on the ratio of the one to the other can be laid down, and here, as elsewhere under this Section, all relevant circumstances must be considered.”).

⁶⁶ See *supra* Part I.

⁶⁷ U.C.C. § 2-601 (2002) (stating the “perfect tender” rule).

⁶⁸ *Id.* § 2-608(1). The United Nations Convention on Contracts for the International Sale of Goods (“CISG”) has a fundamental default standard. United Nations Convention on Contracts for the International Sale of Goods art. 25, Apr. 11, 1980, S. TREATY DOC. NO. 98-9 (1988), 1489 U.N.T.S. 3.

cases have found that courts are very protective of buyers' rights in applying this seemingly seller-friendly standard, so long as a buyer revokes promptly upon discovering a defect.⁶⁹

*Colonial Dodge, Inc. v Miller*⁷⁰ nicely illustrates this principle. Miller bought a station wagon with special-ordered extra-wide tires.⁷¹ The car was delivered without a spare extra-wide tire. Miller discovered the tire was missing later the same day, but only after he had driven the car four hundred miles. He demanded a spare from the dealer and was told that it could not be supplied because of a strike at the factory. Miller immediately parked the car in front of his house and demanded the dealer retrieve it. Eventually the car was towed from the street by the police, who impounded it for several years as the case passed through the courts. The dealer sued for the price of the car. He won in the trial court, lost on appeal, won on rehearing, and finally lost at the state supreme court by a vote of six to three.⁷² The expected loss to Miller from the temporary lack of a spare was small but, perhaps, meaningful to him.⁷³ Much of the loss would have been psychological in worrying while driving without a spare. There was a small chance that Miller would be stranded without a spare. Miller's worries would never be compensated, and had he been stranded without a spare, few if any, of those losses would be compensated either. Returning the car imposed a large loss on the dealer – for the car could no longer be sold as new. That the case was thought close despite the imbalance between Miller's likely loss if he drove the car for a short period without the spare and the loss to the dealer from returning the car (the thirteen judges who heard the case split seven to six with one switching) is telling evidence of the unwillingness of judges to require buyers to take and pay for clearly defective performance when it might leave them with even a small uncompensated loss though the defaulting seller is subjected to a certain larger loss.

*Plante v. Jacobs*⁷⁴ is a textbook counter example. A builder, Plante, misplaced a living room wall, narrowing the space by one foot.⁷⁵ The Jacobses were ordered to pay the balance due on the contract for the work done (around

⁶⁹ John A. Sebert, Jr., *Rejection, Revocation, and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals*, 84 NW. U. L. REV. 375, 399-408 (1990); see also Donald W. Garland, *Determining Whether a Nonconformity Substantially Impairs the Value of Goods: Some Guidelines*, 26 UCC L.J. 129, 143 (1993).

⁷⁰ 362 N.W.2d 704 (Mich. 1984).

⁷¹ *Id.* at 705.

⁷² *Id.*

⁷³ The dealer and the manufacturer thought Miller was returning the car on a pretext and that he knew it came without a spare. *Id.* at 706. The case took place in Detroit where local newspapers and television had reported that dealers were delivering new cars without spares because of the auto workers' strike. STEWART MACCAULEY, JOHN KIDWELL & WILLIAM WHITFORD, *CONTRACTS LAW IN ACTION: THE CONCISE COURSE* 130-31 (2d ed. 2003).

⁷⁴ 103 N.W.2d 296 (Wis. 1960).

⁷⁵ *Id.* at 297.

\$5000) and could not offset the expected cost to move the wall (around \$4000), because narrowing the room did not lower their home's market value.⁷⁶ This is the upshot of two rules that excuse minor defaults in construction contracts. The court applied the rule of substantial performance to give the builder a right to the contract price, and it applied the rule measuring the owner's damages by loss in market value when the remedial cost is much greater to allow the builder to recover most of the balance due.⁷⁷ The second rule sometimes is said to be concerned with avoiding the economic waste that would result from repairing a defect when the cost of doing so is much greater than the actual loss from the defect.⁷⁸ Others have observed that this misstates the purpose of both rules, which is to avoid forfeiture and unjust

⁷⁶ *Id.* at 299.

⁷⁷ *Id.* at 298-99. *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962), is a famous and troublesome illustration of an application of the second rule. Garland failed to fulfill its promise to restore seven acres of farmland that it had strip-mined. *Id.* at 111. The Peevyhouses were left with a large water-filled pit that barred access to other land they owned and leased. The estimated cost of restoring the land was \$29,000 while the diminution in market value of the seven acres was only \$300. *Id.* at 111-12. The jury awarded the Peevyhouses \$5000. *Id.* at 111. The Oklahoma Supreme Court reduced the award to \$300, reasoning that damages were limited to the loss in market value when the remedial cost was grossly disproportionate. *Id.* at 114. *Peevyhouse* often is paired with *Groves v. John Wunder Co.*, 286 N.W. 235 (Minn. 1939), which holds that a defendant who willfully fails to perform must pay the remedial cost though it is far in excess of loss in market value. *Id.* at 236.

Decisions such as *Peevyhouse* and *Groves* are further testament to the value placed on remedial simplicity in American law. Often in these cases, the loss to the plaintiff, if converted to dollars, would be an amount between the remedial cost and the loss in market value. The rule requires choosing one or the other objective measure of damages though we are confident one over-compensates and the other under-compensates. The plaintiff is entitled to submit evidence that he has abnormal interests or preferences that justify an award of remedial costs. The rule only requires choosing one of two objective measures of damages, which makes it possible for the court to resolve the issue. *See, e.g., Peevyhouse*, 382 P.2d at 111 (articulating the question on appeal as whether the plaintiff will receive the cost to obtain performance of the work or the diminution in value of the property caused by the incomplete work); *cf. Ruxley Elecs. & Constr. Ltd. v. Forsyth*, [1996] A.C. 344, 361 (H.L.) (appeal taken from Eng.) (U.K.) (adopting a middle-ground award of damages "for loss of amenity" where cost was great and affect on market value was zero of deepening swimming pool to unusual depth specified by tall buyer in contract). This middle-ground is possible because there is no jury trial in civil litigation in the United Kingdom. *See, e.g., id.*

⁷⁸ Carol Chomsky, *Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts*, 75 MINN. L. REV. 1445, 1451-60 (1991), reviews many similar cases and argues that the primary focus of the courts is avoiding economic waste. Professor Chomsky favors a rule that would permit the owner to recover remedial cost if a court was persuaded the owner was likely to do the remedial work. *Id.* at 1497-98.

enrichment.⁷⁹ In *Plante*, the objective view that the wall was not worth moving and the fact that the Jacobses chose not to move the wall combine to raise a strong inference that allowing the Jacobses to retain the unpaid contract price or to recover the cost of moving the wall would give them a windfall at the builder's expense.⁸⁰

If you remain unconvinced, then an often-overlooked⁸¹ limitation on the rule might persuade the reader that this body of law is not about avoiding economic waste. If a party completes unfinished work, then courts routinely award the cost of completion without questioning the reasonableness of the decision to complete the work.⁸² While there is less authority for the point, the same

⁷⁹ See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 348 cmt. c (1981) ("It is sometimes said that the award would involve 'economic waste,' but this is a misleading expression since an injured party will not, even if awarded an excessive amount of damages, usually pay to have the defects remedied if to do so will cost him more than the resulting increase in value to him."); FARNSWORTH, *supra* note 59, at 619 ("[T]he concept of substantial, as opposed to strict, performance evolved in response to the risk of forfeiture . . ."). *Hancock v. Northcutt*, 808 P.2d 251, 256 (Alaska 1991), follows this reasoning to the logical conclusion that if the jury finds that the claimant will make the repair, it must award cost of repair regardless of the loss in market value.

⁸⁰ See *Plante*, 103 N.W.2d at 299.

⁸¹ My impression is that few Contracts teachers are aware of this rule. The treatment of *Jacobs & Young v. Kent*, 129 N.E. 889, 891 (N.Y. 1921) (refusing to award the cost of replacing piping from an incorrect factory because the defect was insubstantial and the cost of replacing the piping would have been great), by RICHARD DANZIG & GEOFFREY R. WATSON, *THE CAPABILITY PROBLEM OF CONTRACT LAW* 95-118 (2d ed. 2004), and by Schwartz & Scott, *supra* note 8, at 614-16, is indicative. Schwartz and Scott argue that courts should tolerate a risk of forfeiture when a final payment is withheld after an architect refuses to certify a builder's performance. This enables parties to use the mechanisms of payment holdback and third-party certification to solve the problem of the unverifiability of the adequacy of the builder's performance. *Id.* Danzig and Watson delve into the background of the case and make the counter-argument that Judge Cardozo's opinion was correct on the facts because it was clear that the purpose of the condition had been served and that the owner was not harmed by the substitution of the pipe. DANZIG & WATSON, *supra*, at 95-118. Neither treatment of the topic mentions the owner's right to repair the defect and withhold or collect the cost. While the existence of such a right is not decisive, it is worth mentioning; it buttresses the Danzig-Watson position and somewhat undercuts the Schwartz-Scott position. An owner's right to repair uncertified work and withhold or collect the cost provides the owner some protection from unverifiable defects or observable defects that cause unverifiable harm. If an owner does not exercise the right, then this is some evidence that the defect did not harm him.

⁸² See, e.g., *R.K. Cooper Builders, Inc. v. Free-Lock Ceilings, Inc.*, 219 So. 2d 87, 88-89 (Fla. Dist. Ct. App. 1969) (allowing owner to recover \$5681 completion cost, despite the trial court's finding that the work could have been done for \$2500, reasoning that any expenditures made in good faith should be recovered); *Kirkpatrick v. Temme*, 654 P.2d 1011, 1013 (Nev. 1982) (awarding \$84,333.73 spent to complete construction where contract price was \$175,000 despite defaulter's testimony that the work was 80% complete and that he could have finished for \$39,200 where the owner and the architect testified that

seems to be true if a party repairs defective work.⁸³ The interest in avoiding economic waste cannot explain why, when the cost to complete unfinished work or to repair defective work is significantly greater than the market value of doing the work, an owner is allowed to recover remedial cost if and only if the owner actually does the remedial work.⁸⁴ The result is utterly unsurprising once one recalls the lesson of *Parker* and *Bomberger*. *Parker* teaches that a party may refuse nonconforming performance to avoid an uncompensated loss even if the refusal inflicts a disproportionate loss on the defaulter.⁸⁵ *Bomberger* teaches that a party may complete performance in response to repudiation and get a judgment for the contract price to avoid an uncompensated loss even if this inflicts a disproportionate loss on the defaulter.⁸⁶ The cases just noted teach that a party may complete unfinished work or repair defective work and recover the cost to avoid an uncompensated loss even if this inflicts a disproportionate loss on the defaulter.⁸⁷

the original plans and specifications were followed). If the owner does additional work, then only the amount that the owner would have paid for the original work is recoverable. *Temple Beth Sholom & Jewish Ctr., Inc. v. Thyne Constr. Corp.*, 399 So. 2d 525, 526 (Fla. Dist. Ct. App. 1981); *St. Joseph Hosp. v. Corbetta Constr. Co.*, 316 N.E.2d 51, 62 (Ill. App. Ct. 1974); *Bachman v. Parkin*, 471 N.E.2d 759, 760 (Mass. App. Ct. 1984); *Martin v. Phillips*, 440 A.2d 1124, 1125 (N.H. 1982). Alternatively, the enhanced value may be subtracted. *State Prop. & Bldg. Comm'n v. H.W. Miller Constr. Co.*, 385 S.W.2d 211, 215 (Ky. 1964).

⁸³ *Hi-Valley Constructors, Inc. v. Heyser*, 428 P.2d 354, 357 (Colo. 1967) (awarding cost of repainting exterior of house); *Carlin v. Comstock*, 450 A.2d 875, 876 (Conn. Super. Ct. 1982) (awarding approximately \$2000 to repair porch though only \$143 was due on the original contract).

⁸⁴ Together, the rule and the exception give an aggrieved party an incentive to repair a defect to avoid being under-compensated for a subjective loss. For example, the rules would give the Jacobses an incentive to spend \$4000 to move the wall, though they place only a \$1000 value on having the wall moved, because they bear the \$1000 loss if the wall is not moved while Plante bears the \$4000 cost of moving the wall. To some extent the law tempers the incentive to make wasteful repairs by allowing the Jacobses to keep the balance due on the contract or recover remedial cost as damages if they can establish the value of moving the wall is sufficiently great to them. For example, if the Jacobses had personal reasons to move the wall that would justify them spending a sum as substantial as \$1000, then they might think they have a fair chance of keeping the \$5000 balance due if they do not make the repairs and present their reasons for wanting the wall moved as compelling enough to retain the balance. Your guess is as good as mine as to how people actually respond to these rules. Personally, I would pay to move the wall only if the value to me was a large fraction of the cost and I had the money in hand as a holdback of the contractor's payment.

⁸⁵ *Parker v. Twentieth Century-Fox Film Corp.*, 474 P.2d 689, 693-94 (Cal. 1970).

⁸⁶ *Bomberger v. McKelvey*, 220 P.2d 729, 734 (Cal. 1950).

⁸⁷ See *supra* notes 82-84.

It is tempting to leave this topic with the law tied into this neat little package. But the common law rarely is so neat.⁸⁸ In some jurisdictions, the law on remedies for takings, negligence, and nuisance contains a rule that limits damages when property is inadvertently or justifiably taken to the lesser of replacement cost and market value, and that limits damages when property is inadvertently or justifiably harmed to the lesser of repair cost and diminution in market value.⁸⁹ In Washington state, this has been called the “lesser than” rule.⁹⁰ In New York, this has been called the “lesser of two” rule.⁹¹ This rule does not always give way if a plaintiff replaces or repairs property at a cost significantly greater than market-based damages even though the plaintiff arguably had to act as it did to avoid a loss that might not be adequately compensated in damages. In the federal law of takings, compensation generally is limited to the lesser of market value and replacement cost, without regard to whether the plaintiff replaces the property,⁹² with limited exceptions for situations in which market-based damages clearly and predictably undercompensate a plaintiff.⁹³ There are negligence and nuisance cases that

⁸⁸ *Granite Construction Co. v. United States*, 962 F.2d 998 (Fed. Cir. 1992), is a contract case that does not fit the pattern. A contractor redid work at a cost of \$3.8 million to comply with specifications for a water stop on a dam under pressure from the government. *Id.* at 1000. The court held the contractor was entitled to recover the cost because it was unreasonable for the government to insist upon strict compliance with the specifications. *Id.* at 1007-08.

⁸⁹ There are numerous recent cases limiting damages to loss in market value when the plaintiff does not repair the property at greater cost but may have good reason to do so. *E.g.*, *Poffenbarger v. Merit Energy Co.*, 972 So. 2d 792 (Ala. 2007) (involving environmental contamination); *Millers Mut. Fire Ins. Co. v. Wildish Constr. Co.*, 758 P.2d 836 (Or. 1988) (involving destruction of home); *Primrose Operating Co. v. Senn*, 161 S.W.3d 258 (Tex. App. 2005) (involving environmental contamination from oil and gas operations); *see also* DAN B. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 5.2 (1973). Many cases pay lip service to the rule. *See, e.g.*, *Sprinkle v. N.C. Wildlife Res. Comm'n*, 600 S.E.2d 473, 477 (N.C. 2004) (“North Carolina is committed to the general rule that the measure of damages for injury to personal property is the difference between the market value of the damaged property immediately before and immediately after the injury.”).

⁹⁰ *Thompson v. King Feed & Nutrition Serv., Inc.*, 105 P.3d 378, 383 (Wash. 2005) (holding that the “lesser than” rule does not apply when the improvement is a component of larger property that is destroyed).

⁹¹ *See In re September 11th Litig.*, 590 F. Supp. 2d 535, 541 (S.D.N.Y. 2008) (“New York courts follow the ‘lesser of two’ rule: a plaintiff whose property has been injured may recover the lesser of the diminution of the property’s market value or its replacement cost.”).

⁹² *United States v. Fifty Acres of Land*, 469 U.S. 24, 35 (1984).

⁹³ A generally recognized exception covers property that is an integral part of a business on the taken property and the adjacent property. *See United States v. Ebinger*, 386 F.2d 557, 560-61 (2d Cir. 1967). Another less generally accepted exception covers “special purpose property” owned by a public or non-profit entity. *See Newton Girl Scout Council, Inc. v. Mass. Tpk. Auth.*, 138 N.E.2d 769, 774 (Mass. 1956).

apply the rule even though a plaintiff replaces or repairs the property at a cost that is significantly greater than market-based damages.⁹⁴

It is hard to know what to make of these cases, particularly the tort cases.⁹⁵ I can think of no good reason to have a different and less generous damage rule in the law of negligence and nuisance than in contract law for similar losses. Perhaps we can ignore these cases as relics of a more rule-bound time. Some courts reject the “lesser of two” rule out of hand and take a more flexible approach that permits a fact-finder to award whatever amount of damages fairly compensates a plaintiff.⁹⁶ Other courts keep the rule but undercut it with more-or-less open-ended exceptions.⁹⁷ Academic commentary is uniformly critical of cases that woodenly apply the rule in circumstances in which the rule’s purpose does not justify its application.⁹⁸ This purpose is to avoid

⁹⁴ *O'Brien Bros., Inc. v. The Helen B. Moran*, 160 F.2d 502 (2d Cir. 1947), is a well known example. A United States government vessel collided with and sunk the plaintiff’s barge valued at \$16,000, which was the purchase price less depreciation. *Id.* at 503. The plaintiff spent \$7000 to raise the barge and \$43,000 to repair it, which may have been reasonable because it was wartime and no barges could be purchased at any price. *Id.* at 504. The trial court awarded repair cost. *Id.* at 503. The court of appeals reversed, ruling that damages were limited to the value of the barge plus the cost of raising the barge (which was required to clear the waterway). *Id.* at 506. Given there was no market for barges, and thus no market value, it seems value was measured either by cost less depreciation or discounted cash flow. *Id.* at 505; *see also* *Warren v. Heartland Auto Servs., Inc.*, 144 P.3d 73, 76 (Kan. Ct. App. 2006) (limiting damages to the market value of the used automobile where plaintiff repaired the used automobile and rented a replacement); *Fisher v. Qualico Contracting Corp.*, 779 N.E.2d 178, 182 (N.Y. 2002) (assuming that home owners who spent \$1,330,000 to replace a home destroyed by a fire could recover only the \$480,000 diminution in market value of the home resulting from the fire).

⁹⁵ The law of takings may be *sui generis* for the remedy is understood to be non-compensatory. Under federal law still and at one time under the law of most states, consequential damages were not available for a taking. *See, e.g., Yuba Natural Res., Inc. v. United States*, 904 F.2d 1577, 1581 (Fed. Cir. 1990); *Emerson G. Spies & John C. McCoid, II, Recovery of Consequential Damages in Eminent Domain*, 48 VA. L. REV. 437, 441 (1962). As for why eminent domain is *sui generis*, that is more difficult to say. If you assume the purpose of eminent domain is compensation, or internalizing to the government the full private cost of a taking, then it is difficult to make a case that public takings are categorically different from private conduct harming property when the conduct is of a type that is not thought to merit punishment.

⁹⁶ *Am. Serv. Ctr. Assocs. v. Helton*, 867 A.2d 235, 243, 240 n.4 (D.C. 2005) (allowing damages for cost of repairing an automobile plus damages for residual loss of market value, while noting that the “lesser than” rule is unprecedented in any of the court’s rulings).

⁹⁷ Many of these cases implicate environmental concerns. *See, e.g., Osborne v. Herst*, 947 P.2d 1356, 1360 (Alaska 1997); *Felton Oil Co. v. Gee*, 182 S.W.3d 72, 80 (Ark. 2004); *Leavitt v. Cont’l Tel. Co.*, 559 A.2d 786, 788 (Me. 1989); *Sunburst Sch. Dist. No. 2 v. Texaco, Inc.*, 165 P.3d 1079, 1088 (Mont. 2007); *Keitges v. VanDermeulen*, 483 N.W.2d 137, 143 (Neb. 1992); *Vaught v. A.O. Hardee & Sons*, 623 S.E.2d 373, 378 (S.C. 2005).

⁹⁸ *See* DOBBS, *supra* note 89, § 5.2(1), (2); LAYCOCK, *supra* note 26, at 23-26.

giving the plaintiff a windfall when the replacement or repair leaves him with an asset that is newer or better than the asset that was taken or damaged.⁹⁹ Still, the contrary cases applying the “lesser of two” rule remind us that it is impossible to give an abstract account of the law that is coherent, consistent, and clear. There will always be odd bits and pieces that do not fit with the general principles that best account for most of the law.

III. THE POWER TO EXERCISE THE NONPERFORMANCE OPTION WHEN THE RIGHTFUL POSITION IS UNCERTAIN

In the cases that are the focus of Parts I and II, the actor’s rightful position under a contract is certain while the magnitude of the actor’s loss from breach is uncertain. This Part looks at how the law regulates the exercise of what I will call the “nonperformance option” (meaning the power to withhold or refuse performance, and the power to threaten to do so to extract concessions) when an actor’s rightful position is uncertain. In addition to the rules on mitigation and material breach, two new sets of rules are brought to bear to determine the consequences of exercising or not exercising the nonperformance option when an actor’s rightful position is uncertain. Which set of rules applies depends on whether nonperformance is likely to have harmful consequences. One set encourages the exercise of the nonperformance option to settle a dispute when nonperformance will not have harmful consequences. The other set, in conjunction with the rules on mitigation and material breach, discourages the exercise of the nonperformance option to settle a dispute when nonperformance will have harmful consequences.

While the general point is novel, the merits of having these two sets of rules are fairly obvious. Picture a contract as two people undertaking to row a boat across a river. On the river, a dispute arises over whether one is pulling his weight. If the river is placid, the day is clear, and there is no need to cross the river quickly, then the law encourages the rowers to resolve the dispute themselves on the river as best they can. The law permits one rower to stop rowing unless the other concedes, and if the rowers manage to make it across the river, the law treats this as the end of the matter and will not allow either rower to seek redress in court unless both rowers clearly agree to stay their dispute for resolution by a court once they get to shore. If the river is dangerous or there is a need to cross quickly, then the law encourages the rowers to put their dispute to the side and row to shore. Once on shore, a court will hear the dispute and try to set matters right. If in dangerous circumstances a rower stops and refuses to row further unless the other pulls his weight, then the rower who stops faces a risk of being held responsible for the resulting loss

⁹⁹ When there is an objective basis for the intermediate measure, the solution is to use a measure of damages between replacement or repair cost and loss of market value. For example, when a plaintiff replaces used property with new, damages can be measured by replacement cost of the new less a factor to account for depreciation of the old. *See, e.g.*, *Penn. Dep’t of Gen. Servs. v. U.S. Mineral Prods. Co.*, 898 A.2d 590, 598 (Pa. 2006).

even if he is in the right in the underlying dispute. The law discourages the rowers from making threats that might lead to disastrous consequences. In sufficiently dangerous circumstances, the rules on duress even permit a rower to deceive the other rower by pretending to submit to a threat to get across the river while planning to assert his rights once safely ashore.

The rules we are about to look at presuppose an honest dispute. Quite different rules come into play if a party makes a dishonest demand for performance or refuses to perform an obligation that he knows is due. A note given to settle a dishonest claim or a release given by a creditor in return for part payment of an undisputed debt may be unenforceable for lack of consideration.¹⁰⁰ Unjustified non-payment of a debt may strip a debtor of contract rights. For example, it may give the creditor the right to accelerate future payments.¹⁰¹ A knowing breach of an indisputable obligation may result in forfeiture of any right to compensation for work done.¹⁰² Merely asserting a position in bad faith may constitute a material breach, justifying the other party's withdrawal from a contract.¹⁰³ And there is the late twentieth century

¹⁰⁰ Lack of consideration is the argument eventually adopted in *Hackley v. Headley*, 14 N.W. 693, 693-95 (Mich. 1883), to excuse a creditor from a release extracted by the debtor by a threat to withhold money that was not in dispute. For a similar, more recent case, see *Wickman v. Kane*, 766 A.2d 241, 249 (Md. Ct. Spec. App. 2001), which found no valid accord and satisfaction where an undisputed sum was paid to obtain release of a disputed claim on grounds of lack of consideration. The weight of authority holds that refusal to pay money, even in bad faith, is not economic duress. *E.g.*, *Selmer Co. v. Blakeslee-Midwest Co.*, 704 F.2d 924, 927 (7th Cir. 1983) (asserting that finding otherwise would "make an inference of duress inescapable in any negotiation where one party makes an offer from which it refuses to budge"). For an unusual case to the contrary, see *Capps v. Georgia Pacific Corp.*, 453 P.2d 935, 938-39 (Or. 1969), which adopted a rule allowing statements of a duress defense to be tried on its facts.

¹⁰¹ LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* 3D § 232:43 (2005); see also *Williams v. Mut. Benefit Health & Accident Ass'n*, 100 F.2d 264, 264-65 (5th Cir. 1938) ("When one who is obligated by contract to make money payments to another, absolutely repudiates and abandons the obligation without just excuse, the obligee is 'entitled to maintain his action in damages at once for the entire breach . . .'" (quoting *Pollack v. Pollack*, 39 S.W.2d 853, 855 (Tex. App. 1931))); *Needham v. Am. Nat. Ins. Co.*, 97 S.W.2d 1016, 1021 (Tex. App. 1936).

¹⁰² See *supra* note 57 and accompanying text.

¹⁰³ See *Peter Kiewit Sons' Co. v. Summit Constr. Co.*, 422 F.2d 242, 257 (8th Cir. 1969); *Pac. Coast Eng'g Co. v. Merritt-Chapman & Scott Corp.*, 411 F.2d 889, 896 (9th Cir. 1969) (holding that the persistent assertion of a position that the party had previously been told by third parties was unjustified constitutes a repudiation).

Good faith assertion of a claim or position is not normally a breach of contract even though the claim or position is invalid. See *Reiss v. Murchison*, 503 F.2d 999, 1007-08 (9th Cir. 1974) (holding that the filing of a claim of total breach does not give the party against whom the claim is asserted the right to halt performance); *In re Chateaugay Corp.*, 104 B.R. 637, 643 (Bankr. S.D.N.Y. 1989); *Dixie Roof Decks, Inc. v. Borggren/Dickson Constr., Inc.*, 395 S.E.2d 19, 20 (Ga. Ct. App. 1990) ("Borggren/Dickson could not commit an

innovation of the tort of bad faith breach of contract. The tort exposes an insurer who unjustifiably denies a claim to liability for emotional distress damages and sometimes to punitive damages.¹⁰⁴ These are dangerous legal shoals, but they do not threaten if a refusal to perform or a demand for performance is honest. Generally, a refusal or demand will be honest if a right is uncertain.¹⁰⁵

anticipatory breach . . . because the duty to pay didn't arise until Dixie Roof Decks was to have produced the requisite documentation."); *Oak Ridge Const. Co. v. Tolley*, 504 A.2d 1343, 1347-48 (Pa. Super. Ct. 1985) (asserting that where one party's communication did not constitute a "definite and unconditional repudiation" or breach of the contract, the other party's failure to perform constitutes a breach). Similarly, it is not a breach of contract or a tort to use the legal process to resolve a dispute or to protect one's position pending resolution of a dispute even if the use of the legal process harms the other party, so long as the process is used in good faith. *Wachter v. Gratech Co.*, 608 N.W.2d 279, 288-89 (N.D. 2000) (holding that it is not abuse of process to file a mechanic's lien that turned out to be grossly excessive in amount if the filing was done in good faith).

¹⁰⁴ Around half the states allow the claim. See *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 519 n.1 (Ind. 1993). *Comunale v. Traders & General Insurance Co.*, 328 P.2d 198, 202 (Cal. 1958), is an early case. In states in which a tort action is available for bad faith breach, the action generally is limited to nonpayment of insurance, and in many of these states, it is further limited to nonpayment of first party insurance. *E.g.*, *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1039 (Cal. 1973) ("Obviously, the non-insurer defendants were not parties to the agreements for insurance; therefore, they are not, as such, subject to an implied duty of good faith and fair dealing."). Often when a breach of contract is egregious, a plaintiff will be able to make out a claim for some other tort for which punitive damages are available, such as fraud. Empirical studies show that punitive damages are levied much more often in business tort cases than personal injury cases. For a summary of the studies, see generally Michael L. Rustad, *Unraveling Punitive Damages: Current Data and Further Inquiry*, 1998 Wis. L. REV. 15. For the most doctrinally granulated data, see ERIK MOLLER, NICHOLAS M. PACE & STEPHEN J. CARROLL, PUNITIVE DAMAGES IN FINANCIAL INJURY JURY VERDICTS 20 (1997), which compiles data from jury verdict reports from six states for the period 1985 to 1994. They report that half of the cases in which punitive damages were levied involved financial injury and that punitive damages were levied in fourteen percent of financial injury verdicts and twenty-two percent of the verdicts in which the plaintiff won. *Id.* Their breakdown of the data barely makes it possible to discern the nature of the legal claim on which punitive damages were levied. In non-employment cases, fraud is the most common basis, followed by insurance bad faith (broadly defined by the authors to include both claims for wrongful failure to pay "first party" claims by an insured and claims for failure to settle "third party" liability claims against an insured), breach of fiduciary duty, and interference with contractual relations. *Id.*

¹⁰⁵ See William T. Barker, *Evidentiary Insufficiency in Insurance Bad Faith Suits*, 6 CONN. INS. L.J. 81, 110 (1999) (exploring the problem in the context of insurance bad faith). In practice, the key problem is defining the quantum of doubt about an obligation that justifies dismissing a bad faith claim on a motion for summary judgment. See *id.* at 99-100. Barker concludes that an insurer has the privilege to test an objectively questionable claim in court no matter how hard the decision to fight may be on the insured and no matter how small the claim. *Id.* at 110.

The voluntary payment doctrine is a good place to start. The doctrine prohibits claims to recover overpayment by debtors who pay disputed debts.¹⁰⁶ The doctrine “ensures that those who desire to assert a legal right do so at the first possible opportunity; this way, all interested parties are aware of that position and have the opportunity to tailor their own conduct accordingly.”¹⁰⁷ The effect of the doctrine is to encourage a debtor not to pay more than it thinks it owes, for it will have no opportunity to recover an overpayment. The rules on accord and satisfaction empower a debtor to tender part payment, with an implicit threat of non-payment if the creditor rejects part payment, to resolve a dispute on favorable terms.¹⁰⁸ This has been described as “an exquisite form of commercial torture.”¹⁰⁹ While torture this may be, a creditor has little hope of avoiding a release on grounds of duress because of the view that it is not improper to exploit another’s financial distress by trying to settle a genuinely disputed claim.¹¹⁰

The voluntary payment doctrine has the familiar stickiness of an interpretive presumption. Payment is final unless the parties state clearly that final payment was not their intent. The rule is sticky in another more unusual way. Under the traditional rule, a debtor cannot avoid the voluntary payment doctrine by saying that when he pays, he reserves his right to recover the money.¹¹¹ The rules on accord and satisfaction (including the unavailability of

¹⁰⁶ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 6 cmt. e, illus. 18 (Tentative Draft No. 1, 2001) (stating and providing authority that the voluntary payment rule will bar recovery of payment of a disputed claim).

¹⁰⁷ *Randazzo v. Harris Bank Palatine, N.A.*, 262 F.3d 663, 668 (7th Cir. 2001).

¹⁰⁸ The history of Uniform Commercial Code section 1-207 attests to the strength of this practice. The statute allows a party to reserve his rights while accepting performance offered by the other party. U.C.C. § 1-207 (1990). Though the statute made no exception, many courts held this provision did not apply to an accord and satisfaction. Courts had split on whether the statute changed the common law doctrine of accord and satisfaction. *Air Van Lines, Inc. v. Buster*, 673 P.2d 774, 779 (Alaska 1984), is a leading case holding that the statute did not alter the common law rule. For a contrary case that reviews the arguments and authority on both sides, see *Horn Waterproofing Corp. v. Brunswick Iron & Steel Co.*, 488 N.E.2d 56, 57-58 (N.Y. 1985). An explicit exception was added in 1990. U.C.C. § 1-207(1).

¹⁰⁹ JAMES WHITE & ROBERT S. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 544 (2d ed. 1980). This sentiment is echoed in *Horn Waterproofing*, 488 N.E.2d at 59.

¹¹⁰ An often litigated question involves the effectiveness of a release given by a creditor to settle a disputed debt when, in exchange for the release, the debtor pays a sum that was not in dispute. The weight of the authority is that a release is valid in these circumstances if there is a single debt or if the debts are closely related. *E.g.*, *Kilander v. Blickle Co.*, 571 P.2d 503, 505 (Or. 1977). However, there is authority that “circumstances of unfair pressure or economic coercion” cut in the other direction. *Flagel v. Sw. Clinical Psychiatrists, P.C.*, 755 P.2d 1184, 1190 (Ariz. Ct. App. 1988).

¹¹¹ Clear statements that a reservation of rights does not avoid the voluntary payment doctrine may be found in *Rowe v. Union Central Life Insurance Co.*, 12 So. 2d 431, 433-34

rescission on grounds of duress) are similar in that they prevent the creditor from unilaterally reserving the right to sue for the balance if the creditor takes the tendered payment. The upshot of these rules is that avoiding finality of payment requires both parties' expressed assent.

The second set of rules permits, and sometimes even requires, a party to perform a disputed obligation, or to accept performance of disputed sufficiency, and then go to court to vindicate a claim that less was owed or more was due. The unusual facts of *Henrici v. South Feather Land & Water Co.*¹¹² serve to illustrate most of these rules. It is a useful case for my purposes because the dispute was over a relatively small sum of money.¹¹³ Due to this

(Miss. 1943), and Comment Note, *Relaxation of Common-Law Rule Regarding Recovery of Voluntary Payment*, 75 A.L.R. 658, 658 (1931), which states that a payment may not be recovered "though the payer makes the payment with an express reservation of his right to litigate the claim." The rule is codified in Georgia. GA. CODE ANN. § 13-1-13 (1982).

A handful of cases hold that a reservation of rights avoids the bar of the voluntary payment doctrine. See *Avianca, Inc. v. Corriea*, Civ. A. No. 85-3277 (RCL), 1992 WL 93128, at *7 (D.D.C. April 13, 1992) ("The voluntary payment doctrine does not generally apply, however, when a party has expressly reserved a right to take some legal action or when the party has paid under protest."); *Cnty. Convalescent Ctr., Inc., v. First Interstate Mortgage Co.*, 537 N.E.2d 1162, 1164 (Ill. App. Ct. 1989) ("[S]ince plaintiff paid the 30 days' interest 'under protest,' plaintiff is not barred from recovery under the voluntary-payment doctrine."). A few other cases state in dicta that a debtor could have reserved his rights. *Randazzo*, 262 F.3d at 671 (admitting that Illinois recognizes protest as particularly good evidence of duress, but that the appellee's protest here was not an assertion of a legal right but an appeal to the appellant's business judgment); *Prenalta Corp. v. Colo. Interstate Gas Co.*, 944 F.2d 677, 685-86 (10th Cir. 1991); *City of Miami v. Keton*, 115 So. 2d 547, 551 (Fla. 1959); *Putnam v. Time Warner Cable*, 663 N.W.2d 254, 263 (Wis. Ct. App. 2001) ("[E]ven if the late fees were improper – either unreasonable in amount or unlawful, in full, under state or federal regulations – the customers paid without protest, and Time Warner relied on those payments.").

The older cases tend to treat a protest as evidence of duress. See *Getto v. City of Chicago*, 426 N.E.2d 844, 850 (Ill. 1981). This comes from framing the issue as a problem in restitution. If the issue is framed as a problem in contract, then the question is what it takes to establish an agreement by the payee that the payment is conditional upon the validity of his claim. There is no doubt that an agreement that a payment is not final avoids the bar of the voluntary payment doctrine. RESTATEMENT OF RESTITUTION § 45 cmt. e (1937) ("The rule stated in this Section does not apply if the parties have agreed that the payment is conditional upon the validity of the transferee's claim."). Approaching the problem from the perspective of contract law places pressure on the rule that a payor cannot unilaterally reserve the right to recover a payment by noting on the payment that this right is reserved. Under the general principle that the offeror is master of the offer, the payee assents to this reservation when he takes the payment. E.g., *Prenalta Corp.*, 944 F.2d at 685-86.

¹¹² 170 P. 1135 (Cal. 1918).

¹¹³ *Id.* at 1138.

fact, neither party needed to withhold or refuse performance to vindicate its right.¹¹⁴

South Feather assumed a long-term contract to supply water to Henrici's farm.¹¹⁵ It proposed a new pricing scheme that would have slightly increased Henrici's payments.¹¹⁶ It was not clear South Feather had this right.¹¹⁷ Henrici refused to take water on the new terms and allowed his farm to go to waste. He had no other source of water for irrigation. The case holds that even though Henrici was in the right in the underlying dispute about price, he could not recover damages for his losses because he should have mitigated damages by taking the water and later suing to recover the overpayment.¹¹⁸ Crucial to the decision is the court's assumption that Henrici would not have relinquished his right to recover an overpayment had he taken the water and paid what South Feather asked.¹¹⁹ While the court did not explain, presumably it would have allowed a restitution claim by Henrici to recover the overpayment.¹²⁰

As we shall see, Henrici had another option. He might have tendered the old price pending resolution of the dispute. Had South Feather responded to this tender by cutting off the water supply, then this would be a material breach and it would be responsible for the harm to Henrici's farm. Henrici's tender of the old price would not be a material breach justifying suspension of performance by South Feather because any loss from under-payment is easily compensated should South Feather be in the right.¹²¹ Further, Henrici's tender

¹¹⁴ I will return at the end of this Part to how the principle in Parts I and II interacts with the principle about to be explained if damages are not an adequate remedy. See *infra* notes 129-32 and accompanying text.

¹¹⁵ *Henrici*, 170 P. at 1136.

¹¹⁶ *Id.* at 1138.

¹¹⁷ *Id.* at 1136.

¹¹⁸ *Id.* ("By paying the excessive price without conceding its correctness, he could have saved his trees, vines, and crops, and reduced his damage to a comparatively trifling sum.")

¹¹⁹ *Id.*

¹²⁰ This assumes the voluntary payment doctrine does not preclude the claim, a point the court did not address. The typical explanation why the voluntary payment doctrine would not prohibit the claim is that Henrici's payment is not considered voluntary. What makes a payment involuntary is not developed in the cases. If the test is similar to that for duress, then arguably South Feather did nothing improper in demanding a payment thought to be within its rights and that Henrici had other options that would have adequately protected his interests. A stronger basis for the restitution claim can be found in RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 cmt. b (Council Draft No. 5, 2003). The rule addresses the case where a party renders performance he disputes he owes and later brings a restitution claim to recover its value. *Id.* The rule allows the restitution claim but only if nonperformance by either party would impose consequential harms. *Id.* I proposed such a rule in Gergen, *Restitution, supra* note *, at 729.

¹²¹ See *supra* notes 100-04 and accompanying text. A breach is not material if damages adequately protect the promisee's interest in performance, particularly if withholding

of the old price would be in good faith. In sum, Henrici had two choices in the case – he could pay either the new or the old price pending resolution of the dispute – between which the law is indifferent. This is sensible because, putting issues like differences in insolvency risk and collection costs to the side, there is no reason to prefer one party over the other when we ask who should hold money in dispute pending resolution of the dispute.

Changing the facts in *Henrici* brings into play other rules that encourage performing a disputed obligation, or accepting performance of disputed sufficiency, when nonperformance is harmful. What would happen if South Feather tells Henrici that taking the water constitutes acceptance of the new price and relinquishment of his claim to the old price? This is the accord and satisfaction gambit. It is clear that Henrici may recover his losses if he refuses the water and is in the right on price. His duty to mitigate does not require him to relinquish his claim of a right to pay less.¹²² By casting the loss back on South Feather, the law punishes South Feather for unnecessarily escalating the dispute.

Alternatively, in this situation, section 1-308 of the Uniform Commercial Code,¹²³ gives Henrici the power to take the water and reserve his rights by announcing that he is ignoring South Feather's gambit and reserving his rights.¹²⁴ The power to parry South Feather's gambit with a reservation of rights enables Henrici to test South Feather's resolve because South Feather will have to follow through on its threat to stop delivery of water.

The law might even allow Henrici to deceive South Feather to defuse the conflict. Assume South Feather refuses to deliver the water until Henrici pays the total amount it claims is due and signs a release of any claim to a lower price. If Henrici agrees to South Feather's demands to get water he desperately needs, then he might be able to avoid the settlement by claiming duress. South Feather's threat to withhold water is border-line extortion and a

performance would impose a significant harm on the defaulter and the breach is in good faith.

¹²² RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. e (1981) ("If the party in breach offers to perform the contract for a different price, this may amount to a suitable alternative. But this is not the case if the offer is conditioned on surrender by the injured party of his claim for breach."); *id.* at illus. 15 (describing *Gilson v. F.S. Royster Guano Co.*, 1 F.2d 82 (3d Cir. 1924)); *see also* ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1043 (West Publishing Co. 1964) (1951) (stating that there is no duty to take substitute performance from the defaulting party if it would involve a surrender of rights, compromise, or accord and satisfaction).

¹²³ U.C.C. § 1-308 (2005) (former version at U.C.C. § 1-207 (1999)).

¹²⁴ There is little case law on the respective fields of this rule and the rule on accord and satisfaction. *Air Van Lines, Inc. v. Busters*, 673 P.2d 774, 779 (Alaska 1984), takes the position that section 1-308(1) applies when there is a continuing dispute on an executory contract. Under this view, Henrici could not have accepted a one-time delivery of water tendered on the condition that he agree to South Feather's price by accepting with a reservation of rights.

core instance of bad faith because the threatened act will inflict a large loss on Henrici while yielding a small benefit to South Feather.¹²⁵ The doctrine of duress and U.C.C. section 1-308 in effect allow a party to unilaterally dictate that performance is not final to preserve a claim of right. This is the mirror image of the voluntary payment rule and the rules on accord and satisfaction, which require both parties expressly to assent to preserve a claim.

These rules are reinforced by the doctrine of material breach, which encourages a party to accept a performance of disputed sufficiency or to perform a disputed obligation when this avoids a loss to the other party and is unnecessary to vindicate a claim of right.¹²⁶ In particular, when a contract breaks down as a result of escalating hostile conduct, the material breach doctrine casts the loss on whichever party, if either, first acts unjustifiably in further escalating the conflict. To illustrate, consider a scenario in which

¹²⁵ RESTATEMENT (SECOND) OF CONTRACTS § 176(2)(a) (1981) (defining a threat as improper “if the resulting exchange is not on fair terms” and “the threatened act would harm the recipient and would not significantly benefit the party making the threat”). *Silsbee v. Webber*, 50 N.E. 555, 555-56 (Mass. 1898), which concerns a threat by the employer directed at the employee’s mother to tell employee’s ill father of employee’s theft if mother did not pay off the loss, is an example in the nature of blackmail. John Dawson, *Economic Duress – An Essay in Perspective*, 45 MICH. L. REV. 253, 258-59 (1947), proposes disproportionality as an organizing principle. A threat to cut off water to a farm that has no alternative source of supply to gain leverage in a dispute over pennies certainly is disproportionate.

The Restatement misfires by suggesting the concern is with malice or vindictiveness rather than with coercion. RESTATEMENT (SECOND) OF CONTRACTS § 176 cmt. f (1981). Illustration 12 gives an example reminiscent of *Silsbee* in which an employer threatens to prevent an employee from working elsewhere if the employee does not release a claim. *Id.* at illus. 12. The employer makes the threat for his own gain and not out of malice. If he carries out the threat, he probably does it to retain his credibility. On the other hand, that rescission on grounds of duress may not be possible in this situation, is suggested by cases that state categorically that “it is not duress for a party to insist upon what he believes to be his legal rights.” *Jacobs v. Atlantco Ltd. P’ship No. 1*, 373 A.2d 1255, 1261 (Md. Ct. Spec. App. 1977).

Subha Narasimhan, *Modification: The Self-Help Specific Performance Remedy*, 97 YALE L.J. 61, 77 (1987), recognizes the deceptive nature of agreeing to a modification and then disavowing it by claiming duress. The article comes to the remarkable conclusion that courts should not permit such deception because it undercuts efficient breach unless the circumstances are such that a court would have ordered specific performance. *Id.* at 82. For a critical response, see Robert A. Hillman, *Contract Modification and “Self-Help Specific Performance”*: A Reaction to Professor Narasimhan, 75 CORNELL L. REV. 62 (1989). A basic fallacy in the argument is the assumption that the limitations on court-ordered specific performance should apply to self-help specific performance.

¹²⁶ See *supra* notes 100-04 and accompanying text. A breach is not material if damages adequately protect the promisee’s interest in performance, particularly if withholding performance would impose a significant harm on the defaulter and the breach is in good faith.

South Feather demands the higher charge, Henrici pays the lower amount that he thinks is due, and South Feather cuts off the water in response. Cutting off the water will be considered a material breach by South Feather and so the loss will be cast upon it even if it is in the right on price.¹²⁷ South Feather does not need to cut off the water to ensure payment of the larger sum, which is pennies

¹²⁷ RESTATEMENT (SECOND) OF CONTRACTS § 250 cmt. d (1981) might be read to cast the loss on Henrici in this situation. It states that “[g]enerally, a party acts at his peril if, insisting on what he mistakenly believes to be his rights, he refuses to perform his duty.” *Id.* The argument would be that Henrici’s act is a repudiation, which would justify withholding delivery. Corbin argues the contrary point: “Disputes often arise as to what performance the contract requires; and the plaintiff’s breach is not willful if he performs in accordance with his own honest interpretation, even though he knows that the other party holds a different one.” CORBIN, *supra* note 122, § 1122. Each proposition is true to a point. The apparent contradiction largely disappears once you realize they are speaking of different responses to breach. The Restatement speaks to whether a defaulter’s belief that he performed his obligation saves him from liability to the other for damages. The answer generally is no. Corbin speaks to whether a defaulter’s belief that he performed his obligation is relevant to deciding whether his breach was material, giving the other the power to exit. The answer is yes, but it is only one factor among several.

Corbin does not cite case authority for his point, which is the pertinent point in this context. For cases discussing this point, see *Walker v. Shasta Minerals & Chemical Co.*, 352 F.2d 634, 638 (10th Cir. 1965); *Golf Carts, Inc. v. Mid.-Pacific Country Club*, 493 P.2d 1338, 1340 (Haw. 1972); *Hanson v. Duffy*, 435 N.E.2d 1373, 1378 (Ill. App. Ct. 1982); *Berke & Co. v. Griffin, Inc.*, 367 A.2d 583, 586-87 (N.H. 1976); *Kiriakides v. United Artists Communications, Inc.*, 440 S.E.2d 364, 367 (S.C. 1994). *New York Life Insurance Co. v. Viglas*, 297 U.S. 672 (1936), is a leading case holding that an insured cannot accelerate payments due under an insurance policy when the insurer fails to make a payment in the honest belief it is not due. Justice Cardozo explained:

Repudiation there was none as the term is known to the law. Petitioner did not disclaim the intention or the duty to shape its conduct in accordance with the provisions of the contract. Far from repudiating those provisions, it appealed to their authority and endeavored to apply them. . . . If it made a mistake, there was a breach of a provision of the policy with liability for any damages appropriate thereto. We do not pause at the moment to fix the proper measure. Enough in this connection that at that stage of the transaction there had been no renunciation or abandonment of the contract as a whole.

Id. at 676-77.

There is a similar confusion of the different issues in *Woodar Investment Development Ltd. v. Wimpey Construction U.K. Ltd.*, [1980] 1 W.L.R. 277, 283. Lord Wilberforce echoes the proposition just above:

[I]t would be a regrettable development of the law of contract to hold that a party who bona fide relies on an express stipulation in a contract in order to rescind or terminate a contract should, by that fact alone, be treated as having repudiated his contractual obligations if he turns out to be mistaken as to his rights.

Id. Lord Salmon, quoting Lord Denning from an earlier case, echoes the Restatement: “I have yet to learn that a party who breaks his contract can excuse himself by saying that he did it on advice of his lawyers; or that he was under an honest misapprehension. Nor can he excuse himself on those grounds from the consequences of a repudiation.” *Id.* at 287.

more. Henrici pays the lower sum in good faith. And cutting off the water inflicts a large loss on Henrici. While the break down is a result of both parties obdurate conduct, and Henrici commits the first breach in paying less than he owes, the loss is cast on South Feather because it does not need to cut off the water to vindicate its right to the additional pennies it is owed.¹²⁸

We might extract from the forgoing a simple rule that requires parties to a contract with uncertain performance terms to cooperate when relevant rights are uncertain and the gains from cooperation are large.¹²⁹ But this is not the law. As we saw in Parts I and II, a party has the power to withhold or refuse performance in response to breach to avoid a loss that may not be adequately compensated with damages, even if the action inflicts a disproportionate loss on the defaulter. This power does not give way because the right a party seeks to protect by withholding or refusing performance is uncertain. In *Parker v. Twentieth Century-Fox*,¹³⁰ if it had been uncertain whether the studio had the right to substitute *Big Man*, *Big Country* for *Bloomer Girl*, then this uncertainty would not change the result once the court determined the contract did not give the studio this right. This is true even if MacLaine's refusal of the second role had imposed a loss on the studio that was disproportionate to MacLaine's likely loss from taking the second role. Of course, if the studio prevailed on the disputed point, then MacLaine would be liable for the studio's unrecoverable costs and any other losses that can be proven with a reasonable degree of accuracy. This is the familiar result in the situation in which a loss is suffered from a breakdown of a contract when both parties are justifiably obdurate in insisting that performance occur only on their terms on the ground that performance on the other's terms would subject each of them to an

¹²⁸ For an illustration of this point, see *K&G Construction Co. v. Harris*, 164 A.2d 451 (Md. 1960). Harris had a contract with K&G to excavate and move dirt in K&G's multi-house construction project. *Id.* at 453. Harris's bulldozer damaged a house and Harris and his insurer denied liability. In response, K&G withheld progress payments totaling less than the amount of its claim. Harris in turn stopped work and K&G hired another company to finish the job. Both parties suffered a loss. K&G paid the substitute more than it would have paid Harris; Harris lost the profit he would have made completing the job. *Id.* If the Court thought K&G acted inappropriately in withholding progress payments, then it could find this was a material breach. Harris would then have been in the right in leaving the job and would recover his lost profits. Instead, the Court concluded that Harris materially breached the contract when it withdrew from the job. *Id.* at 456. K&G recovered the additional cost of the substitute. *Id.* at 456-57.

¹²⁹ For an argument that courts should apply an "interim-efficiency rule" in passing on a motion for preliminary injunction, see Richard R.W. Brooks & Warren F. Schwartz, *Legal Uncertainty, Economic Efficiency, and the Preliminary Injunction Doctrine*, 58 STAN. L. REV. 381, 409 (2005). A duty to cooperate is similar to the interim efficiency rule; both are designed to encourage the parties to perform in whatever manner is in their joint interest in the face of legal uncertainty. The authors note their proposal is "a radically different perspective than that articulated in judicial opinions and prior legal scholarship." *Id.* at 382.

¹³⁰ 474 P.2d 689 (Cal. 1970); see also *supra* notes 15-27 and accompanying text.

uncompensated loss in the event they turn out to be in the right in the underlying dispute. In this situation, the law casts the loss (insofar as it is compensable in damages) on whomever the court finds is in the wrong in the underlying dispute.¹³¹

Natural features of the situation encourage parties to cooperate if rights are uncertain and if the gains from cooperation are large. The pressure to cooperate is strongest if each party anticipates the entire joint loss will fall on them if they are found to be in the wrong in the underlying dispute. In this situation, a party always may expect to bear his own loss from non-cooperation if he is found to be wrong in the underlying dispute, and he may expect to bear the other party's loss to the extent it is recoverable in damages. So long as the anticipated gains from cooperation are large and symmetric, the incentives to cooperate are strong because cooperation improves each party's individual expected return and reduces risk. Even if the gains from cooperation are asymmetric – as they are if one party faces a significantly larger loss from noncooperation that cannot be recovered in damages – the party with the natural advantage should worry that a court is likely to be unsympathetic to a disputable claim of right that is asserted to justify wasteful or coercive conduct.¹³² But nothing in the rules we have looked at to this point requires cooperation in derogation of even an uncertain right.

IV. SELF-HELP REMEDIES AND NORMATIVE THEORIES OF CONTRACT

In this Part and the next, I argue that the rules just described are consistent with norms both of economy and autonomy. In my opinion, the best normative theory of contract is pluralist, both in terms of the theory's descriptive accuracy (or fit) and its moral appeal. The most stable and least controversial parts of contract law are consistent with norms both of economy and

¹³¹ See *Hope's Architectural Prods. Inc. v. Lundy's Constr., Inc.*, 781 F. Supp. 711, 714-17 (D. Kan. 1991). This case involves specially manufactured windows and a dispute over the parties' respective rights and obligations when the windows were delivered later than the buyer expected. *Id.* at 712. The decision casts the loss on the seller after thoughtfully working through who was in the right in the underlying disputes. *Id.* at 717. A prologue to the opinion observes:

This case presents a familiar situation in the field of construction contracts. Two parties, who disagreed over the meaning of their contract, held their positions to the brink, with litigation and loss the predictable result of the dispute. What is rarely predictable, however, (and what leads to a compromise resolution of many construction disputes when cool heads hold sway) is which party will ultimately prevail. The stakes become winner-take-all.

Id. at 711-12.

¹³² The principle of construction in *Jacobs & Young v. Kent*, 129 N.E. 889, 891 (N.Y. 1921), also is a warning: "Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution."

autonomy. One of my goals in the rest of this Article is to make the case that the rules described in the preceding Parts are of this character. One hope is to make my account of the law more palatable. The next Part will look at a question on which different theories may indicate different answers. The question has to do with the legal status of informal agreements. I argue that the rules examined in Part III represent a uniquely attractive solution to the problem of determining when courts should give effect to an informal agreement.

The leading monistic normative theories of contract are usefully divided into two groups. Melvin Eisenberg describes these as “autonomy theories” and “revealed-preference theories.”¹³³ The first group includes promissory theories,¹³⁴ consent theories,¹³⁵ reliance-based theories,¹³⁶ and rights-based or entitlement theories.¹³⁷ Many of these theories are liberal in value, i.e., they take as the primary goal something like enabling individuals to live fulfilling lives while giving other individuals equal regard and respect. There are also illiberal autonomy theories. Examples include natural rights theories and libertarian theories.¹³⁸ Some autonomy theories are opaque to their ultimate values. They treat rules apparently enforcing consensual obligations, as self-evidently justified and not as requiring justification by some ultimate value.¹³⁹ The second group is economic theories. These generally seek to maximize

¹³³ Eisenberg, *supra* note 7, at 223-40.

¹³⁴ See CHARLES FRIED, *CONTRACT AS PROMISE* 8 (1981).

¹³⁵ See Randy E. Barnett, *A Consent Theory of Contracts*, 86 COLUM. L. REV. 269, 270 (1986); Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 827-28 (1992).

¹³⁶ See P.S. ATIYAH, *ESSAYS ON CONTRACT* 42-43, 80-82 (1988).

¹³⁷ See STEPHEN A. SMITH, *CONTRACT THEORY* 42-49 (2004) (observing that this sort of typology conflates the analytical question of what is the legal basis (or causative event) of contractual obligation – e.g., promise, reliance, transfer, etc. – and the normative question of the justification for imposing an obligation upon the relevant causative event and embracing a rights-based theory); Peter Benson, *Contract*, in *A COMPANION TO PHILOSOPHY OF LAW AND LEGAL THEORY* 24, 33-43 (Dennis Patterson ed., 1996); Peter Benson, *The Unity of Contract Law*, in *THE THEORY OF CONTRACT LAW* 118, 163 (Peter Benson ed., 2001).

¹³⁸ A libertarian theory of contract grounds legal obligation on an actor's manifested consent to be under a legal obligation. For a theory along these lines, see Barnett, *supra* note 135, at 270. Self-described natural law theories of contract include JAMES GORDLEY, *THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE* (1991) and HENRY MATHER, *CONTRACT LAW AND MORALITY* (1999).

¹³⁹ See, e.g., Curtis Bridgeman, *Reconciling Strict Liability with Corrective Justice in Contract Law*, 75 FORDHAM L. REV. 3013, 3022 (2007). Bridgeman argues a corrective justice theory of contract is immune from the problem that besets a corrective justice theory of torts, which is explaining the grounds for making an actor responsible for harm the actor causes, because “[b]inding contracts create entitlements in the promisee, and any loss of those entitlements becomes the promisor's responsibility to repair.” *Id.* As for why this is so, Bridgeman leaves it at “the widely held intuition that individuals are generally free to assume obligations if they so desire.” *Id.*

welfare or utility. I will call these “economic theories,” rather than “revealed preference theories,” as I expect this name will be more familiar to most readers. I will use Professor Eisenberg’s label of “autonomy theories” for the first group for lack of anything better.¹⁴⁰ This destroys the symmetry between the names of the two groups, but the obvious alternatives to “autonomy theories” are worse.¹⁴¹

The two groups of theories differ in more than their ultimate values. At least as important is a difference in perspective. When it comes to private law (e.g., contract, tort, and restitution), economic theories almost always are forward-looking. In particular, when it comes to contract law the general goal of economic theories is to establish rules that will best enable individuals and firms to engage in welfare-enhancing transactions. This is particularly true for complex transactions involving reasonably sophisticated parties on all sides that require forward-planning and commitment in the face of significant uncertainty about future events, including uncertainty about the other party’s trustworthiness or creditworthiness. Victor Goldberg aptly captures the mindset of economic theorists when he proclaims that “the theoretical framework of the transaction-cost engineer is appropriate for analyzing contract disputes and for developing contract doctrine.”¹⁴²

Autonomy theories generally are backward-looking, though there are significant exceptions.¹⁴³ The backward looking perspective is clearest in rights based and corrective justice theories. These theories often stipulate or presuppose a right to be vindicated or a wrong to be corrected upon the occurrence of some causative event. For example, a promissory theory of contract may assert that the causative event of an apparent promise (perhaps with the added element of a bargain or reliance) creates a right held by the

¹⁴⁰ Eisenberg, *supra* note 7, at 223.

¹⁴¹ The obvious alternatives to “autonomy theories” are “non-economic theories” or “moral theories.” Both names cede too much ground to economic theories. “Non-economic theories” defines the group by what they are not. A prescriptive economic theory is a moral theory.

¹⁴² VICTOR GOLDBERG, FRAMING CONTRACT LAW 1 (2006).

¹⁴³ For example, two of Fuller’s three functions of contract formalities – the cautionary and channeling functions – emphasize the ability of formal rules to empower individuals to determine their legal obligations. Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800, 801 (1941) (describing the cautionary function as a mechanism for “inducing the circumspective frame of mind appropriate in one pledging his future” and the channeling function as a “simple and external test of enforceability”). This could be a species of a liberal consequential theory that has the goal of designing contract law rules to best enable individuals to live fulfilling lives. Professor Smith classifies all consequentialist theories as utilitarian “in the broad sense” he uses the term. See SMITH, *supra* note 137, at 46-47. While American readers will find this use of the term “utilitarian” jarring, it does emphasize the tension in a rights-based theory of having courts self-consciously decide rights-claims before them with an eye on how a decision will affect future behavior.

promisee to the promised performance.¹⁴⁴ Even a forward-looking autonomy theorist who is amenable to crafting a right in a particular case with an eye on how the right will influence future behavior, i.e., a person such as a liberal consequentialist, would insist on respecting the rights and dignity of people who come to a court seeking justice. Such a theorist would be uncomfortable with a court refusing to enforce a right or denying a person access to justice based on the expected beneficial effects of doing so in other cases, for this would treat the person before the court as a means to an end. Even a forward-looking autonomy theorist will be backward-looking in this important respect.

Parts I and II repeatedly make the point that contract law permits a party to act in response to breach to avoid suffering a loss that may not be adequately compensated with damages, even if the response inflicts a loss on the defaulter that is disproportionate to the party's likely avoided loss. This point may seem to support autonomy theories of contract and to undercut economic theories. Certainly, the point undercuts the theory of efficient breach for it shows the law sometimes tolerates a great deal of waste to vindicate the right to performance.¹⁴⁵ The theory of efficient breach ties into the view that breach of contract is not morally blameworthy.¹⁴⁶ It also ties into the view that contract rights are qualitatively different from property rights because contract rights are not protected by punitive or profit-stripping sanctions.¹⁴⁷ Both views are at odds with autonomy theories. Parts I and II show these views are too simplistic. Breach is sufficiently blameworthy to justify allowing a party to act to protect herself from suffering an uncompensated loss even if the action imposes a cost on the defaulter that is disproportionate to the likely value of the avoided loss. And a right-holder may withhold performance (or obtain

¹⁴⁴ SMITH, *supra* note 137, at 54 helpfully characterizes many such theories of contract as addressing the “analytic question” of the nature of contract law, meaning the distinctive features of contract as a species of obligation. Smith groups these theories into three categories – promissory theories, reliance theories, and transfer theories. Smith correctly distinguishes such theories from theories that try to justify contractual obligation.

¹⁴⁵ For an argument that the theory is descriptively inaccurate for other reasons, see Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 18-23 (1989).

¹⁴⁶ The classic statement of the view is by Holmes: “The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, – and nothing else.” Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897). Holmes said this in a lecture to beginning law students to “dispel a confusion between morality and law.” *Id.* at 459. Holmes understood that his audience (like most people) thought breach of contract was immoral. He was telling them to try to put their views on the immorality of breach aside in learning contract rules defining the legal consequences of breach. *Id.* When contemporaries interpreted Holmes as asserting a right to breach a contract so long as one paid the price (some call this the “option theory of contract”), he chided them for misunderstanding his point and responded that he considered breach of contract a wrong on par with a tort. Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 FORDHAM L. REV. 1085, 1086-90 (2000).

¹⁴⁷ See *supra* note 4.

substitute performance and recover the cost or complete performance and recover the contract price) to vindicate a contract right even if the action has disproportionate consequences for the defaulter.

But economic theories of contract are not wedded to the theory of efficient breach. The theory of efficient breach is no more than a normatively-tinged description of one type of behavioral response to the expectation damage measure. It is, by now, old hat in the economic literature on contract remedies that, while the expectation damage measure may create desirable incentives for performance decisions, it creates undesirable incentives for precautions in entering into contracts (it makes people too cautious)¹⁴⁸ and for reliance on contracts (it invites excessive reliance).¹⁴⁹ And it is old hat that a right to specific performance or to supra-compensatory damages will not result in inefficient decisions in contract performance if parties are able to renegotiate.¹⁵⁰

Coming closer to matters at hand, recent economics-minded contracts scholarship has a worldview that is quite supportive of the rules described in Parts I and II. This worldview combines a high opinion of private ordering (particularly in transactions with reasonably sophisticated parties on all sides) and a low opinion of the capacity of courts to improve upon private ordering either on a case-by-case basis or using finely tailored rules. A worldview favoring private ordering underpins the arguments for enforcing a liquidated damage term¹⁵¹ and a forfeiture term¹⁵² even if the result in a particular case seems punitive. The virtue of such terms is that they are simple and reliable mechanisms to provide redress for nonperformance when the adequacy of performance or the harm from nonperformance is difficult for a court to verify.

¹⁴⁸ Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. LEGAL STUD. 401, 412 (1988); David J. Friedman, *An Economic Analysis of Alternative Damage Rules for Breach of Contract*, 32 J.L. & ECON. 281, 284 (1989).

¹⁴⁹ William P. Rogerson, *Efficient Reliance and Damage Measures for Breach of Contract*, 15 RAND J. ECON. 39, 47 (1984).

¹⁵⁰ Douglas Laycock summarizes the state of the debate at the turn of the century as it looked to a non-economist:

Scholars on all sides of the controversy have mostly recognized that if there were no transaction costs, the parties would always transfer the carrots to the party with the most valuable use. Thus, the economic wisdom was to select the rule with the lowest transaction costs, and much of the literature turned on ever-more-detailed speculative analyses of the likely transaction costs of each remedy.

LAYCOCK, *supra* note 26, at 390. Professors Scott and Triantis, focusing on two-party situations, make a similar point with a different twist: "The premise that parties can often renegotiate to efficient ex post outcomes is sufficiently well accepted that contract theorists have largely set aside the concern with efficient breach to focus on the hold-up problems caused by renegotiation." Robert E. Scott & George G. Triantis, *Embedded Options and the Case Against Compensation in Contract Law*, 104 COLUM. L. REV. 1428, 1451 (2004).

¹⁵¹ Schwartz, *supra* note 8, at 383-87.

¹⁵² See Schwartz & Scott, *supra* note 8, at 614-16.

While there is also vice in the performance incentives created by excessive damage and forfeiture terms (one vice is in the incentive created for a party who will reap a windfall on default to find or create a basis for claiming default), the reasoning is that courts will do better by assuming that the virtues of a term outweigh the vices when reasonably sophisticated parties adopt a term of mixed virtue. Alan Schwartz and Robert Scott go so far as to argue that *Jacobs & Young v. Kent*¹⁵³ is wrongly decided.¹⁵⁴ One can disagree with this conclusion while accepting their general point that allowing an owner to withhold compensation on an architect's say-so is the least bad mechanism to protect the owner from the risk of defects in construction, given the cost and difficulties of proving a defect or harm to a court's satisfaction and the difficulty of collecting damages from a contractor.¹⁵⁵ Schwartz and Scott would have us live with the occasional unfairness of enforcing a forfeiture term even in a case, such as *Jacobs & Young*, in which it seems clear that enforcing the term gives the owner a large windfall, for they fear any back-sliding by courts in enforcing agreed upon terms. It is a small step from this defense of enforcing excessive liquidated damage terms and forfeiture terms to a defense of the rules described in Parts I and II. The major difference is that Schwartz and Scott make a case for enforcing agreed terms while Parts I and II describe background legal rules that apply in the absence of a contrary term. I will come back to this difference in a moment.

My account of self-help remedies is at odds with recent economic thinking about contract remedies on a subtle point. Recent economic scholarship rejects the idea that the general goal of contract remedies is to place the aggrieved party in the position the party would have been in had the contract been performed. The way Robert Scott and George Triantis put the point is memorable, though it is purposefully tendentious. They describe damage rules as providing an "embedded option" rather than as being compensatory.¹⁵⁶ This may seem to hearken back to the theory of efficient breach, which has been called "the option theory of contract," on the reasoning that contract law gives an actor the option to pay damages in lieu of performing.¹⁵⁷ But the theory of efficient breach assumes compensatory damages. Professors Scott and Triantis defend rules that yield damages that predictably differ from the actual harm caused by breach even if the actual harm is measurable in dollars.¹⁵⁸ Prominent examples are the rules giving an aggrieved buyer or seller of

¹⁵³ 129 N.E. 889, 891 (N.Y. 1921) (refusing to award the cost of replacing piping from an incorrect factory because the defect was insubstantial and the cost of replacing the piping would have been great).

¹⁵⁴ See Schwartz & Scott, *supra* note 8, at 614-16.

¹⁵⁵ See *id.*

¹⁵⁶ See Scott & Triantis, *supra* note 150, at 1429.

¹⁵⁷ See, e.g., Brooks, *supra* note 4, at 579 ("The efficient breach hypothesis is premised on the Holmesian option theory of contract obligation . . .").

¹⁵⁸ See Scott & Triantis, *supra* note 150, at 1491.

fungible goods the contract-market differential as damages on repudiation. It is well known the contract-market damage measure can be under- or over-compensatory. For example, the measure under-compensates a lost-volume seller.¹⁵⁹ In a rising market, the measure over-compensates a middle-man who is obligated to pass the goods on at mark-up over the price the middle-man pays.¹⁶⁰ People who are wedded to the expectation principle argue that the contract-market measure should give way in these situations. Scott and Triantis defend the contract-market measure as normatively correct in these and others situations even if the measure is under or over-compensatory.¹⁶¹ Readers who are uninterested in Scott and Triantis's economic arguments will still want to look at their historical argument. They argue that prior to the nineteenth century, contract remedies were heterogeneous, and typically served ends other than compensation, and that the compensation principle, which was borrowed from tort law, came to dominate in the nineteenth century as scholars tried to provide a unified account of contract doctrine.¹⁶²

In Parts I and II, I assume the general objective of self-help is to place an aggrieved party in the position the party would have been in had the contract been performed – i.e., I embrace the expectation principle – both as an organizing principle and as a limiting principle. Sometimes self-help places a party precisely in the promised position. A party exercising the power to repair a defect in performance and collect the cost of repair is one example. Another is a party exercising the power to complete performance on repudiation and collect the contract price. In these situations, vindicating the expectation interest may result in waste, but there is no windfall or shortfall to the aggrieved party. Sometimes the exercise of self-help will leave the aggrieved party with a windfall or shortfall, taking the promised position as the benchmark. In *Parker v. Twentieth Century-Fox*,¹⁶³ the plaintiff got a windfall, if she valued leisure over whatever benefits she would have derived from

¹⁵⁹ See GOLDBERG, *supra* note 142, at 233-42 (using the classic case of *Neri v. Retail Marine Corp.*, 285 N.E.2d 311 (N.Y. 1972), to demonstrate the economic implications of compensatory damages for breach of contract when dealing with lost-volume retail sellers).

¹⁶⁰ See *id.* at 225-32 (using *Allied Cannery & Packers, Inc. v. Victor Packing Co.*, 209 Cal. Rptr. 60 (1984), and *Tongish v. Thomas*, 840 P.2d 471 (Kan. 1992), to illustrate the sometimes over-compensatory effect of damages in the case of middle-men).

¹⁶¹ Professors Scott and Triantis argue for a background rule of contract-market damages in thick markets in non-consumer contracts. See Scott & Triantis, *supra* note 150, at 1479-80. They favor a background rule of no damages in a case of repudiation by a consumer of a purchase agreement with a merchant. They would allow a merchant to collect a non-refundable deposit to recover the merchant's cost of giving a consumer a purchase option. See *id.* at 1488-90; accord GOLDBERG, *supra* note 142, at 237-38. In thin markets in commercial contract, Professors Scott and Triantis propose a background rule of specific performance around which people could contract. Scott & Triantis, *supra* note 150, at 1486-88.

¹⁶² See Scott & Triantis, *supra* note 150, at 1436-47. This rings true to me.

¹⁶³ 474 P.2d 689, 694 (Cal. 1970).

performing in *Bloomer Girl* apart from the fee. In *Colonial Dodge, Inc. v. Miller*,¹⁶⁴ the Millers suffered a small shortfall, if they actually wanted a car with extra-wide tires, including a spare, at the contract price, and they did not revoke out of buyer's remorse. If the Millers acted out of buyer's remorse, then they got a windfall. Such windfalls and shortfalls are inherent in the power to withhold performance in response to breach, and the power to reject non-conforming performance, for these are simple but clumsy tools for protecting the expectation interest. Nevertheless, my assumption in Parts I and II is that these powers should give way if a party does not need to exercise a power to avoid suffering an uncompensated loss or if exercising a power results in too great a windfall, in each instance taking the promised position as the benchmark. For example, in *Colonial Dodge*, if a judge or finder of fact was convinced that the Millers acted out of buyer's remorse, and believed the Millers cared not a whit or trivially about the prospect of not having a spare tire for a few months, then I would concede the court should deny them the power to revoke.

My disagreement with Professors Scott and Triantis is both abstract and practical. The abstract disagreement is over whether we should think about remedial rules as cohering around the expectation principle. The practical disagreement is over whether a remedial term or rule should give way when the term or rule clearly yields a result inconsistent with the expectation principle. There is much force in Scott and Triantis's argument for enforcing agreed-to remedial terms that violate the expectation principle, particularly in a case in which there is no gross defect in bargaining and it is plausible that a term was meant to serve some function that non-enforcement of the term would impair.¹⁶⁵

I am not quite sure what to make of their argument when it comes to remedial rules. Professors Scott and Triantis do not argue that remedial rules that are consistent with the expectation principle are undesirable. To the contrary, they are skeptical about the possibility of tailoring situation-specific efficient background rules.¹⁶⁶ Moreover, they support some remedial rules that are consistent with the expectation principle. In particular, they favor specific performance as a background rule in thin markets and contract-market damages as a background rule in thick markets, recognizing that a rule establishing contract-market damages is equivalent to specific performance if

¹⁶⁴ 362 N.W.2d 704, 707 (Mich. 1984).

¹⁶⁵ An example is when an over-booked airline charges a passenger a cancellation fee. While the cancellation fee would seem to be a windfall to the airline (which was over-booked), the fee might well be the price the passenger pays for an option of a seat on the flight, which bears no relation to the airline's loss if the passenger cancels. Indeed, the more likely a flight will be over-booked, the more valuable the option to the passenger. See Scott & Triantis, *supra* note 150, at 1468-70.

¹⁶⁶ *Id.* at 1433 ("Courts are not well suited to set default contract damages either.").

cover is available.¹⁶⁷ Probably Professors Scott and Triantis would support the power to complete performance on repudiation and collect the contract price, for this is self-help specific performance with the additional benefit that the contract-price remedy places less burden on a court than does specific performance. The same may be said of the power to complete unfinished work or repair defective work and collect the cost. As best I can tell, they are arguing that we should not fall into the trap of thinking these rules are justified because they are consistent with the expectation principle, and that we should not use the expectation principle as a touchstone in deciding whether a rule should apply in a case that is at the margin of a rule.

While this disagreement raises timeless issues about the place of principle in law,¹⁶⁸ the differences between their way of thinking and mine has practical consequences only in a case at the margin of a background rule. Our old friend *Parker v. Twentieth Century-Fox*¹⁶⁹ may be such a case. The treatment of *Parker* by economic-minded theorists shows they are as prone as legal theorists to imposing their heuristics on a world in the face of the unknown. Victor Goldberg has argued that the \$750,000 guaranteed fee was understood within the movie industry to be the price paid by the studio for the right to have an option on a block of the plaintiff's time should the studio decide to go ahead with a project.¹⁷⁰ It was, in industry parlance, a "pay-or-play" clause.¹⁷¹ An oddity of the case is that this interpretation of the contract was a basis for the trial court's decision, but the argument disappears from the opinions of the two appellate courts.¹⁷² The appellate opinions assume a duty to mitigate and

¹⁶⁷ They endorse a specific performance default for commercial contracts in thin markets because of the simplicity of the rule and because it will force parties to bargain for alternative termination terms. See *id.* at 1479-86.

¹⁶⁸ In raising these questions about the expectation principle, Professors Scott and Triantis are extraordinarily provocative. That lawyers and legal theorists make too much of principle, or abstract legal maxims, is hardly news. Jack Dawson's observations about the principle opposing unjust enrichment come to mind. He warned the principle "had the peculiar faculty of inducing quite sober citizens to jump right off the dock" and attributed this to its "strong appeal to the sense of equal justice [combined with] the delusive appearance of mathematical simplicity." JOHN P. DAWSON, UNJUST ENRICHMENT 8 (1951). The expectation principle has an even stronger pull. The idea that the remedy for a wrong is to place the wronged person in the position she would have been in had the wrong not been committed seems self-evidently correct. The idea unifies the fields of remedies and causation and transcends contract and tort. It is the organizing principle of the leading remedies casebook. LAYCOCK, *supra* note 26. Scott and Triantis may well be right in arguing that we have taken the principle too far. Lawyers, particularly academic lawyers, are prone to a "hardening of the categories."

¹⁶⁹ 474 P.2d 689 (Cal. 1970).

¹⁷⁰ See Goldberg, *supra* note 11, at 1052-53.

¹⁷¹ *Id.*

¹⁷² See GOLDBERG, *supra* note 142, at 284-86.

ignore the plaintiff's argument that she had an absolute right to the money.¹⁷³ *Parker* may be an example of judicial blindness to the option-like characteristics of termination terms, which is precisely the phenomenon Scott and Triantis warn against.¹⁷⁴ But this blindness ends up having little practical consequences in the context. The rule in *Parker* gives an actor who is offered a different role an absolute right to turn it down, which is functionally the same as treating the guaranteed compensation as the price of an option.

Characterizing the contract as an option would make a difference if an actor did other work during a period covered by the option. But here the claim that people probably understood termination rights as embedded options breaks down. It seems that everyone assumes an actor's earnings during the period covered by the option would be offset against the guaranteed payment.¹⁷⁵ If you come at the problem believing the goal is to put the plaintiff in the promised position but no better, then this seems right. Perhaps Professors Scott and Triantis would want a court to pause and consider the possibility that a "pay-or-play" clause is a genuine option without an offset. It is hard to object to this. But it is not clear to me what Professors Scott and Triantis would want a court to do if, as may well have been the case, there is no clear understanding or practice in the industry on offsetting earnings against guaranteed compensation. If they would default to the embedded-option theory, then they are guilty of the same vice as those of us who default to the expectation principle. We all fall back on our particular preferred heuristic.

V. THE POWER TO EXIT FROM AN INFORMAL OR INCOMPLETE AGREEMENT

This Part examines an unsettled legal and normative question that hovers in the background of Part III. The question relates to the general question of the legal status of informal or incomplete agreements. The trend in current economic thinking about contract law is to push courts to get out of the business of resolving contracts disputes if the existence of a contract, material terms of a contract, the fact of breach, or the monetary value of a loss are determined only at significant cost and with a significant risk of error.¹⁷⁶ What seems to be envisioned is a world in which courts perform an essentially administrative role in contract, lending the coercive power of the state to back up indisputable private obligations. Courts would not play much of an adjudicative role in this world. If this world seems far-fetched, then recall Grant Gilmore's wry observation that classical contract law "seems to have

¹⁷³ See *id.* at 286.

¹⁷⁴ Scott & Triantis, *supra* note 150, at 1429-30.

¹⁷⁵ See GOLDBERG, *supra* note 142, at 286 (reporting statements of the trial court in *Parker*); *id.* at 292-94 (reporting a case with a similar holding); *id.* at 298 (reporting that the Director's Guild union contract provides for the offset of additional earning against the guaranteed payment); *id.* at 302-03 (offering a tendentious explanation of the offset as damages for violating an implicit covenant not to compete during the option period).

¹⁷⁶ See Scott, *Formalism*, *supra* note 6, at 875-76; Scott, *Death*, *supra* note 6, at 389-90.

been dedicated to the proposition that, ideally, no one should be liable to anyone for anything."¹⁷⁷ While this is hyperbole, it does get at a sea change in contract law in the twentieth century. Contract law used to be much less receptive than it now is to damage claims predicated on informal, incomplete, indefinite, or otherwise defective agreements, much of which remains contested legal terrain.¹⁷⁸

Robert Scott makes a provocative case for a rule of non-enforcement that would cover many informal and incomplete agreements.¹⁷⁹ The nominal topic of Professor Scott's article is the doctrine of indefiniteness. Scott argues for a rule of non-enforcement of avoidably indefinite agreements.¹⁸⁰ In doing so, he eschews the familiar libertarian and prudential arguments for a policy of non-

¹⁷⁷ GRANT GILMORE, *THE DEATH OF CONTRACT* 15 (2d ed. 1995) (1974).

¹⁷⁸ There has been movement to weaken or eliminate formal requirements for contract. The Uniform Commercial Code directs courts to try to enforce indefinite agreements if the parties appeared to intend to make a contract. *See* U.C.C. § 2-204(3) (1977) ("Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."). The Code also weakens the statute of frauds by requiring little in the way of a writing to satisfy the statute. *See id.* § 2-201(1) & cmt. 1. Additionally, the U.C.C. abolishes the strict form of the mirror image rule; an apparent acceptance still will not create a contract if the acceptance states that it is conditional on assent to its terms. *See id.* § 2-207(1).

Formal requirements for contract also are subject to qualifications that limit an actor's power to dishonor an agreement with impunity once the other party performs, and in some jurisdictions, once the other party relies. For example, if an agreement is unenforceable on grounds of indefiniteness, then a party may recover the reasonable cost of performance rendered on a restitution claim. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 31 (2004). And in some jurisdictions, a promissory estoppel claim is available to recover expenses made in reliance on an indefinite agreement if the indefiniteness does not preclude a finding of breach. *See, e.g.,* *Wheeler v. White*, 398 S.W.2d 93, 97 (Tex. 1965). The limited holding of *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267, 275 (Wis. 1965), is that a promissory estoppel claim is available to recover expenses made by the claimant in anticipation of receiving a franchise though there was no agreement on essential terms of the franchise.

¹⁷⁹ *See* Scott, *supra* note 9, at 1645. Professor Scott begins with a descriptive claim based on his review of five years of cases in which the issue of indefiniteness is addressed. He finds that courts more often than not decline to enforce contracts with material uncertain terms. *Id.* at 1644. Of eighty-nine cases found by Scott in which the issue is genuinely joined, courts decline to enforce the contract in fifty-five cases while they enforce the contract in thirty-four others. *Id.* at 1652-53. Digging into the cases, Professor Scott finds an interesting pattern. Typically, when courts enforce an indefinite agreement, the parties have a good reason to leave a material term unspecified. These are complex transactions in which "[t]he parties wrote as complete an agreement as they could under the circumstances." *Id.* at 1656. Courts do not enforce indefinite agreements if the parties leave a material term unresolved by oversight (which is rare) or if the parties deliberately chose an indefinite agreement over a "more explicit and verifiable alternative." *Id.* at 1657.

¹⁸⁰ *See id.* at 1688.

enforcement of informal and incomplete agreements, and takes on the harder task of explaining why such a policy is justified on economic grounds as being in the interest of rational actors.¹⁸¹ He begins with a theory explaining why people sometimes deliberately chose an incomplete agreement, which carries a risk of non-enforceability, over a more complete and enforceable alternative. Professor Scott suggests an answer may lie in the salutary effect of reciprocal norms of fairness in situations in which the optimal performance term is unspecifiable or unverifiable and so is unachievable.¹⁸² Rather than trying to make do with specified and verifiable terms that predictably over-shoot or under-shoot the mark, Scott argues, people rely on “self-enforcement” of unspecified terms through the suasion of reciprocal norms of fairness.¹⁸³ Scott argues that reciprocal norms of fairness may work to “self-enforce” indefinite agreements even in essentially one-off deals between strangers.¹⁸⁴ All of this is plausible and heartening to hear from a leading economics-minded theorist.

The hard task is explaining why a rule of not enforcing avoidably indefinite agreements enhances the power of reciprocal norms of fairness. The gist of Professor Scott’s argument on this last crucial claim is that the prospect of legal enforcement may crowd out reciprocal norms of fairness.¹⁸⁵ Crowding out may occur on two dimensions. One is that people may be less inclined to use incomplete contracts because they cannot trust that a court will not give undesired effect to an unspecified term. People may forgo a contemplated transaction, or they may proceed with the transaction but contract for terms that are specified and verifiable, and so less prone to court enforcement in undesired ways, but that produce worse outcomes than would an unspecified term under a regime of self-enforcement only.¹⁸⁶ The other dimension is that people may be less inclined to be trusting or to act fairly in performing an unspecified obligation because of the prospect that the transaction may end up in litigation.¹⁸⁷

These arguments are an implausible justification for a rule like the doctrine of indefiniteness, because the doctrine is a poor shield against litigation. The doctrine will apply to make an alleged agreement unenforceable only if, after

¹⁸¹ *See id.* (“In short, any enforcement rule (or standard) that conditions on unverifiable factors (such as high quality) will produce an [economically] inferior outcome to a nonenforcement rule that leaves the parties’ room for reciprocity.”).

¹⁸² *Id.* at 1661-63 (considering reciprocal fairness as a means of self-enforcement).

¹⁸³ *See id.*

¹⁸⁴ *See id.* at 1662 (“In particular, the social preferences for reciprocity and equality of treatment are the strongest candidates for developing a theory that expands the range of self-enforcing contracts to include isolated interactions between relative strangers.”).

¹⁸⁵ *See id.* at 1645.

¹⁸⁶ *See id.* at 1687-88 (explaining how a policy of enforcing intentionally incomplete agreements may lead parties not to use an intentionally incomplete contract though it is preferable to the alternative fully specified contract).

¹⁸⁷ *See id.* at 1690 (“The *explicit*, ex-ante nature of legal sanctions may . . . undermine the instinct to reciprocate.”).

discovery and litigation, a court concludes the parties did not apparently agree on the content of some term that is essential to determining breach or damages. A contract with a clear disclaimer of obligation or a clear exculpatory term can be a genuine shield against litigation. A contract with an indefinite performance term is an invitation to a prolonged fight over the content of the parties' apparent agreement in fact. It is slightly more plausible that the doctrine gives people comfort that a court will not give unwanted effect to an underspecified term, and so it may make such terms more palatable, but I am skeptical that people actually rely on a forum's policies concerning indefinite terms when entering into contracts with unspecified terms. The doctrine is too obscure and inscrutable.

This criticism of Professor Scott's argument may miss his real point. While his nominal topic is the doctrine of indefiniteness, his real target seems to be the sea change in contract law remarked on by Grant Gilmore.¹⁸⁸ In the early twentieth century, parties to an informal agreement would have thought there was little risk of their agreement being the subject of a lawsuit. This was a result of a bevy of rules that made the likelihood of recovering damages in a suit for breach of an informal agreement very low. Many of these rules were reliable shields to litigation within the rule's field, such as the statute of frauds and the employment-at-will rule.¹⁸⁹ Others – like the doctrine of indefiniteness, the requirement that damages be proven to a reasonable degree of certainty, the requirement of consideration, and the hard form of the parol evidence rule – raised a series of hurdles to a claim for damages for breach of an informal agreement. These hurdles have been eroded, often in cases in which the traditional rules produced palpably unfair results.¹⁹⁰ Professor Scott's arresting argument is that in striving to do what is fair in particular cases, courts have cast a pall of potential litigation over informal agreements generally, making people less inclined to be trusting, to earn trust by acting fairly, or to rely on informal agreements, with a net harmful effect on human welfare.¹⁹¹ This is plausible, though I can think of no way of testing the latter claims, which are crucial to Scott's policy conclusion.

¹⁸⁸ See GILMORE, *supra* note 177, at 15 (commenting on the expanding function of courts in contract disputes).

¹⁸⁹ Many formal requirements for contract have the effect of making unenforceable agreements infected with particular types of uncertainty. For example, the statute of frauds, by requiring reliable written evidence of the existence of a contract, makes unenforceable an oral agreement of disputed existence. See RESTATEMENT (SECOND) OF CONTRACTS § 110 (1981). And the mirror image rule, by treating an apparent acceptance with new or different terms as a counter-offer, makes unenforceable an agreement that has uncertain terms because of discrepant communications. See *id.* § 59.

¹⁹⁰ See, e.g., *Pac. Gas & Elec. Co v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 646 (Cal. 1968); *Hoffman v. Red Owl Stores*, 133 N.W.2d 267, 274-77 (Wis. 1965).

¹⁹¹ See Scott, *supra* note 9, at 1692-93.

This is an area of genuine disagreement between economic theories and many autonomy theories.¹⁹² From the perspective of many autonomy theories, it is bizarre to allow a defendant to escape liability to a plaintiff for a harm resulting from the plaintiff's predictable reliance on an informal agreement the defendant breaches on what seems a legal technicality, such as an unnoticed discrepancy between an offer and acceptance or the absence of a writing.¹⁹³ From the perspective of economic theory (and of forward-looking theories more generally), the unfairness of absolving a party of an apparent commitment based on a formal rule in a particular case may be outweighed by the benefits of having clear formal rules to define the existence and content of contractual obligations.¹⁹⁴ Beyond this deep point of disagreement, a variety of sociological and empirical assumptions that tend to be associated with autonomy theories cut in favor of giving some legal effect to informal agreements. These include the assumption that people generally intend to stand by informal commitments they make to others as an inducement to deal or to action, the assumption that people generally trust others to deal with them in good faith, the assumption that people generally trust others to take reasonable care not to mislead them in their dealings together, and the assumption that courts do a decent job of determining when an actor has made and breached an informal commitment, acted in bad faith, or negligently misled another. These sorts of assumptions, combined with a backward looking perspective, tend to make one sympathetic with the result in *Hoffman v. Red Owl Stores, Inc.*,¹⁹⁵ which is an exemplar of the type of case that would come out the other way if courts behaved as Professor Scott advocates.

Professor Scott and like-minded scholars are on the strongest ground when they argue that courts should give strict effect to explicit harsh terms, such as harsh stipulated damage terms and conditions of forfeiture, in contracts involving sophisticated parties on all sides.¹⁹⁶ The sophistication of the parties, the explicitness and harshness of the term, and the clarity of a rule strictly enforcing such terms combine to give us some reason to have faith in private ordering, though in the end this remains a matter of faith, unless a term is a

¹⁹² Some forms of autonomy theories do not disagree on the point. A germane counterexample is the liberal/libertarian forward-looking argument for formal rules that enable people to determine their contractual obligations. See *supra* note 143 (explaining certain aspects of Fuller's autonomy-based contract theory that are forward-looking rather than backward-looking).

¹⁹³ See, e.g., William C. Whitford, *Relational Contracts and the New Formalism*, 2004 WIS. L. REV. 631, 641-42.

¹⁹⁴ See Robert E. Scott, *Hoffman v. Red Owl Stores and the Myth of Precontractual Reliance*, in *CONTRACTS STORIES*, *supra* note 33, at 87.

¹⁹⁵ 133 N.W.2d 267, 275 (Wis. 1965).

¹⁹⁶ Schwartz & Scott, *supra* note 8, at 544-45 (narrowing claim that contract law should do no more, and no less, than "facilitate the efforts of contracting parties to maximize the joint gains" to "economic entities that can be expected to understand how to make business contracts").

dickered term that is a subject of real bargaining. Professor Scott's argument for a policy of not enforcing avoidably indefinite agreements is on much weaker ground. This is partly for the reasons already stated. The doctrine of indefiniteness does not reduce litigation and by its very nature is unpredictable in application. In addition, the fact that people choose to have unspecified terms in a contract is not much of a signal that they chose (or would have chosen had they actually contemplated the question) to forego the right to redress in court, particularly in outcomes in which one party violates another's likely expectations by acting unreasonably or in bad faith. Professor Scott's policy argument assumes most people distrust courts as much as he does.

This brings me back to the rules examined in Part III. The rules serve a function similar to a rule of non-enforcement of informal or incomplete agreements in that they channel some contract disputes to be resolved privately outside of court when a right is uncertain. But the rules operate in a manner quite unlike a rule of non-enforcement that makes them relatively easy to justify on economic grounds and inoffensive on autonomy grounds, unlike a rule of non-enforcement of informal or incomplete agreements. The rules are easy to defend because they prod parties to resolve certain types of disputes outside of court but they do not completely foreclose judicial resolution of a claim.

Recall the rules on disputed debts, which encourage and empower a debtor to use the threat of nonpayment to force settlement of a dispute outside of court.¹⁹⁷ The attraction of this arrangement from an economic perspective is obvious. Correctly resolving the amount of a debt is of value only insofar as peoples' expectation that courts will correctly resolve this amount has salutary effects on their behavior in contracting, reliance, and performance. While there are some situations in which getting it right has salutary value,¹⁹⁸ these situations are fairly far afield from the typical disputed debt. These situations to the side, from an economic perspective it is preferable to resolve an honest dispute over the amount of a debt by a flip of a coin, for this resolution minimizes litigation costs with no clear sacrifice on other dimensions of behavior. Better yet, do what the rules on disputed debts do, which is to enable a debtor to use the threat of nonpayment to coerce a settlement but also allow a stalwart creditor to refuse the payment and preserve the right to have a claim of

¹⁹⁷ See *supra* notes 106-10 and accompanying text.

¹⁹⁸ A commonplace example is an agreement retaining a professional to accomplish a general task, such as hiring a lawyer to defend a legal claim or hiring a doctor to treat an ailment. Successful contracts of this sort have three general characteristics: (1) the parties cannot specify the precise terms of performance *ex ante*, often because this depends on future events that are impossible or costly to predict; (2) the factors determining the desirable level of performance, and the actual quality of performance, are observable *ex post* by a court, which is likely to make accurate decisions; and (3) the court can accurately assess damages from inadequate performance.

right resolved. The power to reject a payment in satisfaction gives a creditor some protection from expropriation and opportunism.¹⁹⁹

The power to use the nonperformance option as a bargaining chip in settling a dispute ebbs as the stakes increase because nonperformance results in other harms. The logic of this from an economic perspective is not as obvious as it may seem. In theory, increasing the “gains from trade” from settling and performing may be expected to drive rational actors to settle (either explicitly or implicitly), avoiding the loss on nonperformance as well as litigation costs.²⁰⁰ But this theory breaks down for familiar reasons, including asymmetric information about gains from trade and a human inclination to sacrifice one’s own short-term interests to punish conduct one perceives as unfair. My hunch is that such phenomena are sufficiently commonplace that the performance gains from discouraging harmful nonperformance and threats of harmful nonperformance outweigh the additional cost of processing disputes that would settle, with no performance loss, if threats of harmful nonperformance are permitted.

It is difficult to make an argument for the rules examined in Part III from the perspective of autonomy theories, but there is a good argument that the rules do not offend these theories. The reason is that both sets of rules protect autonomy (and rights) by allowing a party to decide whether to forego a rights-claim. A debtor who pays a disputed debt can avoid the bar of the voluntary payment doctrine by withholding payment unless the creditor agrees to a reservation of rights.²⁰¹ A creditor faced with a tender of part payment of a disputed debt in satisfaction can preserve its claim by returning the payment.²⁰² These rules push parties to settle disputed debts outside of court, but they do not prevent them from going to court. As for the second set of rules, while the rules encourage parties to perform an uncertain agreement when performance avoids a loss, the rules permit a party to stand and gamble on an uncertain claim of right if the stand is necessary to avoid a risk of suffering a loss that may not be adequately compensated by damages.²⁰³ Implicit in this last point is that uncertain rights are not discounted or disregarded in determining if a breach is material. Instead, a court determines whether there is a right and then

¹⁹⁹ See *supra* notes 106-10 and accompanying text.

²⁰⁰ See Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067, 1075-77 (1989).

²⁰¹ See RESTATEMENT OF RESTITUTION § 45 cmt. e (1937) (“The rule stated in this Section does not apply if the parties have agreed that the payment is conditional upon the validity of the transferee’s claim.”).

²⁰² See, e.g., *Builders Contract Interiors, Inc. v. Hi-Lo Indus., Inc.*, 134 P.3d 795, 799 (N.M. Ct. App. 2006).

²⁰³ See *supra* notes 129-32 and accompanying text.

decides if a party was justified in withholding or refusing performance given that right.²⁰⁴

The same qualities that preserve these rules from criticism on autonomy grounds make the rules inadequate to achieve what I take to be Professor Scott's broader goal, which is to erect rules that give a party to an informal or incomplete agreement a fair degree of confidence that a court will not find them liable for breach of an obligation they did not mean to undertake. The reason is that the rules do not prevent the other party from getting a claim of right resolved and the right vindicated by a court if the other party is adamant about pursuing the claim. As I have said, the doctrine of indefiniteness also is poorly suited to achieve what I take to be Professor Scott's broader goal. But perhaps there are other tools better suited to achieve this goal that stand up pretty well on both economy and autonomy grounds.

One such rule bears a family resemblance to the rules on self-help. The rule permits a party to withhold or refuse performance under a contract if the other party unjustifiably refuses to commit to terms, exposing the first party to unwanted legal uncertainty. *C.L. Maddox, Inc. v. Coalfield Services, Inc.*²⁰⁵ is authority for the rule. Written by Judge Richard Posner, the opinion's facts illustrate the rule's application. Perhaps not surprisingly, given the author, the opinion echoes Professor Scott in disvaluing claims to uncertain rights because of the cost and risk of error in resolving such claims.

Maddox subcontracted with Coalfield to do underground mine demolition work at a price of \$230,000.²⁰⁶ Coalfield faxed a contract stating that it would do the work in three weeks, provided it could work day and night seven days a week. Maddox requested and received a change to a term that was irrelevant to the eventual dispute and said that it would sign and return the contract. Maddox never did this despite repeated requests by Coalfield. Coalfield worked for over two weeks and found the work much slower than expected, partly because it could not work Sundays.²⁰⁷ Coalfield estimated the job was forty-five percent complete at this point and submitted its first bi-weekly bill. At the same time, Coalfield pulled its men off the site. It is not clear how much this stoppage delayed work.²⁰⁸ Maddox offered to pay the amount requested less ten percent, but asked Coalfield to sign a letter agreeing to extend the deadline by one week and to pay \$1000 liquidated damages per day

²⁰⁴ *Hope's Architectural Prods., Inc. v. Lundy's Const., Inc.*, 781 F. Supp. 711, 714-17 (D. Kan. 1991) (explaining that stakes become winner-takes-all when parties in a contract dispute hold their positions to the brink).

²⁰⁵ 51 F.3d 76 (7th Cir. 1995).

²⁰⁶ *Id.* at 77.

²⁰⁷ *Id.* at 78.

²⁰⁸ Coalfield argued that it could have put men back to work immediately. *See id.* at 80. The court inferred that the stoppage entailed at least an eight-day delay based on a Coalfield fax. *See id.*

after this deadline.²⁰⁹ Coalfield refused to go back to work on these terms, telling Maddox that the job would take five to six more weeks to finish.²¹⁰ The trial judge initially concluded that Coalfield breached the contract, but he had qualms about this conclusion and passed the case over to a magistrate, who decided that Maddox breached the contract.²¹¹ The court of appeals affirmed.²¹²

A striking feature of the court of appeals decision is that the court did not ground its decision for Coalfield on a finding that Maddox's demand letter was a material breach of contract. Whether the demand letter was a material breach would turn on how the demand was couched and on whether Coalfield was itself in breach, by falling behind on the work schedule, or at least if it had given Maddox grounds for insecurity. Nor did the court respond to Maddox's argument that Coalfield had wrongfully asserted the demand letter was a material breach to get out of a losing contract. The court left these underlying claims unresolved, merely remarking that how litigation under the contract would have come out was uncertain.²¹³ Even more striking is the argument for why Coalfield acted properly in pulling off the job:

Every day that Coalfield continued working, it put itself further in Maddox's power. Had it finished the job it would have found itself owed \$230,000 with no leverage over Maddox to extract the money short of a suit to enforce what, depending on Mr. Maddox's testimony and its reception by a jury, might be merely a vague oral contract.²¹⁴

The court found a novel basis for allowing Coalfield to halt performance in U.C.C. section 2-609, which allows a party who has reasonable grounds for insecurity regarding the other's performance to suspend performance, if the party requests and does not receive adequate assurances of the other's

²⁰⁹ It is not clear from the opinion how strongly Coalfield insisted upon this. On this potentially crucial point, the opinion says: "[H]e appeared to condition this promise [to pay the invoice] on Coalfield's signing an 'acceptance letter' that Maddox enclosed." *Id.* at 78.

²¹⁰ *See id.*

²¹¹ *See id.* at 78-79.

²¹² A few of the specific factual arguments for the decision are questionable. The opinion concludes "that the most plausible interpretation of Maddox's action is that it was seeking excuses for not paying Coalfield anything." *Id.* at 80. Maddox's failure to sign and return the contract hardly suggests this. Given Maddox's acquiescence in Coalfield starting, no one could reasonably question that there was some sort of contract under which Maddox would pay for the work that was done. Nor does the letter "demanding" that Coalfield agree to pay liquidated damages support the conclusion. Maddox offered to pay for the work done less ten percent of the contract price. *Id.* at 78. Liquidated damages were only \$1000 per day. *Id.* Had the job taken the eight weeks predicted by Coalfield, liquidated damages would have been \$28,000 on a \$230,000 contract.

²¹³ *See id.* at 81-82.

²¹⁴ *Id.* at 80.

performance.²¹⁵ The novelty involves the nature of Coalfield's request for assurances and the reason for its insecurity. The request was that Maddox sign and return Coalfield's form contract.²¹⁶ It was not a request for assurances that Maddox intended to and was able to honor its obligations. The insecurity went to whether the form contract defined the parties' agreement. While Coalfield could be assured of being paid a reasonable price for its work, its managers might well have felt insecure because not having a signed contract made important terms and conditions uncertain, such as the schedule or potential liability for consequential damages for delay.

The doctrine of indefiniteness might seem an alternative ground for the decision, but the parties had agreed indefiniteness was not an issue.²¹⁷ The issue disappeared once Maddox admitted in litigation that it had said it would sign and return Coalfield's contract; this meant that the terms on Coalfield's form would govern.²¹⁸ This illustrates a point I made earlier.²¹⁹ The doctrine of indefiniteness applies to make an agreement unenforceable only if, after factual investigation and litigation, a court concludes that the parties did not apparently agree on some material term. This is not the perspective Judge Posner took in arguing that Coalfield had the right to withdraw from the job to avoid the cost and uncertainty of litigation. His argument embraced Coalfield's perspective at the time it chose to withdraw from the contract before factual investigation and litigation.

The decision and its reasoning resonate with autonomy theories of contract once we recognize that confronting another person with a risk of litigation can be a cognizable harm in itself. When Maddox refused to return Coalfield's form contract, despite its earlier representations that it would do so, Maddox either acted in bad faith or negligently. It acted in bad faith if it withheld the form to leverage Coalfield in the dispute. It acted negligently if it merely forgot to return the form. The harm, precisely identified by Judge Posner, is the insecurity Maddox faced at the time because it could not be sure that it could hold Coalfield to the terms on Maddox's form. The law does not try to compensate for this sort of harm directly with damages. How could it, other than by awarding legal fees to a prevailing party, which would redress only part of the cost and none of the uncertainty? The materials in Parts I and II teach that contract law often redresses harms not compensable with damages by allowing a party to withhold performance, which is precisely what the rule I extract from the case does.

²¹⁵ See *id.* at 80-81 ("The principle of section 2-609[']s] . . . applicability here is straightforward."); U.C.C. § 2-609 (1977).

²¹⁶ *C.L. Maddox*, 51 F.3d at 78.

²¹⁷ See *id.* at 79.

²¹⁸ *Id.*

²¹⁹ See *supra* notes 185-96 and accompanying text (discussing the doctrine of indefiniteness).

CONCLUSION

I had several goals in this Article. The primary goal was to give a general account of the rules that regulate the powers to withhold or refuse performance in response to breach, and the power to threaten to do so to extract concessions, which is normatively appealing and well-grounded in the law's specifics. A subsidiary goal was to encourage people who teach and write about contract law to rethink some familiar shibboleths, such as the theory of efficient breach and the idea that contract rights are categorically different from and weaker than property rights. Another subsidiary goal was to show that any descriptively accurate theory of contract law and contract remedies must have the interest in remedial simplicity at its core. You will not understand contract law if you do not appreciate the importance the law places on remedial simplicity. Going beyond these goals, I hoped to show that while some of the specifics of my account of the law will seem strange and even perverse in the incentives a rule creates, the rules jibe with current economic thinking about contract remedies, which favors enforcing simple and predictable terms to protect parties from non-performance when non-performance or its harm are difficult to verify. The convergence of traditional contract law with economic theory is unsurprising for they share a strong distaste for cost of litigation and legal uncertainty.

Parts IV and V raise some points where my account diverges from current economic thinking. A minor point of disagreement is over the merit of the expectation principle. A more significant potential point of disagreement is over the project to make contract law less hospitable to claims based on informal and incomplete agreements, in particular the effort to reinvigorate the doctrine of indefiniteness. I say "potential" because the disagreements here may be mostly over technique. I think it possible that the turn against rule formalism has made contract law unduly costly to administer and unpredictable, and that the law's greater openness to claims based on informal agreements has made people less willing to use informal agreements to order their dealings with others in ways that on balance make people worse off. But the solution to these problems cannot be to return to classical contract law, for its formal rules proved a weak constraint on courts. This will always be with rules that are clumsy and opaque to their purposes. Nevertheless, in the ebbing of formal requirements for contract there is a space for better crafted rules that are transparent to their purposes that will delimit when informal agreements and undertakings entail legal obligation. A final goal of the Article was to suggest one such rule that allows a party to withhold or refuse performance under an informal agreement if the other party unjustifiably refuses to commit to terms.

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