Maurer School of Law: Indiana University
Digital Repository @ Maurer Law

Articles by Maurer Faculty | Faculty Scholarship

1970

Breach of Contract, Damage Measures, and Economic Efficiency

Robert L. Birmingham
Indiana University School of Law

Follow this and additional works at: http://www.repository.law.indiana.edu/facpub

Part of the Contracts Commons, and the Economic Theory Commons

Recommended Citation
Birmingham, Robert L., "Breach of Contract, Damage Measures, and Economic Efficiency" (1970). *Articles by Maurer Faculty.* Paper 1705.
http://www.repository.law.indiana.edu/facpub/1705

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Repository @ Maurer Law. It has been accepted for inclusion in Articles by Maurer Faculty by an authorized administrator of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.

LAW LIBRARY
INDIANA UNIVERSITY
Maurer School of Law
Bloomington

BREACH OF CONTRACT, DAMAGE MEASURES, AND ECONOMIC EFFICIENCY

ROBERT L. BIRMINGHAM*

For my own part, I often doubt whether it would not be a gain if every word of moral significance could be banished from the law altogether, and other words adopted which should convey legal ideas uncolored by anything outside the law. We should lose the fossil records of a good deal of history and the majesty got from ethical associations, but by ridding ourselves of an unnecessary confusion we should gain very much in the clearness of our thought.†

[J]urisprudence inevitably rests on faith. . . . We cannot reject the religion of the Bible and permanently retain our law and justice. . . .

* * * * * * *

[L]aw is not safe unless it be related to the transcendent will or law of God.‡

I. INTRODUCTION: CONTRACT LAW AND CLASSICAL ECONOMIC THEORY

The restructuring of the economic foundations of the Anglo-American world during the late 18th and the 19th centuries was accompanied by development of a legal framework facilitating and an ideology legitimating entrepreneurial activity. Although an action would lie for breach of an informal promise as early as the 16th century,[1] well-articulated rules of contract law were a product of later elaboration:

> Our courts in the early nineteenth century were writing on a largely clean slate. There is little in our law of contracts, for example, that has any recognizable ancestry before 1800. The explanation for this is not that we had discarded English law and were deliberately making a fresh start: there was in fact no English law for us to discard and it is quite as true of England as it is of the United States that the law in this and in many other areas was a nineteenth century invention. Our rules of contract came into existence in the course of the industrial revolution . . . .[2]

The fundamental postulates of contract law are thus inevitably

* Assistant Professor of Law, Indiana University School of Law; A.B., Pittsburgh, 1960, LL.B., 1963, Ph.D., 1967; LL.M., Harvard, 1965.

† Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 464 (1897).

‡ MICKLEM, LAW AND THE LAWS 114, 119 (1952).

1. CHESHIRE & FIFOOT, THE LAW OF CONTRACT 8-11 (6th ed. 1964).

2. Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037, 1040 (1961).

closely related to the premises of the free enterprise system.[3] The principle of freedom of contract in particular has shared support from the Benthamite logic used to justify individual initiative:

> Once admit that *A*, *B*, or *C* can each, as a rule, judge more correctly than can any one else of his own interest, and the conclusion naturally follows that, in the absence of force or fraud, *A* and *B* ought to be allowed to bind themselves to one another by any agreement which they each choose to make—*i.e.*, which in the view of each of them promotes his own interest, or, in other words, is conducive to his own happiness.[4]

But advocacy of party autonomy on moral grounds without reference to utilitarian calculus was possible; Adam Smith claimed that to restrain people from entering voluntary transactions "is a manifest violation of that natural liberty which it is the proper business of law, not to infringe but to support . . . ."[5]

Nevertheless the interrelationship between contract law and capitalism goes beyond a simple sharing of ideological foundations. Freedom of contract, a prerequisite of market systems, is necessarily urged by arguments supporting free enterprise.[6] Although frequently defended as in some sense morally right, the competitive ideal, or at least many of its components, can be upheld without requiring substantial reliance on unverifiable value judgments. As a consequence, some problems of contract law usually handled through appeal to subjective standards of justice can be dealt with by application of more neutral principles. The need for such principles has been recognized:

> Contract implies some kind of agreement of wills, as expressed between two or several parties, on a common objective. But what more can we say? Is there any compelling order, whether from outside or from within the nature of the institution, telling us that there should be damages for breach of contract only in the case of fault or in any situation of default by one party? Can natural law tell us whether and under what

3. "[P]art of contract law is the counterpart, if not the product, of free-enterprise capitalism. Contract, in this point of view, is the legal machinery appropriate to an economic system which relies on free exchange rather than tradition and custom or command for the distribution of resources." KESSLER & SHARP, CONTRACTS—CASES AND MATERIALS 2 (1953). "The abstraction of classical contract law is not unrealistic; it is a deliberate renunciation of the particular, a deliberate relinquishment of the temptation to restrict untrammeled individual autonomy or the completely free market in the name of social policy. The law of contract is, therefore, roughly coextensive with the free market. Liberal nineteenth-century economics fits in neatly with the law of contracts so viewed." FRIEDMAN, CONTRACT LAW IN AMERICA—A SOCIAL AND ECONOMIC CASE STUDY 20 (1965).

4. DICEY, LECTURES ON THE RELATION BETWEEN LAW & PUBLIC OPINION IN ENGLAND DURING THE NINETEENTH CENTURY 150 (1930).

5. SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 308 (Modern Library ed. 1937).

6. "[F]reedom of contract does not commend itself for moral reasons only; it . . . is the inevitable counterpart of a free enterprise system." Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943).

> circumstances a supervening change of circumstances should permit the discharge of contractual obligations? Can it tell us whether a contract concluded between parties of grossly unequal economic power should be valid, voidable, or totally void?[7]

Restatement of legal doctrine in terms of weaker assumptions unidentified with concepts of fairness derived through introspection should expedite dispute resolution even if substantive conclusions remain generally unaltered. This paper seeks to derive a less value-laden justification for the common law rule "that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."[8]

II. THE EFFICIENCY OF COMPETITIVE EQUILIBRIUM

A. *Just Price*

Scholastic philosophers sought to evaluate economic aspects of medieval life through application of what they believed to be divinely established principles of proper conduct. Commercial transactions were ideally regulated by desire on the part of the individual to avoid unjust behavior which might threaten his salvation. An approved price was considered not a morally neutral allocative mechanism but a measure of intrinsic worth from which it was sin to deviate without excuse:

> [C]ertainly, whenever a little less is given or a little more received knowingly, merely by reason of the act of buying or selling, where the true value of the property is reasonably estimable in good faith, then there is injustice in the sight of God. . . . [W]hatever the price demanded by the seller of goods, he must believe in good faith that he has received by reason of the sale nothing beyond the just price. . . . This principle is clear in the first place because without its application equality of justice would not be preserved between the thing given and the thing received, and in the second place it is obvious sound morality in and of itself.[9]

One who violated such an economic standard could expect to pay dearly for his material gain.[10] Although market forces undoubtedly

7. Friedmann, *An Analysis of "In Defense of Natural Law,"* in LAW AND PHILOSOPHY 144, 158-59 (Hook ed. 1964). Failure to base a decision on testable hypotheses can preclude meaningful dialogue concerning its correctness: "Bryan got his simple Protestant piety from his father, Silas Lillard Bryan, a country judge at Salem. Some of the judge's decisions were upheld; some, reversed. About one of the latter, he once remarked: 'I know I was right in that decision, because I consulted God about it.'" DE CAMP, THE GREAT MONKEY TRIAL 35-36 (1968).

8. Robinson v. Harmon, 154 Eng. Rep. 363, 365 (Ex. 1848).

9. NIDER, ON THE CONTRACTS OF MERCHANTS 34, 39 (Reeves transl., Shuman ed. 1966).

10. "[A]ll the saints and all the angels of paradise cry then against him, saying, 'To hell, to hell, to hell.' Also the heavens with their stars cry out, saying, 'To the fire, to the fire, to the fire.' The planets also clamor, 'To the depths, to the depths, to the depths.'"

influenced and perhaps frequently determined what actions were thought just, competition was valued primarily because scrutinization of the parallel bargains of others mitigated potential dangers to the soul resulting from personal miscalculation.[11] Indeed, deductions from ethical premises independent of considerations of supply and demand were frequently accepted in spite of their potentially harmful implications:

> [A] merchant ought to receive with caution a profit reasonably proportioned to the nobility, seriousness, and usefulness of the care, exertions, industry, and costs which he undertakes . . . . In proportion to . . . essentiality, and other things being equal, the debt ought to be measured. . . . For example, other things being equal, the purveying of necessary food and clothing is of greater service to the community of men than that of less useful items.[12]

B. *Competitive Equilibrium*

Expansion of trade and industry gradually led to the establishment of a largely self-regulating market system. Over the last 2 centuries economists have developed and refined a model of perfect competition which seeks to describe this system by abstracting from it to isolate its essential equilibrating mechanisms. The resulting ideal commodity market, seldom approximately attainable even in the days of Adam Smith, requires that:

(1) firms produce a homogeneous commodity, and consumers are identical from the sellers' point of view, in that there are no advantages or disadvantages associated with selling to a particular consumer;
(2) both firms and consumers are numerous, and the sales or purchases of each individual unit are small in relation to the aggregate volume of transactions;
(3) both firms and consumers possess perfect information about the prevailing price and current bids, and they take advantage of every opportunity to increase profits and utility respectively;
(4) entry into and exit from the market is free for both firms and consumers.[13]

Perfectly competitive factor markets must satisfy similarly rigorous conditions:

St. Bernardine, *De Evangelio Aeterno* sermon 45, art. 3, c. 3, in 2 OPERA OMNIA (de la Haye ed. 1745), *quoted in* NOONAN, THE SCHOLASTIC ANALYSIS OF USURY 77 (1957).

11. Just as they stand in less moral peril who deal in things which can be found and bought from many sources, so [too] one ought to be much more an object of suspicion to himself [in weighing his own motives, that is] who has something unique for sale or who exercises an office or type of work which cannot be found in anyone else. This follows, first, because a fair estimate can be had more easily or more closely when men are not constrained to deal with a single person. Where, however, a monopoly situation exists, a man ought much more to be an object of suspicion to himself and exercise great care not to drive another to extremes through his necessity nor seek to receive more than the just value of his [the seller's] property or his labor.

NIDER, *supra* note 9, at 44.

12. *Id.* at 19.

13. HENDERSON & QUANDT, MICROECONOMIC THEORY 86 (1958).

(1) the input is homogeneous and the buyers are uniform from the sellers' point of view,
(2) buyers and sellers are numerous,
(3) both buyers and sellers possess perfect information,
(4) both buyers and sellers are free to enter or leave the market.[14]

Various markets must be linked by perfect knowledge of the characteristics of their products or factors. As the number of economic units operating within each market becomes very large, the change in commodity or factor prices as a result of variations in the behavior of any individual unit will approach zero.

The consequences of perfect competition in the consuming sector may be derived without difficulty. Retained primary factors, such as labor, should be considered goods consumed. A consumer will maximize his satisfaction if, at the margin, the rate at which he is willing to exchange any pair of goods is equal to the ratio of their market prices. Since there is only one set of prices, the rate of exchange or substitution between any two goods will be the same for all consumers.[15] Parallel conditions prevail under perfect competition in the producing sector. Profit maximization requires that the rate of technical substitution between any two inputs and the rate of product transformation between any two outputs equal their respective price ratios. In addition, the rate at which an input can be transformed into an output must equal the ratio of the prices of the input and the output. Again the ratios will be identical for all economic units.[16]

14. *Id.* at 107.

15. Assume that there exist m goods and n consumers. Let the utility function of the i th consumer be

(1) $$U_i = U_i(q_{i1}, \ldots, q_{im}),$$

where q_{ik} is the quantity of the good k which he consumes. If p_k is the price of good k, equilibrium entails

(2) $$-\frac{\partial q_{ik}}{\partial q_{ij}} = \frac{p_j}{p_k} \qquad (j, k = 1, \ldots, m)$$

and

(3) $$-\frac{\partial q_{ik}}{\partial q_{ij}} = -\frac{\partial q_{hk}}{\partial q_{hj}} \qquad \begin{matrix}(i, h = 1, \ldots, n)\\ (j, k = 1, \ldots, m).\end{matrix}$$

The analysis in this footnote and in footnotes 16 and 22 relies heavily on HENDERSON & QUANDT, *supra* note 13, at 202-08. Throughout the discussion second-order conditions are assumed fulfilled. *See id.* at 257-83.

16. Let there be m goods and N firms. The production function of the h th firm may be written

(4) $$F_h(q_{h1}, \ldots, q_{hm}) = 0,$$

where q_{hk} is an output if positive and an input if negative. Equilibrium entails

(5) $$-\frac{\partial q_{hk}}{\partial q_{hj}} = \frac{p_j}{p_k}$$

and

(6) $$-\frac{\partial q_{hk}}{\partial q_{hj}} = -\frac{\partial q_{ik}}{\partial q_{ij}} \qquad \begin{matrix}(i, h = 1, \ldots, N)\\ (j, k = 1, \ldots, m).\end{matrix}$$

C. *Pareto Optimality*

Like determinations of just price, the economic realities idealized by the competitive model have often been defended as an inevitable consequence of immutable principles of justice: "It is not clear that Adam Smith believed that laissez faire would carry the wealth of a nation to some kind of theoretically-conceivable maximum. . . . [F]or Adam Smith laissez faire, beyond its material benefits, had ethical or moral value in that it left to the individual unimpaired that 'natural system of liberty' to which he had a natural right."[17] Yet economists, aspiring to standards of objectivity set in the natural sciences,[18] have been able to condemn violation of the conditions of competitive equilibrium as inefficient with only minimal appeal to moral precepts.

The principal difficulty limiting the development of value-free economic theory is the impossibility of making verifiable interpersonal welfare comparisons. One can nevertheless differentiate, at least conceptually, a set of states of the economy from which movement benefiting any one individual may be made only at the cost of injury to another. Such states are characterized as Pareto optimal.[19] Although choice among Pareto optimal states requires appeal to subjective values, the superiority of at least one such state over any given state outside the set may be defended as almost tautological.[20] Argument for such optimality is essentially a plea for efficiency:

---

17. Viner, *The Intellectual History of Laissez Faire*, 3 J. LAW & ECON. 45, 60 (1960). Advocacy has often been less restrained: "It can . . . be affirmed that thanks to the non-intervention of the state in private affairs, wants and satisfactions would develop in their natural order. . . . Away, then, with the quacks and the planners! Away with their rings, their chains, their hooks, their pincers! Away with their artificial methods! . . . Let us cast out all artificial systems and give freedom a chance—freedom, which is an act of faith in God and in His handiwork." BASTIAT, *The Law*, in SELECTED ESSAYS ON POLITICAL ECONOMY 51, 53, 96 (de Huszar ed. 1964). The frequency and meaninglessness of such arguments in the domestic arena have led one American critic to describe "our beloved free enterprise ideology" as "that centerpiece of national idiocy." BAZELON, POWER IN AMERICA: THE POLITICS OF THE NEW CLASS 16 (1967).

18. "The economist, to maintain his self-respect, must hold fast to the faith that there does exist an independent body of truth in his discipline, truth that can be discerned independently of value judgments." BUCHANAN, *Economics and Its Scientific Neighbors*, in THE STRUCTURE OF ECONOMIC SCIENCE 166, 179 (Krupp ed. 1966).

19. The concept was first isolated by the economist whose name it bears:

> [C]onsider any particular position and suppose that a very small move is made [from it] . . . . [Then if] the well-being of all the individuals is increased, it is evident that the new position is more advantageous for each of them; vice versa it is less so if the well-being of all the individuals is diminished. The well-being of some may remain the same without these conclusions being affected. But if, on the other hand, this small move increases the well-being of certain individuals, and diminishes that of others, it can no longer be said that it is advantageous to the community as a whole to make such a move.

PARETO, MANUEL D'ÉCONOMIE POLITIQUE 617-18 (1927), *translated in* HUTCHISON, A REVIEW OF ECONOMIC DOCTRINES, 1870-1929, at 225 (1953).

20. This Pareto rule is itself an ethical proposition, a value statement, but it is one which requires a minimum of premises and one which should command wide assent. The rule specifically eliminates the requirement that interpersonal comparisons of utility be made. As stated, however, a fundamental ambiguity remains in the rule. Some objective content must be given to the terms "better off" and "worse off." This

> In all cases . . . where a certain policy leads to an increase in physical productivity, and thus of aggregate real income, the economist's case for the policy is quite unaffected by the question of the comparability of individual satisfactions; since in all such cases it is *possible* to make everybody better off than before, or at any rate to make some people better off without making anybody worse off.[21]

If constraints outside the formal structure of the model are disregarded, Pareto optimality requires satisfaction of the conditions of the preceding sections. If each individual is presumed to possess some of each good, violation of an equality in the consuming sector would permit profit from further exchange; similar imbalance in the producing sector would allow an increase in the output of one good without a concomitant reduction in the supply of another.[22] In equilibrium, the consumer rate of substitution must equal the producer rate of substitution or transformation for any pair of goods, since each is equal

---

is accomplished by equating "better off" with "in that position voluntarily chosen." Individual preferences are taken to indicate changes in individual well-being, and a man is said to be better off when he voluntarily changes his position from A to B when he could have remained in A.

Buchanan, *Positive Economics, Welfare Economics, and Political Economy*, 2 J. LAW & ECON. 124, 125 (1959).

21. Kaldor, *Welfare Propositions in Economics and Interpersonal Comparison of Utility*, 49 ECON. J. 549, 550 (1939).

22. Assume that the economy includes only two consumers and two goods. The utility functions of note 15 *supra* may then be restated as $U_1(q_{11},q_{12})$ and $U_2(q_{21},q_{22})$, where $q_{11} + q_{21} = q_1^0$ and $q_{12} + q_{22} = q_2^0$. Let the second consumer enjoy a constant level of satisfaction U_2^0. Write.

$$U_1^* = U_1(q_{11}, q_{12}) + \lambda[U_2(q_1^0 - q_{11}, q_2^0 - q_{12}) - U_2^0], \tag{7}$$

where λ is a Lagrange multiplier. Set the partial derivatives of this function equal to 0:

$$\frac{\partial U_1^*}{\partial q_{11}} = \frac{\partial U_1}{\partial q_{11}} - \lambda \frac{\partial U_2}{\partial q_{11}} = 0 \tag{8}$$

$$\frac{\partial U_1}{\partial q_{12}} = \frac{\partial U_1}{\partial q_{12}} - \lambda \frac{\partial U_2}{\partial q_{12}} = 0 \tag{9}$$

$$\frac{\partial U_1^*}{\partial \lambda} = U_2(q_1^0 - q_{11}, q_2^0 - q_{12}) - U_2^0 = 0. \tag{10}$$

The utility of the first consumer will be maximized, given the level of satisfaction of the second, if these conditions are satisfied. Optimality thus requires

$$\frac{\partial U_1/\partial q_{11}}{\partial U_1/\partial q_{12}} = \frac{\partial U_2/\partial q_{11}}{\partial U_2/\partial q_{12}}. \tag{11}$$

The left and right sides of equation (11) are the rates of substitution between goods of the first and second consumers respectively. The necessity of satisfaction of the conditions of note 16 *supra* can be similarly demonstrated.

to the ratio of the prices of the goods. This requirement precludes profit in an economic sense: Consequent divergence between return to the worker for sacrifice of leisure and gain to the entrepreneur in terms of added output would restrict labor input to a suboptimal level. Taxation will generally cause similar distortion.

Acceptance of these conclusions does not require retreat to laissez-faire principles. Although Pareto optimality is a characteristic of any equilibrium which maximizes community utility, this characteristic is shared by an infinite set of economic states.[23] Indeed, if the marginal utility of money to the individual declines significantly as income increases,[24] distribution patterns associated with perfect competition are likely to reduce community welfare substantially below levels obtainable through efficient controls which promote equality at some cost in terms of output.[25] Moreover, to stigmatize a state of the economy as not Pareto optimal is not to assert that a shift to a given Pareto optimum, for example that of perfect competition, will raise welfare. Nor is movement toward competition inevitably beneficial even if the competitive system is assumed ideal; if some aspects of a system are constrained to nonmaximizing levels, there is no reason to assert that satisfaction of other conditions of optimality will necessarily prove advantageous.[26] Nevertheless, "what can be persuasively argued—perhaps even 'proved' . . . —is that random interferences with the working of a competitive market will make it a less efficient organizer of economic activity."[27]

---

23. "[C]ompetitive equilibrium is such that not everyone can be made better off by any intervention. . . . There are literally an infinite number of equilibrium states just as 'efficient' as that of laissez-faire individualism. Such an efficiency state is a necessary but not sufficient (repeat, not) condition for maximization of a social-welfare function." Samuelson, *Modern Economic Realities and Individualization*, TEXAS Q., Summer 1963 at 128, 131, *reprinted in* 2 SAMUELSON, COLLECTED SCIENTIFIC PAPERS 1407, 1410 (1966).

24. "Happiness will not go on increasing in anything near the same proportion as . . . wealth. . . . It will even be a matter of doubt whether ten thousand times the wealth will in general bring with it twice the happiness. . . . Happiness produced by a particle of wealth . . . will be less and less at every particle." BENTHAM, *Pannomial Fragments*, in 3 WORKS 211, 229 (Tait ed. 1843). *But see* MUSGRAVE, THE THEORY OF PUBLIC FINANCE 102-05 (1959).

25. Perfect competition represents a welfare optimum in the narrow sense of fulfilling the requirements of Pareto optimality.

> An additional difficulty is introduced by the fact that the analysis of Pareto optimality accepts the prevailing income distribution . . . . The problem of finding an optimal income distribution is not considered. . . . The analysis of welfare in terms of Pareto optimality leaves a considerable amount of indeterminacy in the solution: there are an infinite number of points . . . which are Pareto-optimal. . . . In order to judge the relative social desirability of alternative points . . . society must make additional value judgments which state its preferences among alternative ways of allocating satisfaction to individuals. Value judgments are ethical beliefs and are not the subject of economic analysis.

HENDERSON & QUANDT, *supra* note 13, at 208.

26. Lipsey & Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUDIES 11 (1956).

27. Viner, *supra* note 17, at 64.

III. Competitive Equilibrium and Damage Measures

A. *The Traditional Standard*

Enforcement of contractual obligations has long been premised, at least in part, on the argument "that a promise has inherent moral force and should be recognized by the law . . . ."[28] Three centuries ago, Hobbes asserted that "the definition of INJUSTICE, is no other than *the not performance of Covenant.*"[29] The belief that repudiation of an agreement is a moral wrong retains vitality in spite of attenuation of the religious certitudes which once supported it:

> Why should promises be enforced?
>
> The simplest answer is that of the intuitionists, namely, that promises are sacred *per se*, that there is something inherently despicable about not keeping a promise, and that a properly organized society should not tolerate this. . . .
>
> Now there can be no doubt that common sense does generally find something revolting about the breaking of a promise . . . . [L]et us not ignore the fact that judges and jurists, like other mortals, do frequently express this in the feeling that it would be an outrage to let one who has broken his promise escape completely.[30]

Nevertheless social condemnation did not induce imposition of punitive sanctions upon the purported wrongdoer: "In fixing the amount of . . . damages, the general purpose of the law is, and should be, to give compensation:—that is, to put the plaintiff in as good a position as he would have been in had the defendant kept his contract."[31] Since "the recapture of profit made through breach of contract . . . has been brushed aside as an objective of our remedial system,"[32] conduct deemed reprehensible seems almost to receive approbation if not encouragement from the law. Scholars have had little success in exploring this apparent anomaly: "The rule is now beyond doubt, but no very convincing reason has been given for it . . . ."[33]

---

28. PATON, A TEXT-BOOK OF JURISPRUDENCE 296 (1946). "The faithful observance of contracts . . . is . . . essential to the public welfare . . . . Property rights, public and private morality, and liberty itself, are insecure, when the law encourages the nonobservance of contract obligations." Citizens' Light, Heat & Power Co. v. Montgomery Light & Water Power Co., 171 F. 553, 561 (C.C. M.D. Ala. 1909).

29. HOBBES, LEVIATHAN 71 (1st ed. 1651).

30. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 571-72 (1933). In Hindu law "a debt is not merely an obligation but a sin, the consequences of which follow the debtor into the next world." One who does not repay "will be born hereafter in his creditor's house, a slave, a servant, a quadruped, or a woman." MAYNE, TREATISE ON HINDU LAW AND USAGE 405, 406 (10th ed. 1938).

31. 5 WILLISTON, CONTRACTS § 1338 (rev. ed. 1937). Thus, in Hoy v. Gronoble, 34 Pa. 9 (1859), the court stated: "The violation of most contracts involves a breach of faith." *Id.* at 11. It nevertheless held: "[T]here was error in charging the jury that . . . they might also allow damages 'for violation of faith.' This is something more than compensation. It is an allowance of vindictive damages, which is not permitted in actions for a breach of contract . . . ." *Id.*

32. Dawson, *Restitution or Damages?*, 20 OHIO ST. L.J. 175, 189 (1959).

33. SALMOND & WINFIELD, PRINCIPLES OF THE LAW OF CONTRACTS 510 (1927).

Attempts to explicate protection of the various interests of the nonbreaching party in terms of natural justice result in a similar though less striking indeterminateness. Demands for restitution of gains made by the breaching party at the expense of his innocent promisee can hardly be resisted as inordinate.[34] In some systems the formal remedy for breach of contract does not sanction recovery beyond this point.[35] Claims founded on injury suffered through reliance on a broken promise may also appear justified even though no concomitant benefit to the party who has not fulfilled his obligations can be demonstrated. But compensation for loss of profits which the innocent party would have received if his promisor had performed seems less essential:

> [T]he promisee who has actually relied on the promise, even though he may not thereby have enriched the promisor, certainly presents a more pressing case for relief than the promisee who merely demands satisfaction for his disappointment in not getting what was promised him. In passing from compensation for change of position to compensation for loss of expectancy . . . [t]he law no longer seeks merely to heal a disturbed status quo, but to bring into being a new situation. . . . With the transition, the justification for legal relief loses its self-evident quality. It is as a matter of fact no easy thing to explain why the normal rule of contract recovery should be that which measures damages by the value of the promised performance.[36]

B. *Toward Objectivity*

Legal scholars have frequently attempted to exclude from their analysis judgments which lack "a generally accepted public sensory test of validity . . . ."[37] Holmes, who wished to "get rid of the whole moral phraseology which . . . has tended to distort the law,"[38] was especially unwilling to apply ethical principles to contract law:

---

34. "For this by nature is equitable, that no one be made richer through another's loss." DIGEST OF JUSTINIAN, lib. 12, tit. 6, § 14, *quoted in* Nordstrom & Woodland, *Recovery by Building Contractor in Default*, 20 OHIO ST. L.J. 193 (1959).

35. 3. A contract may be revoked by either party in a position to do so, or to put it more exactly, a man cannot take action against another for withdrawal from a promise to perform provided that restitution of the original consideration is made. Thus a man who has taken a bullock for a future heifer may withdraw from the contract by returning the bullock or its equivalent. With certain limitations upon the freedom of women, this proposition applies even to the marriage contract.

. . . .

5. No contract implies a time clause. There is no means other than moral suasion to force a person to perform within a limited time. A man may have to go to considerable lengths to enforce performance on a contract; however, in a community of men known personally to one another, moral forces serve to press conformity to expectations . . . .

GOLDSCHMIDT, SEBEI LAW 188 (1967).

36. Fuller & Perdue, *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 56-57 (1936).

37. Knight, *The Pragmatic Conception of Justice*, 72 ETHICS 57, 59 (1961).

38. Letter from O.W. Holmes to Sir Frederick Pollock, May 30, 1927, in 2 HOLMES-POLLOCK LETTERS 200 (Howe ed. 1941).

> Nowhere is the confusion between legal and moral ideas more manifest than in the law of contract. . . . The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can.[39]

He defended his position by appeal to *Bromage v. Genning*,[40] where Coke said that to decree specific performance of a covenant to grant a lease "would subvert the intention of the covenantor, when he intends it to be at his election either to lose the damages or to make the lease . . . ."[41] Pollock disagreed: "The inventors of assumpsit clearly thought that breach of contract was *wrong*—not merely an election to pay damages rather than perform."[42]

The difficulty with extraction of value judgments from legal reasoning is that frequently only a sterile taxonomic structure remains. Discarded appeals to introspection must be replaced by other points of reference. The success of capitalism during the 19th century, manifested by the rise of England to industrial and political preeminence and rapid American growth, added an objective component to the considerations of natural justice which had been instrumental in the development of contract law. Recognition of the material benefits of free enterprise motivated efforts to facilitate competition through development of appropriate legal controls. Although assertions of efficacy were frequently diluted through retention of moral phraseology,[43] many recognized the importance to economic activity of "the

39. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

40. 81 Eng. Rep. 540 (K.B. 1616).

41. *Id.*; DAWSON & HARVEY, CONTRACTS AND CONTRACT REMEDIES 94 (1959).

42. Letter from Sir Frederick Pollock to O.W. Holmes, Sept. 17, 1897, in 1 HOLMES-POLLOCK LETTERS 79-80 (Howe ed. 1941). He argued: "[I]f the obligation is, as you maintain, only alternative, how can it be wrong to procure a man to break his contract, which would then be only procuring him to fix his lawful election in one way rather than another? . . . *Lumley v. Gye*, and your cases as well as ours which have confirmed it, would be all wrong." *Id.* at 80. Other critics have attacked on a more formalistic level: "The duty of the promisor is, with due respect to Justice Holmes, to perform his promise, but by the exercise of a power he may in certain cases convert this duty into a liability. The exercise of a power in such case is wrongful but effectual; for it is of the essence of a power that it may alter, divest, or create rights." Note, *The "Right" To Break a Contract*, 16 MICH. L. REV. 106, 109 (1917).

43. "[U]nder the influence of the classical economists, freedom of contract becomes a sacred thing. . . . [T]o thinking men contract is not simply important; it is everything, or at least everything that is good." HAVIGHURST, THE NATURE OF PRIVATE CONTRACT 19-20 (1961).

> The individualism of our rules of contract law, of which freedom of contract is the most powerful symbol, is closely tied up with the ethics of free enterprise capitalism and the ideals of justice of a mobile society of small enterprisers, individual merchants and independence craftsmen . . . . [This society] was firmly convinced of a natural law according to which the individual serving his own interest was also serving the

guarantee of the law that enterprise or speculation, in so far as it implies contracts for labour, goods, or shares, will be protected by the award of damages or specific performance."[44] They came to "view the law of contract as directed to strengthening the security of transactions by enabling men to rely more fully on promises . . . ."[45]

C. *Rule Efficiency*

Scholars frequently urge stability of commitment as a primary goal of contract law. Havighurst assumes "that as a rule the social interest is served when promises are performed . . . ."[46] Dawson notes, seemingly with some regret, that "prevention of profit through mere breach of contract is not yet an approved aim of our legal order . . . ."[47] Such emphasis would appear misplaced. Pursuit of this value ultimately compels renunciation of individual autonomy and reversion to social forms stressing status.

Mueller notes: "[I]t is an open secret that a contract breaker rarely stands to lose as much by his breach as he would by performance. And the more deliberate the breach, the more apt he is to gain."[48] Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered. Failure to honor an agreement under these circumstances is a movement toward Pareto optimality: "Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about."[49] To penalize such adjustments through overcompensation of the innocent party is to discourage efficient reallocation of community resources.

> interest of the community. . . . The play of the market if left to itself must . . . maximize net satisfactions. Justice within this framework has a very definite meaning. It means freedom of property and of contract, of profit making and of trade. Freedom of contract thus received its moral justification. . . . [A] social system based on freedom of enterprise and perfect competition sees to it that the "private autonomy" of contracting parties will be kept within bounds and will work out to the benefit of the whole.

Kessler, *supra* note 6, at 640.

44. FRIEDMANN, LAW IN A CHANGING SOCIETY 91 (1959).

45. COHEN, LAW AND THE SOCIAL ORDER 102 (1933). "Now, as much of the business of human life turns or moves upon conventions, frequent disappointments of those expectations which conventions naturally excite, would render human society a scene of baffled hopes, and of thwarted projects and labours. To prevent disappointments of such expectations, is therefore a main object of the legal and moral rules whose direct and appropriate purpose is the enforcement of pacts or agreements." 1 AUSTIN, LECTURES ON JURISPRUDENCE 299-300 (2d ed. 1861).

46. HAVIGHURST, *supra* note 43, at 64.

47. Dawson, *supra* note 32, at 187.

48. Mueller, *Contract Remedies: Business Fact and Legal Fantasy*, 1967 WIS. L. REV. 833, 835.

49. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 15-16 (1960).

Identical consequences follow from condemnation of breach of contract on moral grounds.[50] Rigidity resulting from thus binding a party to his undertaking limits the factor and product mobility essential to proper functioning of the market mechanism. Fulfillment of the conditions set out in part II above is therefore precluded.

Disagreement with these conclusions can generally be reduced to a concern that the damage remedy does not adequately compensate the innocent promisee. The traditional measure, closely associated with the oversimplifications of competitive theory, indeed falls short of perfection:

> The law of contract damages took into account only generalized types of economic damage, ignoring any personal element (for example, embarrassment or humiliation resulting from breach of contract). Recoverable damages for breach of contract to deliver goods were computed on the basis of the difference between contract price and market price at the moment of breach. This formula assumed a frictionless and perfect market, operating instantaneously and universally.[51]

Assumed absence of transaction costs is particularly unrealistic: An efficient damage standard may do nothing more than lower negotiating expense, since presumably the bound party confronted with a more attractive opportunity can buy his freedom by offering to share the gain with his promisee. Objections of undercompensation do not support punishment or condemnation of one who repudiates an agreement; at most, they urge reevaluation of the success of the courts in implementing what is conceded to be the general rule of recovery. Efficiency demands that the breaching party bear the transaction costs which accompany his actions.

A parallel argument requires protection of the expectation interest of the innocent promisee. Contracts are formed because cooperation offers opportunity of gain to the parties jointly. Optimal division of this joint gain cannot be determined without comparison of individual utility schedules. If recovery for breach of contract were limited to protection of restitution and reliance interests, a party could frequently profit through repudiation of one agreement and entry into another offering him a larger share of a smaller joint gain.

The conclusion that efficiency requires a measure of damages for breach of contract which places the innocent party in as good a position as he would have been in if default had not occurred rests largely

---

50. The breaker of the typical indisputable promise must be brazen. . . . Thus quite apart from law, many persons who will furtively steal will not openly refuse to keep a promise as to which it is impossible to manufacture a plausible ground of dispute. . . . [A]lthough the social sanctions applicable to breach of contract are not so severe as those attaching to detected dishonesty, they are substantial, tangible and certain. The man who does not keep his promises is not exactly a pariah, but he loses much that the great majority of people find essential to an agreeable existence.
HAVIGHURST, *supra* note 43, at 71.

51. FRIEDMAN, *supra* note 3, at 21.

in the presumed relevance of the competitive model to the modern market system. It is obvious, however, that the problems considered arise from nonfulfillment of the conditions of perfect competition. Indeed, the bilateral contract would itself serve no function if the requirements of the model were satisfied. Opportunity cost would equate reliance and expectation interests:

> If we rest the legal argument for measuring damages by the expectancy on the ground that this procedure offers the most satisfactory means of compensating the plaintiff for the loss of other opportunities to contract, it is clear that . . . [i]t would be most forceful in a hypothetical society in which all values were available on the market and where all markets were "perfect" in the economic sense. In such a society . . . [t]he plaintiff's loss in foregoing to enter another contract would be identical with the expectation value of the contract he did make.[52]

The argument thus rests rather tenuously on the assumption that competitive conditions are violated but that divergence from the ideal is not so complete that attempts to strengthen the market mechanism are futile.

IV. Illustration: The Common Law Labor Contract

A. *Defaulting Employee*

In *Britton v. Turner*,[53] plaintiff, having agreed to labor for the defendant for 1 year at a wage of $120, voluntarily abandoned his employment after 9 months and 18 days. The trial judge instructed the jury that plaintiff could recover the value of his services in *quantum meruit* in spite of his having left without good cause. The jury awarded the plaintiff $95, apparently valuing his labor at approximately the contract rate. Judgment was entered on the verdict.

In spite of warning by defendant's counsel that "[t]o hold out inducements to men to violate their contracts, when fairly entered into, is of immoral tendency,"[54] the judgment was affirmed on appeal. Noting that a refusal to permit recovery could place one who completely disregards his obligation in a better position than one who attempts performance, the court asserted: "[T]he general understanding of the community is, that the hired laborer shall be entitled to compensation for the service actually performed, though he does not

52. Fuller & Perdue, *supra* note 36, at 62. In Flureau v. Thornhill, 96 Eng. Rep. 635 (C.P. 1776), opportunity cost perhaps exceeded anticipated profit: "The loss of bargain which the plaintiff sought to recover was evidently not the difference between the market value of the real estate and the contract price but was, instead, the difference between the selling price of stock (which the plaintiff had liquidated in order to make the purchase) at the time of the sale and the price of that stock at the time the plaintiff learned that the defendant did not have good title to the real estate." Nordstrom, *Toward a Law of Damages*, 18 W. Res. L. Rev. 86, 99 (1966).

53. 6 N.H. 481 (1834).

54. *Id.* at 485.

continue the entire term contracted for, and such contracts must be presumed to be made with reference to that understanding, unless an express stipulation shows the contrary."[55] Recovery at a rate above that specified in the contract was prohibited. Defendant, who did not plead injury in the present action, was left free to sue separately for damages resulting from the plaintiff's breach. The court, reasoning that its solution would promote harmony between the contracting parties, urged:

> This rule, by binding the employer to pay the value of the service he actually receives, and the laborer to answer in damages where he does not complete the entire contract, will leave no temptation to the former to drive the laborer from his service, near the close of his term, by ill treatment, in order to escape from payment; nor to the latter to desert his service before the stipulated time, without a sufficient reason . . . .[56]

The rule of *Britton v. Turner* has not been fully accepted in a majority of American jurisdictions. Wider explicit adoption has probably been prevented not by opposing concepts of fairness but by infrequent litigation of such problems in recent decades.[57] The *Restatement of Contracts* would, in general, deny recovery of unapportioned payments by the defaulting employee when his "breach or non-performance is . . . wilful and deliberate . . . ."[58]

Such a position receives support primarily from classical authorities. In the early case of *Stark v. Parker*,[59] the court concluded that to allow recovery by the worker would be "a flagrant violation of the first principles of justice."[60] It stated:

> Courts of justice are eminently characterized by their obligation and office to enforce the performance of contracts, and to withhold aid and countenance from those who seek, through their instrumentality, impunity or excuse for the violation of them. And it is no less repugnant to the well established rules of civil jurisprudence, than the dictates of moral sense, that a party who deliberately and understandingly

55. *Id.* at 493. "The opinion in Britton v. Turner, 6 N.H. 481, was written by Chief Justice Parker, and when his portrait was afterward painted for the State of New Hampshire, the distinguished jurist animated by a just pride, had the artist show him seated with an open volume before him and his index finger resting upon 6 N.H. at p. 481." *Quoted in* FULLER & BRAUCHER, BASIC CONTRACT LAW 44 n.2 (1964).

56. 6 N.H. at 494.

57. *See* 5A CORBIN, CONTRACTS § 1127 (1964).

58. RESTATEMENT OF CONTRACTS § 357(1)(a) (1932). "This section is intended to lay down a rule opposed to that adopted by the court in Britton v. Turner." FULLER & BRAUCHER, *supra* note 55, at 48. An exception permits recovery when "the defendant, with knowledge that the plaintiff's breach of duty or non-performance of condition has occurred or will thereafter occur, assents to the rendition of the part performance, or accepts the benefit of it, or retains property received although its return in specie is still not unreasonably difficult or injurious." RESTATEMENT OF CONTRACTS § 357(1)(b) (1932).

59. 19 Mass. (2 Pick.) 267 (1824).

60. *Id.* at 274.

> enters into an engagement and voluntarily breaks it, should be permitted to make that very engagement the foundation of a claim to compensation for services under it.[61]

Similarly, in *Haslack v. Mayers*,[62] the court ruled: "The plaintiff here has deliberately broken his covenant with the defendant . . . . For the court to aid him, would be to lend its aid to an act of bad faith. . . . Let him perform his contract . . . or . . . the loss is the consequence of his own act."[63]

Woodward asserted that "perhaps the strongest argument that can be urged against the rule" is that "denying a recovery is *unjust* in that its effect is to enable the defendant to retain a sum in excess of adequate compensatory damages for the plaintiff's breach."[64] He nevertheless stated:

> [W]hen it is remembered that the plaintiff's position is the direct consequence of a willful and inexcusable violation of his legal and moral duty to the defendant, it is difficult to feel that the result complained of is harsh or unjust. . . . [E]ven if some hardship to the plaintiff were conceded, the argument, it is submitted, would be distinctly outweighed by the consideration that the denial of relief must have a salutary effect in discouraging the willful breach of contractual obligations.[65]

He noted that even the New Hampshire court has admitted that its rule induces a "direct tendency to the willful and careless violation of express contracts fairly entered into."[66]

Nontechnical arguments against recovery by a willfully defaulting employee either appeal to concepts of morality or allege that preclusion of relief will benefit the community by encouraging fulfillment of contractual obligations. Proponents of *Britton v. Turner* defend its doctrine primarily through assertions that fairness compels restitution. Claims concerning the justness of the rule or its converse largely offset each other. Opposition to recovery on the ground that voluntary nonperformance is socially injurious is misguided. In many cases the employee will leave his position for another offering greater remuneration. Assuming suit follows, the consequent increase in pay will not advantage the employee if the original employer can show, usually through proving the cost of replacement, that damages resulting from transfer equal or exceed this gain. Breach of contract will be improbable in these circumstances regardless of the likelihood of quasi-contractual recovery for services rendered.

On the other hand, repudiation of the agreement should be encour-

61. *Id.* at 271.
62. 26 N.J.L. 284 (Sup. Ct. 1857).
63. *Id.* at 290-91.
64. WOODWARD, THE LAW OF QUASI CONTRACTS 272 (1913).
65. *Id.*
66. Davis v. Barrington, 30 N.H. 517, 529 (1855); *see* WOODWARD, *supra* note 64, at 274.

aged where gain to the employee will exceed loss to the employer. Such a situation will normally arise where the particular skills of the employee can be more fully utilized in his second position. Here transfer will produce social gain through more efficient allocation of labor. If jobs or workers are identical, replacement of the repudiating employee without payment of the wage he will receive in his new position appears unlikely. Under these conditions, however, increased transaction costs can cause social injury. In general, reallocation benefits should substantially exceed losses due to friction. Such losses should of course be borne by the breaching party.

Refusal to permit recovery for services rendered by the employee which are not counterbalanced by damages resulting from his breach tends to lock him to his job by making transfer to a better position less profitable or even unprofitable. Resulting divergence between prospective worth to society and anticipated personal gain precludes Pareto optimality. Efficient adjustment of factors of production to changes in demand and supply is thus impeded.[67]

B. *Defaulting Employer*

In *James v. Board of Commissioners*,[68] plaintiff was hired by defendant at a wage of $100 per month to supervise until completion of the stone and brick work in the construction of a courthouse. Wrongfully discharged while the work was in progress, plaintiff recovered the promised remuneration for a subsequent period of approximately 2 months. He then brought another action seeking payment for an additional 2 months. Defendant, alleging that the prior recovery barred the second action, received judgment on the pleadings at the trial level.

On appeal, the court framed the issue as "whether . . . the employee can, after being discharged, . . . maintain an action for each installment as though earned upon an allegation of readiness to perform the work; or whether his action is simply one for damages for the employer's breach of contract, and he is limited to one action . . . ."[69]

67. More substantial disincentives formerly prevailed. In England, breach by the employee could be punished by imprisonment until the late 19th century. *See* Avins, *Involuntary Servitude in British Commonwealth Law*, 16 INT'L & COMP. L.Q. 29 (1967); Dodd, *From Maximum Wages to Minimum Wages: Six Centuries of Regulation of Employment Contracts*, 43 COLUM. L. REV. 643, 651 (1943). Employers have not been the sole favored group. The Twelve Tables, for example, provided "that the body of the defaulting Roman debtor might be cut into pieces and divided pro rata among his creditors." HAVIGHURST, *supra* note 43, at 86. As late as 1360, a money-changer was beheaded in Barcelona because he had failed to pay his creditors. MEDIEVAL TRADE IN THE MEDITERRANEAN WORLD 290 (Lopez & Raymond eds. 1955). The prospect of loss of seniority rights today discourages labor mobility. *See, e.g.*, BEAL & WICKERSHAM, THE PRACTICE OF COLLECTIVE BARGAINING 557 (rev. ed. 1963).

68. 44 Ohio St. 226, 6 N.E. 246 (1886).

69. *Id.* at 229-30, 6 N.E. at 247.

Support for plaintiff's position was garnered from *Strauss v. Meertief*,[70] where the court, elaborating the doctrine of constructive service, stated that the employee need not accept his dismissal as termination of the contract but "may elect to treat it as continuing, and, keeping himself in readiness to perform the contract on his part, may recover the wages due on the expiration of the term. . . . And if the wages are payable by installments, he may sue for and recover each installment, as it becomes due."[71] In *James*, plaintiff argued that to preclude recovery "would entail great injustice";[72] the court agreed that "the doctrine contended for appeals strongly to the feelings . . . ."[73]

Judgment for defendant was nevertheless affirmed. The court relied on language from *Howard v. Daly*:[74]

> This doctrine is . . . so wholly irreconcilable to that great and beneficient rule of law, that a person discharged from service must not remain idle, but must accept employment elsewhere if offered, that we cannot accept it. . . . The doctrine of "constructive service" is not only at war with principle, but with the rules of political economy, as it encourages idleness and gives compensation to men who fold their arms and decline service, equal to those who perform with willing hands their stipulated amount of labor. Though the master has committed a wrong, the servant is not for one moment released from the rule that he should labor; and no rule can be sound which gives him full wages while living in voluntary idleness.[75]

The *James* court concluded that only damages could be recovered, and that under "the universal rule that a person injured by the act of another is bound to use ordinary diligence to make the damage as light as may be, the discharged employe must . . . use ordinary effort to obtain similar employment in the same vicinity."[76] It further asserted that "[p]ublic policy, not to say public morals, forbids the encouragement of an idle class. . . . It would be a direct encouragement to idleness to hold that he who may have, but refuses, similar service, is entitled to full compensation the same as though he performed full labor."[77]

The reasoning of the court appears to rest on the twin assumptions that work is a moral duty and that work is economically beneficial to the community. The inability to isolate the importance of each assumption is due to the failure of the court adequately to differentiate them. The approach, perhaps explicable in terms of class conflict, is reminiscent of that adopted in early programs for the poor:

70. 64 Ala. 299 (1879).
71. *Id.* at 307.
72. 44 Ohio St. at 231, 6 N.E. at 248.
73. *Id.*
74. 61 N.Y. 362 (1875).
75. *Id.* at 373-74.
76. 44 Ohio St. at 233-34, 6 N.E. at 250.
77. *Id.*

> When these children are four years old, they shall be sent to the country work-house and there be taught to read two hours a day, and be kept full employed the rest of their time, in any of the manufactures of the house, which best suits their age, strength and capacity. If it should be objected that, at these early years, they cannot be made useful, I reply, that at four years of age, there are sturdy employments in which children can earn their living; but besides that, there is a very considerable use in their being, somehow or other, constantly employed, at least, twelve hours a day, whether they earn their living or not; for by these means, we hope that the rising generation will be so habituated to constant employment that it would, at length, prove agreeable and entertaining to them.[78]

The conclusion of the court is nevertheless correct. If unaccompanied by imposition of a duty to seek other work, a rule permitting recovery of the promised remuneration less earnings during the contract period would normally eliminate all gain to the dismissed employee from labor presumably beneficial to the community. If the stipulated wage were paid regardless of other earnings, incentive to seek work could be largely retained. Here, however, the employer would be discouraged from making socially advantageous changes in his labor force; an individual would usually be retained unless his presence actually lowered output.

Limitation of recovery through adherence to the general damage measure implies award of the difference between the contract wage and what the worker is able to earn through available comparable employment. Application of this rule, adopted by the court, promotes mobility of labor essential to competitive efficiency. If the value of a worker hired at a salary of $10,000 falls to $8,000, an employer will gain through repudiation of their agreement when the resulting cost to him is less than $2,000. If transaction costs are disregarded, breach will thus be profitable to the employer if and only if the worker can obtain another job paying more than $8,000. A new employer will not normally pay the worker more than what he anticipates his services will contribute to the undertaking. The rule therefore encourages breach where the product of the worker would be greater in an alternative position and discourages breach where the product would be less. Movement toward Pareto optimality is facilitated.

Unavailability of comparable employment implies distortions of the

---

78. TEMPLE, AN ESSAY ON TRADE AND COMMERCE 266-67 (1770).

Less than a hundred years ago the merchants and shipowners of Boston were able to answer the demand of their employees for a ten-hour day with the argument that "the habits likely to be generated by this indulgence in idleness . . . will be very detrimental to the journeymen individually and very costly to us as a community." Fifty years ago a United States Commissioner of Patents, Mortimer D. Leggett, declared amid the applause of well-meaning persons that "idleness . . . stimulates vice in all its forms and throttles every attempt at intellectual, moral, and religious culture."

THE TWENTIES—FORDS, FLAPPERS & FANATICS 46 (Mowry ed. 1963).

market mechanism sufficiently severe to preclude satisfactory solution through application of criteria of economic efficiency. Absence of a requirement that the employee accept an inferior position or work in another locality is probably justified because subjective losses resulting from such a shift are likely to be both large and difficult to compute. Similar considerations urge limitation of recovery by the employee to a sum not exceeding the contract wage.

V. Conclusion

The general damage remedy for breach of contract, which seeks to place the injured party in as good a position as he would have occupied if the agreement had been performed, has usually been defended through an appeal to subjective concepts of natural justice. A less introspective justification is available. Such protection of the expectation interest is also dictated by considerations of economic efficiency, since it encourages optimal reallocation of factors of production and goods without causing material instability of expectations. More rigorous adherence to this standard would promote proper functioning of the market mechanism. Encouragement of repudiation where profitable through elimination of moral content from the contract promise might also be socially desirable.