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Punitive Damages, Liquidated Damages, and *Clauses Penales* in Contract Actions: A Comparative Analysis of the American Common Law and the French Civil Code

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**PUNITIVE DAMAGES, LIQUIDATED
DAMAGES, AND *CLAUSES PÉNALES* IN
CONTRACT ACTIONS: A COMPARATIVE
ANALYSIS OF THE AMERICAN COMMON
LAW AND THE FRENCH CIVIL CODE**

*Charles Calleros**

ABSTRACT

Although American common law allows punitive damages for reckless or intentional torts, it will neither allow a jury to assess punitive damages for breach of contract nor permit enforcement of a contractual damages clause that is deemed to be punitive. This approach is rooted in an early Chancery practice of granting equitable relief from oppressive penal bonds and has been more recently justified as a means of facilitating efficient breach. Economic efficiency, however, can be accomplished even if punitive damages could be assessed for intentional breach, because the parties would have an incentive to negotiate a release from the first contract to enable both to share in the surplus offered by an intervening contractual opportunity. Moreover, negotiation of an enforceable penalty clause would allow some parties to maximize their utility by exchanging a signal of assurance of performance for a premium fee. Additionally, the French experience invites a fresh look, because—although it generally disallows punitive damages of a judicial origin for any civil wrong, tort or breach of contract—it honors freedom of contract and the autonomy of the parties by enforcing a contractual penalty clause (although the court may reduce an excessive contractual penalty). Taking a cue from the French approach, American courts and legislatures should reconsider their refusal to sanction freely negotiated penalty clauses and enforce them to the extent that they permit the parties to maximize their collective utility.

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I. INTRODUCTION

Although the United States is infamous for headline-grabbing punitive damages awards in tort actions, most jurisdictions in the United States adhere to the traditional common law rule against punitive damages for breach of contract, if the breach neither constitutes nor is accompanied by tortious conduct. This hostility to punitive damages in contract actions extends to (or perhaps originates in) contractual liquidated damages clauses, which courts in the United States will not enforce if they are deemed to be punitive rather than compensatory. In contrast, even though the French Civil Code (the Code) limits judicial awards to compensatory damages in tort actions as well as those in contract, it specifically requires enforcement of *clauses pénales*, even if—as the term *pénale* suggests—they are designed to compel the breaching party to pay extra-compensatory damages. Although amendments to the Code authorize judges to reduce grossly excessive penalty clauses, the Code permits a punitive element to remain.

This article joins several other commentators in questioning the rule against judicial punitive damage awards for intentional breaches of contract, at least in those cases in which the breach is not efficient. More centrally, taking a cue from the French Civil Code, this article proposes enforcement of a freely negotiated stipulated damages clause for intentional breaches of contract, even if the clause is both prospectively and retrospectively punitive in nature.

II. PUNITIVE DAMAGES AND LIQUIDATED DAMAGES IN THE UNITED STATES

A. Legal Rules and Tests

Under the common law, juries in the United States have discretion¹ to award punitive damages for egregiously tortious conduct, defined in most states as a tort committed with at least reckless disregard for the rights of others.² Some statutes also authorize awards of punitive dam-

1. *E.g.*, *Smith v. Wade*, 461 U.S. 30, 52 (1983) (referring to the jury's "discretionary moral judgment" in describing general common law tort principles applicable to remedies under 42 U.S.C. § 1983).

2. *See* William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 689 & nn.325–27 (1999) (stating the general standard, collecting cases, and noting that gross negligence will also suffice in a few states). *See also* 42 U.S.C. § 1981a (2000) (requiring proof of "malice or reckless indifference to . . . federally protected rights" for punitive damages for violations of Title VII of the 1964 Civil Rights Act);

ages, either open-ended or as a multiplier of actual damages.³ Although awards of punitive damages in tort actions are not as ubiquitous, excessive, and unjustified as they are often portrayed in popular culture,⁴ and though they are subject to constitutional limitations imposed by due process,⁵ they nonetheless hold out the possibility of total recovery that greatly exceeds the amount needed to compensate the plaintiff for actual injury.⁶

Smith, 461 U.S. at 37–51 (reviewing the historical development of federal and state tort law, and requiring proof of intentional violations of federal law or “reckless or callous disregard for the plaintiff’s rights” for punitive damages for violations of 42 U.S.C. § 1983).

3. *See, e.g.*, 42 U.S.C. § 1981a (2000) (authorizing punitive damages, subject to caps, for disparate-treatment violations of Title VII of the 1964 Civil Rights Act if the plaintiff has no right of action under 42 U.S.C. § 1981 (2000)); *Smith*, 461 U.S. at 35–36 (stating that punitive damages are available for constitutional torts under 42 U.S.C. § 1983); JOHN YUKIO GOTANDA, SUPPLEMENTAL DAMAGES IN PRIVATE INTERNATIONAL LAW 195 & n.3 (1998) (discussing statutory punitive damages in the form of multiples of compensatory damages, and noting that the RICO statute is an example of one that imposes treble damages).

4. *See* Patrick S. Ryan, *Revisiting the United States Application of Punitive Damages: Separating Myth from Reality*, 10 ILSA J. INT’L & COMP. L. 69 (2003) (lamenting the urban legends and other inaccuracies about U.S. tort law and punitive damage awards that are circulated even by academics in Europe); Theodore Eisenberg, *John M. Olin Program in Law and Economics Conference on “Tort Reform”: The Predictability of Punitive Damages*, 26 J. LEG. STUD. 623, 634 (1997) (noting that punitive damages were awarded in only about three percent of tort cases in a study, with a modest median punitive damage award of \$50,000, contrary to the popular perception, which is influenced by a few very large awards).

5. *Pac. Mut. Life Ins. Co. v. Haslip*, 517 U.S. 559 (1996) (requiring, among other things, meaningful judicial review of jury awards of punitive damages); *BMW of N. Am. v. Gore*, 116 U.S. 559 (1986) (finding that the state award of punitive damages violated due process by considering the defendant’s activities outside the jurisdiction, by permitting punitive damages 500 times greater than compensatory damages, and by failing to give adequate notice of the possibility of such liability). In 2003, the Supreme Court stated that due process does not impose a strict limit on the ratio of punitive damages to compensatory damages, but it hinted in dictum that a single-digit ratio is safest. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003). In a more recent case, after the Supreme Court vacated a decision of the Oregon Supreme Court for reconsideration in light of *Campbell*, the Oregon Supreme Court applied the standards of *Gore* and *Campbell* and approved a punitive damages award far beyond a single-digit ratio for particularly outrageous tortious conduct, spurring the Supreme Court to grant review of the second decision. *Williams v. Philip Morris, Inc.*, 127 P.3d 1165 (Or. 2006), *cert. granted*, *Phillip Morris USA v. Williams*, 126 S.Ct. 2329 (2006).

6. *See, e.g.*, *Williams*, 127 P.3d at 1171, 1181–82 (approving punitive damages of approximately 97 times the amount of compensatory damages awarded by the jury, or 159 times the amount of compensatory damages as capped by the trial court); *Mathias v.*

All but a handful of states, however, follow some version of the traditional common law rule denying punitive damages for breach of contract, subject only to a few exceptions.⁷ Under the traditional rule, punitive damages are not available for even a deliberate breach of contract.⁸ Possible exceptions to the traditional rule include: a breach of promise to marry; a public service company's breach of contract that also constitutes a breach of duty otherwise owed by law to the public; and a breach of contract that also constitutes, or is accompanied by, either a breach of fiduciary duty or "a tort for which punitive damages are recoverable."⁹

Accor Econ. Lodging, Inc., 347 F.3d 672 (7th Cir. 2003) (approving punitive damages amounting to more than thirty-seven times the amount of compensatory damages). Because the Supreme Court has granted review in *Williams*, 126 S.Ct. at 2329, it may yet disapprove of punitive damages that greatly exceed compensatory damages, even if other circumstances seem to justify an unusually large award.

7. A few states permit punitive damages for any breach of contract that is accomplished with a certain level of culpability or that is accompanied by certain tortious elements, regardless of whether all the elements of an independent tort have been pleaded and proved. *E.g.*, *Vernon Fire & Cas. Ins. Co. v. Sharp*, 349 N.E.2d 173, 180 (Ind. 1976) (allowing punitive damages whenever "elements of fraud, malice, gross negligence or oppression mingle" with the contract breach, regardless of whether an independent tort is established) (quoting *Taber v. Hutson*, 5 Ind. 322, 324 (1854)); *Wright v. Pub. Sav. Life Ins. Co.*, 204 S.E.2d 57, 59 (S.C. 1974) (allowing punitive damages for "the breach of a contract, committed with fraudulent intent, and accompanied by a fraudulent act"); *Bank of N.M. v. Rice*, 429 P.2d 368 (N.M. 1967) (permitting punitive damages for a malicious breach of contract or a breach that reflects a wanton disregard of the other party's rights).

8. *See Thyssen, Inc. v. S.S. Fortune Star*, 777 F.2d 57, 62–63 (2d Cir. 1985) (identifying this standard as a general rule in the United States); *White v. Benkowski*, 155 N.W.2d 74 (Wis. 1967) (holding that absent an independent basis for punitive damages in tort, punitive damages were not available for breach of a water supply contract, even though the jury found that the breaching parties had maliciously cut off the flow of water to the other parties for the purpose of harassing them).

9. Dodge, *supra* note 2, at 636; HENRY MATHER, *CONTRACT LAW AND MORALITY* 117–18 (1999). *See, e.g.*, *Brown v. Coates*, 253 F.2d 36, 39 (D.C. 1958) (approving punitive damages for an agent's flagrant and intentional contract breach constituting a breach of fiduciary duty to his principal). The final exception—stated in the Restatement (Second) of Contracts as a breach of contract that "is also a tort for which punitive damages are recoverable"—appears to state the obvious. *RESTATEMENT (SECOND) OF CONTRACTS* § 355 (1981). After all, if the plaintiff pleads and proves a tort that independently supports an award of punitive damages, why would the plaintiff need a contractual basis for punitive damages? This exception might still be meaningful if some states allow an award of punitive damages when the evidence showing breach of contract also establishes an egregious tort, even though only the contract claim is properly before the jury for procedural reasons. *Cf. Brown*, 253 F.2d at 39 (holding that punitive damages may be awarded for a calculated, flagrant contract breach in disregard of obligations of trust when it "merges with, and assumes the character of, a willful tort").

In recent decades, courts in many states have authorized punitive damages for “bad faith” breaches of the implied contractual duty of good faith and fair dealing,¹⁰ at least in certain kinds of contractual relationships.¹¹ This development, however, should not be viewed as a widespread expansion of exceptions to the traditional contracts rule because most courts following this trend have recognized the breaching party’s conduct to be tortious,¹² thus providing an independent basis for awarding punitive damages.¹³ Alternatively, bad-faith breach in the context of

10. See *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198 (Cal. 1958) (holding that an insurer’s breach of an implied covenant of good faith and fair dealing sounds in tort as well as contract, thus opening up the possibility of tort recovery, including punitive damages); W. DAVID SLAWSON, *BINDING PROMISES* 74–80, 104–16, 131–32 (1996) (discussing “relational torts,” “bad faith breach,” and justifications for punitive damages); Dodge, *supra* note 2, at 637–44 (discussing the expansion of punitive damages for breach of contract in the 1970s and 1980s followed by partial retraction of this doctrine beginning in 1988).

11. Courts in some states, for example, limit punitive damages for breach of an implied duty of good faith and fair dealing to “bad faith breaches” of duties in insurance contracts. *E.g.*, *Am. Health Care Providers, Inc. v. O’Brien*, 886 S.W.2d 588, 590 (Ark. 1994). Others extend such treatment to a broader class of contracts involving “special relationships” with attributes similar to that between an insurer and insured. *E.g.*, *Rawlings v. Apodaca*, 726 P.2d 565 (Ariz. 1986) (referring to contractual relationships implicating the public interest, giving rise to fiduciary responsibilities, or raising problems of adhesion).

12. See SLAWSON, *supra* note 10, at 122 (Although parties “ought not to be liable for punitive damages merely for breaching a contract . . . [b]ad faith breach is a tort, not a mere breach of contract . . .”). With respect to courts that awarded punitive damages for bad-faith breach without recognizing it as a tort, some of them had already liberalized their law-of-contract remedies to permit punitive damages for egregious contract breaches. See, *e.g.*, *Romero v. Mervyn’s*, 784 P.2d 992, 998 (N.M. 1989) (stating that punitive damages for bad faith breach in an insurance contract were available on the relaxed basis of gross negligence or recklessness, but noting that punitive damages had long been available for breaches of other kinds of contracts on a showing that the breaching party acted at least “recklessly with a wanton disregard for the plaintiff’s rights”).

13. Of course, if the courts characterized the breach of the implied duty as a tort solely to make punitive damages available for a particularly troublesome type of contract breach, then the “tort” label may draw no more than a semantic distinction and the authority to award punitive damages for this breach ought to be viewed as an expansion of contract remedies. See generally Dodge, *supra* note 2, at 637–38 (referring to punitive damages for breach of the duty of good faith and fair dealing as an “expansion of punitive damages for breach of contract,” regardless of whether characterized as contract or tort claims); MATHER, *supra* note 9, at 132 n.24 (“Rather than tempt courts to invent new torts, . . . it would be preferable to say that certain breaches of contract call for punitive damages, regardless of whether such breaches are tortious.”). Professor David Slawson, however, argues convincingly that the tort classification in the bad-faith cases reflects a finding that the defendant’s conduct does more than breach the private contractual obliga-

certain special relationships can be viewed as a breach of fiduciary duty, falling within one of the traditional exceptions.¹⁴ The trend of awarding punitive damages in this context eventually reached a plateau and even retreated in some states.¹⁵

The general rule in the United States against awarding punitive damages for breach of contract extends to cases in which the parties' agreement attempts to set the amount of damages that a party would owe for breaching the contract.¹⁶ In general, courts in the United States will not enforce such clauses if they are designed to impose a penalty for breaching the contract rather than to fix compensatory damages at a reasonable estimate of actual injury.¹⁷ The traditional common law test in the United States is a prospective one: courts will enforce a liquidated damages clause if, at the time of contracting, the liquidated damages clause represents a reasonable estimate of the damages that would flow from a breach, taking into consideration the difficulty in calculating damages in the event of a breach or the difficulty of estimating the damages in advance.¹⁸

tions owed to the other party; it also violates community standards, causing injury to the public. SLAWSON, *supra* note 10, at 90–96, 115. The same can be said for other torts that arise out of a contractual relationship, such as wrongful discharge in violation of public policy. *See id.* at 80–81 (briefly summarizing the history of this claim and criticizing cases that find the public policy violation to constitute solely a breach of an implied contractual obligation rather than a tort). These torts, then, provide grounds for punitive damages independent of any contract claim, even though they arise out of a contractual relationship.

14. *See, e.g., Romero*, 784 P.2d at 998 n.3; Bruce Chapman & Michael Trebilcock, *Punitive Damages: Divergence in Search of a Rationale*, 40 ALA. L. REV. 741, 767–68 (1989) (speculating that intentional breach of a fiduciary duty might explain the “increasing number of American punitive damages cases in the context of insurance contracts”).

15. *See Dodge*, *supra* note 2, at 642–43 (describing the effects of a “backlash” against punitive damages); SLAWSON, *supra* note 10, at 110–12 (describing retrenchment in California jurisprudence).

16. Indeed, the historical basis for the common law's rejection of punitive damages for breach of contract may be traced to penalty bonds, which are a form of contractual penalty clause. *See infra* notes 30–38 and accompanying text.

17. *E.g., Wasserman's Inc. v. Twp. of Middletown*, 645 A.2d 100, 108–09 (N.J. 1994); U.C.C. § 2-718(1) (1998) (finding that in transactions in goods, “[a] term fixing unreasonably large liquidated damages is void as a penalty”); RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981) (stating that under the common law, “[a] term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty”).

18. *See Wasserman's*, 645 A.2d at 105–07 (tracing history, summarizing policy considerations, and synthesizing authorities). *See also* U.C.C. § 2-718(1) (1998) (stating that for a transaction in goods, a liquidated damages clause is assessed on the basis of its rea-

Under the modern trend, liquidated damages clauses may be upheld if they are reasonable in light of either the anticipated injury, viewed prospectively, or the actual injury caused by breach, viewed retrospectively.¹⁹ A retrospective test, however, generally will not be used to *defeat* a liquidated damages clause: if the liquidated damages clearly represent a reasonable estimate of actual injury in light of information available at the time of contracting, the clause will be upheld by most courts even though the actual injury caused by the breach is unexpectedly low or even non-existent.²⁰ Still, a great disparity between the liquidated damages and the actual harm suffered by a breach may help raise doubts about the integrity of the parties' estimate and may lead to particularly careful scrutiny of the clause under the prospective test.²¹ At bottom, the court must determine whether the evidence suggests that the parties, at the time of contracting, were less concerned with fixing uncertain damages than with compelling performance with an *in terrorem* penalty clause.

B. Historical Roots and Policy Justifications in the Common Law

1. Historical Dichotomy Between Torts and Contracts

Early references to extra-compensatory damages appear in the Code of Hammurabi²² and the Old Testament,²³ but the first award of punitive

sonableness in light of the "harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy").

19. See *Wasserman's*, 645 A.2d at 107; U.C.C. § 2-718(1) (1998) (judging reasonableness in light of either the "anticipated or actual harm"); RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981). It is unlikely that this second bite at the apple, however, will greatly increase the number of liquidated damages clauses that are upheld. The additional retrospective branch of the test would rescue a clause only if (1) the parties' estimate was unreasonably large in light of information available at the time of contracting, but (2) the actual harm turns out to be greater than could be anticipated, so that (3) the inflated estimate in fact corresponds reasonably to the actual damages suffered.

20. See JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 14.31(c), at 613–15 (5th ed. 2003); James Arthur Weisfield, Note, "*Keep the Change!*": A Critique of the No Actual Injury Defense to Liquidated Damages, 65 WASH. L. REV. 977 (1990) (critiquing the minority view that a reasonable liquidated damages clause is not enforceable if the victim of the breach in fact suffers no injury).

21. See generally *Wasserman's*, 645 A.2d at 107 (citing to sources suggesting that hindsight may influence the application of a purportedly prospective test, including *Wassenaar v. Panos*, 331 N.W.2d 357, 364 (Wis. 1983)).

22. See GOTANDA, *supra* note 3, at 194 & n.2.

23. See *id.*; *White*, 155 N.W.2d at 76 (quoting *Exodus* 22:1 for the mandate that a wrongdoer "shall restore five oxen for an ox, and four sheep for a sheep").

damages in the common law is attributed to the eighteenth century English case of *Wilkes v. Wood* as part of the damages awarded for a warrantless search.²⁴ Professor John Gotanda surmises that separate awards for punitive damages in appropriate cases grew out of an earlier judicial deference to extra-compensatory jury awards disguised as compensatory damages for non-pecuniary injury.²⁵

In the wake of *Wilkes v. Wood*, English courts allowed punitive damages for a wide variety of tort actions, but withheld them in actions on contractual undertakings.²⁶ Even as England limited punitive damages more narrowly to a few categories of cases for four decades in the latter half of the twentieth century,²⁷ courts in the United States continued to embrace the dichotomy of early English common law.²⁸ U.S. courts granted punitive damages for a wide variety of tortious conduct, if committed intentionally or recklessly, but generally denied them for breach of contract.²⁹

Ironically, the English common law rule against punitive damages for breach of contract may have originated with judicial and legislative antipathy to a clever form of liquidated damages clause: the conditional bond.³⁰ In such a bond, a debtor would, for a fee, make a bond to pay a certain sum of money to the creditor, which would be discharged if the debtor timely completed some other performance, such as constructing a bridge, which was the true object of the transaction.³¹ This manner of framing the obligation to construct the bridge allowed the creditor to enforce the obligation in an action on debt, which brought certain procedural advantages over an action for breach of covenant.³² Moreover, as with any form of liquidated damages, the fixed debt eliminated uncer-

24. *Wilkes v. Wood*, (1763) 98 Eng. Rep. 489 (K.B.) (discussed in GOTANDA, *supra* note 3, at 196).

25. GOTANDA, *supra* note 3, at 200–01.

26. *See id.* at 195–97.

27. *See id.* at 197–98; Andrew Tettenborn, *Punitive Damages—A View from England*, 41 SAN DIEGO L. REV. 1551, 1551–56 (2004).

28. *Id.* at 1552.

29. *See supra* notes 1–13 and accompanying text.

30. *See* Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principles: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 554–55 (1977) (cited in Wasserman's, 645 A.2d at 105).

31. *See* D.J. IBBETSON, *A HISTORICAL INTRODUCTION TO THE LAW OF OBLIGATIONS* 29 (1999).

32. *Id.* at 28–30.

tainty about the damages that might be awarded for failure to construct the bridge in an action in covenant.³³

The creditor in a conditional bond normally had sufficient bargaining power to introduce a punitive element, so that the sum conditionally owed by the debtor could significantly exceed the cost or value of the alternative performance (in this example, constructing the bridge) or of any damages that the creditor likely would suffer from the obligor's failure to render the alternative performance.³⁴ The punitive element of a conditional bond was most obvious if the alternative performance, the true object of the transaction, was itself the payment of money by a certain date. Failure to render that performance and thus discharge the bond would result in an obligation to pay a much higher amount, typically double the amount needed to discharge the bond.³⁵

During the fourteenth and fifteenth centuries, the device of the conditional bond was widely used and generally enforced with little regard for the penalties that it frequently imposed.³⁶ During the sixteenth century, however, the Chancery developed a practice of granting equitable relief from judgments at law enforcing punitive conditional bonds if the debtor had innocently failed to discharge the bond and if he promptly completed the necessary performance and paid damages for any remaining actual injury.³⁷ In 1697, this equity approach was extended by statute to actions at law, at least for conditional bonds with obvious penalties, thus eliminating the need for a two-step process of securing a full judgment at law on the bond and then adjusting the relief in a separate action in equity.³⁸

Thus, by 1763, when English courts began awarding punitive damages in tort actions,³⁹ a tradition against penalties in contract actions was well-established. The historical dichotomy in the common law between tort and contract in the availability of punitive damages, however, still begs the policy question: Why did the Chancery find that punitive conditional bonds violated principles of equity, a reaction later echoed by Parliament just seventy years before the advent of punitive damages awards in

33. *Id.*

34. *See id.* at 29.

35. *Id.* at 30.

36. IBBETSON, *supra* note 31, at 28–29, 29 n.23.

37. *Id.* at 29 n.23, 213–14.

38. *Id.* at 214. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 356(2) (1981) (as a matter of contemporary U.S. common law, declaring a conditional bond to be unenforceable on grounds of public policy to the extent that it imposes a penalty in excess of the loss caused by non-occurrence of the condition of the bond).

39. *See supra* note 24 and accompanying text.

common law tort actions? More to the point, because the rule against punitive damages in contract actions in the United States is defended now on grounds of public policy rather than purely as a historical hold-over from English law, what are the policies that support the rule? Do these policies justify withholding punitive damages across the board for all contract breaches and withholding enforcement of all penalty clauses? In exploring the policy justifications for the general rule against punitive damages in contract actions, it may be impossible to fully separate post-hoc policy arguments from those that may have motivated early hostility to penalty clauses in the common law legal system.⁴⁰ A brief survey of the leading arguments, however, will inform a comparative analysis of the French approach.

2. Policy Justifications for the Rule Against Punitive Damages and Against Enforcing Penalty Clauses

Unlike civil law jurisdictions, common law jurisdictions within the United States cannot justify the contract rule against punitive damage awards on the ground that punishment should be reserved for the criminal justice system due to its elevated burden of proof and other procedural protections.⁴¹ In contrast to, for example, the French Civil Code,⁴² U.S. common law permits punitive damages in civil actions in tort,⁴³ using the same general civil procedures and burdens of proof as would apply for any civil claim, including one for breach of contract.⁴⁴

40. Cf. Dodge, *supra* note 2, at 630 & n.3 (quoting Timothy J. Sullivan, *Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change*, 61 MINN. L. REV. 207, 221 (1977) (other than simple adoption of the traditional English rule, the reasons for the U.S. contract rule against punitive damages are unclear)).

41. See GOTANDA, *supra* note 3, at 193.

42. See *infra* Part III.

43. See *supra* notes 1–4 and accompanying text.

44. True, the power to impose punitive damages outside the restrictions of the criminal justice system “increases our concerns” in the American judiciary about the administration of punitive damages. *State Farm Mut. Auto. Ins. Co.*, 538 U.S. at 417. Accordingly, punitive damage awards are subject to constitutional review for possible violations of due process, see *supra* note 3, and the constitutional imperative to police punitive damage awards in turn mandates effective review procedures, see *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 440–43 (2001) (engaging in an unrestricted review of the mixed question of law and fact of whether a jury’s award of punitive damages comports with due process). These due process restrictions on punitive damages, however, would apply equally to punitive damages awarded for breach of contract, and they do not import the full range of safeguards for which our criminal system is known.

One might attempt to explain the difference in availability of punitive damages between tort and contract actions in the United States on the basis of the source of the obligation in each type of action. While tort duties are based on community standards of conduct,⁴⁵ contractual obligations are, for the most part,⁴⁶ created and defined by the parties.⁴⁷ It may be plausible to assume that parties normally do not intend to create mutual obligations that place themselves at risk of paying an uncertain amount of punitive damages in the event of breach. This assumption, however, might not hold true for all breaches. If they addressed the question, some parties might favor the availability of punitive damages for reckless or intentional breaches, particularly if each could not envision acting with such culpability himself. The inability of the parties to draft around the rule shows that the contract rule against punitive damages is based on broader public policy concerns, and not simply on generalizations about the intentions of the parties. Penalty clauses, even though voluntarily adopted by the parties, are unenforceable.⁴⁸

Our efforts to explain the different treatment of contracts and torts in the common law system likely will bear more fruit if we begin with the goals or purposes of punitive damages and then examine the extent to which the contract rule against punitive damages is consistent with those goals or purposes and with policies underlying contract law.

As underscored by the frequent characterization of punitive damages as “exemplary damages,”⁴⁹ the primary purpose of punitive damage awards is to supplement compensatory damages as a means of deterring future reckless or intentional torts.⁵⁰

Secondarily, punitive damages serve a broad retributive purpose. Punitive damages allow the jury to express the community’s outrage at egregiously wrongful conduct by imposing punishment that the wrongdoer deserves.⁵¹ Moreover, punishment of the wrongdoer provides the victim of the wrongdoing with a sense of satisfaction that justice has

45. Patrick J. Kelley, *Restating Duty, Breach, and Proximate Cause in Negligence Law: Descriptive Theory and the Rule of Law*, 54 VAND. L. REV. 1039, 1063 (2001).

46. Of course, the parties’ agreement is subject to judicial interpretation, *see* RESTATEMENT (SECOND) OF CONTRACTS §§ 201–04 (1981), to judicial trimming of provisions that are unconscionable or that violate public policy, *see id.* §§ 178, 208, 356, and to the addition of legally implied obligations, such as the obligation of good faith and fair dealing, *see id.* § 205.

47. E. ALLAN FARNSWORTH, CONTRACTS 3–5 (3d ed. 1999).

48. *See supra* notes 16–21 and accompanying text.

49. SLAWSON, *supra* note 10, at 122.

50. MATHER, *supra* note 9, at 117.

51. SLAWSON, *supra* note 10, at 122–23.

been done⁵² or a sense of satisfaction that may come with exacting revenge on the wrongdoer.⁵³

Punitive damages also supplement compensatory damages as a means of substituting for, and thus discouraging, violent or otherwise antisocial self-help remedies.⁵⁴ Finally, an award of punitive damages may help to cure any deficiency in the compensatory damage award's redress of all injuries, as well as to pay for the costs of litigation.⁵⁵

The final two purposes of punitive damages described above need not detain us long. The goal of discouraging self-help remedies does not explain the tort/contract dichotomy because egregious breaches of contract,

52. SLAWSON, *supra* note 10, at 122 (referring to retribution that gives the defendant "his just deserts," thus both "vindicat[ing] the public values against which the wrongdoer offended" and "assuag[ing] the suffering of the injured party"). "In the retributive view, the justification of any punishment is backward-looking and desert-based rather than forward-looking and consequentialist." Chapman & Trebilcock, *supra* note 14, at 780. The secondary nature of the retributive purpose of punitive damages is underscored by Professor Mather: "Punishment is not justified when it is purely retributive But punitive damages can serve beneficial purposes." MATHER, *supra* note 9, at 118–19. *But cf.* Chapman & Trebilcock, *supra* note 14, at 780 (discussing the Kantian view that retribution should be the primary goal of punishment, without constraints induced by other benefits that might flow from punishment or from abandoning or reducing it).

53. Studies suggest that humans have an evolved tendency to punish others within their group who act unfairly or uncooperatively in the pooling or distribution of resources, even if the punishment would further reduce resources immediately available to the punishing party. Karl Sigmund, Ernst Fehr & Martin A. Nowak, *The Economics of Fair Play*, 286 SCI. AM. 82, 83–87 (2002) (referring to "an ambitious cross-cultural study," to variations of an "ultimatum game" studied by economists, to an evolutionary model studied by authors Sigmund and Nowak and by Karen M. Page, and to experiments conducted by author Fehr and Simon Gächter). Early humans who acted this way may simply have derived a sense of satisfaction that outweighed the immediate economic cost of exacting the revenge. *See id.* at 86–87 (noting that "revenge is sweet"). Humans possessing that tendency, in turn, likely developed a reputation in the community that discouraged unfair behavior toward them in the future, thus increasing the chances that they would survive, thrive, reproduce, and pass their vengeful genes to offspring. *See id.* at 85–86. In other cases, their actions may have served to maintain discipline and cooperation in a group whose solidarity is threatened by external forces, thus increasing the possibility that the entire group will survive. *Id.* at 87. Interestingly, although the punishing parties may have acted solely in response to an emotional desire to exact revenge, rather than in response to a conscious calculation of the long-term effects of their actions, *id.*, an evolutionary observer should conclude that the vengeful actions incidentally served the policy of deterring others from directing unfair actions toward the punishing party in the future or of deterring antisocial behavior that threatens the entire group. Thus, a retributive desire for revenge may ultimately serve the goal of deterrence.

54. GOTANDA, *supra* note 3, at 195.

55. *Id.*

as well as egregious torts, presumably would increase pressures for self-help in the absence of adequate damages. Compensatory damages likely will be sufficient to discourage extra-legal self-help in the case of a tort or contract breach of low culpability that causes less offense to the other party. Conversely, some residual pressure for self-help likely will remain in the absence of punitive damages in the case of either a tort or contract breach that provides great offense to the other party, such as conduct taken with a malicious intent to harm.

At first blush, the final purpose of redressing deficiencies in non-punitive awards might support the rule permitting punitive damages in tort actions but not contract actions. Tort plaintiffs generally must pay attorneys' fees out of their own pockets or damage awards, whereas prevailing parties in contract actions will frequently receive an award of reasonable attorneys' fees, either by statutory authorization⁵⁶ or by provision of the contract being enforced. Unless the means for calculating punitive damages⁵⁷ were changed, however, punitive damage awards would provide an exceedingly crude and imprecise means of financing the costs of litigation. Moreover, punitive damage awards should not be employed as a covert means of correcting deficiencies in compensatory damages or addressing runaway costs in our adversary system. Such problems, to the extent they exist and can be redressed, should be addressed more directly.

Thus, even this cursory inquiry shows that the third and fourth goals of punitive damages are inadequate to explain the tort/contract dichotomy in U.S. law. The goals of retribution and deterrence, however, raise some interesting questions that warrant fuller discussion.

a. Retribution

If a reckless or deliberate breach of contract does more than disappoint the expectations of the other party, and if it constitutes a moral wrong or otherwise injures the public by offending community values, then the breaching party may deserve to be punished—and the community, through the jury, may be justified in expressing its disapproval—with extra-compensatory damages. If so, then this retributive purpose of punitive damages would also be served by judicially enforcing a penalty

56. *E.g.*, ARIZ. REV. STAT. ANN. § 12-341.01 (2003).

57. *See, e.g.*, *Kirkbride v. Lisbon Contractors, Inc.*, 555 A.2d 800, 803 (1989) (using factors listed in the Restatement of Torts § 908(2) for assessment of punitive damages, such as the character of the act, the extent of the harm, and the wealth of the defendant).

clause if its application is limited to breaches reflecting a requisite degree of culpability.

On the other hand, the retributive purpose for punitive damages awards can be consistent with the current practice of awarding punitive damages for reckless or intentional torts, and not for similarly culpable breaches of contract, if such breaches of contract are viewed as less blameworthy than their counterparts in tort. Justice Holmes guaranteed himself a place at the table for any discussion of this issue with his widely quoted remarks about the nature of contractual obligations: “[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else.”⁵⁸ Accordingly:

The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfilment has gone by, and therefore free to break his contract if he chooses.⁵⁹

All will agree that purely innocent breaches, such as ones arising from non-culpable oversight, miscalculation, or inability to accomplish a promised task despite best efforts, do not merit retributive punishment beyond compensatory damages.⁶⁰ On their faces, however, Justice Holmes’ statements appear to support the argument that even a deliberate breach of contract is not a moral or legal wrong, but instead is a legitimate option open to the obligor who may exercise that option by paying compensatory damages, measured by expectation interest, in lieu of performance.⁶¹

Professor Joseph Perillo has argued that Holmes’ statements have been misinterpreted and that Holmes’ private correspondence and utterances from the bench suggest that he would characterize contract breaches as wrongful conduct, on the same plane as tortious conduct.⁶² Aside from

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

59. O.W. HOLMES, *THE COMMON LAW* 301 (1881).

60. See, e.g., MATHER, *supra* note 9, at 119 (arguing that unavoidable or negligent breaches, or ones that are the product of misinterpretation of the contract, are insufficiently blameworthy to justify punitive damages).

61. See SLAWSON, *supra* note 10, at 122 (stating that persons who breach contracts “have done nothing wrong if they pay full compensation”).

62. Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 FORDHAM L. REV. 1085, 1085–87 (2000).

the intended meaning of Holmes' remarks, others have argued that at least some kinds of breaches reflect moral fault.⁶³

One can hardly deny that some breaches are more morally blameworthy than others. For example, an innocent oversight that leads to installation of the wrong brand of pipe⁶⁴ reflects less culpability than a malicious breach of contract committed for the purpose of harming the other party.⁶⁵ The ultimate question is whether contract remedies should distinguish between these levels of culpability or leave notions of fault out of the equation.

Some have justified the denial of punitive damages for breach of contract by noting that contract liability, unlike most tort liability, is not fault-based.⁶⁶ This assertion, however, is subject to critique. True, if a promisor undertakes to achieve a certain result, rather than merely exercise a certain degree of skill or effort, the promisor's failure to achieve that result will constitute a breach of contract, regardless of the promisor's degree of effort, skill, good faith, and conscientiousness,⁶⁷ subject

63. *E.g.*, MATHER, *supra* note 9, at 118–19 (arguing that contract remedies should depend on the degree of moral fault, justifying punitive damages for intentional breach of contract).

64. *Jacob & Youngs, Inc. v. Kent*, 192 N.E. 889, 890 (N.Y. 1921) (finding that “the omission of the prescribed brand of pipe was neither fraudulent nor willful,” but the result of “oversight and inattention”).

65. *White*, 155 N.W.2d at 75 (finding that the breaching parties had maliciously cut off the flow of water to the other parties for the purpose of harassing them). In *White*, evidence submitted at trial tended to show an escalating series of personal squabbles between the parties, who were neighbors, prior to the malicious breach of contract. *See* Robert A. Hillman, *Enriching Case Reports*, 44 ST. LOUIS U. L.J. 1197, 1201 (2000) (quoting ROBERT S. SUMMERS & ROBERT A. HILLMAN, *CONTRACT AND RELATED OBLIGATION* 17 (3d ed. 1997)).

66. *E.g.*, MATHER, *supra* note 9, at 117 (noting that the rule against punitive damages is partly based on the traditional rule that “the remedy for breach of contract should not depend on the degree of fault of the breaching party”).

67. *See, e.g.*, *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 750 (7th Cir. 1988). A finding that the breach was innocent, unintentional, or in good faith, rather than willful, however, may combine with other factors to help show that the breach was minor, rather than material, and that it thus satisfied constructive conditions for counter-performance. *See, e.g.*, *Walker & Co. v. Harrison*, 81 N.W.2d 352, 355 (Mich. 1957) (quoting RESTATEMENT (FIRST) OF CONTRACTS § 275(e) (1932), which refers to the “willful, negligent or innocent behavior” of the breaching party as relevant to the determination of material breach); *Jacob & Youngs, Inc.*, 192 N.E. at 891 (stating that the “willful transgressor,” unlike one whose “default is unintentional and trivial,” has “no occasion to mitigate the rigor of implied conditions”). RESTATEMENT (SECOND) OF CONTRACTS § 241(e) (1981) (relevant to the determination of the materiality of breach is “the extent to which

only to limited legal excuses such as supervening impossibility.⁶⁸ Conceding that breach may be found on the basis of strict liability, however, does not answer the question of whether retributive goals might yet be vindicated by awarding differing levels of recovery for breaches that reflect different degrees of culpability.

Thus, one might reasonably ask whether some highly culpable breaches of contract would sufficiently offend community values as to justify retribution in the form of punitive damages. Professor Henry Mather would find “damage to social trust and to the practice of contracting,” and would award punitive damages, in the case of any “clearly knowing and intentional breach” of contract, subject only to a narrow exception for breaches compelled by the need to perform a “higher moral duty to a third person” such as deliberately failing to pay a phone bill on time so that hungry children can be fed.⁶⁹

Not all intentional breaches, however, warrant punishment to satisfy the plaintiff’s and the community’s desire for retribution. Retribution may provide partial justification for punishing a defendant who has maliciously breached for the purpose of harassing the plaintiff,⁷⁰ or perhaps one who has intentionally breached in an attempt to reallocate from the plaintiff to himself a greater proportion of a fixed amount of resources.⁷¹ Community values, on the other hand, may not be offended by even intentional breaches that are “efficient” in the sense that they serve to increase total wealth, rather than diminish or selfishly reallocate existing wealth.⁷²

the behavior” of the breaching party “comports with standards of good faith and fair dealing”).

68. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981).

69. MATHER, *supra* note 9, at 119 (arguing also that punitive damages for such breaches satisfy a deterrence function and would educate the public that performing contracts “is an important community norm”). See also SLAWSON, *supra* note 10, at 123 (punitive damages would promote a private attorney general function by “encouraging people to identify and punish those who are guilty of civil wrongdoing”).

70. See, e.g., *supra* note 52.

71. See Dodge, *supra* note 2, at 652–57 (arguing for punitive damages for such breaches, which the author characterizes as “willful” breaches that are “opportunistic” rather than “efficient”).

72. See *id.* at 663 (even a deliberate breach “is not necessarily blameworthy” if supported by efficiency concerns) (quoting Judge Richard A. Posner in *Patton v. Mid-Continent Sys.*, 841 F.2d 742, 750 (7th Cir. 1988)); SLAWSON, *supra* note 10, at 122 (People who breach contracts “have done nothing wrong if they pay full compensation. Indeed, society loses if people do *not* breach contracts that would cost them more to perform than to pay compensation for breaching.”).

Professor Mather reached his conclusions favoring punitive damages for intentional breaches of contract after rejecting efficient breach arguments.⁷³ The arguments grounded in economic efficiency, however, merit further discussion in the context of the deterrence goals of punitive damages.

b. Deterrence

If the time for contract performance has not passed, and if the victim of a repudiation can overcome the significant hurdles to the extraordinary and discretionary equitable remedy of specific performance,⁷⁴ a court can deter further breach of that contract in a most direct manner by issuing an injunction compelling performance.⁷⁵ In the typical case, however, specific relief will be unavailable for practical or legal reasons,⁷⁶ and the threat of liability for damages will serve as the main legal deterrent to breach. Although the prospect of paying compensatory damages for a civil wrong has deterrent value,⁷⁷ the risk of liability for a potentially much larger award of punitive damages presumably enhances the deterrence considerably.

With assistance from the efficient breach doctrine, the policy of deterrence may help to explain the tort/contract dichotomy in the availability of punitive damages in the United States. Because reckless or intentional torts by their very nature offend community values, and because they often cause their victims to suffer significant physical or emotional injuries, legal rules that tend to deter such conduct, such as the availability of punitive damage awards, are viewed as appropriate in the common law system.⁷⁸ The efficient breach doctrine, on the other hand, argues that some kinds of contract breaches will benefit the community and should

73. MATHER, *supra* note 9, at 118.

74. *See, e.g.*, E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1151–56 (1970).

75. Specific relief would not necessarily serve a retributive purpose, nor would it necessarily deter other parties in the future as surely as would the availability of punitive damages. Its primary effect would be to prevent breach, or prevent further breach, in the case at hand.

76. *See generally* STEPHEN A. SMITH, *CONTRACT THEORY* 398–408 (2004) (critically examining explanations for the common law's reluctance to grant the "secondary remedy" of specific performance).

77. *See, e.g.*, DAN B. DOBBS, *THE LAW OF TORTS* 17–19 (2001).

78. *See generally* SMITH, *supra* note 76, at 419 (contrasting the seriousness of a physical assault with even a deliberate breach of contract that causes only pecuniary harm, particularly when the deliberately breaching party does not compound the breach by then denying liability).

be permitted, or even encouraged, rather than deterred with extra-compensatory damages.⁷⁹

The most easily defended efficient breach is one that achieves Pareto optimality by leaving some entities better off because of the breach, while leaving no party in a worse position than if the contract had been performed.⁸⁰ For an illustration, suppose that Pierce Construction Company of Desert City (Pierce) is hired to excavate a site for a new parking garage at Mercado Shopping Center (Mercado), with a completion date of August 1, earning the owner an estimated \$20,000 in profit after payment of materials, labor, and other expenses. After Pierce bound itself to Upstart Development Company (Upstart), but before commencement of performance, Upstart received the final permits and financing needed to begin construction on an upscale boutique shopping center on the edge of the city around a picturesque array of huge boulders. Anxious to break ground immediately, and recognizing that Pierce was uniquely qualified to perform the complicated grading and excavation around the boulders, Upstart offered Pierce a lucrative contract to perform that work, which would earn Pierce an estimated \$60,000 profit. Pierce, however, did not have the capacity to complete both the Mercado contract and the Upstart project by August 1, and Upstart remained firm on the completion date, fearing that any delay would disrupt parking during the onset of the holiday shopping season in early November. If Pierce repudiated the Mercado contract, Mercado could hire another perfectly well qualified contractor to perform its rather routine excavation, but only at a fee of \$10,000 above Pierce's fee under the original contract because of extra costs associated with the short notice, causing Mercado to suffer \$10,000 in damages.

In these circumstances, if Pierce breached the contract with Mercado, voluntarily paid (or was compelled to pay) \$10,000 in compensatory damages to Mercado, and reallocated its resources to the Upstart project, then the community would benefit. With the \$10,000 in damages, Mercado would realize its expectation of securing timely and competent excavation without expending any more of its own resources than it had

79. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 142 (5th ed. 1998); Dodge, *supra* note 2, at 631–32 nn.6–9 (citing to sources that promote the efficient breach argument).

80. See Dodge, *supra* note 2, at 652–53 (explaining the difference between Pareto efficiency, in which the breach causes some to be better off and no one to be worse off, and Kaldor-Hicks efficiency, in which the breach increases total wealth but the victim of the breach may be worse off for the breach); Perillo, *supra* note 62, at 1091–92, 1091 n.40.

originally bargained to pay Pierce. Indeed, because contract remedies thus protect the expectation interest of the victim of breach, Mercado theoretically should be “*indifferent* between performance and breach.”⁸¹ In turn, having abandoned the Mercado contract, Pierce would have the opportunity to put its unique capabilities to full use in a new project that will boost its profits by \$40,000, for a net gain of \$30,000 additional profits after paying \$10,000 in compensation to Mercado. Theoretically, Mercado is no worse off than if Pierce had performed its contract, Pierce is better off for having breached that contract, and the greater income to Pierce and the advancement of the Upstart project likely will have further multiplier effects on the local economy.

Pierce will have an economic incentive to breach its contract with Mercado if it is confident that, in a suit by Mercado to secure damages for Pierce’s breach of contract, a court would award only Mercado’s compensatory damages in the amount of Mercado’s expectation interest, which is \$10,000 in this case. If the law instead would permit a jury to award additional and substantial punitive damages for Pierce’s intentional breach, Pierce would face the risk of total liability that exceeded the additional profit earned on the Upstart project, and Pierce likely would turn down the Upstart project to avoid that risk.

In sum, according to the efficient breach theory, the welfare of the community will be enhanced if the law does not permit the threat of punitive damages to deter parties in Pierce’s position from breaching. By extension, concerns about efficient allocation of resources would also support a rule that denies enforcement of contract clauses that go beyond liquidating compensatory damages and that contemplate penalties large enough to deter efficient breaches.⁸²

81. ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 226 (3d ed. 2000) (emphasis added).

82. Because Pierce’s performance, once provided to Mercado, cannot then be transferred to Upstart, economic efficiency would also support a court’s exercise of discretion to refrain from ordering specific performance of Pierce’s obligation to Mercado. *See Walgreen Co. v. Sara Creek Prop. Co.*, 966 F.2d 273, 274 (7th Cir. 1992) (opinion by Judge Posner, citing to fact-based discussion in *N. Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 279 (7th Cir. 1986)); COOTER & ULEN, *supra* note 81, at 240–41; SMITH, *supra* note 76, at 405. One scholar argues that specific performance should be more widely granted because setting awards of money damages presents uncertainties in valuation, which in turn complicates settlement negotiations and increases transaction costs. Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 365–66 (1984). Regardless of whether specific enforcement is widely or only rarely granted, it would not necessarily prevent efficient allocation of resources, because an efficiently breaching party can always seek

Although the efficient breach theory is the dominant contemporary justification offered for the unavailability of punitive damages for contract breaches,⁸³ it has attracted criticism on a number of grounds. Most obviously, not all breaches are economically efficient. The suppliers of water in *White v. Benkowski* breached the water supply contract not to reallocate the water resources to a more valuable use⁸⁴ but to maliciously harass the other parties with whom the suppliers had been embroiled in an escalating series of personal squabbles.⁸⁵ In other cases, a party might breach a contract in an effort to gain a greater share of fixed resources in a zero-sum game with the other party, without increasing the size of the economic pie.⁸⁶ In either case, unlike an efficient breach, the breach disappoints expectations without increasing total wealth. If such cases could be easily distinguished from efficient breaches, and if parties contemplating breach could accurately predict whether their breaches would be deemed to fall outside the category of efficient breaches, the threat of punitive damages for inefficient breaches could provide deterrence without offending the efficient breach doctrine.

In addition, some commentators reject the efficient breach doctrine even as applied to breaches that economists would define to be Pareto efficient. These critics argue that the victim of breach is in fact worse off for the breach because payment of compensatory damages, as defined by applicable legal standards, will not fully compensate the victim for all losses caused by the breach;⁸⁷ that few breachers, efficient or otherwise, voluntarily offer to pay compensation, often causing victims of the breach to take less than is due to them to avoid litigation costs;⁸⁸ that the

to persuade the other party to release it from contractual obligations, and thus from the threat of specific relief, by offering to share a substantial proportion of the increased profits to be earned in the new enterprise. See *Walgreen Co.*, 966 F.2d at 275–76 (warning about the risk of negotiations breaking down when two parties must bargain in a bilateral monopoly where much is at stake).

83. Dodge, *supra* note 2, at 630–31.

84. One could assert such a purpose if the jury had believed that the Benkowskis had shut off the Whites' water supply for the purpose of conserving a scarce resource for a more valuable use than fulfilling the contract with the Whites; however, the jury found otherwise. See *White*, 155 N.W.2d at 75.

85. See *supra* note 63.

86. Dodge, *supra* note 2, at 652–53 (discussing Posner's views on such "opportunistic breaches"). See POSNER, *supra* note 79, at 130.

87. E.g., Perillo, *supra* note 62, at 1093–94. See also *infra* note 216.

88. E.g., Dodge, *supra* note 2, at 664. This objection to efficient breach theory is partially vindicated by the willingness of courts to award punitive damages for bad faith breaches in some contexts. See *supra* notes 8–12 and accompanying text.

efficient breach doctrine fails to account for and internalize the social costs and harm to community values engendered by a breach of contract;⁸⁹ that failing to allow for punitive damages will encourage deliberate breaches that are inefficient because the breaching party is apt to overestimate the gains to be earned by the breach and to underestimate the losses suffered by the victim of the breach;⁹⁰ and that allowing punitive damages for a deliberate breach will not discourage efficient breaches but will simply force efficient breachers to negotiate a release in exchange for a share of the gain to be earned by the breach.⁹¹

Indeed, as applied to enforcement of freely negotiated extra-compensatory liquidated damages clauses, some argue that enforcing the penalty helps to realize other efficiencies by permitting parties to allocate their risks in a way that best meets their interests.⁹² For example, suppose that a bride and groom have an intensely sentimental attachment to the five-piece swing band that performed at a local club the night they first danced together and fell in love. They greatly desire to hire the band to play at their wedding reception, but the bride and groom are terrified that the band might cancel and leave them scrambling for a substitute band or playing recorded music. The bride and groom will derive so much subjective benefit from the appearance of this band, and they will gain such peace of mind if they can secure special assurances of the band's performance, that they are happy to pay \$5,000—double the band's normal rate of \$2,500—if the band agrees to waive the right to that fee and be liable for additional damages of \$6,000 in the event that it fails to perform at the appointed time and place. The bride and groom are willing to pay a premium for special assurance of performance, which we might cleverly call an “assurance of performance policy,” and which is more valuable to the bride and groom than insurance coverage from a third party, because—at least at the time of contracting—the bride and groom derive more value from the ability to compel performance than from the right to collect money for non-performance.⁹³

89. MATHER, *supra* note 9, at 118.

90. *Id.*

91. Dodge, *supra* note 2, at 632–34, 665–99.

92. See, e.g., *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1289 (7th Cir. 1985) (dicta criticizing the state common law rule that uniformly withholds enforcement of penalty clauses); Juergen Noll, *Economic Implications of Contractual Penalties—Where Courts Go Wrong*, in *TRENDS IN MACROECONOMIC RESEARCH* 143, 150–60 (Lawrence Z. Pelzer ed., 2005).

93. Charles Goetz & Robert Scott, *Liquidated Damages Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model of Efficient Breach*, 77

In turn, the band members are happy to agree to these terms, because they cannot foresee any event that would cause them to cancel their performance or even to arrive late, and they recognize that the penalty clause allows them to send a strong signal of their reliability, a signal for which the bride and groom are willing to pay a premium that is greatly valued by the impecunious members of the band.⁹⁴ Assuming that the damages clause, coupled with the band's waiver of the \$5,000 fee, exceeds any reasonable estimate of the actual damages that the bride and groom could recover under legal standards in their jurisdiction, it will be viewed as a penalty, designed to compel performance. If it were enforceable, the band likely would be induced to take extra precautions to avoid breach in the days preceding the performance date, such as avoiding situations that might cause band members to become seriously ill, injured, or stranded at a faraway airport.⁹⁵

The common law rule against enforcing such a penalty clause deprives the bride and groom of the peace of mind for which they are willing to pay a premium and also deprives the band members of the opportunity to double their pay in exchange for essentially surrendering the option of deliberately breaching—an option on which they placed little or no value—and for incurring the cost of taking reasonable precautions against an unintentional breach. A rule that enforced such a clause would enhance efficiency by allowing the parties to increase their total utility.⁹⁶

COLUM. L. REV. 554, 578 (1977) (illustrating this point with their example of the Anxious Alumnus, an unusually loyal fan of his alma mater's basketball team, who is concerned that a bus carrying friends to an important college basketball game will not arrive on time or at all); COOTER & ULEN, *supra* note 81, at 236–37 (discussing the case of the Anxious Alumnus); UGO MATTEI, *COMPARATIVE LAW AND ECONOMICS* 179–81 (1997) (presenting his example of a bride's father who is anxious to ensure that a builder renovates a country house in time for the wedding, and who wants to ensure performance rather than simply collect money from a third-party insurer in the event of breach).

94. See COOTER & ULEN, *supra* note 81, at 237 (explaining that a penalty clause may be the cheapest way to “convey information about the promisor's reliability”); POSNER, *supra* note 79, at 142.

95. Some argue that the threat of penalty for breach will induce precautions to a degree that is inefficient. *E.g.*, Samuel A. Rea, Jr., *Efficiency Implications of Penalties and Liquidated Damages*, 13 J. LEGAL STUD. 147, 166 (1984). The party assuming the risk of penalty, however, presumably can assess the precautions appropriate to comfortably assure performance and can determine the increase in fee that will compensate for the additional precautions and residual risk. If the other party is willing to pay that premium, then the value placed on that assurance of performance by the other party outweighs the costs of taking precautions.

96. Of course, courts would need to police penalty clauses to ensure that they are not the products of overreaching. Judge Posner has suggested a rule that ordinarily enforces a

Moreover, in the highly unlikely event that another client valued the band sufficiently to offer \$10,000 to perform at the same time and date of the wedding reception, the band would not be absolutely precluded from taking advantage of the new opportunity. Even though the \$6,000 net penalty exceeds the net benefits of an additional \$5,000 in earnings to be derived from taking advantage of the new opportunity, the band could attempt to negotiate a release from the bride and groom. The latter would then have the opportunity to reassess the level of their desire for this band and to weigh it against other benefits that could be purchased with the settlement offered by the band.

True, the bride and groom set the penalty over and above withholding the band's \$5,000 fee at the *in terrorem* level of \$6,000 for the purpose of compelling performance, and not because they prefer to collect the penalty, much less a smaller amount.⁹⁷ Accordingly, they would not likely agree to a release on terms that made sense to the band. However, just as an intervening opportunity has altered the band's valuations, changes in the circumstances of the bride and groom might increase their willingness to negotiate. For example, suppose the wedding reception guest list unexpectedly expanded by twenty percent after the bride and groom contracted with the band, with no additional funding from parents and other relatives available. In light of these changed circumstances and the great desire of the bride and groom to retain the quality of the food and drink that they plan to serve, the bride and groom might reluctantly accept the notion of hiring a substitute band if the contracted band agrees not only to forgo its fee of \$5,000—more than sufficient to allow the bride and groom to hire a good substitute band—but also to pay an additional \$4,000 in damages, which the bride and groom desperately need to meet the new catering budget. Unless other considerations outweigh their expected net gain of \$1,000,⁹⁸ the band will be willing to agree to this

penalty clause freely negotiated by a sophisticated party such as a "substantial corporation." *Lake River Corp.*, 769 F.2d at 1288–89.

97. See MATTEI, *supra* note 93, at 180 (explaining why the anxious father of the bride in his example prefers to compel performance over collecting money from a third-party insurer).

98. For example, non-pecuniary considerations might make the new offer less attractive than its fee suggests. The band members might be motivated to forgo the additional \$1,000 if they were acquainted with the bride and groom and would derive considerable psychic income from performing at the wedding reception, and if the alternative performance imposed psychic costs because it was a fundraiser for a cause that the band members abhor.

settlement because obtaining a release from the contract permits it to increase its income by \$5,000 while paying \$4,000 in damages.

If, on the other hand, the circumstances of the bride and groom have not changed, and if they value performance more than an offered settlement of \$5,000 in waived fees and up to \$5,000 in additional damages, the band will not obtain a release. In that case, if the penalty clause was enforceable, the band would be forced to forgo the new opportunity even though the third party valued the band at \$10,000, and the wedding couple will pay only \$5,000, arguably resulting in an inefficient result. The supposed inefficiency, however, rests on acceptance of a measure of compensatory damages based on general market valuations. It may be that most wedding couples would suffer little damage if the contracted band canceled with ample notice, foregone its fee, and allowed the wedding party to arrange a substitute transaction at perhaps a slightly higher fee to obtain a comparable band on shorter notice. However, if the bride and groom in this case rejected the band's offer to forgo its fee and pay up to an additional \$5,000 in damages, the bride and groom apparently would have determined that their subjective injury exceeds the gains that the band could earn from breaching, so that the breach would not be efficient by those standards. Whether this more subjective valuation of damages should be honored is worth discussion and debate.

Moreover, although a rule enforcing the penalty clause, coupled with the band's failure to obtain a release from its obligation, prevents the band from earning a higher fee, its position is similar to that of any party who feels regret after a change in the market. In this case, the band voluntarily committed itself irrevocably to an attractive fee—double its normal rate—while gambling that a still more lucrative but conflicting opportunity would not later present itself. It had the option of insisting on a contract promising payment of its normal fee and with no more than the usual consequences for breach, but it found the opportunity to earn double the normal rate to be sufficiently attractive to place economic restrictions on its Holmesian option to breach and to pay the standard expectation interest.⁹⁹

c. Summing Up but Suspending Judgment

A review of the arguments outlined above suggest that some kinds of contract breaches—such as a deliberate breach accomplished solely for the purpose of depriving the other party of contractual benefits, without increasing total wealth—merit retributive punishment and justify an

99. See *supra* notes 57–58 and accompanying text.

award that will deter such breaches in the future. Purely innocent breaches do not merit retributive punishment. Moreover, the risk of liability for compensatory damages should be sufficient to deter overly casual promising by those who lack the ability to perform, whereas the threat of extra-compensatory damages could discourage bargaining between honest and able parties.¹⁰⁰ Between these extremes of the spectrum lie deliberate but efficient breaches, which promoters of the efficient breach doctrine would not punish, but for which Professor Dodge would award punitive damages in the hope of inducing the breaching party to buy a release from the victim of the breach, using part of the gains from the efficient breach.¹⁰¹ Alternatively, a legal rule could award the more certain amount of the breaching party's gains from deliberate breach, once again providing an incentive for an efficiently breaching party to buy a release from the victim of the breach. The victim will be motivated to sell a release to pave the way for a share of the additional profits in an alternative opportunity.

The efficient breach argument is often advanced to justify the historical tort/contract dichotomy in the common law, which excludes punitive damages for all breaches. However, because the goals and purposes of punitive damages are advanced by awards of extra-compensatory damages for some kinds of breaches but not for others,¹⁰² public policy might be better vindicated with a more nuanced rule if the sheep can be separated from the goats. Because punitive damages are not a matter of right, but are left to the discretion of the jury,¹⁰³ contract law could permit punitive damages in all cases—or in a broadly defined class of cases, such as deliberate breaches—and could leave it for the jury to assess whether a particular breach is sufficiently antisocial in the circumstances to merit retribution and deterrence. However, because common law rules regarding compensatory damages are designed to control jury discretion,¹⁰⁴ any tinkering with the general rule against punitive damages would most realistically take the form of a relatively bright-line rule that identifies certain kinds of breaches generally warranting punishment and deterrence. Discretion would still be left to the jury within such categories to award or withhold punitive damages for such breaches, in light of the particular circumstances of the case.

100. Nicholas J. Johnson, *The Boundaries of Extracompensatory Relief for Abusive Breach of Contract*, 33 CONN. L. REV. 181, 185 (2000).

101. Dodge, *supra* note 2, at 682.

102. *Supra* notes 64–65, 69–72, 84–85.

103. *Supra* note 1.

104. PERILLO, *supra* note 20, §§ 14.5(a), 14.8.

Similarly, some kinds of penalty clauses might be consistent with the purposes and goals of punitive damages and with the policies underlying contract law. If so, and if the sheep again can be separated from the goats, a nuanced rule could permit enforcement of some penalty clauses though not others. For example, a rule that departs from the current common law approach might allow enforcement of a penalty clause that applies only to deliberate and inefficient breaches, but withhold enforcement of others. A more aggressive departure from the current rule might enforce penalties that applied even to efficient breaches—perhaps only if the penalty were limited to the gain to be realized from breach—on the ground that the parties likely would share the gain and would negotiate a release from the contract. An even more radical rule might enforce all penalty clauses, subject only to policing for overreaching, on the ground that parties can adequately assess the premium that will make it worth their while to take extra precautions against breach.

All of these considerations, however, have been presented and evaluated in the context of a common law system that has traditionally singled out contract actions for its rule excluding punitive damages and has applied that rule across the board to liquidated damages clauses that are penal in nature. Before finally assessing the various arguments supporting and opposing the enforcement of penalty clauses in a common law jurisdiction, this article will now turn to the approach in the French civil law system to determine whether the very different experiences and traditions of a contrasting legal system can provide any fresh insights.

III. PUNITIVE DAMAGES AND LIQUIDATED DAMAGES UNDER THE FRENCH CIVIL CODE

A. The French Civil Code and French Legal Method

As first of the original Napoleonic codes,¹⁰⁵ the French Civil Code is a leading example of codification that is designed to, or at least purports to, comprehensively set forth the law on designated topics,¹⁰⁶ such as property, torts, contracts, and domestic relations.¹⁰⁷ Some modern amendments to the Code, such as Title V of the Third Book of the Code, which relates to community property rights and other legal incidents of

105. JOHN P. DAWSON, *THE ORACLES OF THE LAW* 382 (Greenwood Press 1978).

106. EVA STEINER, *FRENCH LEGAL METHOD* 29, 32 (2002).

107. See *CODE CIVIL [C. CIV.] Table Des Matières*, at 1943–57 (101st ed. Dalloz 2002) (Fr.) (table of contents of the annotated French Civil Code); *THE FRENCH CIVIL CODE* vii–xvii (John H. Crabb trans., rev. ed. 1995) (presenting an “Analytical Summary” of French Civil Code, as translated into English).

marriage, address the topic in great detail¹⁰⁸ and in a manner similar to the style of legislation frequently seen in common law systems.¹⁰⁹ Much of the Code, however, remains largely unchanged since its enactment in 1804, when it was drafted in a simple, concise style.¹¹⁰ This style of brevity and simplicity was influenced by the writings of Pothier, a judge and academic who sought to synthesize and simplify the chaotic mosaic of Roman Law, local and regional customary laws, and supplementary judicial doctrines that defined private law in France in the eighteenth century.¹¹¹

The exegetical school of thought, which dominated French legal method during the nineteenth century, advanced the view that the Napoleonic Codes were comprehensive and internally consistent.¹¹² This view supported techniques of statutory interpretation that sought to discover and give effect to the original intentions of the legislature that enacted the Code provision in question.¹¹³ The post-revolutionary judiciary, on the other hand, was constrained by a backlash against the pre-revolutionary high courts, the *Parlements*, which had grown over several centuries from a royal advisory council to a system of central and regional courts that sometimes exercised quasi-legislative powers in the form of regulations or decrees.¹¹⁴ Corrupted by the sale of judicial offices and having earned a reputation for wielding excessive political and legal power, the *Parlements* did not long survive the French Revolution.¹¹⁵ The Constituent Assembly of 1790 prohibited the post-revolutionary courts from issuing regulations.¹¹⁶ In 1804, the Code prohibited the courts from announcing legal principles unrelated to the disputes before

108. See CODE CIVIL [C. CIV.] art. 1387–1581; THE FRENCH CIVIL CODE, *supra* note 107, at 253–73.

109. See STEINER, *supra* note 106, at 18–20 (comparing the greater complexity of English drafting style with that of Continental code systems such as the French Civil Code, but noting that some French legislation resembles the English style in verbosity and complexity).

110. See, e.g., CODE CIVIL [C. CIV.] art. 1382–1386 (Fr.) (setting forth a body of tort law in five concise articles); STEINER, *supra* note 106, at 15 (underscoring the brevity of articles 1382–1386, but noting that the Code currently addresses selected contemporary topics of tort law with additional groupings of articles).

111. DAWSON, *supra* note 105, at 349–50.

112. *Id.* at 392–93.

113. *Id.* at 394; STEINER, *supra* note 106, at 61.

114. DAWSON, *supra* note 105, at 273–74, 306–14.

115. *Id.* at 350–71.

116. *Id.* at 375–76.

them.¹¹⁷ Although such proscriptions might appear to do little more than restrict the publication and effect of dicta, which is not binding even in the United States,¹¹⁸ these restrictions in fact combine with other facets of the legal system to challenge the very power of the courts to make any law at all.

When viewed in light of the exegetical school of thought, the drafting and enactment of the apparently comprehensive Napoleonic Codes,¹¹⁹ the strong adherence to the separation of powers,¹²⁰ and the restrictions on the judiciary, helped to create a legal paradigm in which the judiciary purportedly did not make law but only discovered and applied the relevant enacted law.¹²¹ Accordingly, the highest appellate court in private law matters, the *Cour de Cassation*, nearly always limits its ruling to a terse syllogism that applies one or more provisions of the applicable Code to material facts, leading to a conclusion either that the decision of the lower court correctly applied the Code and should be affirmed or that the decision should be quashed on the ground that the lower court misapplied the applicable Code provisions.¹²² Even in the rare instances in which the *Cour de Cassation* announces a general principle that applies to a broader category of cases than the single dispute before it, it will do

117. “Il est défendu aux juges de prononcer par voie de disposition générale et réglementaire sur les causes qui leur sont soumises.” CODE CIVIL [C. CIV.] art. 5 (Fr.); THE FRENCH CIVIL CODE, *supra* note 107, at 2 (translating article 5 to read: “[j]udges are forbidden to pronounce decisions by way of general and regulative disposition on causes which are submitted to them”); STEINER, *supra* note 106, at 78 (explaining the scope of article 5). See also DAWSON, *supra* note 105, at 375–76, 379 (noting that the prohibition against judicial issuance of “regulations” originated in the Constituent Assembly of 1790 and carried over to the Code of 1804).

118. DAWSON, *supra* note 105, at 412–13.

119. STEINER, *supra* note 106, at 29, 32–33 (discussing the form and appearance of the Code, and its claim to comprehensiveness).

120. *Id.* at 76–78 (noting that the Law of 16–24 August 1790, which precludes the judiciary from exercising legislative power or interfering with the legislative process, “forms the basis for the French doctrine of separation of powers”); DAWSON, *supra* note 105, at 391–92.

121. See generally DAWSON, *supra* note 105, at 390–93 (explaining that the exegetical school promoted the view that the legislature was the sole law-making body, to the exclusion of the judiciary, supported by the views of Proudhon, an academic who espoused consulting the text of the Code for the law without diverting attention to citations of prior judicial interpretations).

122. *Id.* at 377, 380–81; Mitchel Lasser, *Judicial (Self-)Portraits: Judicial Discourse in the French Legal System*, 104 YALE L.J. 1325, 1342 (1995).

so only if the principle does apply to the case before it, as mandated by the Code.¹²³

The narrow holdings of most French decisions, coupled with the occasional statement of broader principles, could form a body of case law if, in future cases, they were accorded deference to an extent similar to that mandated by the doctrine of *stare decisis* in the United States.¹²⁴ French judicial decisions, however, are not officially recognized as sources of law and do not create binding precedent on questions of interpretation of Code provisions.¹²⁵ Under such a regime, each case presents a new opportunity to discover the true meaning of a Code provision, without formal deference to previous and possibly mistaken judicial interpretations.

Nonetheless, many provisions of the French Civil Code, and in particular those of the original 1804 enactment, state general principles rather than detailed rules,¹²⁶ thus creating gaps in the text in the context of specific disputes.¹²⁷ An adherent to the exegetical school might argue that courts, without making law themselves, could fill such gaps by determining what meaning the legislature must have intended in light of the surrounding text and in the general context of the purpose, spirit, and structure of the entire Code.¹²⁸ By the close of the nineteenth century, however, it became clear that the original Code could not keep up with transformations in French society,¹²⁹ and the exegetical school had come under attack for promoting a fiction of discovering legislative intent in a process dominated by the subjective views and values of the judicial interpreters.¹³⁰ The question of whether French judges in fact make law when filling textual gaps has “tortured French lawyers ever since . . .”¹³¹

123. STEINER, *supra* note 106, at 78, 89–90.

124. *See generally* CHARLES R. CALLEROS, *LEGAL METHOD AND WRITING* 51–65 (5th ed. 2006) (discussing case law and *stare decisis* in the United States).

125. STEINER, *supra* note 106, at 75, 79–82.

126. *Id.* at 15.

127. DAWSON, *supra* note 105, at 391–92 (noting that “great gaps and fissures” had appeared in the Code by 1830).

128. *See generally supra* notes 112–13 and accompanying text.

129. STEINER, *supra* note 106, at 61.

130. *See* DAWSON, *supra* note 105, at 394 (referring to an 1899 critique of the exegetical school). Courts may receive guidance in interpreting ambiguous legislation, however, from Parliament in subsequent explanatory statutes, from a government department in a written interpretation submitted in response to a question posed by members of Parliament, or from commentaries published by legal academics). STEINER, *supra* note 106, at 71–73, 179–85.

131. DAWSON, *supra* note 105, at 399. *See also id.* at 416–31 (reviewing theories that attempt to reconcile the formal prohibition of judicial lawmaking with the practical reality); STEINER, *supra* note 106, at 75 (noting that French legal academics “argue endlessly

One can reasonably assert that French courts have created at least a weak and informal species of case law that supplements the Code. Attorneys and court officials regularly argue or analyze previous decisions for their persuasive value, though courts generally do not formally acknowledge the precedent in their published judicial decisions.¹³² For example, repeated judicial decisions that reach the same result on an issue in a variety of factual contexts can provide a plausible basis for predicting how a court might react to a similar dispute in the future.¹³³ It remains true, however, that previous decisions of even the highest French courts are not *binding* on them or even on lower courts; at most, therefore, they have the status as secondary sources of law.¹³⁴

With this explanation of the French Civil Code as background, this article next turns to the provisions of the Code that address, or indirectly shed light on, the enforceability of penalty clauses.

B. Punitive Damages and Penalty Clauses Under the French Civil Code

1. Damages Awarded by the Court in the Absence of a Contractual Damages Clause

Specific enforcement of contract obligations compels performance, thus deterring further breach in a particular case more directly than a threat of punitive damages. Contrary to the beliefs of many, however, specific performance of contracts is not sought and granted with substantially greater frequency in France than in the United States.¹³⁵ Thus,

and inconclusively” over “[t]he contradiction between the traditional post-revolutionary concept that law can only be legislative in origin and the reality of judicial law making”); MATTEI, *supra* note 93, at 84 (citing French judicial development of the law of nuisance as an example in arguing that “[i]n practice, courts in civil law countries make law”).

132. STEINER, *supra* note 106, at 82, 97. See Lasser, *supra* note 122, at 1349–51.

133. STEINER, *supra* note 106, at 87–88 (discussing the concept of “*jurisprudence constante*, whereby a particular interpretation or principle is repeated in a series of decisions”); DAWSON, *supra* note 105, at 409–10 (using the metaphor of a kaleidoscope formed by multiple decisions).

134. See *supra* note 120 and accompanying text.

135. See Henrik Lando & Caspar Rose, *On the Enforcement of Specific Performance in Civil Law Countries*, 24 INT’L REV. L. & ECON. 473 (2004). Lando and Rose point out the tension between the apparent right to claim specific performance in France and French Civil Code article 1142, which limits the state’s authority to compel citizens to take certain actions; they report a consensus in the literature that damages for breach of contract are “by far the dominant form of relief” in Germany and France. *Id.* at 478. See also BARRY NICHOLAS, *THE FRENCH LAW OF CONTRACT* 211 (2d ed. 1992) (specific enforcement is a primary remedy in principle in France, but is less important in practice); James Beardsley, *Compelling Contract Performance in France*, 1 HASTINGS INT’L &

damages are the primary remedy in France for breach of contract¹³⁶ and are a potential tool for deterrence and retribution.

The French Civil Code, however, explicitly provides for compensatory damages for torts¹³⁷ and breaches of contract,¹³⁸ without explicitly mentioning the possibility of punitive damages for either. As with many other civil law countries, punishment is generally reserved for the criminal law.¹³⁹

In the context of civil liability, the exclusion damages that are punitive in nature is not absolute. Some statutes authorize a court to impose a civil fine, known as *amende civile*, for certain kinds of serious wrongs that warrant a punitive response but not necessarily criminal sanctions.¹⁴⁰ A judge might also respond to a particularly egregious tort or breach of contract with a generous damages award that is compensatory in name but arguably includes a covert punitive element. For example, the French

COMP. L. REV. 93, 93–96 (1977) (specific performance in France often is constrained either by article 1142 or by broader considerations similar to those that counsel restraint in common law countries). Even in a case in which the parties could anticipate the availability of specific enforcement as a remedy, in practice this remedy would not necessarily prevent efficient breach and reallocation of resources, because the breaching party might succeed in persuading the victim to release it from obligations in exchange for a share of the profits in the new venture. *See supra* note 82 (making the same point about specific performance under U.S. common law, after explaining that efficient breach is a factor in withholding specific relief in the common law system).

136. Lando & Rose, *supra* note 135, at 478.

137. “*Tout fait quelconque de l’homme, qui cause à autrui un dommage, oblige celui par la faute duquel il est arrivé, à le réparer.*” CODE CIVIL [C. CIV.] art. 1382 (Fr.). Professor Crabb translates article 1382 to read: “Any act whatever of man which causes damage to another obliges him by whose fault it occurred to make reparation.” THE FRENCH CIVIL CODE, *supra* note 107, at 252.

138. “*Les dommages et intérêts dus au créancier sont, en général, de la perte qu’il a faite et du gain dont il a été privé, sauf les exceptions et modifications ci-après.*” CODE CIVIL [C. CIV.] art. 1149 (Fr.). Professor Crabb translates article 1149 to read: “Damages due to a creditor are, in general, from the loss which he incurred and from the gain of which he was deprived, apart from the hereinafter exceptions and modifications.” THE FRENCH CIVIL CODE, *supra* note 107, at 223. Article 1147 states that the debtor is liable to the creditor for non-performance or late performance, subject to some excuses for non-performance. *Id.* at 222 (translating the French text of article 1147).

139. *See* GOTANDA, *supra* note 3, at 193.

140. *See, e.g.*, CODE DE COMMERCE [C. COM.] art. L442-6 (Fr.) (the French Commercial Code, modified in 2001, authorizes a fine, not to exceed two million euros, for distortion of competitive markets); Martine Behar-Touchais, *L’Amende Civile Est-elle un Substitut Satisfaisant À L’Absence de Dommages et Intérêts Punitifs?* [Is the *Amende Civile* a Satisfactory Substitute in the Absence of Punitive Damages?], 232 PETITES AFFICHES 36, 36–44 (2002) (discussing whether the *amende civile* is adequate to compensate for the absence of punitive damages under French law).

Civil Code permits a court to award the full damages caused by a bad-faith breach of contract, free of the foreseeability limitation that would otherwise apply.¹⁴¹ This lifting of the foreseeability requirement must cause some awards for bad-faith breach to blur the line between maximum compensation and punishment.¹⁴²

Finally, *astreinte* is a legislatively authorized judicial mechanism for compelling a breaching party to perform its obligations after a judicial finding of a breach of obligation.¹⁴³ An *astreinte* is an order compelling the breaching party to pay the victim of a breach a certain sum of money for each day, week, or other designated period that performance of the obligation is further delayed. Because the judge can impose the *astreinte* in addition to full compensatory damages,¹⁴⁴ its purpose is to deter further breach.

The *astreinte* might be likened to a front-loaded contempt sanction for violation of a court order, or perhaps as a penalty clause of judicial origin. This second analogy, in turn, raises the topic of our next inquiry.

2. Enforcement of the *Clause Pénale* Under the French Civil Code

a. Textual Analysis of the Code as Enacted in 1804

In light of the absence of a formal doctrine of stare decisis in French law,¹⁴⁵ and in the spirit of the traditional view of the French Civil Code as comprehensive and internally consistent,¹⁴⁶ an analysis of the Code's application to a particular issue ought to begin with the text of all of the Code's articles that may shed light on the topic.

141. “*Le débiteur n’est tenu que des dommages et intérêts qui ont été prévus ou qu’on a pu prévoir lors du contrat, lorsque ce n’est point par son dol que l’obligation n’est point exécutée.*” CODE CIVIL [C. CIV.] art. 1150 (Fr.). Professor Crabb translates article 1150 to read: “A debtor is held only to damages which were foreseen or which could have been foreseen at the time of the contract, when it is not by his willfulness that the obligation is not executed.” THE FRENCH CIVIL CODE, *supra* note 107, at 223.

142. See generally 5 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1077, at 437–48 (1964) (commenting on the difficulty of relying on “nice distinctions between compensation and punishment” in contract remedies).

143. Law No. 72-626 of July 5, 1972, Journal Officiel de la République Française [J.O.] [Official Gazette of France], July 9, 1972, art. 5–8, p. 7181; Law No. 91-650 of July 9, 1991, J.O. July 14, 1991, art. 33–37, p. 9230, available at <http://www.legifrance.gouv.fr>; Beardsley, *supra* note 135, at 101.

144. Law No. 72-626, J.O. July 9, 1972, art. 6, p. 7181; Law No. 91-650, J.O. July 14, 1991, art. 34, available at <http://www.legifrance.gouv.fr>.

145. *Supra* notes 124–34 and accompanying text.

146. *Supra* note 112 and accompanying text.

The plain text of the French Civil Code supports an argument, albeit a strained one, that extra-compensatory stipulated damages are not recognized under the Code. Article 1226 of the French Civil Code defines “*clause pénale*” as a clause that is designed “*pour assurer*” performance of a contract by committing a breaching party to some alternative obligation or contractual liability.¹⁴⁷ Modern French dictionaries define “*assurance*” as an indemnity insurance policy,¹⁴⁸ and “*assurer*” as “to insure.”¹⁴⁹ Thus, when article 1226 states that a *clause pénale* is designed “to insure” (“*pour assurer*”)¹⁵⁰ performance, it could refer to a liquidated damages clause designed to provide indemnification in the sense of compensation for actual injury. Even section 1226’s use of the term “*clause pénale*,” which literally means “penalty clause,”¹⁵¹ might be assigned a counter-intuitive definition by article 1229 of the Code. The first line of article 1229 appears—at least when viewed in isolation—to limit a *clause pénale* to non-punitive liquidated damages because it states that a “penalty clause is the compensation for damages” (“*[l]a clause pénale est la compensation des dommages*”)¹⁵² suffered by the victim of a breach.

Finally, the first sentence of article 1152 (which sets forth the complete text of that article as originally drafted) refers to the enforcement of contractual provisions requiring payment of “a sum certain by way of

147. “*La clause pénale est celle par laquelle une personne, pour assurer l’exécution d’une convention, s’engage à quelque chose en cas d’inexécution.*” CODE CIVIL [C. CIV.] art. 1226 (Fr.). Professor John H. Crabb has translated article 1226 to read: “A penalty clause is one whereby a person, in order to insure execution of an agreement, binds himself to something in case of inexecution.” THE FRENCH CIVIL CODE, *supra* note 107, at 231.

148. HENRY S. DAHL, DAHL’S LAW DICTIONARY 26 (2001).

149. MICHEL DOUCET, LEGAL AND ECONOMIC DICTIONARY 22–23 (1980).

150. See *supra* note 138 (setting forth language of the Code as well as Professor Crabb’s translation into English).

151. *Id.* When used outside the contractual context, “*pénal*” or “*pénale*” is an adjective that typically refers to things related to the criminal justice system, reinforcing its association with penalties. DAHL, *supra* note 148, at 244.

152. “*La clause pénale est la compensation des dommages et intérêts que le créancier souffre de l’inexécution de l’obligation principale.*” CODE CIVIL [C. CIV.] art. 1229 (Fr.). As translated by Professor Crabb, the first line of article 1229 reads: “A penalty clause is compensation for damages which the creditor suffers from the inexecution of the principal obligation.” THE FRENCH CIVIL CODE, *supra* note 107, at 232. Dahl defines “*clause pénale*” as a penalty clause or as “liquidated damages,” the latter being a common term for stipulated damages that are compensatory in nature. DAHL, *supra* note 148, at 57–58. Dahl does not indicate, however, whether that association with the broader term, liquidated damages, is a relatively recent phenomenon or might have been current in 1804.

damages” (“*une certaine somme à titre de dommages-intérêts*”)¹⁵³ for breach and does not refer to the term “*clause pénale*.”¹⁵⁴ It thus could be read to provide only for enforcement of non-punitive liquidated damages clauses, even if the term “*clause pénale*” refers to a true penalty clause in articles 1226 and 1229.¹⁵⁵

An alternative explanation, however, gives the term “*clause pénale*” its more natural meaning as one that provides for extra-compensatory damages. This explanation permits the broader language of article 1152 to refer to enforcement of any stipulated damages clause, whether it be a non-punitive liquidated damages clause or a true penalty clause. The term “*assurer*” in article 1226, although sometimes translated to mean “to insure” and sometimes associated with the provision of indemnity insurance,¹⁵⁶ could easily have been used to mean “to ensure” in the sense of ensuring performance, or “to assure” in the sense of providing reassurance by signaling an absolute commitment to perform.¹⁵⁷ Indeed, “*assurer*” is unambiguously used in that last sense in other, more recently amended Code provisions.¹⁵⁸ These possible connotations of “*assurer*” would point to a clause that seeks to deter breach by requiring payment of extra-compensatory damages, and such an interpretation would fit more naturally with the literal meaning of “*clause pénale*” (literally, “penalty clause”)¹⁵⁹ used in the same article. This interpretation is also consistent with the diction and syntax of article 1226, which links the verb “*assurer*” to performance (“*pour assurer l’exécution*”)¹⁶⁰ rather

153. The first sentence of article 1152 reads: “*Lorsque la convention porte que celui qui manquera de l’exécuter payera une certaine somme à titre de dommages-intérêts, il ne peut être alloué à l’autre partie une somme plus forte, ni moindre.*” CODE CIVIL [C. CIV.] art. 1152 (Fr.). As translated by Professor Crabb, this sentence reads: “When an agreement provides that he who fails to execute it shall pay a sum certain by way of damages, there may not be awarded to the other party a greater or lesser sum.” THE FRENCH CIVIL CODE, *supra* note 107, at 223.

154. CODE CIVIL [C. CIV.] art. 1152 (Fr.); THE FRENCH CIVIL CODE, *supra* note 107, at 223.

155. See DENIS MAZEAUD, LA NOTION DE CLAUSE PÉNALE § 510, at 295 (1992).

156. See *supra* notes 148–50.

157. Cf. *supra* notes 91–92 and accompanying text (discussing a penalty clause’s possible purpose of signaling a promisor’s reliability).

158. E.g., CODE CIVIL [C. CIV.] art. 80 (Fr.) (amended 1993) (“*Celui-ci s’y transportera pour s’assurer du décès et en dressera l’acte . . .*”). As translated by Professor Crabb, this passage reads: “The latter will repair there to assure himself of the death and draw up a certificate of it . . .” THE FRENCH CIVIL CODE, *supra* note 107, at 13.

159. See *supra* notes 147, 152 (setting forth language of the Code as well as Professor Crabb’s translation into English).

160. *Supra* note 147.

than to non-performance, suggesting that the article refers to ensuring performance rather than indemnifying for a breach.

Although the first line of article 1229, when viewed in isolation, may appear to equate the term “*clause pénale*” rather unnaturally to non-punitive compensation (“[l]a *clause pénale* est la compensation de dommages . . .”),¹⁶¹ the second line suggests a different perspective. The second line of article 1229 prohibits the victim of a breach from simultaneously demanding both the stipulated damages and performance of the principal obligation, except when the stipulated damages are solely for breach due to delay.¹⁶² In that light, the first line of article 1229 may not be intended to state that the clause necessarily is limited to a compensatory measure of damages. Rather, it probably is intended to emphasize that the *clause pénale* generally provides the sole redress, in the sense of the exclusive remedy, for breach.

Finally, because article 1152 does not restrict its terms to stipulated damages clauses of a particular measure, its provision for enforcement of contractual agreements for payment of “damages”¹⁶³ could refer quite naturally to payment of either compensatory or extra-compensatory damages. That the French Civil Code could contemplate enforcement of a penalty is suggested by the Code’s recognition of freedom to contract in article 1134,¹⁶⁴ which is a manifestation of the post-revolutionary regard for individual liberty and autonomy.¹⁶⁵

161. *Supra* note 152 (setting forth language of the Code as well as Professor Crabb’s translation into English).

162. “Il ne peut demander en même temps le principal et la peine, à moins qu’elle n’ait été stipulée pour le simple retard.” CODE CIVIL [C. CIV.] art. 1229 (Fr.). As translated by Professor Crabb, the second line of article 1229 reads: “He may not claim at the same time the principal obligation and the penalty, unless it was stipulated for a mere delay.” THE FRENCH CIVIL CODE, *supra* note 107, at 232.

163. *See supra* note 153 (setting forth Professor Crabb’s translation of the term “*dommages-intérêts*” in article 1152).

164. Article 1134 provides that the law generally will defer to the will and the agreement of the parties when executed in good faith: “*Les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites. Elles ne peuvent être révoquées que de leur consentement mutuel, ou pour les causes que la loi autorise. Elles doivent être exécutées de bonne foi.*” CODE CIVIL [C. CIV.] art. 1134 (Fr.). As translated by Professor Crabb, article 1134 reads: “Agreements legally made take the place of law for those who make them. They may be revoked only by mutual consent or for causes which the law authorizes. They must be executed in good faith.” THE FRENCH CIVIL CODE, *supra* note 107, at 221.

165. *See* MAZEAUD, *supra* note 155, § 53, at 43 (referring to the principle of *l’autonomie de la volonté* (autonomy of the will), a fundamental concept of French contract law).

To help resolve a debate about which of the above textual analyses is most consistent with legislative intent, even the exegetical school of the nineteenth century would look beyond the text and gather evidence of legislative purpose from legislative history, or *travaux préparatoires*.¹⁶⁶ The legislative history of the 1804 French Civil Code supports the second textual analysis above, which in turn mandates the enforcement of contractual penalty clauses. A preliminary draft of article 1152 authorized judges to reduce stipulated damages that obviously exceeded actual damages. However, objections to that draft, based on respect for the parties' agreement, prevailed.¹⁶⁷ The final language of article 1152, as enacted in 1804, provided that judges were bound to enforce the precise amount of stipulated damages agreed to by the parties.¹⁶⁸ Accordingly, the *Cour de Cassation* interpreted the 1804 French Civil Code to mandate judicial enforcement of *clauses pénales* as written, without judicial adjustment of any penalties.¹⁶⁹

It might seem anomalous, particularly to one with common law sensibilities, for French law to largely exclude judicial awards of punitive damages from a broad category of civil liability, including liability for torts as well as breaches of contract, but then to enforce contractual penalties originating with the contracting parties. The common law approach appears to earn higher grades for consistency, at least within the field of contract law. Even though it permits punitive damages for egregious torts,¹⁷⁰ it generally denies punitive damages for breach of contract, whether awarded independently by the court¹⁷¹ or originating with the parties in unreasonably large liquidated damages.¹⁷²

The approach of the 1804 French Civil Code, however, can be explained by the post-revolutionary backlash against the judiciary¹⁷³ and newly won respect for individual liberty and autonomy.¹⁷⁴ The Napole-

166. See STEINER, *supra* note 106, at 61, 67–70 (noting that *travaux préparatoires* include: draft bills, statements by the minister or others in promoting a bill, reports by official parliamentary debates, discussed and proposed amendments, and parliamentary debates).

167. MAZEAUD, *supra* note 155, §§ 512–14, at 295–96.

168. *Supra* note 153.

169. See, e.g., Cour de cassation, Première chambre civile [Cass. 1e civ.] [highest court of ordinary jurisdiction, first civil law chamber], Nov. 21, 1967, Bull. civ. I, 1968, Arrêt No. 337, Pourvoi No. 65-13.412, 253, 254 (Fr.).

170. *Supra* notes 1–6 and accompanying text.

171. *Supra* notes 7–15 and accompanying text.

172. *Supra* notes 16–21 and accompanying text.

173. See *supra* notes 112–15 and accompanying text.

174. *Supra* notes 164–65.

onic Codes could check the power of the judiciary by requiring criminal process for judicial imposition of penalties,¹⁷⁵ while simultaneously requiring courts to respect the rights of individuals to freely enter into a contract in which they agreed to impose a penalty for breach.¹⁷⁶

b. Amendments to Article 1152

Beginning in the 1970s, the French devotion to freedom of contract was tempered by recognition that parties with greater sophistication and bargaining power could employ *clauses pénales* to threaten the other party with excessive penalties or forfeitures for breach or to limit their own liability to an unconscionable degree.¹⁷⁷ As a result, article 1152 was amended in 1975 to authorize the exercise of judicial discretion to reduce or increase the stipulated sum in a *clause pénale* if the judge first determines that the clause is manifestly excessive or plainly inadequate.¹⁷⁸ A companion amendment directs judges to apportion damages under a *clause pénale* in the event that the victim of the breach has received the benefit of partial performance.¹⁷⁹ This amendment still leaves the judge free to adjust the stipulated damages further, if appropriate, pursuant to article 1152.¹⁸⁰ Both articles were amended in 1985 to permit the judge to adjust the stipulated damages on the judge's own motion,¹⁸¹

175. See *supra* note 139 and accompanying text.

176. MAZEAUD, *supra* note 155, §§ 512–13, at 295–96.

177. See *id.* §§ 40–52, at 35–42.

178. Article 1152 was amended again in 1985 to authorize a judge to take these actions on the judge's own motion. The discretion to modify the damages seems squarely at odds with the original language of article 1152, *supra* note 153, which remains in place and which directs a judge to enforce a damages clause in precisely the agreed amount, creating an awkward juxtaposition between the original text and the subsequent additions. As amended in 1975 and 1985, article 1152 now includes the following clauses, inserted as a new paragraph immediately after the language in the original 1804 provision: “*Néanmoins, le juge peut, même d’office, modérer ou augmenter la peine qui avait été convenue si elle est manifestement excessive ou dérisoire. Toute stipulation contraire sera réputée non écrite.*” CODE CIVIL [C. CIV.] art. 1152 (Fr.) (amended 1985). Professor Crabb translates this passage to read: “Nevertheless, the judge, even on his own motion, may moderate or increase the penalty which had been agreed upon, if it is manifestly excessive or pitiful. Any contrary stipulation will be considered not written.” THE FRENCH CIVIL CODE, *supra* note 107, at 223. Of course, if it were ever in doubt whether article 1152 authorized enforcement of contractual penalties, see *supra* Part III.B.2.a, the language of the amended article puts that doubt to rest by specifically referring to penalties and to judicial authorization to moderate them.

179. CODE CIVIL [C. CIV.] art. 1231 (Fr.).

180. *Id.*

181. CODE CIVIL [C. CIV.] art. 1152, 1231 (Fr.).

which is a significant development in light of new rules of civil procedure that generally limit judicial action to claims and issues raised by the parties.¹⁸² These articles are supplemented by other laws that permit judges, in narrow circumstances, to strike down rather than simply modify stipulated damages or limitations on liability.¹⁸³

The French courts have not been entirely consistent in the time frame that they employ to resolve the threshold question of manifest excess in clauses that impose extra-compensatory damages.¹⁸⁴ In most cases, however, courts have applied an objective, retrospective test that compares the stipulated damages to the damages actually sustained.¹⁸⁵ As discussed in Part III.A above, even published decisions of the *Cour de Cassation* do not constitute primary legal authority that binds itself or other

182. See THE FRENCH CODE OF CIVIL PROCEDURE IN ENGLISH 1 (Christian Dodd trans., 2004) (Article 4 provides that the “subject matter of a dispute shall be determined according to the respective claims of the parties.”); *id.* at 2 (Article 5 provides that a “judge must rule upon all the points at issue and only upon them.”); MAZEAUD, *supra* note 155, §§ 61, 67, 69, at 46, 49 (referring to judicial discretion in article 1152, raising the issue on the judge’s own motion, and tension with new rules of civil procedure); STEINER, *supra* note 106, at 168 (referring to restrictions in the New Code of Civil Procedure on judicial initiatives).

183. See, e.g., CODE CIVIL [C. CIV.] art. 1134 (Fr.) (deference to the parties’ agreement in article 1134 is subject to execution of the agreement in good faith); *id.* art. 1108, 1131, 1133 (a contract that violates public policy or morals lacks legitimate “cause,” a requisite for formation of an enforceable contract); Law No. 78-23 of Jan. 10, 1978, J.O. Jan. 11, 1978, art. 35, p. 301, available at <http://www.legifrance.gouv.fr> (Fr.) (explaining that the highest court for administrative law, the *Conseil d’Etat*, is authorized to limit, regulate, or even prohibit abusive clauses (“*clauses abusive*”) in contracts between professionals and consumers).

184. See MAZEAUD, *supra* note 155, § 86, at 57–58 (explaining that courts in a minority of cases have determined the excessive character of a *clause pénale* based on a number of factors surrounding formation of the contract, while courts in the majority of cases have used an objective, retrospective test).

185. See *id.*; Cour de cassation, Chambre commerciale et financière [Cass. com.] [highest court of ordinary jurisdiction, commercial and financial law chamber], Jan. 22, 2002, available at <http://www.legifrance.gouv.fr> (Fr.) (approving the appellate court’s finding that the penalty clause was not grossly excessive when compared to actual damages). *But cf.* Cour de cassation, Troisième chambre civile [Cass. 3e civ.] [highest court of ordinary jurisdiction, third civil law chamber], Jan. 12, 1994, Bull. civ. I 1994, Arrêt No. 5, Pourvoi No. 91-19.540, 3, 3–4 (Fr.) (enforcing the *clause pénale* even though the victim of the breach suffered no actual injury, suggesting either a determination that the *clause pénale* was not manifestly excessive when imposed in the absence of actual damages or that the court justified the award on the basis of a comparison of the penalty with the damages that could reasonably have been estimated by the parties at the time of contracting).

courts.¹⁸⁶ However, general predictions may be based on the high court's rulings that the breaching party's bad faith in the performance and breach of the contract is not relevant to the initial question of manifest excess in the penalty clause, or at least cannot be the sole determining factor.¹⁸⁷ It would not be surprising if the courts settle into a pattern of determining manifest excess solely or largely on the basis of the court's comparison of the stipulated damages to actual injury or to the total value of the contract. The courts may do so while allowing nearly unlimited equitable discretion in determining the extent to which the punitive surplus should be reduced, if at all, once a penalty clause is found to be manifestly excessive.¹⁸⁸ Such an approach would be consistent with the text of article 1152, which refers abstractly to a penalty clause's status as manifestly excessive while more specifically and personally granting the judge authority, without stating any limitation, to moderate a manifestly excessive clause.¹⁸⁹

The amended version of article 1152 potentially gives French judges the power to bring their law regarding *clauses pénales* in line with the common law antipathy to penalty clauses. If judges consistently find extra-compensatory stipulated damages to be manifestly excessive, and if they reduce the stipulated damages to an amount that approximates either the actual injury or a reasonable prospective estimate of the injury that breach would cause, then the approaches of the two legal systems will be substantially identical.

The final sentence in amended article 1152, however, speaks not of moderating the total damages referred to in the first sentence, but of moderating the *penalty*. This suggests that the penalty portion of the total sum of damages will not be *eliminated*, leaving only compensation, but may be *moderated*, leaving compensation plus a smaller penalty. In practice, the courts have indeed retained the discretion to reduce a mani-

186. *Supra* notes 124–34 and accompanying text.

187. *See, e.g.*, Cour de cassation, Chambre commerciale et financière [Cass. com.] [highest court of ordinary jurisdiction, commercial and financial law chamber], Feb. 5, 2002, available at <http://www.legifrance.gouv.fr> (Fr.) (finding that lack of bad faith and substantial fault in connection with a breach was not properly considered by the court of appeals in the determination of whether a penalty clause was manifestly excessive). *Cf.* Cour de cassation, Chambre commerciale et financière [Cass. com.] [highest court of ordinary jurisdiction, commercial and financial law chamber], Feb. 11, 1997, Bull. civ. II 1997, Arrêt No. 47, Pourvoi No. 95-10.851, 42, 43 (Fr.) (finding that behaviors of the parties cannot be the sole basis for a finding of a manifestly excessive penalty; comparison of the penalty to the actual damages suffered is a necessary element of the analysis).

188. *See, e.g.*, Cass. Com., Feb. 11, 1997, No. 95-10.851.

189. *See supra* note 176.

festly excessive *clause pénale* to a point that still exacts a penalty, albeit a reduced one.¹⁹⁰ Indeed, all members of two small groups of French magistrates that I interviewed in 2005 stated that they would normally retain an extra-compensatory element in a *clause pénale*, even after moderating it to avoid a manifestly excessive penalty, in keeping with the parties' intent to discourage breach. Authority for retaining such a punitive element arguably lies in article 1226, which defines without condemning a *clause pénale* as one designed to ensure performance,¹⁹¹ and thus to deter further breach of that particular contract by compelling performance.¹⁹²

Additionally, if the breaching party acted in bad faith, judicial retention of a punitive element in a *clause pénale* might be encouraged by article 1150's expansive view of compensatory damages for a bad-faith breach.¹⁹³ When acting without the benefit of a *clause pénale*, judges are accustomed to awarding an expanded measure of compensatory damages for bad-faith breach. Thus, they likely will feel comfortable exercising discretion to lessen their reductions of manifestly excessive *clauses pénales*, leaving some extra-compensatory damages for bad faith breach when the parties have voluntarily agreed to a penalty. Even though the *Cour de Cassation* has quashed lower court decisions that considered the bad-faith, or lack of bad faith, of a party on the threshold issue of manifest excess in the *clause pénale*,¹⁹⁴ a judge almost certainly has broader discretion to consider the breaching party's bad faith when exercising discretion to reduce stipulated damages that the judge has independently found to be manifestly excessive.

Finally, in comparison to common law judges, French judges are generally more willing to view a contractual promise as a moral obligation

190. See *Cour de cassation, Chambre commerciale et financière* [Cass. com.] [highest court of ordinary jurisdiction, commercial and financial law chamber], Jan. 29, 1991, Bull. civ. I 1991, Arrêt No. 43, Pourvoi No. 89-16.446, 27 (Fr.) (approving an award with a punitive element beyond compensation).

191. *Supra* notes 147, 154–58 and accompanying text.

192. See Cass. com., Jan. 29, 1991, No. 89-16.446 (citing article 1226 and noting that compensation for loss is not the exclusive function of a *clause pénale*; it can also function to compel performance). See also MAZEAUD, *supra* note 155, at 7 (in light of the purpose of compelling performance, arguing that even a revised *clause pénale* should always remain slightly higher than actual damages, and that the judge should award some amount under a *clause pénale* even if the non-breaching party suffers no injury).

193. See *supra* notes 141–42 and accompanying text.

194. See *supra* note 184 and accompanying text.

and are less persuaded by arguments of economic efficiency.¹⁹⁵ When coupled with the strong regard for freedom of contract and the pre-1975 tradition of enforcing penalty clauses as written, these values presumably will frequently translate into enforcement of penalties. In some cases, judges will find penalties to be fully enforceable rather than manifestly excessive; in other cases, they will moderate a manifestly excessive penalty but not to the point of eliminating all extra-compensatory damages.

c. Summary

In sum, in contrast to both the common law and the Uniform Commercial Code in the United States,¹⁹⁶ the French Civil Code permits judges to enforce contractual penalties for breach of contract. The practice of enforcing penalty clauses was strongly established under the original language of article 1152, which mandated enforcement of stipulated damages without adjustment of the amount, thus respecting freedom of contract.¹⁹⁷ Although the 1975 and 1985 amendments to article 1152 authorize the judiciary to moderate manifestly excessive penalty clauses,¹⁹⁸ the judges retain the discretion to permit a punitive element to remain. When judges exercise their discretion in that manner, they have either made a determination that the breach is not efficient, or—and this is more likely in the context of French legal culture—they are acting on the assumption that economic efficiency is less important than respecting the parties' freedom to agree to a monetary means of compelling performance, which can substitute for the coercive remedy of specific enforcement. This view is supported by the Code's reference to the purpose of a *clause pénale* to ensure performance.¹⁹⁹

The wild card in this remedial scheme is the *astreinte*, which is the equivalent of a graduated penalty clause drafted by the court rather than the parties and imposed for the same purpose of compelling performance.²⁰⁰ This judicial power does not sit comfortably within a legal system in which punitive damages generally are excluded from civil liability except when interests in protecting autonomy and freedom of contract require enforcement of a contractual *clause pénale*. This apparent anomaly is minimized, at least, if commentators are correct in

195. NICHOLAS, *supra* note 135, at 211–13. This sentiment was echoed by French magistrates that the author interviewed in 2005.

196. *See supra* note 18.

197. *See supra* notes 161–67 and accompanying text.

198. *Supra* notes 187–90 and accompanying text.

199. *See supra* notes 147, 154–58 and accompanying text.

200. *See supra* notes 138–39 and accompanying text.

noting that this remedy, like specific performance, is enforced “in a very grudging manner.”²⁰¹

IV. LESSONS FROM THE COMPARATIVE ANALYSIS

A. Summary of the French and American Approaches

U.S. law and French law are consistent in their refusal, with some exceptions, to grant punitive damages for breach of contract in the absence of a contractual penalty clause.²⁰² If the parties have freely negotiated a stipulated damages clause, however, the approaches of the two legal systems diverge. Although the divergence is less pronounced than might be apparent on the surface.

In the United States, stipulated damages clauses are enforceable only if they represent reasonable attempts to liquidate compensatory damages.²⁰³ Unreasonably large stipulated damages are unenforceable as a penalty.²⁰⁴ This reflects an antipathy that traces back 500 years to the English equity practice of granting relief from extra-compensatory conditional bonds.²⁰⁵ U.S. law, however, defers to the parties’ freedom to contract in one minor way: it will enforce a liquidated damages clause that is prospectively reasonable at the time of contracting, even if the liquidated damages exceed actual damages because the breach causes unexpectedly little injury.²⁰⁶

Throughout much of the history of the Napoleonic Code, French law deferred to the contracting will of the parties to a far greater degree by enforcing validly negotiated *clauses pénales*, without adjustment, even if the clauses imposed penalties both from a prospective and retrospective view.²⁰⁷ After 1975, French law retreated from its position of total deference to the will of freely contracting parties. French law granted judges the authority to eliminate or moderate the punitive element of a *clause pénale* if it was found to be manifestly excessive, which the courts

201. KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 475 (1998) (referring to grants of specific performance and *astreinte*). See also Lando & Rose, *supra* note 135, at 478 (quoting Zweigert and Kötz and agreeing that this “special system of fines” is not strictly enforced by the courts).

202. See *supra* notes 5–13, 135–42, 201 and accompanying text.

203. *Supra* note 17 and accompanying text.

204. *Id.*

205. See *supra* notes 30–38 and accompanying text.

206. See *supra* notes 18–21 and accompanying text.

207. See *supra* notes 154–65 and accompanying text.

usually assessed by retrospectively comparing the clause with actual damages caused by the breach.²⁰⁸

From a U.S. perspective, even after 1975, French law offers a more favorable environment for enforcing penalty clauses. French law will enforce any extra-compensatory clause that is not retrospectively manifestly excessive and will offer the probability of enforcing part of a penalty clause that is manifestly excessive and must be reduced.²⁰⁹ From a French perspective, however, U.S. law—although exhibiting greater hostility toward penalty clauses in its rhetoric—appears to give penalties a partial reprieve, because it enforces liquidated damages that are prospectively reasonable but turn out to be extra-compensatory after actual injury is sustained.²¹⁰

B. A Proposal to Consider Facets of the French Approach, While Retaining Goals of Efficiency and Guarding Against Abusive Penalty Clauses

One steeped in American law, and particularly in the school of law and economics, might advise the French Parliament to facilitate efficient breaches and encourage economic growth by eliminating the enforcement of all extra-compensatory *clauses pénales*, thereby completing the evolution of the Civil Code begun in 1975. This author believes, however, that U.S. law may have more to gain by adopting features of the French approach. By distinguishing contractual penalty clauses from court-awarded punitive damages and by adopting sufficient flexibility to distinguish efficient breaches from inefficient and malicious breaches, U.S. law could achieve results that are fairer to the victim of breach.

First, as shown in the approach of the French Civil Code, penalty clauses, if freely and fairly negotiated, need not be treated with the same hostility accorded to court-awarded punitive damages for breach of contract. If the parties with relatively equal bargaining position have negotiated a penalty clause for the purpose of providing one party with special reassurance against breach, the other party likely is agreeable to using the clause as a means of signaling its serious intention to perform. The party's acceptance of the clause puts it in a better position to extract a higher fee for the promised services.²¹¹ A legal regime that signals at least partial enforceability of these agreements will give substance to

208. See *supra* notes 175–92 and accompanying text.

209. See *id.*

210. See *supra* notes 18–19 and accompanying text.

211. See *supra* notes 92–99 and accompanying text.

such clauses and help the parties maximize the benefits to be derived from bargaining.²¹²

This approach rests strongly on an assumption of mutual consent without overreaching, which requires vigilant policing by courts to guard against fraud, duress, and unconscionability. Indeed, courts might desire to take a modest step in the direction of this approach by enforcing only a penalty clause that is specifically negotiated by these parties, or—in the case of a standard-form clause—is brought to the attention of the non-drafting party.²¹³ Moreover, if the clause would operate solely against one party, that party should have the option during bargaining of paying a reasonable fee to delete the provision, rather than being stuck with the provision in an unalterable adhesion contract.²¹⁴ Penalty clauses that do not meet these standards would generally be unenforceable as unconscionable contract terms or as ones that violate public policy.

The purpose of adopting a rule that permitted enforcement of penalty clauses would be to compel or ensure performance in transactions in which the victim of breach would find compensatory damages to be an inadequate substitute for actual performance and specific performance would be impractical or otherwise not readily obtainable. Recall, for example, the hypothetical wedding reception in which the wedding couple places great sentimental value on the appearance of a particular musical group;²¹⁵ if that group repudiated at the last minute or simply failed to show up, the wedding couple would find it impossible to secure specific performance of that band and nearly impossible to secure the services of any comparable and available band. It is unlikely that a court would define the couple's expectation interest in a manner that would allow compensatory damages to fully remedy their sense of injury.²¹⁶ In such a

212. See *supra* notes 92–95 and accompanying text.

213. See *supra* note 96. Cf., e.g., U.C.C. § 2-205 (1998) (requiring separate signing of a promise to an hold offer open if made on a form supplied by the other party).

214. See generally *Crawford v. Buckner*, 839 S.W.2d 754, 757–59 (Tenn. 1992) (holding that an exculpatory clause in a residential lease violated public policy, partly because it adhered to the contract and was not subject to removal in exchange for a tenant's payment of additional fees).

215. See *supra* notes 92–99 and accompanying text.

216. See, e.g., *Levin v. Halston Ltd.*, 398 N.Y.S.2d 339, 340–41 (N.Y. Civ. Ct. 1977) (denying damages for emotional distress for an alleged breach of a contractual duty to supply a well-fitting wedding dress). See also RESTATEMENT (SECOND) OF CONTRACTS § 351 (limitations on damages related to foreseeability); *id.* § 352 (damages not recoverable unless proved with reasonable certainty); *id.* § 353 (damages for emotional distress excluded in the absence of bodily harm unless the breach, by its nature, would quite likely cause “serious emotional disturbance”). The Restatement suggests that damages

case, the wedding couple might be willing to pay a premium to secure an elevated commitment from the band through its acceptance of an enforceable clause that would deter breach through extra-compensatory damages.

Granting punitive damages for innocent breach in the absence of a freely negotiated penalty clause would punish a party who is blameless and did not agree to assume the risk of a penalty. A freely negotiated penalty clause, however, could justifiably apply to unintentional as well as deliberate breaches. If the law predictably enforces a penalty clause against even an innocent breach, obligors who negotiated a premium for assuming the risk of paying a penalty for breach will have an incentive to take precautions against inadvertent breach. Additionally, obligors will have obvious incentives to refrain from recklessly or intentionally breaching the contract.

Just as due process imposes limits on punitive damage awards in tort actions,²¹⁷ under this proposal the law should impose upper limits on enforceable penalty clauses. Indeed, in light of the historical common law antipathy toward punitive damages and stipulated penalties in contracts actions,²¹⁸ considerations of public policy and the need to guard against overreaching should impose stricter limits than would be imposed by due process in the absence of an enforceable penalty clause. As with the rule

might be calculated on the basis of the non-breaching party's subjective valuation of the contract's subject matter, *see id.* § 347(a) ("the loss in value to him"); however, the non-breaching party may have difficulty establishing the foreseeability of such loss, *see id.* § 351, and establishing the loss with reasonable certainty, *see id.* § 348 (default rules that apply "if the loss in value to the injured party is not proved with reasonable certainty"). In one celebrated case, an appellate court declined to award damages of \$29,000 measured by the cost to complete restoration of the non-breaching parties' farm land after the breaching party had strip-mined it for coal, and it instead awarded the sum of \$300, representing the diminution in market value. *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1962). Finally, if the general marketplace would be equally satisfied with a substitute swing band that cost no more than the contract fee for the wedding couple's favored band, and if the court did not allow the sentimental value associated with the favored band to preclude a finding that another band was a valid substitute, then principles of avoidability could bar all compensatory damages other than the transactions costs of finding and hiring a substitute band. *See* RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981) (barring recovery for loss that reasonably could have been avoided "without undue risk, burden or humiliation").

217. *See supra* note 3.

218. *See supra* notes 5–38 and accompanying text.

of reasonableness in enforcing non-competition clauses,²¹⁹ courts should enforce penalty clauses only to the extent that they are necessary to protect the legitimate interests of the parties.²²⁰

This proposal contemplates that some parties will have a legitimate interest in deterring breach, perhaps because they reasonably believe that compensatory damages, if defined conventionally, will not adequately protect their interests. In such circumstances, a court could exercise its policing powers to enforce “reasonable” penalties, which are those designed to provide a reasonably effective extra-compensatory disincentive to breach. Such “reasonable” penalties would neither provide an additional windfall to the plaintiff nor reflect excessive vindictiveness toward the breaching party. A penalty clause that failed this test would be struck down on grounds of unconscionability²²¹ or public policy,²²² or would be modified to eliminate the objectionable surplus.²²³

The proposed rule would apply effectively to intentional efficient breaches, even while retaining a strong policy of encouraging efficient allocation of resources. In balancing the parties’ freedom to contract, due recognition of their legitimate interests, and public policy favoring economic efficiency, a court could reduce any excessive penalty. This reduced penalty could facilitate reallocation of resources to a higher use but still guarantee some portion of the extra-compensatory damages for which the victim of breach bargained, particularly considering any premium that the victim paid in exchange for inclusion of the penalty clause. In keeping with the centuries-old practice of Chancery courts to grant equitable relief from oppressive penal bonds,²²⁴ but emulating the flexibility provided by the French Civil Code, a revised American law could vest courts with discretion to eliminate the portion of a contractual

219. See, e.g., *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 540 (Wyo. 1993); RESTATEMENT (SECOND) OF CONTRACTS § 186(1) (1981); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 648–49 (1960).

220. See, e.g., *Hopper*, 861 P.2d at 545; RESTATEMENT (SECOND) OF CONTRACTS § 188(1)(a) (1981).

221. See, e.g., U.C.C. § 2-302 (1998); RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

222. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§ 178, 179 (1981).

223. See, e.g., *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 36–37 (Tenn. 1984) (approving judicial modification of an unreasonable but good-faith non-competition clause so that it comported with public policy, and enforcing it as modified). See generally U.C.C. § 2-302 (1998) (authorizing a court to “limit the application” of an unconscionable contract clause).

224. See *supra* note 37 and accompanying text.

penalty that served no purposes except to produce a windfall and block a more economically efficient result.

For example, suppose that the victim of a breach expected to, and actually does, suffer net damages of \$10,000, measured by conventional standards and after factoring in costs avoided by withholding the breaching party's fee of \$101,000. Because of great sentimental investment in the promised performance, which likely would not be fully protected by an award of compensatory damages under conventional market-based measures, the non-breaching party had paid a premium of \$1,000 for a penalty clause that called for \$20,000 in damages in the event of a breach—over and above the withholding of the breaching party's fee. Before performance was due, the other party intentionally breached to take advantage of an intervening opportunity that will pay it \$150,000 and will net for the breaching party a profit of \$30,000, which amounts to \$20,000 more than the \$10,000 it would have earned under the first contract. If the penalty clause was unenforceable, the victim of the breach would be entitled only to a conventional measure of her compensatory damages, which would be \$10,000, secured perhaps only after expenditure of significant transaction costs. Fully enforcing the penalty clause, however, would eliminate the breaching party's economic incentive to reallocate its resources to a use that the market values more highly. Taking a cue from the French authority to moderate a *clause pénale* in certain circumstances,²²⁵ a court could vindicate public policy and could recognize both freedom of contract and the legitimate interests of the parties by enforcing only part of the penalty clause, say \$16,000. This amount would pay the \$10,000 in conventional damages and \$6,000 in additional "penalties," \$1,000 of which might represent the premium paid for the penalty clause, which is being only partly enforced. Such an award would allow the breaching party to retain an incentive of \$4,000 to reallocate its resources while compelling it to share some of its new gains with the victim of the breach. Thus the victim would be at least partially compensated for subjective injuries that might not normally be compensable under market-based measures for damages, but for which the party bargained.

Indeed, if the court believed that the victim of the breach would suffer such subjective injury that complete deterrence of breach was a legitimate end of bargaining, the court might enforce the penalty clause in its entirety, eliminating the incentive for reallocating resources. This result could be justified on the basis that the alternative use for the breaching

225. See *supra* notes 177–95 and accompanying text.

party's resources was not a higher use when taking into consideration the subjective needs of the victim of the breach. For example, if the band, with whose music the wedding couple fell in love, repudiates one day before the wedding, a conventional market-based measure of compensatory damages might bring an award of only \$1,000, which represents the additional funds, beyond the canceled fee to the first band, needed to hire a band on short notice that the market would find to be comparable. If a court credited the notion, however, that compensatory damages, especially as measured by the market, could not substitute for actual performance in these circumstances, it might find that a breach would not be efficient. In other words, it might find that—by negotiating the penalty clause—the parties had honestly and reasonably defined the unusual subjective value of the band to the wedding event so that it not only exceeded the value that the general market would place on that performance but also exceeded the value of the band's performance to the alternative client.

If the rules regarding enforcement of penalties are to influence the actions of the parties before performance or breach, however, they must be predictable. A party who receives a more valuable offer before its performance is due may decide to perform or breach the first contract depending on its ability to predict whether a court will enforce a penalty clause fully, partially, or not at all. In some cases, the prediction may not be difficult. For example, case law in a jurisdiction may establish that courts recognize the great subjective value of certain kinds of performances with sentimental meaning to a wedding party and—subject only to due process constraints—will fully respect a wedding couple's negotiation of a penalty designed to deter breach. Courts may do so even if in the absence of a penalty clause, the case law would neither define compensatory damages so expansively nor permit a jury to award punitive damages.

The parties would not need to depend on the development of predictable lines of authority in various contexts, however, if the jurisdiction applies a rule of always fully enforcing any penalty clause that is: freely negotiated without overreaching; falls within a range consistent with the public interest;²²⁶ and proportionate to the parties' legitimate interests to

226. The public interest might come into play, for example, if the competing opportunity for the potentially breaching party is one that would not go forward without that party and is one that would bring benefits to the entire community. In such a case a court might not honor the non-breaching party's full subjective valuations and could appropriately reduce the penalty clause to a point that rewarded reallocation of the breaching party's resources, even after payment of the penalty. If such an approach was made pre-

satisfy special needs to ensure performance and to signal an elevated commitment to perform in exchange for a premium. Such an approach would not necessarily deter efficient breach; instead, it would help internalize the full costs associated with breach and force the breaching party to negotiate with the victim of a breach. If circumstances have not changed, and the victim of the breach truly places a higher value on performance than is reflected by additional profits available from a competing opportunity, then a negotiated settlement is unlikely—and indeed the breach is not even “efficient” as viewed from the non-breaching party’s subjective valuations—and the contracting party likely will perform rather than breach. On the other hand, if a share in the profits from a competing opportunity would more than fully compensate the non-breaching party for even their subjective sense of loss, or if circumstances and their valuations have changed, the parties likely will reach an agreement sharing the gains of breach with the non-breaching party, in place of enforcement of the penalty clause after possible judicial modification.

Return to the example of the wedding party above. If the musical group could accurately predict that a court would fully enforce the penalty clause, then it would not breach the contract unless it thought that the wedding couple would not assert their rights or unless it obtained a release from the wedding couple. In negotiations for a release, the wedding couple could reassess the value of the band’s performance in light of their own current circumstances and could determine whether voluntary payment by the band of less than the full penalty would fully assuage the couple’s sense of injury. If so, and if the modified penalty were low enough to permit the band to make an increased profit in the new enterprise after paying the penalty, the band could obtain a voluntary release from the wedding couple. This voluntary release thus preserves their goodwill and rebuts any argument that the couple’s damages are not fully redressed, while retaining an incentive to reallocate their musical resources to a more valuable use. If the couple refused to grant a release for a sum acceptable to the band, then the couple is placing a subjective value on the performance that makes the wedding the most valuable place to allocate the band’s resources. Breach would not be efficient, at least as defined by the wedding couple’s subjective valuations.

dictable by statute or case law, the breaching party might be encouraged to breach and reallocate its resources, or the non-breaching party might be encouraged to negotiate a release at a price that removes any disincentive for such reallocation.

In the absence of a penalty clause, the law would be reluctant to recognize subjective valuation to this extent and likely would find the breach to be efficient from the perspective of the marketplace. When the parties themselves have credited those subjective valuations by freely negotiating a penalty clause, however, the courts should take a cue from the French approach and honor their agreement. Although other players in the market might assess the relative values differently, enforcing the clause permits the parties to this agreement to maximize their utilities. Moreover, in the event that a substantial public interest might be served by a reallocation of the band's resources, and if it were predictable that a court would accordingly reduce the penalty clause to a point below that which would recognize the couple's subjective valuations,²²⁷ then the parties likely would consider that factor in their negotiations of a release. This would increase the possibility of a settlement and release.

Of course, the transaction costs of negotiating a release must be added to each party's calculus. However, if the penalty clause were not enforceable, then the parties could easily dispute the amount of compensatory damages that would be owed for breach. The transaction costs of litigating that issue or negotiating a settlement likely would be at least as great as that of negotiating a release from a penalty clause to permit efficient breach.

C. Comparison with a Proposal to Liberalize Compensatory Damages

One may argue that parties would freely negotiate a penalty clause only when subjective valuations on performance would make market-based compensatory damages an inadequate substitute for actual performance. Further, one may argue that this inadequacy could be addressed more directly by expanding compensatory damages²²⁸ to fully redress subjective injuries, at least when the injuries are foreseeable because the circumstances giving rise to the special injuries have been communicated to the other party. This approach, too, has some merit. If the parties are aware of the subjective value of a performance during bargaining, and if the law predictably awards compensatory damages based on the full subjective value, then the obligor can determine the fee that will cover the risk of non-performance and the liability for disappointed expectations based on full subjective valuation. If the fee is a deal-breaker, then the obligee may need to sacrifice the availability of

227. *See id.* and accompanying text.

228. For an outline of limitations on recovery of damages for breach of contract, see *supra* note 216.

this fulsome measure of damages by agreeing to a liquidated damages clause that limits compensatory damages to a more conventional measure and allows the obligor to lower its price.

Simply expanding the availability of non-market-based or non-pecuniary losses will not help the members of our wedding party if they are not confident of their ability to persuade the band members at the time of breach of the full extent of their injuries, or of their ability to prove those subjective injuries to a court. Moreover, expanding the definition of recoverable compensatory damages might inject excessive uncertainty into the consequences of bargaining. Such an expansive definition may have a chilling effect on contract formation, even on the negotiation of some bargains to which the expansive definition would not ultimately apply.

Consequently, the better approach would retain the current default rules concerning compensatory damages and allow the parties to depart from those rules by explicitly agreeing to stipulated damages. If the stipulated damages exceed the normal measure of compensatory damages, they might be viewed as compensation supplemented by a penalty. Or, they might be viewed as liquidated compensatory damages with a stipulation that reflects an agreement to expand the normal range of compensable injuries. The distinction would be largely semantic, although some courts might find one framework to be a more palatable departure from the current regime than the other.

However the damages are characterized, enforcement of the penalty or expanded compensation would not depart from a general rule against extra-compensatory damages much more than the current rule, which allows enforcement of prospectively reasonable liquidated damages that exceed the damages actually sustained. In both cases, deference to the parties' voluntary agreement concerning damages permits a departure from the damages that would be available in the absence of such an agreement.

V. CONCLUSION

Although U.S. common law achieves apparent consistency in refusing both to enforce contractual penalty clauses and to award punitive damages for breach of contract in the absence of such clauses, the French experience shows that the two cases can be distinguished in a principled manner. Even if a legal system adheres to a general rule against punitive damages for breach of contract, it can justify cautious enforcement of a freely negotiated penalty clause in the name of respecting the autonomy of the parties. This would permit the parties to achieve an economically

efficient result through an obligor signaling an unqualified commitment to perform and the obligee paying a premium for a highly valued assurance of performance.