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A Comparative Fault Defense in Contract Law

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Abstract

This Article calls for the recognition of a comparative fault defense in contract law. Part I sets the framework for this defense and suggests the situations in which it should apply. These situations are sorted under two headings: cases of non-cooperation and over-reliance. Part II unfolds the main argument for recognizing the defense. It recommends applying the defense only in cases where cooperation or avoidance of over-reliance is low-cost.

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Introduction

In the 1970s, the comparative fault defense (“CFD”) in tort law began to spread across the United States,¹ about thirty years after it became prevalent in the United Kingdom.² Both legislatures and courts adopted this defense, with the latter applying it in tort cases on a daily basis. Today, few will call for the restoration of the doctrine which

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1. Several states had adopted it earlier. See Dan D. Dobbs, *The Law of Torts* § 201, at 503–04 (2000).

2. Winfield & Jolowicz on Torts 247-51 (16th ed., by W.V.H. Rogers, 2002).

preceded it: the contributory negligence defense. That defense enabled courts to either impose full liability on the injurer (when there was no contributory negligence) or leave the burden of harm completely on the victim's shoulders (when there was contributory negligence).³ The CFD rejects this binary approach to fault, instead allowing apportionment of damages between the injurer and the contributorily negligent victim.

Over the years, the CFD has infiltrated the contract law of many countries (such as Canada, the United Kingdom, and Israel), albeit primarily in cases where a party breached a contractual duty of care or in cases of concurrent tort and contract liability.⁴ Yet, the same shift has been slow to occur in American contract law.⁵

This Article calls for a reversal of this state of affairs and for the recognition of a CFD in American contract law. Part I begins by presenting the nature and scope of the advocated CFD. It also illustrates the categories of cases to which it should apply: cases where (1) efficiency requires that the promisee take steps during performance to reduce the probability of a breach (to cooperate) or to reduce his potential losses (to avoid over-reliance) and (2) the cooperation or avoidance of over-reliance is low cost. Part II unfolds the main argument for applying the defense in contract law. According to this argument,

3. There were many variations of the contributory negligence defense that I cannot elaborate here. Other principles evolved alongside this defense (the most important being the "last clear chance"), which, under certain conditions, shifted loss back to the injurer. See Dobbs, *supra* note 1, §§ 199–200, at 494–503 (describing the contributory negligence rule and its exceptions).

4. On the United Kingdom, see the Law Commission No. 219, *Contributory Negligence as a Defence in Contract* ¶ 1.4. On Canada, see *Smith v. McInnis*, [1978] 91 D.L.R. (3d) 190 (S.C.C.) (Justice Pigeon, in the minority opinion, applied the CFD to a contractual case). Lower courts in Canada have generally been willing to apply the CFD in all contractual case or in cases where parties breached a contractual duty of care. See, e.g., *Doiron v. Caisse Populaire D'inkerman Ltee.*, [1985] 17 D.L.R. (4th) 660 (N.B.). The Australian Supreme Court has refused to apply the CFD in contractual cases. *Astley v. Austrust Ltd.* (1999) HCA 6. The Israeli Supreme Court has applied the defense in contracts with no *a priori* limitations, *C.A. 3912/90, Eximin SA v. Itel Style Ferarri*, 47(4) P.D. 64 (1993) (available in both English and Hebrew). See also Ariel Porat, *Contributory Negligence in Contract Law: Toward a Principled Approach*, 28 U. B.C. L. Rev. 141, 141–43 (1994).

5. For refusal to apply the CFD to contracts, see *Fortier v. Dona Anna Plaza Partners*, 747 F.2d 1324 (1984); *Danca v. Taunton Sav. Bank*, 429 N.E.2d 1129 (1982); *Federal Sav. & Loan Ins. Corp. v. Huff*, 704 P.2d 372 (1985); *Arcon Corp. v. Liberty Mutual Ins. Co.*, 591 F. Supp. 15 (1983). For willingness to apply the defense to contracts, see *Am. Mortgage Inv. Co. v. Hardin-Stockton Corp.*, 671 S.W.2d 283 (1984); *Elam v. Smithdeal Realty & Ins. Co.*, 109 S.E. 632 (1921); *United States Fid. & Guar. Co. v. Frantl Indus., Inc.*, 241 N.W.2d 421 (1976). There is an increasing willingness to apply the CFD to implied warranties cases, see James J. White & Robert S. Summers, *Uniform Commercial Code* § 11-8, at 401–03 (4th ed. 1995), and *infra* discussion. See also John Barclay Phillips, *Note: Out with the Old: Abandoning the Traditional Measurement of Contract Damages for a System of Comparative Fault*, 50 Ala. L. Rev. 911 (1999) (suggesting the adoption of a comparative fault principle in contracts mainly for cases where both parties were in breach).

the CFD is warranted because it would provide the promisee with incentives to cooperate and rely efficiently while at the same time maintaining incentives for the promisor to perform the contract even if the promisee failed to fulfill his part. The CFD would also encourage the promisor to efficiently reduce the need for cooperation and avoiding over-reliance, thereby decreasing the losses from failures to cooperate or avoid over-reliance.

I. The Nature and Scope of the Comparative Fault Defense

The CFD should be available to a breaching party (“promisor”) against an aggrieved party (“promisee”) when the latter’s fault has contributed to his own losses. The promisee should be considered "at fault," and should shoulder part of the loss, when he fails to meet a legal burden to reduce his potential losses by cooperating with the promisor or avoiding over-reliance. Below, I present eight categories of cases in which the promisee should be considered at fault and a CFD applied. These are sorted under two headings: cases of non-cooperation and cases of over-reliance. In all eight categories, efficiency entails that the promisee take steps either to reduce the probability of breach or otherwise reduce his potential losses, and prevailing contract law mostly fails to provide him with adequate incentives to do so.

A. Non-Cooperation

In the cases that can be classified as instances of non-cooperation, the promisee failed to take steps to prevent or reduce the likelihood of breach during performance. Example 1 presents the case where a promisee fails to assist in performance by act or omission. Example 2 presents the case where a promisee could have reasonably prevented the breach by clarifying for the promisor her legal rights and duties under the contract. The next two examples concern the conveyance of information from the promisee to the promisor. In Example 3, the promisee fails to provide the promisor with information necessary for performance, while in Example 4 he fails to inform the promisor of the high potential losses he would incur in the event of breach. In both cases, the failure to provide information contributes to the breach of the contract. In the

fifth and final example, the promisee is responsible for creating apprehensions that he will not perform, thereby inducing a breach by the promisor.

Example 1. Failing to assist in performance. A undertakes to construct a building for B. During the last stage of performance, B gives A's employees confusing instructions as to the construction work required. In the end, there is a delay in the completion of performance; moreover, some of the construction work is found to be defective. Had B refrained from instructing A's employees, the contract would have been adequately performed.⁶

Prevailing contract law would take a binary approach to such situations: any losses due to non-performance would be shouldered in their entirety by either A or B. The choice between the two alternatives would hinge on the interpretation of the contract.⁷ Courts rarely opt for an intermediate solution that apportions damages between the parties.⁸

Example 2. Failure to clarify misunderstandings. A is a subcontractor and B is a primary contractor. They enter a contract for A to perform construction work and for B to pay installments at different stages of the work. At a certain point in time, A argues that she has reached one of these payment stages and is therefore entitled to an installment. In fact, A is not entitled to any payment, since she failed to meet an additional condition stipulated by the contract. A is not aware of this additional condition because of an oversight on her part. B refuses to pay, stating that he is not obliged to do so under the contract and providing no other explanation. A then stops her work, causing loss to B. Only after a month, during which B stubbornly refuses to meet with A, does B explain to A why she was not entitled to payment.

6. This Example is an adaptation of *Lesmeister v. Dilly*, 330 N.W.2d 95 (1983), in which the court apportioned damages between the parties.

7. See Restatement (Second) Contracts § 205 cmt. d (non-cooperation could be considered a breach of the duty of good faith). While Melvin Eisenberg agrees that cooperation should hinge on interpretation of the contract, he also suggests that unanticipated circumstances can give rise to a duty of cooperation, Melvin A. Eisenberg, *The Duty to Rescue in Contract Law*, 71 *Fordham L. Rev.* 648, 672–75 (2002). For the same view, see Judge Posner's opinion in *AMPAT/Midwest, Inc. v. Ill. Tool Works, Inc.*, 896 F.2d 1035, 1041 (7th Cir. 1990) ("The parties to a contract are embarked on a cooperative venture, and a minimum of cooperativeness in the event unforeseen problems arise at the performance stage is required even if not an explicit duty of the contract.").

8. *Lesmeister*, 330 N.W.2d.



Traditional contract law would impose liability on A since she breached the contract. The fact that B could have easily clarified the misunderstanding and prevented the breach is taken to be irrelevant: after all, B is not A's legal advisor, and it is A's responsibility to fulfill her obligations under the contract. Under a different approach, which finds some support in the case law, when one party is aware of the other party's ignorance of his legal rights and duties and can easily clarify them, he is under obligation to do so. He is not allowed to take deliberate advantage of the other party's oversight.⁹ The CFD is a third option: it makes both parties responsible for the losses in such cases.

Example 3. Failure to provide information necessary for performance. A, a contractor, and B, the owner of a certain piece of land, enter a contract for the performance of construction work. Due to geological difficulties, there is a delay in performance that causes B substantial losses. It becomes evident, however, that B knew about these obstacles at an early stage (although not prior to entering into the contract with A). Had he revealed this to A in due time, the delay could have been prevented.

Contract law imposes a limited duty of disclosure at the contract formation stage. In shaping this duty, courts balance the interest of the party possessing information to use it for his own benefit against the interest of the other party not to be misled.¹⁰ Contract law does not impose any duty to disclose information at the performance stage. However, one might expect an even broader disclosure duty at this stage since disclosing the information necessary for performance, especially when it is costless (or nearly so), increases the surplus of the contract without distributional effects.¹¹ As I argue in Part II, under certain conditions, applying the CFD is a better solution than imposing a duty of disclosure.

9. *Market Street Ass'n P'ship v. Frey*, 941 F.2d 588, 594 (7th Cir. 1991). In this case, one party refused to fulfill her duties and the other party could have easily corrected the mistake. *Id.* Judge Posner ruled that the contracting parties bore a duty not to take deliberate advantage of each others' oversights concerning their rights and duties under the contract. *Id.* For a thorough discussion of this case, see Eisenberg, *supra* note 7, at 667–70.

10. Melvin Eisenberg, *Disclosure in Contract Law*, 91 Cal. L. Rev. 1645 (2003) (discussing both efficiency and moral considerations in shaping the duty of disclosure).

11. See Hugh Collins, *Implied Duty to Give Information During Performance of Contracts*, 55 Mod. L. Rev. 556 (1992) (advocating recognition of an implied duty to give information during performance).

Example 4. Failure to warn of a high potential loss. A, a carrier, undertakes to ship a crank shaft from B's mill for repair and to bring it back in one week's time. A instead brings the shaft back after 2 weeks, and this results in high consequential losses to B, who could not find a substitute shaft. At the time of contracting, the parties were aware of a small risk that a substitute shaft would not be available. A week later it had become clear to B, but not to A, that this risk had materialized. Had B conveyed this information to A on time, A would have taken costly precautions to ensure that he would return the shaft on time and would have prevented the breach.¹²

Under the *Hadley v. Baxendale* principle, A would be liable for B's losses, since the non-availability of a substitute shaft was foreseeable at the time of contracting. Yet, had B informed A of his potentially high losses when he realized the non-availability of a substitute shaft, the inefficient breach would have been avoided.¹³ One way to provide promisees with incentives to convey such information would be to deprive B of his entitlement to damages.¹⁴ A less extreme approach would be to make the CFD available to A and reduce his liability accordingly.¹⁵

Example 5. Creating apprehensions. B constructs a building for A. At a certain point in time, B brings heavy equipment to the construction site and places it on a concrete floor that was poured only a few days earlier. At A's request, the equipment is removed to avoid damaging the floor. A suspects that it is already damaged, however, and demands its replacement. B refuses. A forbids B from continuing the construction

12. The inspiration for this example is, of course, *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854).

13. The following illustrates numerically the principles behind Example 4: Assume at the time of contracting that the probability of losing \$1000 was .1, yielding an expected loss of \$100, but that a week after contracting, the probability of loss increased to 1, yielding an expected loss of \$1000. Assume now that by investing \$500 in precautions, A could prevent the breach. So long as A assumes the expected loss to be \$100, he won't make this investment, whereas if he is aware that it has risen to \$1000 he will make it. Since efficiency requires making the investment, efficiency also dictates that B should convey the information regarding his high potential loss to A.

14. Others have supported the use of this solution in analogous cases. See Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 Va. L. Rev. 967, 1012–14 (1983); Eisenberg, *supra* note 7, at 670–72.

15. Another situation in which the *Hadley v. Baxendale* principle would allow recovery, and where applying the CFD could be valuable, is one in which the high potential losses are foreseeable (objectively) but unforeseen (subjectively) by the promisor at both the time of contracting and later on. Here, too, if the promisee realizes during performance that the promisor is unaware of the high potential loss entailed by a breach, efficiency requires conveying the information to the promisor. The CFD would provide incentives to achieve this result.

work and both suffer losses. It later becomes evident that the concrete floor was not damaged and that B's placement of the heavy equipment on the floor was no more than a minor breach that had not warranted A's repudiation. It also becomes evident that B could have assured A that the floor was not damaged or, alternatively, that it would be repaired if necessary. Had B provided such assurances, A would not have repudiated.¹⁶

Under traditional contract law, A should be found liable for breach of contract—her suspicions of damage are her own problem and do not affect B's rights and duties under the contract. In contrast, the modern approach, as reflected through the Restatement, allows a party who has reasonable grounds to suspect that the other party will not perform his or her contractual obligations to demand adequate assurance of due performance. If the party fails to provide assurances, the requesting party can treat the contract as having been repudiated.¹⁷ The Restatement does not explicitly discuss cases in which the apprehensive party responds by breaching the contract (as in our Example). However, there is an implicit assumption that that party would be considered in breach and liable for the ensuing consequences. As Part II explains, a better solution for Example 5 would be apportionment of damages under the CFD.¹⁸

B. *Over-Reliance*

There are three categories of cases that can be classified as instances of over-reliance—where efficiency would have required the promisee to restrain his reliance, but he failed to do so. In the sixth example, the promisee engages in reliance despite knowing the promisor will likely breach. In the next example, the promisee has no concrete reason to suspect an imminent breach, but his reliance prior to the breach is nonetheless unreasonable. In the last example, the promisee unreasonably assumes that the contract was performed and thus fails to minimize his expected losses.

16. This Example is an adaptation of *Carfield & Sons v. Cowling*, 616 P.2d 1008 (Co. 1980). There, the court stated that in order to avoid liability, “[A] was obligated to request adequate assurance of performance. If [B] then refused to provide that assurance, [A] could treat the contract as terminated.”

17. Restatement (Second) of Contracts § 251.

18. For an argument in favor of apportioning damages in the cases depicted by Example 5, see W.F. Young, *Half Measures*, 81 Colum. L. Rev. 19 (1981).

Example 6. Failure to restrain reliance in the face of a concrete risk of breach. A agrees to sell his house to B. As the time of delivery of possession approaches, there are signs of a substantial risk that A will not make timely delivery because A's lessee is refusing to vacate the premises. Even though B is well aware of this risk, he enters into a contract with a contractor to refurbish the house starting on the day set for delivery. He also incurs expenses advertising the house for rent. In the end, A breaches due to late delivery, and B suffers losses due to forfeiting the contractor's deposit and his advertising expenses. These losses would have been prevented had B waited to see whether the contract would be adequately performed.

B's reliance on the contract was unreasonable since the expected losses of reliance exceeded the expected gains of reliance. But since contract law does not sanction for over-reliance, B could externalize his costs and internalize his gains. Consequently, the risk that he would over-rely was a substantial one. Note that Example 6 is not a case of anticipatory breach, where the mitigation of damages defense would apply¹⁹ and thus provide efficient incentives for B to restrain his reliance. In situations represented by Example 6, then, the application of the CFD would unambiguously improve B's incentives relative to those currently provided by contract law. The CFD would also be superior to the mitigation of damages defense, as will be explained in Part II.

Example 7. Failure to restrain reliance when there is no concrete risk of breach. A undertakes to guard B's house, where valuable goods are stored. However, B fails to activate the alarm system. A breaches the contract by neglecting to guard the house. As a result, thieves steal B's goods and inflict bodily injury on B. Had B activated the alarm system, all losses would have been prevented. B also could have taken other precautionary measures to reduce the risk of theft.²⁰

Even if B had no concrete reason to suspect that A would breach the contract, it could still have been unreasonable for B to rely only on A for protection. In order to determine whether his reliance was unreasonable, it is necessary to consider the value of

19. Restatement (Second) of Contracts § 350 cmt. f.

20. The Australian Supreme Court considered a similar situation. While refusing to apply the CFD to contracts, it maintained that "[a] plaintiff may be guilty of contributory negligence . . . even if the "very purpose" of the duty owed by the defendant is to protect the plaintiff's property." Astley, (1999) HCA, at 23.

the assets, the risk of theft and bodily injury, the capabilities of A as a guard, the cost of additional precautionary measures and their effectiveness, and so on. Applying the CFD if B's reliance was unreasonable would provide incentives to similarly situated promisees to make reasonable efforts to protect their property. Conditioning A's liability on B's activating the alarm system or taking other precautionary measures would be an inefficient solution, as will be clarified in Part II.

Example 8. Relying on the mistaken belief that the contract has been adequately performed. A constructs a heating system for B's business. The heater malfunctions due to A's failure to fulfill her contractual obligations, and B suffers property losses. Due to these losses, B is unable to perform third party contracts and suffers additional losses. A few hours prior to the malfunction, there were signs of something going wrong. A reasonable person could have inferred the impending malfunction and taken steps to avoid losses.²¹

Here, as in the sixth and seventh examples, the mitigation of damages defense does not apply because B was not aware of the breach at the relevant points in time.²² The CFD provides a compromise between the two extreme solutions of either A or B bearing all the losses. And indeed, some courts have allowed the defense in similar situations—as when the promisor breached an implied warranty and consequential losses ensued.²³

II. The Argument for Adopting the Comparative Fault Defense

A. Setting the Stage

Though several arguments have been raised against recognizing a CFD as a general defense in contract law,²⁴ the most significant one is that the CFD would impair

21. This Example is an adaptation of *Signal Oil & Gas Co. v. Universal Oil Prod.*, 572 S.W.2d 320 (Tex. 1978). In that case, the plaintiff suffered losses due to a fire from a malfunctioning heater. The defendants, who had manufactured, designed, and installed the heater, were found liable for breach of implied warranties of fitness and suitability. The court applied the CFD and reduced damages. It found that the plaintiff had been contributorily negligent in not shutting down the heater despite warnings about the impending hazard.

22. Restatement (Second) Contracts § 350 cmt. f.

23. See, e.g., *Signal Oil & Gas Co.*, 572 S.W.2d; *Karl v. Bryant Air Conditioning Co.*, 331 N.W.2d 456 (Mich. 1982) (where the Michigan supreme court applied a comparative fault defense).

24. For a discussion and refutation of these arguments, see Ariel Porat, *Comparative Fault in Contract Law* (1997) (Hebrew).

the promisee's reliance and planning abilities.²⁵ Were a CFD applicable, the argument runs, the promisee could no longer be certain of full compensation for an unfulfilled contractual promise. He could no longer "sit and wait" until the promisor fulfilled her contractual obligation, but would have to assist, supervise and take precautionary measures with regard to either the other party's performance or his own potential losses.

Yet, I disagree. In the analysis below, I posit that under certain conditions, most contractual parties would benefit ex ante from the availability of a CFD, making it an efficient default rule for contract law. If my argument holds, the reliance and planning argument unravels: even if the promisee's ex post reliance and planning abilities are impaired, this does not justify rejecting the CFD since it is consistent with both parties' ex ante interests.

My analysis assumes the following sequence of events: first, the promisee observes the behavior of the promisor or some part of it; second, the promisee responds by taking or not taking steps to cooperate or avoid over-reliance; third, the promisor observes the response of the promisee; and fourth, the promisor responds by performing or not. The analysis also assumes that the relevant behaviors are verifiable—in other words, that they can be proven in court. Finally, it is assumed that renegotiation is costly and the parties would prefer their rights and duties to be regulated from the outset.

B. *Non-Cooperation*

1. *When Should Cooperation Be the Default Rule?*

Below, I argue that cooperation should be the default rule where cooperation is low cost. But before explaining why, let me clarify what I mean by "costs of cooperation" and by "high cost" and "low cost" cooperation. Costs of cooperation do not refer only to the costs of executing the cooperation; they also include the costs associated with monitoring the promisor's performance to anticipate a need to cooperate, as well as the costs necessary to infer from the circumstances that a need to cooperate arose. The

25. See Law Commission No. 219, *Contributory Negligence as a Defence in Contract* ¶¶ 4.5–4.7; Ariel Porat, *The Contributory Negligence Defence and the Ability to Rely on the Contract*, 111 *Law Q. Rev.* 228 (1995).

two latter costs are often far more substantial than the former type, as most of the examples discussed in Section I.A. illustrate. Thus, in Example 2 (clarifying misunderstandings), the costs of clarifying for the promisor that she was about to breach the contract were close to zero; however, in order to know that such a clarification was needed, the promisee would have had to monitor the promisor's behavior and infer such a need when it arose. These costs of monitoring performance and inferring a need to cooperate, even if not high, are not nil.

There is no bright line rule for distinguishing between high-cost and low-cost cooperation. While it is relatively easy to conceive of the two poles, it is difficult to draw the line between them. The costliness of cooperation is certainly a function of the surplus created by the contract: cooperative efforts that are high-cost in the context of a contract for renting an apartment could be low-cost in the context of a contract for performing a huge construction project. For the purposes of this Article, I define "low-cost cooperation" as any cooperation that a reasonable person would not consider to materially affect the division of the contract surplus. I define all other forms of cooperation as "high-cost."

a. High-Probability, High-Cost Cooperation

When the parties to a contract anticipate a high probability that the promisor will need the promisee's cooperation during performance and the costs of cooperation are high, they tend to address this need in their contract. The parties can set either a burden or a duty of cooperation for the promisee, making it so that non-cooperation will result in deprivation of the promisee's entitlement to damages (a burden) or the promisee's liability for the promisor's losses (a duty). In contrast, silence on this matter can indicate that the parties did not intend to impose a high-cost burden or duty of cooperation on the promisee, at least when the need for the promisee's cooperation is anticipated at a high level of probability.

The question that arises, however, is whether, in order to save transaction costs, there should be a default rule imposing a burden or duty of cooperation when cooperation is of high probability, high cost and efficient. I believe that the answer is no.



First, it is often hard to know whether the parties would have preferred high-cost cooperation and, if so, to what extent. Occasionally, different modes of cooperation are available and there is no clearly preferable choice among them. Moreover, the need to cooperate and the efficiency of doing so could be debatable and could fluctuate from case to case.²⁶

Second, when cooperation is high-probability and high-cost, it becomes part of the substance of the exchange. From both positive and normative points of view, default rules do not and should not regulate the substance of the exchange but only its ancillary terms; the substance of the exchange should be left for the parties to regulate.

Third, on many occasions the promisee could refuse to undertake a burden or duty of high-cost cooperation—or the parties could deem it inefficient—because of the parties' asymmetric information and control regarding the conditions relevant to cooperation. Typically, the promisor knows more than the promisee about the promisor's ability to perform and about her expected need for the promisee's cooperation. The promisor will try to underestimate the likelihood of this need arising while negotiating the contract, and the promisee, well aware of this fact, will be reluctant to bear a burden or duty of high-probability and high-cost cooperation. But more importantly, in addition to possessing better information, the promisor often has better control over the conditions giving rise to a need for cooperation. Knowing that the promisee bears a burden or duty to cooperate, the promisor may try to manipulate the promisee or to maneuver events so that greater cooperation is required than efficiency would dictate.²⁷ Often, such inefficient behavior is unverifiable and therefore cannot be deterred.²⁸

26. The parties will sometimes prefer to leave the question of cooperation open for future negotiation. However, that can only be done when the costs of renegotiation are not prohibitively high.

27. Sometimes the parties may overcome this hurdle by imposing a duty (or burden) of cooperation on the promisee and a duty for the promisor to compensate the promisee for his costs. But since this solution could only work for some cases, it cannot serve as a default rule.

28. In different terminology, under certain circumstances, the promisee can be the cheapest cost avoider of the breach, while the promisor is the cheapest cost avoider of the circumstances giving rise to the need to avoid the breach.

All three of these reasons are compelling grounds for a default rule under which there is no burden or duty of high-cost and highly-probable cooperation and under which the parties are left to regulate cooperation as they see fit.²⁹

b. Low-Probability, Low-Cost Cooperation

However, a different situation arises when one or more low-probability contingencies that require low-cost cooperation are expected to transpire. Regulating any low-probability contingency by contract yields high, even prohibitive, transaction costs for the parties, thereby encouraging them to leave many contingencies unregulated. When the potential cooperation is low-cost, the argument that default rules should not regulate the substance of the exchange also collapses: it is precisely in such cases that default rules are most needed. And the above-discussed issue of asymmetric information and control over the circumstances giving rise to the need of cooperation is decidedly less acute. Therefore, given that specific low-cost cooperative behavior on the part of the promisee is typical in many contractual settings, it is desirable to shape a clear default rule regulating such behavior. The five categories of cases represented by the five examples discussed in Part I.A. could set the framework for five sets of default rules regulating repeat low-cost and efficient cooperative modes of behavior by promisees.

Example 1 (assistance) can be used to illustrate this. In that Example, the owner failed to cooperate by issuing confusing instructions. While not necessarily costless, such cooperation would not have been high-cost. But many parties would not regulate such contingencies when the default rule is non-cooperation. Even when cooperation is efficient, regulating these kinds of contingencies would involve high transaction costs that the parties would not willingly shoulder. A default rule encouraging cooperation would be desirable in such cases. And the same conclusion holds with respect to the other examples presented in Part II.A. In most of those examples, a substantial part of the cooperation costs were not related to executing the cooperation, but rather, to monitoring the promisor's performance and inferring from the circumstances that cooperation was needed. The latter types of costs are typically "fixed". The magnitude of

29. For a general argument against cooperative default rules in contracts, see Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. Leg. Stud. 597 (1990).

fixed costs cannot be significantly affected by the promisor's manipulations and maneuvers, and the promisee will therefore be more willing to bear them in the first place. Therefore, in all the examples, and especially when most of the cooperation costs are fixed, efficiency mandates that the promisee should assume a burden or a duty of cooperation.

c. High-Probability, Low-Cost Cooperation

The crucial need for a low-cost, low-probability cooperation default rule does not preclude a default rule requiring low-cost, high-probability cooperation. Indeed, even for high-probability contingencies, a default rule could operate efficiently by reducing the parties' transaction costs. Suppose that in Example 5 (apprehensions), the parties anticipate a high probability that the owner will be uncertain, at different stages of the work, as to whether performance is adequately executed, but that assurance of performance will not be high-cost. With a default rule of non-cooperation, the parties will probably regulate cooperation in their contract for such a contingency. However, a cooperation default rule would save them the transaction costs of negotiating and drafting a contract provision.

d. Low-Probability, High-Cost Cooperation

The case of low-probability, high-cost cooperation is different, and the main reason pertains to the above-mentioned problem with asymmetric information and control. A burden or duty of cooperation could spur the promisor to take advantage of the promisee by creating conditions in which cooperation is required too often and inefficiently. The fact that cooperation is high-cost could provide good grounds for rejecting a rule of cooperation from the outset.³⁰

2. The Remedy

One way to encourage low-cost cooperation in the cases depicted by Examples 1 to 5 is to impose a duty of cooperation on the promisee—or a full burden of cooperation,

30. But if most of the costs are fixed and their magnitudes not dependent on the promisor's behavior, a different conclusion could be warranted. See *supra* Section II.B.1.b.

which has a similar effect when he is the only party expected to incur losses —with the result that if he fails to fulfill his duty, he will shoulder all losses from a breach. When the promisee expects to internalize the entirety of the costs stemming from his inefficient non-cooperation, he will tend to cooperate. But there is still a flaw in this solution: it provides no incentive for the promisor to perform efficiently if the promisee fails to cooperate. In an ideal world, if the promisee expected to internalize all the costs of his inefficient non-cooperation, he would always cooperate efficiently; but in our non-ideal world, he will often fail to do so. The parties may therefore be willing to give the promisor incentives to perform in the event that the promisee fails to cooperate. But placing full liability (or full burden) on the promisee will not achieve this goal.

Just as full promisor liability creates a moral hazard for the promisee, full promisee liability creates a moral hazard for the promisor. Example 3 (providing information necessary for performance) can illustrate such an outcome. In that Example, the owner failed to convey geological information to the contractor. It could still have been efficient to perform on time without knowledge of this information. But if the contractor knew that the owner would bear all the losses since he had failed to apprise him, she might inefficiently refrain from performing on time.

The CFD could solve this problem. Since the defense apportions damages between the parties, it leaves substantial incentives for the promisor to perform even when the promisee has failed to cooperate. Thus, in Example 3, the contractor would have incentives to perform on time even if he did not receive the information at an early stage and even if he knew of the promisee's omission. These incentives are admittedly imperfect since the CFD forces the promisor to bear less than the amount of the full losses generated by the breach. But, given the importance of the promisee's cooperation, this is a price worth paying.

There is yet another cost of using the CFD over a duty (or full burden) of cooperation: the loss of perfectly efficient incentives for the promisee to cooperate (which exist when he fully internalizes all the costs of the breach). However, this cost is trivial in the context of low-cost cooperation, where much less than the threat of full liability is necessary to induce the promisee to cooperate. In such cases, it is typically



sufficient to threaten the promisee with an expected burden (or liability) that is higher than his costs of cooperation even if it is much lower than the costs of non-cooperation. Using Example 3 to demonstrate this, much less than the threat of full liability is necessary to incentivize the owner to convey the geological information to the contractor.³¹ Granted, there is still the potential for strategic behavior on the part of the promisee: aware that the promisor has sufficient incentives to perform even if cooperation is not rendered, the promisee may choose from the outset not to cooperate. But this is not a major concern. As illustrated by Examples 1 to 5, the promisee typically knows there is significant risk that the promisor will not perform in the absence of cooperation. In light of this knowledge and given the low-cost burden of cooperation, the promisee will cooperate because he expects to bear part of his losses. To illustrate with Example 3, the risk that the owner will not convey the geological information to the contractor to save cooperation costs is very low. He must realize that the failure to convey this information would not only make performance more costly but could also lead to a breach with him bearing partial consequences.

In addition to providing efficient incentives for the promisee to cooperate and for the promisor to perform when the promisee has failed to cooperate, the CFD offers at least one other important advantage over a duty or full burden rule. It provides the promisor with more efficient incentives to reduce the expected losses from breach before the need for cooperation arises, and this is crucial because of the promisor's superior information and control over the circumstances giving rise to the need for cooperation. If the promisee bears all the costs of non-cooperation as a duty rule would mandate, then the promisor will covertly, inefficiently, and too often create situations in which the promisee is required to cooperate. Given that cooperation is low-cost, it would seem this is an insignificant risk. But since the outcome is sometimes a high-cost failure to cooperate, reducing the probability of the need to cooperate—even if cooperation is not high-cost—could be cost-justified. The CFD, as opposed to its alternatives, provides

31. But sometimes the promisee may refrain from cooperating in order to induce a breach and find a way out of the contract; placing an expected burden on him, equivalent to the costs of cooperation, would not be sufficient to efficiently deter him.

incentives to the promisor not only to perform when cooperation has been withheld, but also to reduce the need for cooperation in the first place.³²

The following numerical example illustrates the incentivizing effects of the CFD in such situations. Assume that, without cooperation, the probability of breach is .5 and the loss the promisee is expected to incur due to the breach is \$80, yielding an expected loss of \$40. Also assume that, with the promisee's cooperation, which costs him \$2, the probability of breach is expected to be reduced to .25, with losses remaining at \$80, thereby yielding expected losses of \$20. Under such circumstances, cooperation is efficient. If the CFD is applied and the promisee failed to cooperate and a breach occurred, it would be sufficient that he be made to bear only \$5 of the total \$80 loss. This would create an ex ante threat of \$2.5 for the promisee (.5 x \$5) and would incentivize him to cooperate from the outset. At the same time, it would leave most of the costs of the breach to be borne by the promisor. This would typically provide her with sufficient incentives to efficiently perform if the promisee failed to cooperate and to reduce the need to cooperate in the first place.

To conclude, in cases of low-cost cooperation, non-cooperation should lead to reduced damages under the CFD. Ideally, from an efficiency perspective, this reduction should be no more than the minimum amount necessary to provide the promisee with incentives to cooperate.

C. Over-Reliance

1. When Should Avoiding Over-Reliance Be the Default Rule?

a. High-Probability, High-Cost Avoidance of Over-Reliance

When over-reliance is anticipated at a high level of probability and its avoidance is high-cost,³³ the parties are expected to regulate the extent of reliance in the contract if

32. Note that instead of leaving some unrecoverable losses on the promisee's shoulders (as the CFD mandates), the law could also make him liable for some of the promisor's losses (as though the promisor and promisee were both responsible for the breach and its consequences). However, the latter solution would add the administrative costs of measuring the promisor's losses.

33. The distinction between high-cost and low-cost over-reliance is analogous to that applied to high-cost and low-cost cooperation. See *supra* Section II.B.1.

they want it controlled at all. They can regulate it directly when over-reliance is verifiable or indirectly when not. Indirect regulation can take the form of a liquidated damages clause that sets the damages the promisee is entitled to in the event of breach. In such a case, the promisee would internalize both the costs and benefits of his reliance and would rely efficiently.³⁴ A default rule regulating reliance is not suitable for cases of a high probability of over-reliance when avoiding that over-reliance is high-cost. This is so for the same reasons that a default rule is not suited for regulating high-probability and high-cost cooperation cases.³⁵

b. Low-Probability, Low-Cost Avoidance of Over-Reliance

In cases of low-probability and low-cost avoidance of over-reliance, however, a default rule that encourages efficient reliance could be justified.³⁶ Let us return to Example 6 (concrete risk of breach). There could be many contingencies in which a risk of breach on the part of the seller of the house could emerge. Regulating each and every such contingency would entail high transaction costs and most parties would not even attempt to do so. Thus, developing default rules adapted to various types of over-reliance could be the best solution. Examples 6 to 8 could serve as paradigmatic cases from which more detailed and nuanced default rules could evolve.

c. Other Situations in the Avoidance of Over-Reliance

So as to avoid unnecessary repetitiveness, I will not discuss at any length the desirability or undesirability of setting a default rule for cases of high-probability, low-cost avoidance of over-reliance and for cases of low-probability, high-cost avoidance. The arguments regarding the desirability of default rules in the corresponding contexts of

34. Robert Cooter, Unity in Tort, Contract, and Property: The Model of Precaution, 73 Cal. L. Rev. 1, 14–15 (1985). Note that this solution does not work for non-cooperation cases. On handling over-reliance, see Richard Craswell, Performance, Reliance, and One-Sided Information, 18 J. Leg. Stud. 365, 367–68 (1989) (suggesting a rule under which the promisor would state the probability of a breach and on which the promisee would rely accordingly). For various doctrines in prevailing contract law that reduce over-reliance, see George Cohen, Fault Lines in Contract Damages, 80 Va. L. Rev. 1225 (1994).

35. See *supra* Section I.B.1.a.

36. For the argument that over-reliance is not a severe or prevalent problem in contract law, see Melvin Eisenberg, Expectation Damages and the Theory of Over-Reliance, 54 Hastings L.J. 1335 (2003). But note that the cases represented by Example 6 are considered by Eisenberg to be “out of the realm of over-reliance,” *id.* at 1346.

cooperation apply here as well. It suffices to say that a default rule for high-probability, low-cost avoidance of over-reliance would be efficiency-justified since it would save transaction costs; in contrast, a default rule for low-probability, high-cost avoidance of over-reliance would be unwarranted because of the promisor's superior information and control.³⁷

2. *The Remedy*

One way to encourage low-cost avoidance of over-reliance would be to deprive the promisee of damages for the reliance losses he inefficiently increased or failed to reduce. The buyer in Example 6 (concrete risk of breach), for example, would not be compensated for his deposit or his advertising costs because they resulted from unreasonable reliance. This solution is tantamount to applying the mitigation of damages defense at the stage before a known breach transpires. It is flawed, however, in that it would reduce the incentives of the promisor to efficiently perform: she would know that she would not have to shoulder any of the promisee's over-reliance losses. In Example 6, given the buyer's over-reliance, efficiency requires that the seller take extra steps to deliver on time. But if the seller knows she is exempt from any liability for the buyer's over-reliance losses, she will make less-than-efficient efforts to perform.

By contrast, applying the CFD would result in a reduction of the promisee's damages for losses resulting from his over-reliance. This would provide the promisee with efficient incentives to undertake low-cost avoidance of over-reliance. No less important, it would create greater incentives for the promisor to perform efficiently when there is a known risk or a tangible instance of promisee over-reliance. Relative to situations in which the promisor shoulders all of the losses, as is the case under prevailing contract law, the CFD would create somewhat weaker incentives for the promisor to perform efficiently. But this is a price worth paying to improve the promisee's incentives to avoid over-reliance, and the point is well illustrated by Example 6 (concrete risk of breach). Under the CFD, the buyer would be expected to bear some of the advertising costs and the cost of the forfeited deposit. This would

37. See *supra* Section II.B.1.d.

provide him with incentives to delay reliance until he saw whether the contract was performed on time. But if the buyer were to inadvertently over-rely, the seller would have incentives to take extra precautions, ensure timely performance, and prevent over-reliance losses.³⁸

As was the case with non-cooperation, the asymmetry in information and control over the conditions generating a need to avoid over-reliance also gives reasons to prefer the CFD over a rule that leaves all over-reliance costs on the promisee's shoulders. Unlike that latter rule, the CFD incentivizes the promisor to reduce the need to avoid over-reliance. The advantage to this is that it ameliorates the risk of high-cost over-reliance, which can result when the promisee fails to avoid over-reliance.³⁹

In sum, in cases of low-cost avoidance of over-reliance, like in cases of low-cost cooperation, the CFD is preferable to a binary approach that leaves one party with the entire burden of loss. Here, as well, from an efficiency perspective, the burden borne by the promisee should amount to no more than the minimum necessary to provide him with incentives for efficient reliance.

Conclusion

This Article calls for recognition of a comparative fault defense in contract law. It presents the categories of cases to which this defense should apply and argues that a precondition for its application is low-cost promisee cooperation or low-cost promisee avoidance of over-reliance. Of course, this is not the only condition courts should consider. Other relevant factors affecting the desirability of the CFD include (1) the benefit to derive from the expected cooperation or avoidance of over-reliance, (2) the extent of asymmetry in the information and control the parties wield over the conditions giving rise to the need to cooperate or avoid over-reliance, and (3) the probability of that need arising. The higher the benefit from cooperation or avoidance of over-reliance, the

38. Knowing the chance of performance increase if he over-relies, the promisee may increase his reliance more when the promisor is aware of his over-reliance. This possibility notwithstanding, when avoidance of over-reliance is low-cost and the risk of breach is significant in spite of his over-reliance, the promisee will prefer to restrain his reliance.

39. This argument seems to be more persuasive in the context of Example 6 than in Examples 7 and 8, since asymmetric information and control are more operative in the former.

lesser the asymmetry in information and control, and the lower the probability of the need to cooperate or avoid over-reliance materializing, the stronger the case for the CFD.

While the Article does not present an in-depth consideration of the criteria for apportioning damages under the CFD, the discussion does imply that courts should assign the promisee no more than the minimum burden necessary to efficiently incentivize him to cooperate or avoid over-reliance. This would often result in imposing a greater share of losses on the promisor.⁴⁰

Despite this Article's primary focus on efficiency, the potential fairness appeal of the CFD is also apparent throughout the discussion: in all categories of cases to which the defense would apply, the promisee has unreasonably brought his losses upon himself, making both parties responsible for them. From a fairness perspective, it would seem that they should share the losses. But establishing an independent fairness rationale for the CFD requires that the promisee's duty or burden to either cooperate or avoid over-reliance be grounded on fairness considerations.⁴¹ It is also necessary to establish that fairness implies the promisee's failure to meet his duty or burden should not release the promisor from her primary obligations under the contract and that it justifies apportioning the damages between the parties as such. While I have not tried to respond to the fairness challenge in this Article, it deserves further consideration and exploration.⁴²

It has only been forty years since tort law was governed by a binary approach to liability and a comparative fault defense was yet to be recognized. Courts and legislatures rightly changed that. And the same should be done in contract law.

40. This is the outcome when cooperation or avoiding over-reliance is low-cost and the probability of a breach without cooperation or avoidance of over-reliance is high. See the numerical example in Section I.B.1.c.

41. Eisenberg, *The Duty to Rescue in Contract Law*, supra note (basing a contract-law duty to rescue on fairness considerations).

42. This Article has assumed that both the breach of contract and the non-cooperation or over-reliance were observable and verifiable. Yet, this is not always the case. When non-cooperation or over-reliance is not observable or verifiable, other mechanisms can be employed to provide both parties with efficient incentives. See, e.g., Robert Cooter & Ariel Porat, *Anti Insurance*, 31 *J. Leg. Stud.* 203 (2002) (proposing a mechanism for creating full liability for both the promisor and promisee and resulting in efficient incentives for both).