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## Foreword: Fault in American Contract Law

Omri Ben-Shahar

*University of Chicago Law School*

Ariel Porat

*Tel Aviv University*

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# FOREWORD: FAULT IN AMERICAN CONTRACT LAW

*Omri Ben-Shahar\**  
*Ariel Porat\*\**

## INTRODUCTION

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

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

To be sure, the unified model takes a very general view of tort and contract. But the divergence puzzle is all the more challenging when we increase the resolution of our view and compare some of the main tort and contract doctrines, only to find again a clear divide. For example, tort law has a substantial causation requirement, but causation is seldom an issue in contract. Tort law recognizes claims for punitive damages; contract law by

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\* Frank and Bernice J. Greenberg Professor of Law, the University of Chicago Law School.

\*\* Alain Poher Professor of Law, Tel Aviv University; Fischel-Neil Distinguished Visiting Professor of Law, the University of Chicago Law School.

1. Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1 (1985).

2. Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629 (1988); Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. LEGAL STUD. 401 (1988).

and large does not. Contract law limits the magnitude of recovery through doctrines like foreseeability and certainty; tort law mainly employs proximate cause and duty of care, which limit liability in a different way. And the list continues: economic harm (common in contract but not in tort), nonpecuniary losses (common in tort but much less in contract), comparative fault (applied as a defense in tort but not in contract), and mitigation of damages (common in contract, not in tort).

It would take more than one symposium to explain the puzzling interface between contract and tort. Any explanation, though, would have to begin with an account of the limited role that fault plays in contract law. This breaks down to separate lines of inquiry: (1) Should lack of fault be a defense against breach? Should the breaching party be able to escape liability if he can show that he worked hard to avoid breach? (2) Should fault be an aggravating factor multiplying damages? Should the breaching party be liable for more than normal damages if breach was “malicious”? (3) Should contract law take the aggrieved party’s fault into account? These three lines of questions—the no-fault defense, the willful-breach multiplier, and contributory fault—are the focus of the present Symposium.

### I. A POSITIVE ACCOUNT

The first thing that an account of “fault in contract law” needs to do is to separate myth from reality and identify the extent to which fault does, or does not, play a role in contract liability. Almost every article in this collection contributes some descriptive nuance to the fault picture. At one end of the spectrum, Melvin Eisenberg argues that contract law is substantially a fault regime, manifested in areas like unconscionability, unexpected circumstances, interpretation, mistake, and nonperformance.<sup>3</sup> In all these areas, fault plays an important role, and liability depends to a large extent on the parties’ blameworthiness. Consistent with this descriptive line, Richard Epstein demonstrates that in many consensual relations, fault is built into the liability rule through a subtle definition of the content of the promise. Taking bailment as the prototype, he shows that the generic understanding of a promise is to take due care, not to guarantee a result.<sup>4</sup> George Cohen, who in the past argued that fault plays a dominant role in contract damages, argues in this Symposium that it also plays an important role in other areas, like mistake, impracticability, misunderstanding, interpretation, and formation of contracts.<sup>5</sup>

At the other end, other contributors highlight the strict-liability side of contract law. Robert Scott, for example, argues that case law is largely con-

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3. Melvin Aron Eisenberg, *The Role of Fault in Contract Law: Unconscionability, Unexpected Circumstances, Interpretation, Mistake, and Nonperformance*, 107 MICH. L. REV. 1413 (2009).

4. Richard A. Epstein, *The Many Faces of Fault in Contract Law: Or How to Do Economics Right, Without Really Trying*, 107 MICH. L. REV. 1461 (2009).

5. George M. Cohen, *The Fault that Lies Within Our Contract Law*, 107 MICH. L. REV. 1445 (2009).

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

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

A glimpse into continental European legal systems makes the "fault in contract law" puzzle even more mysterious. Stefan Grundmann, a leading authority in comparative contract law, provides a compelling doctrinal journey through the ways the law merges both fault and strict liability. His discussion demonstrates that although fault plays a role in contractual liability, this role varies significantly between common law and the civil law prevalent in continental Europe: in fact, fault is often a condition to any imposition of contractual liability in European law. Fault has also varied over time in European law, with more recent reforms aimed at bolstering its role.<sup>12</sup>

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6. Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract*, 107 MICH. L. REV. 1381 (2009).

7. Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349 (2009).

8. *Id.* at 1351.

9. Eric A. Posner, *Fault in Contract Law*, 107 MICH. L. REV. 1431 (2009).

10. Ariel Porat, *A Comparative Fault Defense in Contract Law*, 107 MICH. L. REV. 1397 (2009).

11. Saul Levmore, *Stipulated Damages, Super-Strict Liability, and Mitigation in Contract Law*, 107 MICH. L. REV. 1365 (2009).

12. Stefan Grundmann, *The Fault Principle as the Chameleon of Contract Law: A Market Function Approach*, 107 MICH. L. REV. 1583 (2009).

## II. A NORMATIVE AND HISTORICAL ACCOUNT

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

An explanation for the limited place of fault in contract, compared to its robust place in tort, begins with a historical account. Two contributions provide new insights into why English common law treated fault differently in tort and contract. Roy Kreitner argues that fault standards were historically considered to be socially imposed, thus inconsistent with the basic premise of contract law that the parties, not society, are the ones who create the content of the obligation. He also shows how the blurring of the contract/tort line in the area of products liability blurred the fault/no-fault distinction within each field.<sup>13</sup> Richard Epstein explores the origins of bailment law as a species of consensual obligation law and argues that the fault standard prevailed in it (and in other types of contractual arrangements) through the definition of the duty owed by one party to another.<sup>14</sup>

The normative question with respect to the role of fault in contract law breaks down, as we suggest, to several separate inquiries: the role of willful breach, whether lack of fault should be a defense to breach, and whether comparative fault should come into play.

### A. Willful Breach

Three separate contributions, by Richard Craswell, by Peter Siegelman and Steve Thel, and by Oren Bar-Gill and Omri Ben-Shahar, address willful breach, which is one of the more puzzling fault-based pockets in contract law. All three contributions provide justifications for the law's occasional harsher treatment of willful breach. They argue that what constitutes "willful" or "malicious" breach cannot be determined conceptually, but rather has to be the *conclusion* of the analysis that identifies situations in which normal damages are not high enough. There are occasions, these articles argue, in which normal damages do not suffice to create optimal deterrence and a damage booster is need. These occasions have nothing to do with the mens rea of the promisor, the volition of his act, or its morality. They surely cannot be explained by reference to an infringement of the "sanctity of contract." Instead, the willful-breach cases have to do with incentives.

In the first of these three contributions, Craswell argues that the willful-breach add-on to damages can be explained in two ways. Higher damages

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13. Roy Kreitner, *Fault at the Contract-Tort Interface*, 107 MICH. L. REV. 1533 (2009).

14. Epstein, *supra* note 4.

are awarded when breach is clearly inefficient, or are awarded when normal damages are undercompensatory and do not provide enough incentive to perform.<sup>15</sup> Another willful-breach rationale is developed by Siegelman and Thel, who argue that higher damages are necessary when the social costs of avoiding breach are zero. They use the notorious example of breach in order to sell to a higher bidder as an example of a case in which there is no social cost to breach avoidance.<sup>16</sup> Finally, Bar-Gill and Ben-Shahar develop an ex-ante view of willful breach. They argue that willful breach is often an indication of a systematic pattern of “nasty” but undetectable behavior, having to do with some failure by the promisor to make earlier investments in performance capacity. The damage increase is needed to deter such propensity and its subsequent mesh of subperformance conduct.<sup>17</sup>

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

### B. *The No-Fault Defense*

A pure fault-based liability rule would allow breaching parties to escape liability whenever it is established that the breach was not due to their fault. Eric Posner presents a strong case for such a fault rule. In his view, when the negligence determination by courts is not difficult (administrative and error costs are low), a fault rule could be superior to a strict liability rule. A fault rule saves transaction costs because under such a rule the breaching party does not insure the victim for inadvertent risks. Conversely, under a strict liability rule, such insurance is forced on the victim, even though there is no reason for the victim to buy such insurance in the first place.<sup>18</sup>

An opposite view, expressed by Richard Posner and by Robert Scott, is that fault is not, and also should not be, relevant to contractual liability, either as a no-fault defense or as a super-fault damage booster. According to these two prominent writers, the Anglo-American contract law is efficient and should remain the way it is.<sup>19</sup>

From a completely different perspective—of philosophy rather than of law and economics—Seana Shiffrin examines whether a deliberate breach of contract is a moral wrong. As opposed to those who argue that fault

15. Richard Craswell, *When Is a Willful Breach “Willful”? The Link Between Definitions and Damages*, 107 MICH. L. REV. 1501 (2009).

16. Steve Thel & Peter Siegelman, *Willfulness Versus Expectation: A Promisor-Based Defense of Willful Breach Doctrine*, 107 MICH. L. REV. 1517 (2009).

17. Oren Bar-Gill & Omri Ben-Shahar, *An Information Theory of Willful Breach*, 107 MICH. L. REV. 1479 (2009).

18. Posner, *supra* note 9.

19. Posner, *supra* note 7; Scott, *supra* note 6.

should not matter at all (like Richard Posner and Scott), and in contrast to the argument that no-fault breaches should (under certain conditions) be excused regardless of whether those breaches were deliberate or not (like Eric Posner), Shiffrin takes the position that breach of a promise can be a moral wrong regardless of its efficiency. Her position is that parties who value performance as an end would not always permit willful breach, even if efficient.<sup>20</sup> Richard Posner dissents. He argues that legal duties do not overlap with moral duties and points out that even Shiffrin would not argue that if breach is not morally wrong it should be excused.<sup>21</sup>

Continuing his previous dialogue with Shiffrin on the role of morality in contractual liability,<sup>22</sup> Steven Shavell argues that efficient breach merely mimics what a complete contract would have stipulated. When the contingency that eventuated and led to the breach of the contract was not explicitly addressed by the contract, the breach coupled with a payment of full expectation damages is not a violation of a promise. In Shavell's view, the reason why many individuals hold the belief that a breach is immoral is their mistaken perception that a contract is a simple set of promises, ignoring the fact that contracts are incomplete and that it is the parties' intent that their contract be supplemented with a nuanced understanding of the obligations. The popular view the breach is immoral—so the argument goes—confuses the breach of a contract with the breaking of an explicit promise.<sup>23</sup>

### C. *The Comparative Fault Factor*

A third question regarding the role of fault in contract law relates to the victim, rather than to the breaching party: should the promisee's fault matter—should contributory negligence or comparative fault be a defense in contract law? Porat advocates for a comparative fault defense in contract law in cases when the victim inefficiently failed to cooperate or to avoid overreliance, and when such cooperation or avoidance of overreliance was of low cost. When the defense applies, damages to the victim should be reduced, to reflect his comparative fault.<sup>24</sup> Robert Scott has a different view on that matter. He argues that promisee's incentives to cooperate are provided either by reputational sanctions or by norms of reciprocity. Therefore a contributory or comparative fault defense is not required.<sup>25</sup> Richard Posner, although not addressing the question directly, seems to imply that fault of both parties to the contract is generally irrelevant to liability, unless their

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20. Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551 (2009).

21. Posner, *supra* note 7, at 1363.

22. Steven Shavell, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439 (2006); Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007).

23. Steven Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, 107 MICH. L. REV. 1569 (2009).

24. Porat, *supra* note 10.

25. Scott, *supra* note 6, at 1394.

behavior is opportunistic.<sup>26</sup> In contrast, Eric Posner, while presenting an argument for a fault-based liability, suggests that in order to solve the promisee's overreliance problem, a rule of contributory negligence should be applied.<sup>27</sup>

### III. PARTIES' POWER TO OPT IN OR OUT

A distinctive feature of contract law is that its rules can be varied by parties. This applies also to its fault doctrines, most of which are default rules. What does this teach us about the role of fault? Can the parties change the background rules and render fault more relevant to assignment of liability? One way to increase the relevance of fault is to create islands of no-fault immunity, effectively saying that the promisor is not liable for breach unless it is his fault. This is often done through *force majeure* and "best efforts" clauses.

Alternatively, in the presence of doctrines that make fault relevant, the parties may want to write contracts that shrink the relevance of fault. For example, the parties may want to use contracts to waive some types of fault-based tort liability. Well-known legal rules bar some such waivers, rendering them presumptively unconscionable. But Richard Posner demonstrates a situation in which the parties can waive fault-based tort liability for precontractual fraud.<sup>28</sup> Levmore identifies another way to make fault less relevant, arguing that parties writing liquidated damage clauses are in effect opting out of the mitigation doctrine. He suggests that liquidated damages create a super-strict liability regime, eliminating some of the comparative fault subtleties of the mitigation doctrine.<sup>29</sup> Finally, Scott points to empirical data indicating that sophisticated parties often incorporate clauses into their contracts in an attempt to eliminate fault-based interpretation of their contracts and adopt instead strict liability-type rules.<sup>30</sup>

### CONCLUSION

With fault having a variety of roles in contract law, is there truly a tort/contract dichotomy based on a fault/no-fault line? With products liability sitting on the interface between tort and sales law, is there any room for separate doctrinal grounds for liability? In the end, was Cooter right—can the two fields be regarded as unified, not only in economic theory, but also in the basis for liability? Against two traditions that provide clear answers—a doctrinal tradition of clear but rigid distinctions between tort and contract, and a law-and-economics tradition of ignoring the differences between the

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26. Posner, *supra* note 7.

27. See Posner, *supra* note 9, at 1436.

28. Posner, *supra* note 7, at 1357.

29. Levmore, *supra* note 11, at 1378.

30. Scott, *supra* note 6, at 1395.



two fields—we hope that the contribution of this Symposium is in *blurring* the answers while portraying a more interesting picture.