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THE EFFICIENT BREACH FALLACY

*DANIEL FRIEDMANN**

> The only universal consequence of a legally binding promise is that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract if he chooses.[1]

So wrote Oliver Wendell Holmes in his seminal discussion of contract remedies in *The Common Law*. That position, while widely discussed, is not acceptable as a normative (nor, as will be shown, as a positive) account of the question of contract remedies. Stated in a phrase, the weakness of Holmes's approach lies in its conclusion that the remedy provides a perfect substitute for the right, when in truth the purpose of the remedy is to vindicate that right, not to replace it. Holmes's analysis mistakenly converts the remedy into a kind of indulgence that the wrongdoer is unilaterally always entitled to purchase. As with any unifying ideal, Holmes's proposition is difficult to confine to the contract cases to which it was originally applied. Why not generalize the proposition so that every person has an "option" to transgress another's rights and to violate the law, so long as he is willing to suffer the consequences?[2] The legal system could thus be viewed only as establishing a set of prices, some high and some low, which then act as the only constraints to induce lawful conduct.

The modern theory of "efficient breach" is a variation and systematic

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[1] O.W. Holmes, Jr., The Path of the Law, in Collected Legal Papers 167, 175 (1920); and O.W. Holmes, Jr., The Common Law, 300–301 (1881).

[2] Douglas Laycock, Modern American Remedies—Cases and Materials 7 (1985).

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extension of Holmes's outlook on contractual remedy. It assumes that role because of the dominance that it gives to the expectation measure of damages in cases of contract breach: the promisor is allowed to breach at will so long as he leaves the promisee as well off after breach as he would have been had the promise been performed, while any additional gain is retained by the contract breaker.

In this article I take issue with this standard analysis of the efficient breach question. In the first section I examine the theory of efficient breach as a matter of both entitlement and economic efficiency. In it, I conclude that the simple entitlement approach, which provides that a party is generally bound to perform his contractual promises unless he obtains a release from the promisee, fares better on both relevant scores. In so doing I examine the particular context in which the issue arises, including contracts first for the sale of existing property, and then for the sale of future property. In most cases under both these heads, the efficient breach rule, while designed to reduce transaction costs, fares poorly precisely because of the expensive transactions that it in fact generates. The second section of the article extends the analysis beyond contracts to deal with those cases of tort and public law in which the state or private parties unilaterally may take or damage the property of others on the payment of compensation. In it, I show that these cases, even if sound in their own realm, do not afford any justification to extending the same take and pay rules to ordinary contract disputes. The tort cases typically involve a situation of imminent private necessity. The power of eminent domain is exercised by a public body that is subject to rules and constraints that are absent when an individual takes another's property for his own gain. In addition, the eminent domain situation typically involves the risks of holdout that are present whenever large numbers of people are required to coordinate their activities to yield some social gain. None of these elements is present in the contract setting. The third section then briefly identifies modern developments in the law of contract, tort, and restitution that are inconsistent as a descriptive matter with the theory of efficient breach. A brief conclusion follows.

I. Entitlement and Economic Efficiency

Proponents of the efficient breach theory have embraced Holmes's approach and endowed it with economic apparel and terminology. In their view, if the promisor's profits from the breach exceed the loss to the promisee, the breach is to be permitted or even encouraged on the

ground that it leads to maximization of resources.[3] Under this theory of efficient breach, the promisor is given the option not to perform his contract so long as he is prepared to pay the plaintiff his expectation damages, that is, a sum necessary to make the plaintiff indifferent between the performance of the contract and the damages so paid. The theory of efficient breach is that the defendant will exercise this option only if the gains from breach are greater than the moneys so paid over. The pristine form of the theory implies that the plaintiff is left as well off from the breach as before, while the defendant is made better off. If so, the program of expectation damages, if faithfully implemented, satisfies not only the Kalder-Hicks standard of hypothetical compensation but the more restrictive Pareto standards of efficiency as well: not only is there a net social gain for the contracting parties, but no one is left worse off after breach than before. Consequently, under either view of efficiency the optimal level of damages is that which compensates the plaintiff only for this loss, and no more.

Originally, this theory was religiously preached and was hardly capable of suffering any qualification.[4] Its modern version, as formulated in the latest (1986) edition of Posner's *Economic Analysis of Law*, evidences a certain retreat from this extreme position. A distinction is drawn between "opportunistic breach" and other breaches of contract. Breaches in the latter category still enjoy respectability and, if considered efficient, are lauded. Opportunistic breaches have lost the patronage of the efficient breach theory and are harshly denounced.[5] The distinction is unsatisfactory[6] and in fact undermines much of the efficient breach theory. Indeed,

[3] Richard A. Posner, Economic Analysis of Law 107 (3d ed. 1986).

[4] It is not even clear whether Posner accepts specific performance in real estate contracts. On the one hand, he recognized the risk that damages will undercompensate the purchaser. On the other hand, if the seller finds another transaction, the profits of which exceed the purchaser's loss, Posner would encourage an "efficient breach." See Richard A. Posner, Economic Analysis of Law 95–96 (2d ed. 1977). In the latest (1986) edition, *supra* note 3, at 117–18, this analysis is extended to all situations in which damages are difficult to compute.

[5] Posner, *supra* note 3, at 79 *et seq.*, and at 105–6.

[6] Opportunism means taking advantage of the promisee's vulnerability. Posner regards the vulnerability mainly as created by the sequential character of performance under the contract. Hence, if A pays in advance for goods or services to be supplied by B in the future, A is vulnerable until B performs (*id.* at 79 *et seq.*). However, the sequence in which the performances are to be made is only one relevant factor. Thus, suppose A paid part of the price in advance while B has not yet performed. Although A has already partly performed, B may be more vulnerable if his need to receive the remaining part of A's payment is greater than A's need for B's promised performance. In fact, vulnerability is a matter of degree. The greater the need for the other party's performance and the more difficult it is to obtain a substitute, the greater the vulnerability. See generally, Timothy J. Muris, Opportunistic

Posner states that the opportunistic contract breaker should be made to "hand over all his profits from the breach to the promisee."[7] Recovery of these gains is diametrically opposed to the efficient breach theory, the essence of which is that the promisor should be allowed or even encouraged to commit a breach whenever his gains exceed the promisee's loss. The theory clearly assumes that the promisor should be allowed to keep his gain, for otherwise he would lose interest in committing the breach that is supposedly so desirable. It is not explained why opportunistic breaches should be discouraged even if they are efficient. Is it because they are morally reprehensible? Is morality more important than efficiency? Or is it because they undermine the institution of contracts in general?

A. Contracts Relating to Existing Property

The essence of the theory is "efficiency." The "right" to break a contract is not predicated on the nature of the contractual right, its relative "weakness," or its status as merely in personam, as opposed to the hardier rights in rem. Rather it is on the ground that the breach is supposed to lead to a better use of resources. The theory, therefore, is, in principle, equally applicable to property rights, where it leads to the adoption of a theory of "efficient theft" or "efficient conversion."[8] To see the point, observe how this account of efficiency plays out in two cases. In the first, A promises to sell a machine to B for $10,000 but then turns around and sells it instead to C for $18,000. In the second, B owns a machine for which he has paid $10,000, which A takes and sells to C for $18,000.

To keep matters simple, assume that B values the machine at exactly $12,000 in both cases. If the willful contract breach is justified in the first case, then the willful conversion is justified in the second. In the first, B gets $2,000 in expectation damages and is released from paying the $10,000 purchase price. In the second, B obtains damages for conversion equal to $12,000 because he has already paid the $10,000 purchase price to his seller. The two cases thus look identical even though they derive from distinct substantive fields.

Behavior and The Law of Contracts, 65 Minn. L. Rev. 521 (1981); Charles J. Goetz & Robert E. Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 Va. L. Rev. 967, 982 (1983).

[7] Posner, *supra* note 3, at 106.

[8] On the "efficient theft," see Ian R. MacNeil, Efficient Breach of Contract: Circles in the Sky, 68 Va. L. Rev. 947, 963 (1982); and Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1124–26 (1972).

No doubt in the contract situation, A may negotiate with B a release from his contractual obligation. But this, in Posner's view, would lead to additional transaction costs.[9] It is, therefore, preferable to permit the "efficient breach." But the property example is indistinguishable on this ground, for in the second, A, when he takes the machine from B, avoids the transaction cost of having to purchase it from him. The similarity between the two situations (breach of contract and conversion) becomes more striking if the converter did not wrongfully deprive the owner of his possession. Thus, suppose that A is a bailee who keeps B's goods. C offers A for the goods an amount that exceeds their value to B.[10] A can negotiate with B for the purchase of the goods and, if he is successful, sell them to C at a profit. The cost of this transaction could be saved, just as in the contract example, if A were allowed to sell the goods to C, while limiting his liability to B's expectation-like damages. Nevertheless, the better rule, which has been universally adopted by Anglo-American law, is that the plaintiff is entitled to recover in restitution the proceeds of the sale from the defendant who converted the plaintiff's property and sold it to a third party.[11] Efficient breach theory does not provide an explanation why the promisee in a contract of sale should not be accorded similar rights.

There are, of course, refinements. Where the promisor is a merchant engaged in selling these types of goods, he may be in a better position to find a buyer willing to pay a higher price for them, so that his transaction costs may be somewhat lower. This, however, is not necessarily the case, and in any event it does not justify the breach. Again, the situation can be compared to conversion. The fact that A, for example, is a car dealer who is likely to know that C is an excellent buyer for B's car does not justify him to take B's car from his driveway in order to sell it to C. Nor if B's car has been left with A for repairs can A sell it to C.

The real issue in both the conversion and the breach situation is who should benefit from C's willingness to pay a high price for the goods owned by B (the conversion example) or promised to him (the breach example). In principle, there should be in both situations only one transaction; in my view it should be between C and B (the owner or the promisee). If A promised to sell a piece of property to B for $10,000 and C is willing to have it for $18,000, he should negotiate its purchase from B. A

[9] Posner, *supra* note 3, at 107, 118.

[10] On the analogy between the bailment and contract situations, see Richard A. Epstein, Inducement of Breach of Contract as a Problem of Ostensible Ownership, 16 J. Legal Stud. 1 (1987).

[11] 1 George E. Palmer, The Law of Restitution 53–61 (1978).

is simply not entitled to sell to C something he has promised to return or transfer to B, and A is therefore not the right party to negotiate with. Consequently, if C negotiates such a purchase, he may be exposed to liability toward B, the promisee.[12] Similarly, with a bailment, C must negotiate with B (the owner) and not with the bailee. Hence, the question of additional transaction costs does not arise.

It is, of course, conceivable that a person (in the above example, A) would like to take advantage of a potential transaction between two other parties (B and C). In some instances this can legitimately be done. A may know that C is the best buyer for B's property (or for the property promised to B), while B and C are unaware of each other. A may buy the property from B and sell it to C, or he may reach an agreement (with B or C or with both) for the payment of a commission. If this is done, the inevitable result would be that the transfer from B to C would involve two or more transactions (and, arguably, additional transaction costs). This course of dealing is not objectionable. What is, however, objectionable is an attempt by A to obtain through the commission of a wrong (breach of contract or a tort such as conversion)[13] the benefit of a transaction that should have been concluded between B and C.

Moreover, the efficient breach rule is inefficient on its own terms. Neither it nor the analogous efficient conversion rule has the desired effect of minimizing either the number of transactions or, more decisively, the total amount of transaction costs. In fact, these rules may often lead to an increase in total transaction costs. In the above contract example, the breach is likely to require two transactions instead of one. If A performs his contract with B, there will be only one additional transaction, that between B and C. If, however, A is "allowed" to break his contract with B, there will be two transactions: one between A and C over the sale of the property promised to B, and the other a dispute between A and B regarding the measure of damages.[14] The implied assumption in Posner's analysis is that the payment of damages by A to B entails no

[12] In some cases, C's conduct may amount to interference with contractual relations. Even if it does not, B may in the appropriate case get specific performance against C if C was aware of the contract between A and B. See Dan B. Dobbs, Handbook on the Law of Remedies 847 (1973). Moreover, if C has not perfected his title, specific performance may be granted against him although he was not aware of the contract (between A and B); see White Marble Lime Co. v. Consolidated Lumber Co., 172 N.W. 603, 605–6 (1919). Compare also Ross Cattle v. Lewis, 415 So. 2d 1029 (1982). As to a third party's liability, see also Section III*B infra*.

[13] See also Harper v. Adametz, 142 Conn. 218, 113 A.2d 136, 55 A.L.R. 2d 334 (1955); and Ward v. Taggart, 51 Cal. 2d 736, 336 P.2d 534 (1959), in which restitution was allowed against a party who through the exercise of fraud got a share in a transaction between the plaintiff and another party.

[14] See also MacNeil, *supra* note 8, at 954 *et seq.*; Epstein, *supra* note 10, at 36 *et seq.*

transaction costs. This, however, is totally unrealistic. The payment of damages is hardly ever a standard transaction of the type the parties are routinely engaged in. It is likely to follow protracted negotiations, or even litigation, over difficult questions of fact and law. Finally, the breach may lead to an expensive tort action for inducement of breach of contract by the promisee (B) against the third party (C). This claim may breed another transaction between C and A regarding A's liability for losses suffered by C.

Hence, the set of remedies that deter breach (such as specific enforcement, injunction, punitive damages or restitution of gains acquired through breach of contract) are likely to reduce the number of transactions as compared to situations in which expectation damages provide the sole remedy. It is, of course, conceivable that the promisor (A) will commit a breach when these rules are in place, forcing the promisee to claim specific performance or restitution of gains.

Here, too, transaction costs will be positive, and it is difficult in the abstract to say whether they are greater with either specific performance or restitution than they are with expectation damages. Nonetheless, there is good reason to believe that the frequency of breach will be reduced where specific performance and restitution are provided, if only because the defendant has less to gain from breach. The *total* level of transaction costs should accordingly be reduced when the plaintiff is provided with strong protection against breach of contract.

The relaxation of contract remedies also has deleterious effects on the willingness of parties to enter into mutually beneficial contracts in the first place. If the legal system imposes severe limitations on specific performance (irrespective of whether they are based on the right to break the contract theory or its modern "efficient breach" offshoot), it undermines the parties' faith in getting what they bargained for, and the consequence is inefficiency and a waste of resources.[15] If a party in need of contracting with another cannot rely on the contract to guarantee performance, then he may turn to other more costly and less efficient means (for example, becoming a self-supplier or vertically integrating with his supplier) to gain greater assurance that he will get what he seeks.[16]

[15] See also Alan Schwartz, The Case for Specific Performance, 89 Yale L. J. 271 (1979), who points out that the availability of specific performance would not generate greater transaction costs than the damages remedy (*id.* at 305) and that it would actually produce certain efficiency gains (*id.* at 291).

[16] Compare E. Allan Farnsworth, Contracts 812 n.4 (1982), suggesting that an "enterprise that does not wish to be subjected to the risks inherent in its supplier's freedom to break its contract" may assure itself of a source of supply by acquiring its supplier. This clearly demonstrates how freedom to break a contract (if such freedom is to be allowed) results in inefficiency.

This insistence on the respect of both property and contract rights will cause some hardship where there is bargaining breakdown and the parties cannot agree on the terms under which property should be sold. Thus, suppose that A can profitably use a machine that is owned by B or promised to him. A cannot get the machine elsewhere. B, who has no use for the machine, is willing to sell or rent it, but the parties cannot agree on the price. If A takes B's machine (or B's contractual right to receive it), he could gain use of a machine that would otherwise remain idle. Hence, greater efficiency. But this obviously cannot be allowed.[17] The inefficiency resulting from failure of the bargaining process is inherent in the market system. If failure to reach an agreement created a license to take another's property (including contractual rights), then a complete breakdown of the market economy could follow. Why negotiate with a determined owner to buy something that can be taken, subject only to a court's subsequent appraisal of its value?[18] Hence, in the context of a sale of existing property, the contract situation is (as far as efficiency is concerned) indistinguishable from the property situation.

B. Contracts for Future Production

An important complication is introduced where the contract requires the production in the future of something (either property or services) not yet in existence.[19] This type of contract raises the problem whether that which was promised should be produced at all. The problem obviously does not arise with the conversion of chattel or in the context of a contract relating to existing property. As will be seen, some contracts for future production involve a mere question of entitlement. But in others the issue is more complex. The question usually arises within one of the following categories:

1. *A Promises B to Produce and Supply Something for Which, after the Contract Was Made, a Third Party (C) or A Himself Are Willing to Pay a Higher Price than B.* This category only raises the entitlement question, analogous to the case of a promise to sell existing property. Thus suppose A promised to build B a ship for $10 million, and six months before completion C, because of his special needs, offers $18 million for that ship, a figure above the market price and the value of the ship to B. The

[17] Compare Olwell v. Nye & Nissen Co., 26 Wash. 2d 282, 173 P.2d 652, 169 A.L.R. 139 (1947).

[18] Furthermore, under such a system the prospect of a favorable settlement of the claim may seem more attractive to the party in need of another's property than negotiating for its acquisition.

[19] Compare William Bishop, The Choice of Remedy for Breach of Contract, 14 J. Legal Stud. 299 (1985).

case raises no efficiency questions. The only issue is entitlement, namely, whether it is the promisor (A) or the promisee (B) who should get the benefit of C's offer.

2. *The Promisee (B) Is No Longer Interested in the Thing to Be Produced.* Suppose B orders A to construct an aircraft or a ship of a type that technological advances render obsolete. Now the question is not merely entitlement but also economic waste. In the first category, the ship ought to be built. Here it clearly should not. The point can be tested by assuming that A (the promisor) and B (the promisee) become a single entity, A-B (say by corporate merger). In category 2, production would be immediately stopped.

If contract rules allowed A in category 2 to produce the obsolete ship, they might lead to sheer waste.[20] But they do not. Under some legal systems B is actually entitled to terminate the contract, subject to the payment of compensation.[21] American law does not openly recognize such a right and deals with the problem via rules on mitigation.[22] The denial of a right to break a contract, even in this extreme situation, may be explained on the ground that any such recognition might undermine the institution of contract[23] and also on the ground that in some instances performance might offer some reputational advantage to the seller that would be lost if not allowed the chance to perform in full.

In this context a strict rule of contract enforcement is inappropriate. Under such a rule waste will be avoided only if the buyer can buy himself out of the contract at this subsequent date. Yet examples can be found in which this was not done,[24] and in any event those negotiations could (because of the holdout problem) prove costly. In addition, the case for using the expectation and mitigation rules in this context (rather than enforcing the contract) is that, unlike their application in other situations, the buyer who terminates is not pretending to be an owner vis-à-vis a third party and is not trying to obtain an undeserved gain from the transaction. He is only attempting to minimize his loss while leaving the seller with his full measure of profits.[25] In practice, all cases for future production in-

[20] Compare the English decision, White & Carter v. McGregor [1962] A.C. 413.

[21] See article 1794 of the French civil code and article 649 of the German civil code (BGB, Bürgerliches Gesetzbuch).

[22] Rockingham County v. Luten Bridge Co., 35 F.2d 301 (4th Cir. 1929), Clark v. Marsiglia, 1 Denio 317 (N.Y. 1845). On mitigation and adjustment of the contract see generally Goetz & Scott, *supra* note 6.

[23] Compare the ideas developed in a different context by Meir Cohen in Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law, 97 Harv. L. Rev. 625 (1984).

[24] See note 20 *supra*.

[25] It is arguable that this approach is incompatible with the rule regarding restitution of part performance of a "losing contract" (note 61 *infra*). A possible explanation is that in the

volve a constant course of dealing in which modification of previous arrangements is part and parcel of an ongoing course of business. Within this limited context of constant contractual readjustment, the use of expectation damages (as a measure of joint contractual intention) appears far stronger than it does with the other breach and conversion cases, previously considered, where implicit business norms seem to preclude leaving one's trading partner for greener pastures.

3. *The Cost of Producing the Thing Promised Is Much Higher than the Contract Price and the Market Value of the Product.* A promises to renovate B's house for $10,000. It transpires that the cost of renovation is $30,000 and that the renovations would not enhance the value of the property. The well-known cases of *Groves v. John Wunder Co.*[26] and *Peevyhouse v. Garland Coal & Mining Co.*[27] fall in this category and give rise to rather intricate problems. The source of the difficulty lies in the fact that, while we know that the market value of the property remains unaffected by the high cost of renovations, we do not know its value to B, who might have ordered renovations even at the cost of $35,000. The situation is thus distinguishable from category 2, where the value of the thing not needed has been defined by the innocent party in monetary terms. The test referred to above (that is, whether the renovation would be made if A and B become one entity) no longer leads to an unequivocal conclusion, except perhaps in most extreme situations. Hence, in the absence of evidence as to the value to B of A's promised performance, there is no reason to grant A a right to substitute an objective appraisal of

typical "losing contract" situation the party in breach does not merely demand that the other party discontinue his performance but commits other breaches (for example, declines to pay). If he offers on time to pay the entire contract price, he should clearly not be exposed to a claim in restitution. A more problematical issue is whether he can escape restitution by offering to pay on time the contract price less mitigation, while the other party declines to accept it, arguing that, if he does not receive the whole contract price (without allowance for mitigation), he will elect to sue in restitution. A detailed discussion of this point is not within the ambit of this article.

[26] Groves v. John Wunder Co., 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502 (1939).

[27] Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Okl. 1962). In this case, the provision that was not performed was incidental to the main purpose of the contract. Where such a provision proves to be very costly and where its performance would not correspondingly increase the value of the plaintiff's property, an insistence on specific performance (or damages measured by the cost of performance) may seem unfair. The plaintiff may be less interested in performance than in recovering high damages, while the defendant could have seriously underestimated the cost of compliance, ex ante. In Rock Island Improvement Co. v. Helmerich & Payne Inc., 698 F.2d 1075 (10th Cir. 1983), the court, though applying Oklahoma law, declined to follow the *Peevyhouse* decision, relying inter alia on the Oklahoma Open Cut Land Reclamation Act. See also Timothy J. Muris, Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value, 12 J. Legal Stud. 379 (1983); Edward Yorio, In Defense of Money Damages for Breach of Contract, 82 Colum. L. Rev. 1365 (1982).

its value for his promise to B. It is, therefore, a sound policy to deny A's "right" to breach the contract, though in extreme cases the harshness of the result can be mitigated through the law of remedies, a point that is discussed in Section II below.

These cases present a powerful claim for "fairness" where the payment or other consideration that B promises to pay A is far below A's cost of renovation. In the case given, a promise to pay $10,000 does not cover renovation that costs $30,000. In practice, this factor may exert pressure on the court to be lenient to the party in breach. The sympathy for the promisor disappears where the contractual price is closer to his actual costs. Thus, if the amount payable for the renovation in the above example was $30,000, or even $26,000, there is no reason to sympathize with A if he fails to perform. In such a case there is every reason to adopt measures that will deter the breach. One possibility is to utilize the law of restitution and to measure A's liability by his enrichment (that is, the amount he saved by nonperformance), although the renovation would not have affected the market value of the property.[28]

4. *The Promisor (A) Can Use the Resources Committed to the Performance of the Contract to Produce Something Different and More Valuable than That Promised to B.* Many of the examples discussed in the literature are within this category. A star performer who contracted to appear in one place is then lured away by a better offer from a rival promoter.[29] Similarly, a contractor (A) promises to build a four-story building on B's plot for $5,000,000. The performance of his promise was not delegable to anyone else. Shortly afterwards C asks A to build a thirty-story building on C's plot for $50,000,000.[30] It is assumed that A does not have the wherewithal to erect both buildings simultaneously, so that he can only build for C if he breaches his contract with B. This category is distinguishable from category 1 because the better use of

[28] Compare Samson & Samson Ltd. v. Proctor, 1 N.Z.L.R. 665 (1975).

[29] Epstein, *supra* note 10, at 38, referring to Chicago Coliseum Club v. Dempsey, 265 Ill. App. 542 (1932). This is, in fact, a Lumley v. Wagner (note 67 *infra*) situation. Where the employee's services are not unique or extraordinary, an injunction is unlikely to be granted. The reason, however, is not efficiency but a concern with personal freedom. This does not mean that the breach is permissible (a third party may still be liable for inducing it), but merely that the court selects the appropriate remedy in the light of the interests involved, a point that is examined below. I have discussed the question of restitution of the gains made by the employee in consequence of the breach in Daniel Friedmann, Restitution of Benefits Obtained through the Appropriation of Property or the Commission of a Wrong, 80 Colum. L. Rev. 504, at 519–21 (1980).

[30] This example is discussed in E. Allan Farnsworth, Legal Remedies for Breach of Contract, 70 Colum. L. Rev. 1145, 1177 (1970). A similar situation occurs in the example discussed by MacNeil, *supra* note 8, in which A, who contracted to manufacture chairs for B, is offered by C a more profitable contract for the manufacturing of tables.

resources can be achieved only by breaching the first contract in order to honor the second. Unlike the sale of property case, C cannot simply disregard A (the promisor) and negotiate with B (the promisee) for the transfer of the promised performance. A promised B to build on his land. He cannot be compelled to erect another building on C's land. B has thus nothing that he can resell to C. The situation in the star performer example is similar.

Again, in this category there is ordinarily no clear evidence that the value to B of having his house completed on time is less than the profit A would make under a contract with C. The test mentioned above—namely, which building will be built if A and B become one entity (or, in the case of a star performer, if he acquires the firm with which he first signed a contract)—does not provide clear guidance. Accordingly, there is no reason to grant A a right to break his contract with B. Obviously, if the value to B of A's performance is less than A's profit from his contract with C, and if B is also entitled to specific performance (or to an injunction enjoining A from performing for C), then A and C will have to "buy B out." B would, thus, be able to obtain part of the increased gain resulting from A's contract with C. I see nothing wrong in this. After all, B is required to give up his entitlement to A's performance, so he should be allowed to charge an amount higher than that arrived at by calculation of expectation damages. This result is most probably in line with the reasonable expectations of the parties. In their original contract, A and B could have agreed on an option to terminate the contract, subject to payment of a specific amount or subject to payment of expectation damages. If they had done so, no problem would arise. Since they did not do so, there is no reason for the court to imply such a term. If they negotiated beforehand their respective rights in case of a third-party offer, it is doubtful that they would have limited B's right to expectation damages only. It is very likely that they would have chosen terms more generous to B, especially if the original contract stipulated that the promisee could obtain an injunction or specific performance.[31]

Any requirement that A and C jointly negotiate with B entails a somewhat greater risk of contracting failure,[32] and it is likely that additional transaction costs will be incurred. But, as before, the point is hardly decisive, even in economic terms. There is no reason to assume that these costs are higher than the transaction costs of settling a damages claim between A and B.

[31] See Epstein, *supra* note 10, at 40.

[32] Nevertheless, there are good prospects that agreement will be reached. See Epstein, *id.*

Even if there were somewhat greater complexities resulting from a tripartite negotiation, it would be unwise to give A a "right" to break the contract with B. Oftentimes there are massive other complications lurking in the wings. If A can repudiate his contract with B at will, B may be forced to repudiate or renegotiate a complex web of contracts that he has entered into with other parties. The ripple effects from B's predicament will only become more complicated, for B's costs in these multiple transactions will be hard to measure in the abstract and harder still to prove in court. The resulting instability is so great that any effort to reduce transaction costs by adopting the theory of efficient breach is again likely to have precisely the opposite effect.

Admittedly, in some situations the breach (as well as other unlawful appropriation) might enable the wrongdoer to derive gains exceeding the victim's loss. But the prospect of some gain does not turn the unlawful appropriation into a lawful one. There are sound policy reasons to deny such legitimization. Efficient appropriations are extremely difficult to identify. This task certainly cannot be left to the transgressor, who usually lacks the information necessary to make the right decision since he can hardly correctly appraise the damage that his act will cause to the other party. Nor should he be allowed to speculate on how a court that is ill equipped to find the value that the owner places on his interest will appraise the damages.[33] In addition, permitting such appropriation will undermine the institutions of property and contract in general.[34] It is practically impossible to estimate the cost of such a result, but it may well exceed whatever benefit is gained in the few "efficient appropriations." The stronger theory of entitlements, associated with the moral point of view, yields better results on the efficiency grounds on which it is so often criticized.

II. The Right to Appropriate Another's Interest and the Remedy of Damages

The efficient breach theory is in fundamental conflict with a basic premise of both the common law and other Western legal systems, namely,

[33] Compare Calabresi & Melamed, *supra* note 8, at 1124–26. The reasons that they give for denying the legitimacy of "efficient theft" would be also applicable for breach of contract. Calabresi & Melamed point out a number of features that justify the choice of a liability rule rather than a property rule in such contexts as eminent domain, accidents, and certain nuisances. These include a large number of owners, some of whom may not be identifiable (the accident situation) and some of whom may hold out and become free riders. None of these features is present in the contract situation. See also Anthony T. Kronman, Specific Performance, 45 U. Chi. L. Rev. 351 (1978).

[34] Note 16 *supra* and accompanying text.

that property (including contractual rights)[35] is not to be taken and given to another without the owner's consent. There are few exceptions to this basic principle. The major one is in public law. The power of the government to take property, subject to payment of compensation (eminent domain), has long been recognized. Its philosophical foundation need not be discussed here. For our purposes it suffices to point out that eminent domain is rooted in the relationship of government qua government to its citizens[36] and is of special importance where the risk of holdouts is acute, as, for example, in assembling land for highways. It is, however, one thing to recognize governmental power to take property for public purpose.[37] It is a wholly different matter to permit an individual to become a judge in his own case, to decide that he has a better use for another's property (including contractual rights), and to appropriate it for the sake of private gain.

Eminent domain has no counterpart in private law.[38] There are, nevertheless, a few exceptional situations in which a deliberate appropriation of another's property is permitted. Efficient breach fits into none of them. They arise where life or property has to be salvaged and conceivably also in cases of extreme hardship. A search for private gain is obviously insufficient.

General average provides an example of permissible private appropriation. Its justification lies in the common risk facing the whole enterprise. Maritime law also defines situations in which a salvor may not deny the use of his resources to the party in need[39] or charge an excessive price for their use.[40] Outside the sphere of maritime law, a person "may trespass upon the property of another to save himself or his own property or even

[35] It is firmly established that contractual rights enjoy constitutional protection granted to property. See Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain 88 (1985).

[36] See, generally, Bruce Ackerman, Private Property and the Constitution (1977); and Epstein, *supra* note 35.

[37] The public use requirement has been very much attenuated: Hawaii Housing Authority v. Midkiff, 467 U.S. 229 (1984). Yet it is clear that "the Constitution forbids even a compensated taking of property when executed for no reason other than to confer a private benefit on a particular private party" (*id.* at 245).

[38] Epstein, *supra* note 35, at 165.

[39] The duty in maritime law is, however, confined to the rescue of human life. There is no similar obligation to salvage property; see 46 U.S.C. § 728; Grant Gilmore & Charles L. Black, Jr., The Law of Admiralty 535–41 (2d ed. 1975); Saul Levmore, Waiting for Rescue: An Essay on the Evolution and Incentive Structure of the Law of Affirmative Obligations, 72 Va. L. Rev. 879, 909–13 (1986).

[40] A contract between the master of a stranded ship and a salvor will be set aside if the price of safety is excessive. See Post v. Jones, 60 U.S. 150 (1856). The Port Caledonia and the Anna [1903] P. 184.

a third person or his property from harm."[41] In this situation, the law does not merely abstain from specifically enforcing the owner's property right but actually imposes a limitation on it since he is not entitled to expel the intruder.[42] Consequently, if a medicine owned by A is urgently needed to save the life of B, B is entitled to appropriate it for his own use (and C would similarly be allowed to take it in order to save B), though he will be required to pay for that which has been taken.[43] In these situations, the owner is not allowed to deny the use of his property[44] (and, in extreme cases, its acquisition by another), though he will be entitled to compensation.[45]

In other less extreme situations, the legal system may fashion the remedy in a way that takes into account the interests involved and avoids economic waste or undue hardship. As a result, specific relief may be denied for property rights so that the plaintiff will only recover money judgment. Thus with nuisances, injunctive relief may be denied in view of the huge economic loss that it could entail.[46] A distinction ought, however, to be drawn between the case in which one person is entitled to appropriate another's property subject to the payment of compensation (incomplete privilege in private law[47] and eminent domain in public law) and the case in which his conduct is wrongful but the remedy of the innocent party is limited to damages (the nuisance example mentioned above).

This distinction has been ignored by proponents of the efficient breach theory.[48] The similarity in the end result (money award) should not, how-

[41] W. Page Keeton *et al.*, Prosser and Keeton on Torts 147 (5th ed. 1984). (Hereinafter cited as Prosser.)

[42] *Id.*

[43] Compare Vincent v. Lake Erie Transportation, 109 Minn. 456, 124 N.W. 221 (1910). The decision provided the basis for the incomplete privilege theory developed by Francis H. Bohlen, Incomplete Privilege to Inflict Intentional Invasions of Interests of Property and Personality, 39 Harv. L. Rev. 307 (1926). This theory was adopted by the Restatement, Restitution § 122, and the Restatement (Second) Torts § 263.

[44] But unlike the rule in marine law (note 39 *supra*), there is generally no obligation to rescue life or lend assistance to a person in emergency. Thus, while a person may not deny his property to others in an emergency, he is not required actively to assist them. See generally, Ernest J. Weinrib, The Case for a Duty to Rescue, 90 Yale L. J. 247 (1980).

[45] However, under the Restatement (Second) Torts §§ 196 and 262, there is no liability to pay compensation in cases of "public necessity." This seems unjustified; see Prosser, *supra* note 41, at 146–47; and Friedmann, *supra* note 29, at 545.

[46] Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 257 N.E.2d 870 (1970).

[47] Note 43 *supra*.

[48] It has also been disregarded in Calabresi & Melamed, *supra* note 8, who include eminent domain (*id.* at 1093, 1108), accidents (1108–9), and nuisance, for which an injunction is denied, in their entitlement protected by liability rule category. This category com-

ever, blur the fundamental distinction between the two situations. In the first category, the appropriation is lawful and permissible. In the second category, it is not. In the nuisance example, the defendant had no right beforehand to pollute, although, ex post facto, the court confined the remedy to damages. There are many instances in which the remedy is similarly limited, yet it is clear that the limitation on the remedy does not amount to a license to commit a tort. Thus, in the case of misappropriation of personal property the defendant can, in some jurisdictions, defeat a claim in replevin for specific restitution by giving a bond.[49] But when a technical rule or administrative complication blocks specific restitution, the defendant does not thereby gain the right to misappropriate the plaintiff's property. The plaintiff may also lose the right to specific restitution by virtue of the doctrine of accession,[50] for example, if the defendant used the plaintiff's logs to build a house[51] or if the defendant converted the plaintiff's dilapidated car and rebuilt it.[52] But the fact that the plaintiff's remedy is limited to damages does not mean that the defendant was originally entitled to convert the plaintiff's property. Indeed, at least in the case of the rebuilt car, it may well be that the defendant would escape specific restitution only if he was unaware that he acted wrongfully. If he were a conscious wrongdoer, he might be compelled to return the car despite his heavy investment in it. It is thus the hardship on the innocent wrongdoer that mitigates the result,[53] not a supposed "right" to convert the property.

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prises every case where "someone may destroy the initial entitlement if he is willing to pay an objectively determined value for it" (*id.* at 1092). However, the fact that the wrongdoer is merely liable in damages does not mean that he "may" (or is entitled to) commit the wrong if he is willing to pay for it. A person is not "entitled" negligently to damage another's property or to cause any other wrong for which, for practical reasons, no remedy other than damages is available. Such damages are not the equivalent of a right to purchase; compare Robert Cooter, Prices and Sanctions, 84 Colum. L. Rev. 1523 (1984). Accidents are distinguishable from both eminent domain and "acquisitive nuisance" in that they do not involve appropriation but are a mere result of a risk-creating activity; see Friedmann, *supra* note 29, at 531.

[49] Restatement, Restitution § 42, comment d. As to the possibilities of recovering the property in specie, see Dobbs, *supra* note 12, at 399 *et seq.*

[50] Kenneth H. York, John A. Bauman, & Doug Rendleman, Remedies—Cases and Materials 277 (4th ed. 1985).

[51] Compare Reese v. Jared, 15 Ind. 142 (1860).

[52] Capitol Chevrolet Co. v. Earheart, 627 S.W.2d 369 (1981).

[53] This mitigation is sometimes achieved via a rule regarding transfer of ownership. See *Capitol Chevrolet* case, *supra* note 52. An alternative approach is to utilize the law of remedies and recognize that the court has a discretion regarding restitution in specie. Consequently, it will not order restitution against an innocent converter who improved the chattel, unless he is paid for his investment; see Greenwood v. Bennett [1972] 3 W.L.R. 691.

The distinction between a lawful appropriation (subject to compensation) and a wrongful one has important practical consequences. Thus, in the first category the defendant is only liable to pay compensation. In the second category the defendant, ex ante, has no immunity from injunction. Consequently, it becomes very difficult for him to predict the outcome beforehand. It is only after the event that his position seems secure. This reflects a general feature that distinguishes rights and duties on the one hand and remedies and sanctions on the other. Broadly speaking, the legal system strives to make rights and duties ascertainable beforehand (though this goal is not always attained). It is therefore usually easier to predict whether a certain conduct constitutes breach of contract or tort than it is to foresee the allowable measure of recovery[54] or whether specific performance will be granted.[55] This is most conspicuous in criminal law. The idea that offenses are to be defined beforehand is a basic tenet of this branch of law. There is no similar commitment regarding the sanction, which is a matter of discretion, subject only to an upper limit. The thief has no vested right to know beforehand whether he will be sentenced to six months or three years in jail. And if the court has mercy on him and merely imposes a fine, it will be ridiculous to conclude that this ex post facto disposition makes his prior conduct proper.

There is another way of testing the issue. Suppose a factory of the type involved in the *Boomer* case[56] is about to be built. A neighbor landowner seeks an anticipatory injunction and offers a definite proof that pollution will occur. Under the "right to pollute" (subject to damages) approach, the plaintiff's demand for an injunction will be denied. It is, however, submitted that no such right exists. The issue merely relates to the appropriate remedy. At this stage, the hardship on the defendant (and others who expect to benefit from this plant) is less severe than after the plant comes into operation. Consequently, an injunction may well be granted.[57]

There are other distinctions between these categories (the permissible appropriation subject to compensation and the wrongful one). Thus, if a

[54] Thus in, for example, the field of torts, it is often impossible for the tort-feasor to make any prediction beforehand as to the extent of his liability, as, for example, where A negligently injures B, whom he did not know before. A is unlikely to have the information necessary for such a prediction (B's income, physical condition, and so on).

[55] Even if equitable and some other remedies are discretionary (as is the sanction in criminal cases), the tribunal vested with the discretion does not enjoy complete freedom in their application. Rules and guidelines have to be observed. In some instances they would almost inevitably lead to a specific result (which in such a case would be highly predictable). But in many other situations the tribunal is allowed considerable flexibility.

[56] Note 46 *supra*.

[57] See, generally, Dobbs, *supra* note 12, at 362.

director or trustee decides not to commit a wrong such as nuisance or breach of contract, his conduct is unlikely to be regarded as a breach of duty toward the corporation or the beneficiary, even if committing it would have been to their economic advantage.[58] Here, as in other contexts, a penny's worth of net gain does not justify the disregard of either the property or the contract rights of others. Property and contract rights are not absolute and may be compromised in various ways under circumstances of genuine necessity. But it is a vast leap from the narrow confines of the necessity cases to the far broader proposition that there is some general right to violate property or contract rights solely if there is some willingness to pay the owner's loss. The theory of "efficient" breach cannot overcome that gap.

III. Descriptive Objections to the Right to Break a Contract

The objections to the theory of efficient breach are positive as well as normative. The law of contract has not remained static from Holmes's time to the present, and the movement has only expanded the gap between the present law and the theory of efficient breach. These changes, moreover, are not part and parcel of the increasing move toward public regulation of private agreements but arise in areas in which freedom of contract remains the dominant principle of voluntary organization. The relevant evidence here comes from two sources: the law that regulates the relationship between the immediate parties and that which regulates the ways in which the contracting parties interact with third-party strangers under the law of tort, restitution, and equity. I shall examine these in order.

A. Relation between the Parties under Contract

The law of contract, especially as it has evolved in recent years, contains a large body of doctrines that implicity reject the theory of efficient breach. Specific performance, an illustration that caused difficulty to Holmes, remains a leading counterexample, and in recent times its scope has spread beyond cases of the sale of real estate to other types of contracts.[59] In addition, a number of modern cases no longer treat the expec-

[58] Ahmed Angullia v. Estate and Trust Agencies [1938] A.C. 624 9P.C.; Friedrich Kessler, Grant Gilmore, & Antony T. Kronman, Contracts—Cases and Materials 105–6 (3d ed. 1986).

[59] The Restatement (Second) Contracts § 359 still maintains the position that specific performance or injunction will not be granted if damages are adequate. The introductory note to topic 3, ch. 16 (*id.* at 162) recognizes, however, that "there has been an increasing disposition to find that damages are not adequate," and that "Courts have been increasingly willing to order performance in a wide variety of cases." Comment (a) to § 359 also says, "Doubts should be resolved in favor of the granting of specific performance or injunction."

tation measure of damages as the ceiling on the plaintiff's recovery but invoke a restitution measure and allow the plaintiff's suit to recover the profits that the defendant has achieved by virtue of the breach.[60] Another rule that is hardly compatible with the right to break a contract theory relates to the right of the innocent party to restitution of the value of his part performance of a "losing contract." Under the prevailing approach he is entitled to the market value of his part performance though it is in excess of the contract rate. Even the contract price for the whole performance does not provide a ceiling on such a recovery. Consequently, in case of wrongful termination the innocent party may recover for his part performance an amount exceeding that which was promised for the whole performance.[61] Similarly, punitive damages, once foreign to the law of contract, have now become available in at least some limited situations where there was no plausible justification for the deliberate decision to dishonor a contract.[62]

The rejection of efficient breach is also found in the law of consideration and duress. The rule of contract that says that a promise to perform a preexisting duty is not adequate consideration rests on the implicit assertion that the promisor is already obligated to perform that obligation,[63] for

[60] See, for example, Unita Oil Refining Co. v. Ledford, 125 Colo. 429, 244 P.2d 881 (1952); and Samson & Samson Ltd. v. Proctor (1975) 1 N.Z.L.R. 665. Recovery of gains obtained through breach of contract was recently granted by the supreme court of Israel in a landmark decision: F.H. 20/82 Adras Ltd. v. Harlow & Jones 42(1) P.D. 221 (1988). I discussed this case in 104 L. Q. Rev. 383 (1988). See also Palmer, *supra* note 11, 437 *et seq.;* Gareth Jones, The Recovery of Benefits Gained from a Breach of Contract, 99 L. Q. Rev. 443 (1983); Friedmann, note 29 *supra;* and E. Allan Farnsworth, Your Loss or My Gain? The Dilemma of the Disgorgement Principle in Breach of Contract, 94 Yale L. J. 1339 (1985).

[61] See, for example, Boomer v. Muir, 24 P.2d 570 (Cal. App. 1933); Southern Painting Co. of Tennessee v. United States, 222 F.2d 431 (10th Cir. 1955); and Palmer, *supra* note 11, at 389 *et sq.* (This rule obviously deters breach [irrespective of whether it is "efficient"] and in any event does not enable the party in breach to limit his liability to the loss suffered by the other party in consequence of the breach.)

[62] Laurence D. Simpson, Punitive Damages for Breach of Contract, 20 Ohio St. L. J. 284 (1959); Timothy J. Sullivan, Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change, 61 Minn. L. Rev. 207 (1977). Recent decisions include Travelers Indemnity Co. v. Armstrong, 442 N.E.2d 349, 358 (Ind. 1982). See also Davis v. Gage, 106 Idaho 735, 682 P.2d 1282 (1984), Wallis v. Superior Court, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984); Seaman's Direct Buying Service Inc. v. Standard Oil of California, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). This development seems to have caught the imagination, and the literature on the subject keeps rapidly growing. See notes in 86 Colum. L. Rev. 377 (1986); 60 So. Cal. L. Rev. 509 (1987); 35 Stan. L. Rev. 153 (1986); 71 Iowa L. Rev. 893 (1986); 69 Minn. L. Rev. 1161 (1985).

[63] Restatement (Second) Contracts § 73, comment c. Ironically, the rule was better established in Holmes's day. Presently it is under pressure; see John D. Calamari & Joseph M. Perillo, Contracts 145 *et seq.* (2d ed. 1977). This is not because the promisor is entitled to break the contract but rather because the doctrine of consideration is itself unsatisfactory. Compare Restatement (Second) Contracts § 89.

if he did enjoy the "right" to breach, he could have surrendered it in exchange for an additional payment. Again, the law often treats as a form of "economic" duress the threat to break a promise, especially where the promisee is in great need of what is promised and the promisor takes unfair advantage of the situation.[64] The promisee will, thus, be able to recover the additional sum paid in order to get the promised performance. Moreover, recovery may be granted irrespective of whether the contract would have been specifically enforced. Indeed, the extra payment made under pressure may be regarded as a kind of "self-help" to obtain performance. It induces the promisor to honor his obligation, yet it is recoverable on the ground of duress.

B. Third Parties' Liability

Ordinarily, no liability is imposed for inducing a lawful act. A person ought not to incur liability if he persuades a public authority to exercise eminent domain. The situation is otherwise where one induces wrongful conduct. Such an inducement is itself wrongful and should be discouraged. There is, thus, a marked incongruity between the "right" to break a contract theory and the tort of interference with contractual relations:[65] why should a person be liable for inducing another to exercise his right? The fact that this theory gained such prominence despite this incongruity[66] can probably be attributed to the way contract law is studied and taught. Ordinarily it concentrates on the internal relations of the parties to the agreement (as well as third-party beneficiaries). This subject is often totally isolated from some of the most conspicuous property characteristics of the contractual right, namely, its effect on third parties and the remedies that the promisee may have against them if they are involved in the breach.

[64] Palmer, *supra* note 11, vol. 2 at 314 *et seq.*

[65] Compare Prosser, *supra* note 41, at 1004, who suggests that in case of efficient breach it is inappropriate to hold the interfering defendant for damages in excess of the ordinary contract measure. See also Harvey S. Perlman, Interference with Contract and Other Expectancies: A Clash of Tort and Contract Doctrine, 49 U. Chi. L. Rev. 61, 92 (1982); Dan B. Dobbs, Tortious Interference with Contractual Relationships, 34 Arkans. L. Rev. 335, 360–61 (1980).

[66] The tort of inducing breach of contract, in its modern form, was already established in Holmes's day. (Note 68 *infra* and accompanying text.) This tort retains its vitality (as is evidenced by the *Penzoil* case) quite unperturbed by the efficient breach theory. In addition, the rights of the promisee against the inducer of the breach have been expanded since he is now entitled to recover in restitution to gains made by the inducer through this tort. See National Merchandising Corp. v. Leyden, 370 Mass. 425, 348 N.E.2d 771, 5 A.L.R. 4th 1266 (1976); Palmer, *supra* note 11, 80 *et seq.;* Graham Douthwaite, Attorney's Guide to Restitution 236–37 (1977).

The discussion of the celebrated decisions concerned with the breach of the contract made between Mr. Lumley and Miss Wagner is instructive. Miss Wagner contracted with Mr. Lumley to sing exclusively for three months in Her Majesty's Opera House. She was, however, induced by Mr. Gye to break her contract with Mr. Lumley in order to perform in the Royal Italian Opera, Covent Garden. These events produced two leading cases. The first is *Lumley v. Wagner,*[67] in which the court, though it would not have ordered specific performance of the contract, granted an injunction to enjoin Miss Wagner from singing for Mr. Gye during the period of her contract with Mr. Lumley. The second decision is that of *Lumley v. Gye,*[68] which held that Mr. Gye was liable in damages for inducing the breach of the contract. Both claims served the same end and were meant to protect the same contractual right. Yet, in legal literature the sequence of events is often cut in two. Most contract books include a reference to *Lumley v. Wagner,* which is sometimes discussed in considerable detail. However, *Lumley v. Gye* is sometimes not even mentioned.[69] This task is left to those who specialize in torts. Such a segmentation of the subject is hardly conducive to the proper understanding of the nature of the contractual right and the legal protection accorded to it.

Inherent in the isolation of contract law from its effect on third parties is the risk that the contractual right will be regarded as a "personal" right in the most outdated meaning of this term. It is also perhaps not surprising that the Reporter of the Restatement (Second) Contracts would state that the interest of the promisee is "not commonly thought of as property or even as similar to property,"[70] leaving it to the Reporter of the Restatement (Second) Torts to state the very opposite.[71]

It is true that liability for the appropriation of traditional property (rights in rem) is generally strict, while liability for interference is based on "inducing" the breach and requires notice of the contract.[72] However,

[67] Lumley v. Wagner, 1 Deg. M. & G. 604, 42 Eng. Rep. 687 (1852).

[68] Lumley v. Gye, 2 El. & Bl. 216, 118 Eng. Rep. 749 (1853); and see Peck, Decisions at Law 125 *et seq.* (1961).

[69] See, for example, Farnsworth, *supra* note 16, at 824.

[70] Farnsworth, *supra* note 60, at 1363. Farnsworth was apparently unmindful of what he himself wrote in the context of assignment—another proprietary feature of the contractual right—namely, "Since a contract right is one kind of property, many of the rules governing its transfer are similar to the rules of property law governing the alienation of land and chattels." See Farnsworth, *supra* note 16, at 745.

[71] Prosser, *supra* note 41, at 981, points out that cases in this field "laid emphasis upon the existence of the contract, as something in the nature of a property interest in the plaintiff, or a right in rem good against the world."

[72] For a suggested explanation of the notice requirement, see Epstein, *supra* note 10, at 24.

once the rules of equity and restitution are taken into account, it transpires that the main difference relates to the position of a bona fide purchaser for value. A third party who acquired from an unauthorized person a chattel that belongs to another commits conversion although he gave value in good faith. But even this rule is subject to qualifications, as there are instances in which a good-faith purchase transfers title (for example, money or negotiable instruments).

The contractual right also receives considerable protection against third parties, the ambit of which can be understood only by an examination of the rules of equity and restitution (in addition to the tort of interference). Where a third party receives the performance promised to another, he may be liable in restitution.[73] This liability is neither dependent on notice of the contract nor on fault. (It is only where the third party acquired title in good faith and for value that he is fully protected.) Thus, suppose that D owes a certain sum of money to P. If he pays this amount to a third party (T), P would ordinarily be entitled to restitution from T (unless T gave value in good faith) provided the payment to T can be "identified" as that owed to P.[74] This, for example, is the case where money drawn from P's bank account, without his authority, is paid to T.[75] The rule also applies where T collects rent from tenants on P's land,[76] where insurance proceeds owed to P are paid to T,[77] and even where the debtor (D) pays T

[73] As to the possibility of getting specific performance against him, see note 12 *supra*.

[74] Claxton v. Kay & Northcutt, 101 Ark. 350, 142 S.W. 517 (1912). Compare also Saunders v. Kline, 55 A.D.2d 887, 391 N.Y.S.2d 1 (1977); Iconco v. Jensen Const. Co., 622 F.2d 1291 (8th Cir. 1980). Older cases sometimes denied restitution: Sergeant v. Stryker, 16 N.J.L. 464, 32 Am. Dec. 404 (1838). See generally Palmer, *supra* note 11, vol. 4, at 298 *et seq.*

[75] 10 Am. Jur. (2d) Banks § 508 at 476. In Hennesy Equipment Sales v. The Valley National Bank, 25 Ariz. App. 285, 287–88, 543 P.2d 123, 125–26 (1975), it was explained that the traditional view is that the depositor's cause of action against the forger who withdrew from his account is based on conversion or money had and received. The court regarded this approach as based on a fiction and suggested that liability is to be based on interference with contractual relations.

[76] King County v. Odman, 8 Wash. 2d 32, 111 P.2d 228, 133 A.L.R. 1440 (1941).

[77] Green v. Levitsky, 120 N.J. Eq. 364, 185 A. 384 (1936). There is also a line of cases that held that, where a person contracted that the claimant shall be the beneficiary of his life insurance policy and later, in breach of his promise, nominates a third party as the beneficiary, the claimant has a right of restitution against the third party who received that which was promised to him (unless the third party gave value in good faith). See Palmer, *supra* note 11, at 457. In Simonds v. Simonds, 45 N.Y.2d 233, 380 N.E.2d 189 (1978), the court, using the constructive trust device, extended the promisee's right to new policies that were regarded as a substitute for the original policies that lapsed or were canceled. The court based its reasoning also on the ground that there were confidential relations between the insured and his wife (the claimant). However, the promise that the wife would be the beneficiary was embodied in a separation agreement between the parties, and it is doubtful whether in these circumstances the parties still maintain confidential and fiduciary relations.

under mistake the debt that he owes to P.[78] The protection granted to the contractual right against its appropriation by a third party is thus assimilated to that granted to negotiables (money, negotiable instruments), though it falls somewhat short of that granted to other types of strict property rights.[79]

IV. Conclusion

The efficient breach theory of contract raises issues of both entitlement and efficiency and succeeds on neither, as either a normative or a descriptive matter. As a normative matter, parties in a contractual setting should be left free to define the ambit of their rights, and it is open to them to stipulate that the promisor will be allowed to terminate the contract subject to payment of damages. The efficient breach theory assumes, however, that, even if they have not done so and even if they intended to confer on the promisee a broader entitlement, the law will nevertheless defeat their joint intention by granting the promisor an option to breach. Such a limitation on the freedom of contract has little to commend it. For those who believe in the parties' freedom to determine their rights, efficient breach means that the promisee's contractual right may be appropriated without his consent if that which was promised to him can be used in a way that would yield profits exceeding his loss. However, such a taking of an entitlement, for the sake of private gains, runs counter to the very basis of private law.

In modern commercial-industrial society, contractual rights constitute a major form of wealth, and consequently their adequate protection be-

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See also § 33(2) of the Restatement (2d) Restitution (tentative draft) that is based on the factual pattern of this case. It does not refer to the requirement of confidential relations but merely speaks of contractual situations in which the claimant "could have enforced against the holder an agreement to preserve or replace (the) asset." The comment does, however, add that "in ordinary commercial transactions a constructive trust or an equitable lien is not an appropriate remedy" (*id.* at 65–66). See, however, Coleman v. Golkin, Bomback & Co., Inc., 562 F.2d 166 (1977), where a constructive trust was impressed in favor of a former employee regarding his right to get 10 percent of an option held by his former employer.

[78] This proposition was already adopted by the Restatement, Restitution § 126, though recovery was limited to the case where the mistake was one of fact. This seems to be a too narrow approach; see Palmer, *supra* note 11, vol. 4, at 301 *et seq.*

[79] In contrast, the protection granted to contractual rights against the infliction of mere damage (as distinguished from their appropriation by another) is much narrower than that granted to property rights. Thus, while negligently damaging another's property right usually entails liability, there is generally no liability for negligently harming a contractual right (assuming the harm falls short of appropriation). Hence, if C negligently injures A, thereby preventing him from performing his contract with B, the latter has no right of action against C. The distinction between appropriation and the infliction of mere damage appropriation is discussed in Friedmann, *supra* note 29, at 530 *et seq.*

comes of the utmost importance. Such a society is likely to reject the idea that a person can be deprived of his bank account, his insurance policy, or pension rights subject merely to payment of expectation damages to be decided at a later date by a tribunal that might not correctly appraise the damage inflicted.

The efficient breach theory also fails as a general proposition on grounds of efficiency. Its sole purported advantage is that it reduces the level of transaction costs by removing the need of the promisor to negotiate a release from the promisee. But the gains here are generally illusory because the unilateral decision by the promisor provokes a dispute over damages that may end in costly litigation.

In the century since Holmes uttered his famous dictum on the right to break a contract, the protection accorded to contractual rights by way of specific performance, restitution, and punitive damages has greatly expanded. The dangers of the theory of efficient breach have not been lost on judges, whose decisions are evidence of that theory's failure not only as a normative but also as a descriptive matter.