

# A COMPARATIVE FAULT DEFENSE IN CONTRACT LAW

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*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 noncooperation and cases of overreliance. Part II unfolds the main argument for recognizing the defense and recommends applying the defense only in cases where cooperation or avoidance of overreliance is low cost.*

## INTRODUCTION

In the 1970s, the comparative fault defense (“CFD”) in tort law began to spread across the United States,<sup>1</sup> about thirty years after it became prevalent in the United Kingdom.<sup>2</sup> Both legislatures and courts throughout the United States 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 that 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). 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 spread into 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 reasonable care or in cases of concurrent tort and contract liability.<sup>3</sup> Yet the same shift has been slow to occur in American contract law.<sup>4</sup>

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1. 1 DAN B. DOBBS, *THE LAW OF TORTS* § 201 (2001). Dobbs also notes that several states had adopted it earlier. *Id.*

2. W.V.H. ROGERS, *WINFIELD & JOLOWICZ ON TORTS* §§ 6.38-6.41 (16th ed. 2002).

3. *See, e.g.*, LAW COMM’N, *CONTRIBUTORY NEGLIGENCE AS A DEFENCE IN CONTRACT* para. 1.4 (1993).

4. For refusal to apply the CFD to contracts, see *Fortier v. Dona Anna Plaza Partners*, 747 F.2d 1324 (10th Cir. 1984). For willingness to apply the defense to contracts, see *American Mortgage Inv. Co. v. Hardin-Stockton Corp.*, 671 S.W.2d 283 (Mo. Ct. App. 1984). There is an increasing

This Article calls for a reversal of this state of affairs and for the recognition of a CFD in American contract law.<sup>5</sup> 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 overreliance), and (2) the cooperation or avoidance of overreliance is low cost. Part II unfolds the main argument for applying the defense in American contract law. It argues that 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 the promisee's cooperation and avoid overreliance, thereby decreasing the losses from failure to cooperate or avoid overreliance.

### 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 overreliance. 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 noncooperation and cases of overreliance. In all eight categories, efficiency requires the promisee to 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. *Noncooperation*

In the cases that can be classified as instances of noncooperation, the promisee fails 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 the promisor's legal rights and duties under the contract for her. 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

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willingness to apply the CFD to implied-warranty cases. See 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 11-8, at 758-60 (5th ed. 2006); *infra* notes 19-21 and accompanying text.

5. For my earlier arguments calling for the adoption of the CFD by Commonwealth and European countries see Ariel Porat, *Contributory Negligence in Contract Law: Toward a Principled Approach*, 28 U. BRIT. COLUM. L. REV. 141 (1994) (focusing primarily on contract law in England, Canada, Australia, France and Germany). The efficiency argument that is the subject of Part II of the current paper was not made in the earlier paper.

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 the promisor to breach.

*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 on 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.<sup>6</sup>

Prevailing contract law would take a binary approach to such situations: either *A* or *B* would shoulder any losses due to nonperformance in their entirety. The choice between the two alternatives would hinge on the interpretation of the contract.<sup>7</sup> Courts rarely opt for an intermediate solution that apportions damages between the parties.<sup>8</sup>

*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, because 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, but *B* provides 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.

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 seen as 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. *B* would not be allowed to take deliberate advantage of *A*'s oversight, and he could not recover for *A*'s breach.<sup>9</sup> The CFD is a third option: in this type of case, it would make both *A* and *B* responsible for the losses.

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

7. *E.g.*, *AMPAT/Midwest, Inc. v. Ill. Tool Works Inc.*, 896 F.2d 1035, 1041 (7th Cir. 1990) (Posner, J.) ("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."); *RESTATEMENT (SECOND) OF CONTRACTS* § 205 cmt. d (1981) (asserting that noncooperation could be considered a breach of the duty of good faith).

8. *Lesmeister*, 330 N.W.2d at 102.

9. *Mkt. St. Assocs. Ltd. 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.* at

*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.<sup>10</sup> In shaping this duty, courts balance the interest the party possessing information has in using it for his own benefit against the interest the other party has in not being misled.

Traditional American 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: disclosing the information necessary for performance, especially when it is costless (or nearly so), increases the surplus of the contract without distributional effects. As I argue in Part II, under certain conditions, applying the CFD is a better solution than imposing a duty of disclosure.

*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 two weeks, which 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, thus preventing the breach.<sup>11</sup>

Under the *Hadley v. Baxendale* principle, A would be liable for B's losses, since the unavailability of a substitute shaft was foreseeable at the time of contracting. Yet, had B informed A of his potentially high losses when he realized that a substitute shaft was not available, the inefficient breach would have been avoided.<sup>12</sup> One way to provide promisees with incentives to convey such information would be to deprive B of his entitlement

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596–97. In reversing summary judgment, 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.* at 597–98.

10. For an overview of the duty of disclosure generally, as well as a more specific discussion of the role of efficiency and morality in shaping this duty, see Melvin A. Eisenberg, *Disclosure in Contract Law*, 91 CAL. L. REV. 1645 (2003).

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

12. The following illustrates numerically the principles behind Example 4: assume at the time of contracting that the probability of losing \$1000 was 0.1, 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. Since efficiency requires making the investment, efficiency also dictates that B should convey the information regarding his high potential loss to A.

to damages.<sup>13</sup> A less extreme approach would be to make the CFD available to *A* and reduce his liability accordingly.<sup>14</sup>

*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 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 did not warrant *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.<sup>15</sup>

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 by 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.<sup>16</sup> 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.

### B. Overreliance

There are three categories of cases that can be classified as instances of overreliance—where efficiency would have required the promisee to restrain his reliance, but he failed to do so. In the sixth example, the promisee

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13. Others have supported the use of this solution in analogous cases. See Melvin A. Eisenberg, *The Duty to Rescue in Contract Law*, 71 *FORDHAM L. REV.* 647, 670–72 (2002); Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 *VA. L. REV.* 967, 1012–14 (1983).

14. 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.

15. This example is an adaptation of *Carfield & Sons, Inc. v. Cowling*, 616 P.2d 1008 (Colo. Ct. App. 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.” *Id.* at 1010.

16. RESTATEMENT (SECOND) OF CONTRACTS § 251 (1981).

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.

*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.

Assuming the expected losses of reliance exceeded the expected gains of reliance, B's reliance on the contract was unreasonable. But since contract law does not sanction for overreliance, B could externalize his costs and internalize his gains. Consequently, the risk that he would overrely was a substantial one. Note that Example 6 is not a case of anticipatory breach, where the mitigation of damages defense would apply<sup>17</sup> 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.<sup>18</sup>

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. To determine whether his reliance was unreasonable, it is necessary to consider the value of 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

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17. *Id.* § 350 cmt. f.

18. The High Court of Australia 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 v. Austrust Ltd.* (1999) 197 C.L.R. 1, 14.

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. As a result of 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.<sup>19</sup>

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.<sup>20</sup> 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.<sup>21</sup>

## II. THE ARGUMENT FOR ADOPTING THE COMPARATIVE FAULT DEFENSE

### A. Setting the Stage

The most significant argument against recognizing the CFD in American contract law is that it would impair the promisee's reliance and planning abilities.<sup>22</sup> Were the 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.

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.

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19. This example is an adaptation of *Signal Oil & Gas Co. v. Universal Oil Prods.*, 572 S.W.2d 320 (Tex. 1978). In that case, the plaintiff suffered losses due to a fire from a malfunctioning heater. *Id.* at 323. The defendants, who had manufactured, designed, and installed the heater, were found liable for breach of implied warranties of fitness and suitability. *Id.* at 329. The court applied the CFD and reduced damages, finding that the plaintiff had been contributorily negligent in not shutting down the heater despite warnings of the impending hazard. *Id.*

20. RESTATEMENT (SECOND) OF CONTRACTS § 350 cmt. f.

21. See, e.g., *Karl v. Bryant Air Conditioning Co.*, 331 N.W.2d 456 (Mich. 1982) (applying a comparative fault defense); *Signal Oil & Gas Co.*, 572 S.W.2d 320 (same).

22. See LAW COMM'N, *supra* note 3, paras. 4.5–4.7; Ariel Porat, Note, *The Contributory Negligence Defence and the Ability to Rely on the Contract*, 111 LAW Q. REV. 228 (1995).

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 overreliance; 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.<sup>23</sup>

## B. *Noncooperation*

### 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 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 promisee’s 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.”

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23. When noncooperation or overreliance 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. LEGAL STUD. 203 (2002) (proposing a mechanism for creating full liability for both the promisor and promisee that would result in efficient incentives for both).

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, so that noncooperation 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 parties anticipate that the need for the promisee's cooperation is highly probable.

But the question arises whether, in order to save transaction costs, there should be a default rule imposing a burden or duty of cooperation when the need for cooperation is highly probable and cooperation is *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.<sup>24</sup>

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

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24. 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.

dictate.<sup>25</sup> Often, such inefficient behavior is unverifiable and therefore cannot be deterred.<sup>26</sup>

All three of these reasons are compelling grounds for a default rule under which there is *no* burden or duty of high-cost cooperation where the need for it is highly probable, instead leaving the parties to regulate cooperation as they see fit.<sup>27</sup>

#### 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 Section I.A could set the framework for five sets of default rules regulating repeat low-cost and *efficient* cooperative modes of promisee behavior.

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, 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 Section I.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 promisor's manipulations and maneuvers

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25. 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 (for example, it would not work when transaction costs involved in measuring the costs of cooperation and in transferring payments for cooperation are high), it cannot serve as a default rule.

26. 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.

27. 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. LEGAL STUD. 597 (1990).

cannot significantly affect the magnitude of fixed costs, so the promisee will be more willing to bear them in the first place. Therefore, in Examples 1 through 5, and especially when most of the cooperation costs are fixed, efficiency mandates that the promisee assume a burden or a duty of cooperation.

*c. High-Probability, Low-Cost Cooperation*

The crucial need for a default rule favoring low-cost cooperation when it is *unlikely* to be needed does not preclude a default rule requiring low-cost cooperation when it is *likely* to be needed. 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 noncooperation, 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, mainly because of the above-mentioned problem of 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.<sup>28</sup>

## 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, which has a similar effect when he is the only party expected to incur losses—so 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 noncooperation, 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 noncooperation, he would always cooperate efficiently; but in our non-ideal world, he will often fail to do so. The parties

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

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 because he had failed to inform her, 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 she did not receive the information at an early stage and even if she 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 noncooperation*. Using Example 3 to demonstrate this, much less than the threat of full liability is necessary to induce the owner to convey the geological information to the contractor.<sup>29</sup> 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 facing part of the consequences.

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29. But sometimes the promisee may refrain from cooperating 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 deter him efficiently.

In addition to providing efficient incentives for the promisee to cooperate and for the promisor to perform when the promisee fails 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, which 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 noncooperation (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 incentives for the promisor not only to perform when cooperation has been withheld, but also to reduce the need for cooperation in the first place.<sup>30</sup>

The following numerical example illustrates the incentivizing effects of the CFD in such situations. Assume that, without cooperation, the probability of breach is 0.5, 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 0.25, 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 \$2.50 for the promisee ( $0.5 \cdot \$5$ ) and would induce 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, noncooperation 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.

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30. 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.

### C. Overreliance

#### 1. When Should Avoiding Overreliance be the Default Rule?

##### a. High-Probability, High-Cost Avoidance of Overreliance

When overreliance is anticipated at a high level of probability and its avoidance is high cost,<sup>31</sup> the parties are expected to regulate the extent of reliance in the contract if they want it controlled at all. They can regulate it directly when overreliance is verifiable or indirectly when it is 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.<sup>32</sup> A default rule regulating reliance is not suitable where overreliance is highly probable and avoiding that overreliance is high cost, for the same reasons that a default rule is not suited for regulating high-probability, high-cost cooperation cases.<sup>33</sup>

##### b. Low-Probability, Low-Cost Avoidance of Overreliance

In cases of low-probability, low-cost avoidance of overreliance, however, a default rule that encourages efficient reliance could be justified.<sup>34</sup> 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 overreliance 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 Overreliance

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-*

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

32. *See* 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 noncooperation cases. On handling overreliance, see Richard Craswell, *Performance, Reliance, and One-sided Information*, 18 J. LEGAL STUD. 365, 367–68 (1989), which suggests 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 overreliance, see George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225 (1994).

33. *See supra* Section II.B.1.a.

34. For the argument that overreliance is not a severe or prevalent problem in contract law, see Melvin A. Eisenberg & Brett H. McDonnell, *Expectation Damages and the Theory of Overreliance*, 54 HASTINGS L.J. 1335 (2003). But note that Eisenberg and McDonnell consider the cases represented by Example 6 to be “out of the realm of overreliance.” *Id.* at 1346.

*probability, low-cost* avoidance of overreliance and for cases of *low-probability, high-cost* avoidance. The arguments regarding the desirability of default rules in the corresponding contexts of cooperation apply here as well. It suffices to say that a default rule for *high-probability, low-cost* avoidance of overreliance would be efficiency-justified since it would save transaction costs; in contrast, a default rule for *low-probability, high-cost* avoidance of overreliance would be unwarranted because of the promisor's superior information and control.<sup>35</sup>

## 2. The Remedy

One way to encourage low-cost avoidance of overreliance 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 promisor's incentives to perform efficiently: she would know that she would not have to shoulder any of the promisee's overreliance losses. In Example 6, given the buyer's overreliance, 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 overreliance 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 overreliance. This would provide the promisee with efficient incentives to undertake low-cost avoidance of overreliance. No less important, it would create greater incentives for the promisor to perform efficiently when there is a known risk of or tangible promisee overreliance. 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 overreliance, a point well illustrated by Example 6. Under the CFD, the buyer would be expected to bear some of the advertising costs and the cost of the forfeited deposit. This would provide him with incentives to delay reliance until he saw whether the contract was performed on time. But if the buyer were to inadvertently overrely, the seller would have incentives to take extra precautions, ensure timely performance, and prevent overreliance losses.<sup>36</sup>

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

36. Knowing the chance of performance increases if he overrelies, the promisee may increase his reliance even more when the promisor is aware of his overreliance. This possibility notwithstanding, when avoidance of overreliance is low cost and the risk of breach is significant in spite of his overreliance, the promisee will prefer to restrain his reliance.

As was the case with noncooperation, the asymmetry in information and control over the conditions generating a need to avoid overreliance also provides reasons to prefer the CFD over a rule that leaves all overreliance costs on the promisee's shoulders. Unlike that latter rule, the CFD induces the promisor to reduce the need to avoid overreliance. The advantage to this is that it ameliorates the risk of high-cost overreliance, which can result when the promisee fails to avoid overreliance.<sup>37</sup>

In sum, in cases of low-cost avoidance of overreliance, 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 American 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 overreliance. Other relevant factors affecting the desirability of the CFD include (1) the benefit to be derived from the expected cooperation or avoidance of overreliance, (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 overreliance, and (3) the probability of that need arising. The higher the benefit from cooperation or avoidance of overreliance, the less asymmetry in information and control, and the lower the probability of the need to cooperate or avoid overreliance 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 induce him to cooperate or avoid overreliance. This would often result in imposing a greater share of losses on the promisor.<sup>38</sup>

Only forty years ago, American tort law was governed by a binary approach to liability and a comparative fault defense had yet to be recognized. Courts and legislatures rightly changed that. The same should be done in contract law.

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37. 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 prevalent in the former.

38. This is the outcome when cooperation or avoiding overreliance is low cost and the probability of a breach without cooperation or avoidance of overreliance is high. See *supra* Section II.B.2 (providing a numerical example).