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Matthew A. Seligman

Benjamin N. Cardozo School of Law

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MORAL DIVERSITY AND EFFICIENT BREACH

Matthew A. Seligman*

Most people think it is morally wrong to breach a contract. But sophisticated commercial parties, like large corporations, have no objection to breaching contracts and paying the price in damages when doing so is in their self-interest. The literature has ignored the profound legal, economic, and normative implications of that asymmetry between individuals' and firms' approaches to breach. To individuals, a contract is a promise that cannot be broken regardless of the financial stakes. For example, millions of homeowners refused to breach their mortgage contracts in the aftermath of the housing crisis even though doing so could have saved them tens or even hundreds of thousands of dollars. Their moral beliefs led homeowners to forgo opportunities for efficient breach that firms would have seized, thus exacerbating already swelling wealth inequalities.

This Article explains this phenomenon, identifies its consequences, and examines strategies to address it. Neither ex post judicial interventions (such as adjusting the remedies for breach) nor traditional ex ante regulatory interventions (such as disclosure requirements) will effectively address the problem. Instead, the most promising approach is a novel solution based on the framework of choice architecture: requiring contracts to include an express term creating an option to exit the contract and pay a fee equivalent to expectation damages. An express exit term elevates an implicit legal option into an explicit contractual option, reframing the moral choice so individuals would perceive exiting the contract as a morally permissible performance of their promise rather than a morally forbidden breaking of it. The presence of that exit term thereby aligns individuals' perceptions of their moral obligations under the contract with sophisticated firms' approaches to breach.

The Article concludes with new empirical evidence that demonstrates the practical impact of an exit clause. It presents the results of two experimental studies I performed that demonstrate the effectiveness of a mandatory exit clause in reducing the effects of the asymmetry between individuals and firms. Those results show that exit clauses could have substantial practical

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implications for the regulation of contracts in contexts like consumer and mortgage contracts.

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INTRODUCTION

Individuals and firms have sharply different moral views about whether it is permissible to breach a contract. Most people think it is wrong to breach even if it is in their economic interest to do so.¹ Contracts, in the eyes of

1. See Daphna Lewinsohn-Zamir, *The Questionable Efficiency of the Efficient-Breach Doctrine*, 168 J. INSTITUTIONAL & THEORETICAL ECON. 5 (2012); Steven Shavell, *Essay, Is Breach of Contract Immoral?*, 56 EMORY L.J. 439 (2006); Tess Wilkinson-Ryan, *Breaching the Mortgage Contract: The Behavioral Economics of Strategic Default*, 64 VAND. L. REV. 1547 (2011) [hereinafter Wilkinson-Ryan, *Breaching*]; Tess Wilkinson-Ryan, *Do Liquidated Damages Encourage Breach? A Psychological Experiment*, 108 MICH. L. REV. 633 (2010) [hereinafter Wilkinson-Ryan, *Liquidated Damages*]; Tess Wilkinson-Ryan, *Fault in Contracts, A Psychological Approach*, in *FAULT IN AMERICAN CONTRACT LAW* 289 (Omri Ben-Shahar & Ariel Porat eds., 2010); Tess Wilkinson-Ryan, *Legal Promise and Psychological Contract*, 47 WAKE FOREST

many, are promises. When you enter a contract, people believe, you make a promise to perform.² And because people also tend to think that breaking a promise is wrong,³ they think they are subject to a corresponding moral obligation to perform the contract.⁴ As a result, contracting parties who hold this view will perform their express obligations under a contract even if they would be better off economically by breaching and paying damages to their counterparty.

But firms often don't hold that view. Instead, they typically view a contract simply as a legal obligation to perform, the violation of which is not a moral wrong to be avoided but rather a legal contingency to be navigated.⁵ Justice Holmes famously claimed that "[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."⁶ According to the view associated with Holmes,⁷

L. REV. 843 (2012) [hereinafter Wilkinson-Ryan, *Legal Promise and Psychological Contract*]; Tess Wilkinson-Ryan, *Transferring Trust: Reciprocity Norms and Assignment of Contract*, 9 J. EMPIRICAL LEGAL STUD. 511 (2012); Tess Wilkinson-Ryan & Jonathan Baron, *Moral Judgment and Moral Heuristics in Breach of Contract*, 6 J. EMPIRICAL LEGAL STUD. 405 (2009); Tess Wilkinson-Ryan & David A. Hoffman, *Breach Is for Suckers*, 63 VAND. L. REV. 1003 (2010). Other empirical research examines the psychological operation of the underlying norm of promise-keeping. See Gary Charness & Martin Dufwenberg, *Promises and Partnership*, 74 ECONOMETRICA 1579 (2006); Christoph Vanberg, *Why Do People Keep Their Promises? An Experimental Test of Two Explanations*, 76 ECONOMETRICA 1467 (2008).

2. See CHARLES FRIED, *CONTRACT AS PROMISE* 17 (2d ed. 2015) ("[S]ince a contract is first of all a promise, the contract must be kept because a promise must be kept . . ."); *id.* at 40 ("Contract law . . . is grounded in the primitive moral institution of promising"); see also Charles Fried, Response, *The Convergence of Contract and Promise*, 120 HARV. L. REV. F. 1, 3 (2007) ("[C]ontract [is] rooted in, and underwritten by, the morality of promising.")

3. Wilkinson-Ryan, *Legal Promise and Psychological Contract*, *supra* note 1, at 855–57. That moral view is widely held among moral philosophers. See, e.g., DAVID HUME, *A TREATISE OF HUMAN NATURE* § 3.2.5 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2007) (1739); IMMANUEL KANT, *GROUNDWORK OF THE METAPHYSICS OF MORALS* 15, 32, 38 (Mary Gregor ed. & trans., Cambridge Univ. Press 1997) (1785); T.M. SCANLON, *WHAT WE OWE TO EACH OTHER* 315 (1998); John Rawls, *Two Concepts of Rules*, 64 PHIL. REV. 3, 13–18 (1955).

4. See, e.g., FRIED, *supra* note 2, at 17 ("The moralist of duty thus posits a general obligation to keep promises, of which the obligation of contract will be only a special case—that special case in which certain promises have attained legal as well as moral force."); Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603, 1604 (2009) ("A natural account of the relationship between contract and promise holds that legal liability in contract enforces a corresponding moral responsibility for a promise."); Wilkinson-Ryan & Baron, *supra* note 1, at 405. As this Article discusses in depth, much of the debate centers on the scope of the promise.

5. See Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939, 1954–55 n.32 (2011); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 550–56 (2003).

6. O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457 (1897), *reprinted in* 110 HARV. L. REV. 991, 995 (1997).

7. Note that, although contemporary scholars typically associate Holmes with the view that individuals ought to breach when it is efficient to do so, it is far from clear that Holmes actually held that view regarding the morality of breach. Holmes, rather, purported both to

law provides the remedy for breach of contract through expectation damages, and submitting to that remedy exhausts both the moral and legal liability of a breacher. For a Holmesian firm, then, there is no further moral obligation to perform rather than to breach and pay damages.⁸ As a result, the Holmesian firm will breach and pay damages whenever it is in its interest to do so.

This asymmetry in moral belief has profound practical consequences. Consider the aftermath of the housing crisis in 2008. Mortgage contracts require monthly payments of the principal and interest that, over the life of the loan, amount to much more than the original loan amount. After housing prices plummeted in 2008, millions of homeowners owed more on their mortgages than their houses were worth.⁹ Their mortgage contracts were “underwater,” and it would have been financially beneficial for many of them to breach those contracts. This was particularly true because many of the contracts were from nontraditional loans, which had become popular before the crisis.¹⁰ Those loans often included balloon payments, teaser interest rates that increased dramatically after an introductory period, and other features that made those loans especially costly after the first several years of the loan term.¹¹ Underwater homeowners thus faced a choice between continuing to make rapidly escalating monthly payments and breaching their mortgage contract. The primary consequence of breach is that the borrower must turn over the house that served as collateral for the loan.¹² When the house is worth less than the balance of the mortgage, and thus worth much less than the homeowner would ultimately have to pay over the life of a nontraditional loan because of interest, the homeowner often best serves her financial interests by breaching the mortgage contract and turning over the house.

Yet hundreds of thousands—or more—of underwater homeowners refused to breach their mortgage contracts. The numbers are staggering. Research by the Federal Reserve indicates that only about 5% of households with negative equity (that is, with underwater mortgages) who could afford

describe the limited role of contract law in enforcing promises and to endorse the view that law ought to be designed to account for the amoral “bad man.”

8. See O.W. HOLMES, JR., *THE COMMON LAW* 301 (Boston, Little, Brown & Co. 1881) (“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.”).

9. Les Christie, *7.5 Million Homeowners ‘Underwater,’* CNN (Oct. 31, 2008, 8:13 AM), https://money.cnn.com/2008/10/30/real_estate/underwater_borrowers/index.htm [https://perma.cc/M3VL-GZE3].

10. See Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1096–1118 (2009).

11. See *id.* at 1076–77.

12. In some states, lenders may also seek a deficiency judgment for the difference between the loan amount and the current value of the house if the former exceeds the latter.

to make their monthly payments¹³ chose to default on their mortgages.¹⁴ If a million homeowners could have saved \$100,000 each by walking away from their underwater mortgages, in aggregate their choices not to do so cost them \$100 billion. Homeowners incurred that astounding cost—to the direct benefit of large financial institutions—in large part because of their perceived moral obligation to make good on the promise they made to pay their mortgage.¹⁵ Those same large financial institutions, by contrast, breached their own contractual obligations—both to the homeowners who were going underwater and to the investors to whom they sold securitized mortgages.¹⁶

This Article thus examines a question the literature has neither recognized nor addressed: how the law and regulation of contracts should account for the fact that legal actors are guided by differing views about the moral permissibility of breach. The Article proceeds in four Parts. Part I situates the phenomenon of moral diversity within the philosophical and economic debate about the morality of breach. It shows that the debate revolves around a disagreement about the moral scope of the promise generated by a facially unqualified contract—that is, a contract that states a primary obligation to perform without providing an explicit alternative like a liquidated-damages clause. Some theorists view such contracts to give rise to categorical promises, but others take those contracts to give rise only to promises-in-the-alternative to perform or pay. That disagreement about the moral scope of a promise, in turn, mirrors the moral diversity among contracting parties: individuals, but not firms, think that a contract generates a promise to perform, not a promise to perform or pay.

Part II presents recent empirical research revealing the asymmetry in moral belief among different types of parties regarding the moral permissibility of breach. Section II.A presents the experimental evidence supporting the conclusion that individual actors tend to view breach as immoral. It extracts from that research two further important conclusions: first, that even among individuals there is substantial heterogeneity in moral belief about breach; and second, that individuals tend to determine the moral scope of their contractual promise by reference to the express terms of the contract. Section II.B presents the evidence that sophisticated parties like commercial firms tend to view a contract as generating alternative options to perform or

13. Households with negative equity who *can't* afford their monthly payments are forced to default; those with negative equity who *can* afford their monthly payments are those who face a real decision of whether or not to breach.

14. Kristopher S. Gerardi, Kyle F. Herkenhoff, Lee E. Ohanian & Paul S. Willen, *Can't Pay or Won't Pay? Unemployment, Negative Equity, and Strategic Default* 25 (Bos. Fed. Reserve, Working Paper No. 15–13, 2015), <https://www.bostonfed.org/publications/research-department-working-paper/2015/cant-pay-or-wont-pay-unemployment-negative-equity-and-strategic-default.aspx> [<https://perma.cc/8ZU9-WDDQ>].

15. See Wilkinson-Ryan, *Breaching*, *supra* note 1.

16. See generally Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 WAKE FOREST L. REV. 971 (2010).

to pay. It presents both the experimental evidence on the breaching beliefs and behavior of sophisticated commercial actors and the theoretical considerations that have led many scholars to conclude that such commercial actors tend to behave as Holmesians.

Part III argues that this asymmetry is normatively problematic. This Part addresses two normative frameworks: economic efficiency, and fairness and distribution. Section III.A argues that the existing legal framework, in conjunction with individuals' moral beliefs, results in those individuals forgoing efficient breaches. That legal framework thus leads to outcomes that are not Pareto optimal and fails to maximize social welfare. Section III.A then considers and rejects the counterargument that some of the forgone breaches would have been opportunistic but not efficient. Section III.B argues that the existing legal framework is distributionally unfair because it facilitates sophisticated commercial actors to systematically exercise economically advantageous legal options that individuals with different moral beliefs would view as morally foreclosed. The distributional consequences are problematic both vertically, between moralist individuals and Holmesian sophisticated commercial actors, and horizontally, between individuals who will breach and those who refuse to breach on moral grounds. The Part then considers and largely rejects the objection that the market will eliminate the distributional disadvantage for the moralist by pricing contracts between firms and individuals to account for individuals' propensity not to breach on moral grounds.

Part IV proposes a novel solution to the problem of moral diversity about breach based on the conceptual framework of choice architecture and demonstrates the solution's viability using empirical data from two new studies I performed. Sections IV.A and IV.B consider the traditional tools the law might use to address the asymmetry: reducing expectation damages to induce individual moralists to breach, adopting specific performance as remedy for breach to require sophisticated Holmesians to perform, and providing disclosure requirements to inform individuals of their legal rights. The Sections show how these tools would be ineffective to address moral diversity and efficient breach. Section IV.C then presents a proposal based on the conceptual framework of choice architecture. My proposal requires contracts to include an exit clause that creates a contractual option not to perform and to pay instead. Because individuals judge the scope of the promise arising from a contract based on the contract's express terms, this proposal would alter the substance of individual moralists' perceived moral obligation to align with the view of sophisticated Holmesians. Finally, this Part presents the results of two new experimental studies I performed that demonstrate the impact of exit clauses. The first study indicates that individuals are more willing to exercise an exit clause than they are to breach a contract with a liquidated-damages clause or a facially unqualified contract with neither an exit clause nor a liquidated-damages clause. The second study indicates that individuals are also more willing to exercise an exit option in a mortgage than they are to default on a mortgage without an exit clause. Indeed, the data indicates that millions more homeowners with underwater mortgages

might have strategically breached during the housing crisis if mortgage contracts contained exit clauses. These empirical results suggest that a mandatory exit clause could be an effective solution to the problem of moral diversity about breach in a wide range of contractual contexts.

I. THE MORAL FOUNDATIONS OF CONTRACT LAW

A. *Contracts as Promises and the Morality of Breach*

A dominant philosophical theory of contract law grounds the normative justification of contract doctrine in the moral obligation to keep promises. Contracts, like promises, create duties that we take upon ourselves. One must enter a contract and one must make a promise in order to be bound to perform. Promissory morality concerns content-neutral obligations that moral agents voluntarily assume, distinct from and beyond the moral duties we owe to all others simply by virtue of their and our own statuses as moral agents. Similarly, contract law enforces only those legal obligations we voluntarily assume, leaving tort and criminal law to enforce mandatory legal duties. Doctrine expressly embraces the foundation of contract in the moral concept of promise. The Restatement defines a contract as a legally enforceable promise.¹⁷ It grounds that conception of contract in the “sanctity of contract and the resulting moral obligation to honor one’s promises.”¹⁸ Courts and scholars accordingly routinely refer to the parties to a contract as the “promisor” and the “promisee.” In Charles Fried’s canonical formulation, “[t]he promise principle,” according to “which persons may impose on themselves obligations where none existed before,” “is the moral basis of contract law.”¹⁹

If the normative foundation of contract doctrine is promissory morality, then contract law serves to enforce the moral obligation to keep promises. Fried maintained that a contract “is first of all a promise,” and therefore “the contract must be kept because a promise must be kept.”²⁰ In his view, the law should enforce contracts because it should respect individuals’ moral capacity to bind themselves through their promises.²¹ Fried further recognized that “promissory obligation . . . ha[s] its roots in [the] deeper moral soil” of “trust

17. RESTATEMENT (SECOND) OF CONTRACTS § 1 (AM. LAW INST. 1981) (“A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.”).

18. *Id.* ch. 16, Introductory Note.

19. FRIED, *supra* note 2, at 1; *id.* at 40 (contract is “grounded in the primitive moral institution of promising”); *see also* Fried, *supra* note 2, at 3 (“[C]ontract [is] rooted in, and underwritten by, the morality of promising . . .”).

20. FRIED, *supra* note 2, at 17.

21. *Id.* at 2 (arguing that contract law’s enforcement of voluntary promises is “a fair implication of liberal individualism” because it “carries to its natural conclusion the liberal premise that individuals have rights” by “respect[ing] the dispositions individuals make of their rights”).

and respect for persons.²² Accordingly, on Fried's view, if the law failed to enforce contracts, it would fail to respect our moral agency and autonomy.²³ Other scholars have similarly found the normative basis of contract in the morality of promising.²⁴

Nevertheless, although the moral duty not to break a promise absent an adequate excuse is widely recognized, the existence of a moral duty not to breach a contract is neither free from debate nor clearly reflected in doctrine. The default and dominant remedy in contract law is expectation damages.²⁵ Specific performance is available only in rare circumstances,²⁶ and punitive damages are almost never awarded.²⁷ Contract doctrine's remedies are thus designed to put the promisee in a position comparable (though not identical) to the one he would have been in had the breaching promisor performed the contractual promise by awarding only the monetary equivalent of performance.²⁸ Seana Shiffrin recently criticized orthodox doctrine on the ground that it thereby fails to treat breach as a moral wrong: "If contract law ran parallel to morality, then contract law would—as the norms of promises do—require that promisors keep their promises as opposed merely to paying off their promisees."²⁹ But, she notes, contract doctrine "diverges from morality in this respect" because its "dominant remedy is not specific performance but expectation damages."³⁰ Accordingly, many scholars believe that contract doctrine diverges from promissory morality by permitting what morality condemns.

The tension between promissory morality and contract doctrine's remedies finds its sharpest expression in the theory of efficient breach, which not only fails to condemn breach—in certain circumstances, it embraces it. Traditional economic analysis of law relies on the theory of efficient breach to

22. Charles Fried, *The Ambitions of Contract as Promise*, in *THE PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW* 17, 21 (Gregory Klass et al. eds., 2014).

23. In a similar vein, Jody Kraus recently argued that "'respect for a person's autonomy [and] respect for his unfettered voluntary choice as the sole rightful determinant of his actions except where the interests of others need protection from him' . . . largely reconciles contract and promise." Kraus, *supra* note 4, at 1608, 1648 (quoting 3 JOEL FEINBERG, *THE MORAL LIMITS OF THE CRIMINAL LAW: HARM TO SELF* 68 (1989)).

24. See, e.g., Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 *HARV. L. REV.* 708 (2007).

25. *RESTATEMENT (SECOND) OF CONTRACTS* § 347 (AM. LAW INST. 1981).

26. *Id.* § 359 ("Specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party.")

27. See *id.* § 355 ("Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.")

28. *Id.* § 344, cmt. a ("[The] 'expectation interest' . . . is [the] interest in having the benefit of [the] bargain by being put in as good a position as [the promisee] would have been in had the contract been performed.")

29. Shiffrin, *supra* note 24, at 722.

30. *Id.* at 722–23.

defend orthodox contract doctrine's remedies,³¹ on the ground that expectation damages provide an incentive to breach when and only when breach and payment of damages would be Pareto optimal.³² The promisor will perform unless the benefit of breaching exceeds his liability in damages.³³ The expectation remedy ensures that liability is sufficient to guarantee that his counterparty is at least as well-off as he would have been with performance.³⁴ For example, if I contract with you to shovel snow from your walk for \$10, but my car breaks down and emergency repairs would cost \$100, we both will be at least as well off if I breach our contract and pay you enough money to put you in as good a position as you would have been had I shoveled your walk as promised. Contract doctrine requires that payment from breaching promisor to disappointed promisee amount to expectation damages. Legal and economic scholars have developed the theory of efficient breach far beyond that original simplistic model to incorporate second-order considerations like the effect of choice of remedy on prices and the role of transaction

31. See A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 33–36 (4th ed. 2011).

32. See Gregory Klass, *Efficient Breach*, in *PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW*, *supra* note 22, at 362, 362–66 (describing the “simplest version of the [efficient breach] theory recommends expectation damages because expectation damages give parties a reason to perform when and only when performance will increase overall social welfare”); see also RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 128–38 (9th ed. 2014); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 *YALE L.J.* 1261 (1980); Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 *U. COLO. L. REV.* 683 (1986). Economists outside the legal academy often bypass reliance on the maximization of aggregate social welfare in favor of a focus solely on Pareto optimality. See generally LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* 28–38 & n.41 (2002). Pareto-optimal outcomes are those in which no party can be made better off without making another party worse off. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 *HARV. L. REV.* 1089, 1093–94 (1972) (“Economic efficiency asks that we choose the set of entitlements which would lead to that allocation of resources which could not be improved in the sense that a further change would not so improve the condition of those who gained by it that they could compensate those who lost from it and still be better off than before. This is often called Pareto optimality.”). As a result, Pareto-optimal outcomes often maximize aggregate welfare. But endorsing Pareto-optimal outcomes need not rely on utilitarianism as a moral philosophy. For example, a contract theorist might endorse the expectation remedy because no party would prefer a different remedy. The ultimate normative foundation of that endorsement need not be the pursuit of maximizing aggregate welfare, but rather the principle that a legal rule governing the private interactions between two parties should be the rule that both parties prefer. That latter principle might be justified on, for example, a conception of freedom or autonomy. As a result, a normative framework that embraces Pareto optimality is not necessarily wedded to utilitarianism. This subtlety does not affect the analysis in this Article.

33. Shavell, *supra* note 1, at 441 (“[I]f the party in breach must pay damages, we can make an important inference: This party would not have been willing to commit breach unless the cost of performing (or the benefit of not performing) in the contingency exceeded the burden of damages.”).

34. See L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 1), 46 *YALE L.J.* 52, 54 (1936) (the aim of the expectation interest is to put the plaintiff in “as good a position as he would have occupied had the defendant performed his promise”).

costs on parties' preferences among remedies. But the fundamental moral structure underlying sophisticated versions of the theory of efficient breach remains unchanged: contract law should permit breach if, and to the extent that, breach would be Pareto optimal and would thus increase social welfare.

The theory of efficient breach has a distinguished pedigree that shades the economic defense of the expectation remedy into the morality of a promisor's breach. The "Holmesian heresy" that "[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"³⁵ both captures contract doctrine's long-standing apparent embrace of the efficient-breach theory and reveals the latent tension between the doctrine and its theoretical foundations in promissory morality. The moral duty to keep a promise is not discharged by breaking the promise and then paying off the victim of your misdeed. But as Shiffrin observes, contract doctrine's preference for expectation damages over other remedies, including specific performance, appears to accept precisely that.³⁶ The theory of efficient breach, in the eyes of some of its proponents,³⁷ converts the economic argument that the expectation remedy is efficient into the moral argument that people *ought* to breach and pay damages when it is in their interest to do so. The efficiency-driven moral theory,³⁸ which recommends expectation damages as a matter of public policy, may be taken even further to excuse breach as a matter of private morality.³⁹ That traditional economic analysis and its underlying moral theory of efficiency thus provide a theoretical foundation for the Holmesian view of the morality of breach and, in the process, apparently rejects the moral condemnation of breaking a promise.

B. *Convergence Theory and the Revisionist Move*

Recent defenses of the Holmesian view of the morality of breach take a different approach. They reject the apparent conflict between promissory morality and economic efficiency, arguing that the expectation remedy is consistent with the moral obligation to keep promises. Contemporary contract theorists thus divide into two camps regarding the relationship between contract doctrine and promissory morality: (1) divergence theorists, who argue that orthodox contract doctrine conflicts with the requirements of promissory morality because the doctrine permits and, indeed, encourages breaking promises through efficient breach; and (2) convergence theorists, who, by contrast defend orthodox contract doctrine on the ground that it

35. Gregory Klass, Response, *To Perform or Pay Damages*, 98 VA. L. REV. 143, 152 (2012) (quoting Holmes, *supra* note 6).

36. See Shiffrin, *supra* note 24, at 722–23.

37. See, e.g., Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349 (2009).

38. As noted above, Pareto optimality may be based on a utilitarian or welfarist moral theory, but it need not be. See *supra* note 32.

39. See Posner, *supra* note 37.

aligns with the moral requirements of promising. Both therefore agree that contract doctrine should conform with the requirements of promissory morality. They disagree about whether it does so.

Traditional versions of the divergence theory are based on the straightforward idea that contract doctrine fails to enforce the requirements of promissory morality.⁴⁰ Implicit in that traditional version of the divergence theory is the view that contract doctrine should prohibit or punish breach simply because it is morally wrong.⁴¹ But even if you think “the law should not aim to enforce interpersonal morality as such,” as Shiffrin argues, one may still hold that the “law’s content should [nonetheless] be compatible with the conditions necessary for moral agency to flourish.”⁴² Through its embrace of the Holmesian view of breach, orthodox contract doctrine on her view “fail[s] to support the morally decent person” and “contribute[s] to a legal and social culture that is difficult for the morally decent person to accept.”⁴³ The core of a divergence theory, of either the traditional variety or Shiffrin’s subtler variety, is that orthodox contract doctrine is morally unsupported and must be reformed in light of its conflict with promissory morality.

Contemporary convergence theorists similarly presuppose that “the justification of [contract doctrine] turns, at least in part, on whether the legal rights and duties it recognizes correspond to individual moral rights and responsibilities.”⁴⁴ That justification thus depends on “whether the legal rights and duties recognized by contract correspond to the moral rights and responsibilities created by promise.”⁴⁵ In this respect, contemporary convergence theorists part ways with earlier defenders of orthodox contract doctrine. Those earlier scholars argued that an expectation remedy is appropriate solely because it properly incentivizes breaches leading to Pareto-optimal outcomes and thus higher social welfare. Their view conceded a conflict between the theory of efficient breach and promissory morality, and it proceeded to argue (or assume) that efficiency trumps any moral obligation to keep a promise. Contemporary convergence theorists, by contrast,

40. See, e.g., Peter Linzer, *On the Amoralism of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111 (1981).

41. See Kraus, *supra* note 4, at 1611–12 n.20 (discussing various normative political theories that underwrite the claim that doctrine should correspond to the requirements of individual morality).

42. Shiffrin, *supra* note 24, at 710; see also Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551 (2009); Seana Valentine Shiffrin, *Must I Mean What You Think I Should Have Said?*, 98 VA. L. REV. 159 (2012).

43. Shiffrin, *supra* note 24, at 710. In particular, she claims, the “divergence [of doctrine and interpersonal morality] raises questions about how the moral agent is to navigate both the legal and moral systems” because a morally decent person will be torn between the normative rationales of promissory morality and the conflicting rationales implicit in contract doctrine. *Id.* at 709.

44. Kraus, *supra* note 4, at 1611.

45. *Id.* at 1606.

endorse (or at least, do not dispute) what Kraus calls the “correspondence” view—that contract doctrine ought to align with promissory morality—and further argue that it does. These scholars thus argue that the initial critical intuition, voiced by Shiffrin and others, that contract law’s expectation remedy conflicts with the requirements of promissory morality is mistaken.

Convergence theorists’ defense of the Holmesian view requires them to make a choice: they must reject one of a pair of premises, both of which hold intuitive appeal. The first premise is that a contract stating an obligation to perform generates a corresponding promise to perform rather than merely a promise in the alternative to perform or to pay damages. This first premise concerns the substantive scope of the primary moral obligation arising from the contract. The second premise is that the moral obligations arising from a promise are not satisfied by breaking the promise and compensating the promisee: that paying off the promisee is not a morally adequate response to the moral violation of breaking a promise. This second premise thus concerns not the content of the primary promise but rather the moral remedy for its breach. If these premises are correct, then a facially unqualified contract generates an unqualified moral obligation to perform, and the required moral remedy for the violation of that promise is performance rather than payment. These two premises thus jointly entail that the expectation remedy fails to correspond to the moral rights and obligations of the contracting parties.

Rejecting either of these premises requires a revisionist move. That is, the convergence theorist must offer interpretations of the terms of contracts that differ from the interpretations that prior scholars had assumed and that the express terms of the contract may suggest. A facially unqualified contract appears, at first glance, to generate an unqualified promise to perform and to require performance rather than mere compensation as a moral remedy for the breach of that promise. To overcome this appearance, the convergence theorists’ revisionist move denies either the first premise regarding the substantive scope of the promise or the second premise regarding the moral remedy for breaking the promise. In either case, the convergence theorist must offer a revisionist account of the moral obligations arising from a facially unqualified contract.

Law and economics scholars tend to take the first approach, reconceiving the substantive scope of the contract’s moral obligation. Steven Shavell deploys a revisionist move that interprets facially unqualified contracts to contain gaps corresponding to “contingencies”—that is, factual scenarios in which performance may become more costly (or less advantageous) than breach.⁴⁶ For Shavell, a contract to shovel snow is incomplete with respect to

46. Steven Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, 107 MICH. L. REV. 1569, 1570–72 (2009) [hereinafter Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*]; see also KAPLOW & SHAVELL, *supra* note 32, at 155–223; Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 466–69 (1980); Shavell, *supra* note 1.

the contingency that the promisor's car is stolen when the contract does not mention the possibility of theft—that is, the contract itself simply doesn't address the possibility that the promisor is unable to shovel as he had promised (except at great cost) because his car was stolen.⁴⁷ Shavell does not dispute that it is immoral for a promisor to breach an express term of a contract because “if a contract provides explicitly for a contingency, then the moral duty to perform in that contingency is governed by the contract.”⁴⁸ But because contracts are typically incomplete, the promise generated by the contract itself is silent with respect to those gaps.⁴⁹ As a result, he argues, both morality and the law should imply into a gap in an incomplete contract a term that corresponds to the term the parties *would* have chosen had they addressed the contingency.⁵⁰ Those gaps often correspond to contingencies where breach is efficient, and Shavell concludes the parties would have chosen a term to fill those gaps permitting nonperformance and payment of damages. Accordingly, on this view, nonperformance is not immoral.

Daniel Markovits and Alan Schwartz's version of the convergence theory takes this first approach even further. Where Shavell's revisionist interpretation of a contract found gaps where none appear on the face of the contract, Markovits and Schwartz find *actual terms* permitting payment in lieu of performance. On their view, “[c]ontracts that are silent about remedies should be read to make dual performance promises.”⁵¹ They hypothesize that “contracts typically impose alternative obligations on the promisor: *either* to supply goods or services for a specified price *or* to transfer to the promisee the gain the promisee would have made had those goods or services been supplied.”⁵² This, too, is a revisionist move. Markovits and Schwartz argue that, accounting for transaction and other costs, sophisticated parties⁵³

47. Steven Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, *supra* note 46, at 1571 (“[B]ecause the contract does not mention theft explicitly, I consider the contract to be incomplete as to that contingency.”).

48. *Id.* at 1570.

49. See Shavell, *supra* note 1, at 441 (“[If a] particular contingency that obtained [was not] explicitly addressed in the contract” then “one will not know directly from the contract whether the parties would have wanted performance in the contingency, and thus, whether the breach should be considered wrongful.”).

50. Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, *supra* note 46, at 1570 (“[I]f a contract is incomplete in the sense that it does not provide explicitly for a contingency, then the moral duty to perform in the contingency is governed by what a completely detailed contract addressing the contingency *would* have stipulated.” (emphasis added)).

51. Daniel Markovits & Alan Schwartz, *(In)Efficient Breach of Contract*, in 2 THE OXFORD HANDBOOK OF LAW AND ECONOMICS 20, 28 (Francesco Parisi ed., 2017).

52. Markovits & Schwartz, *supra* note 5, at 1948.

53. Markovits and Schwartz expressly limit the dual performance hypothesis by assuming that “[c]ontracting parties are sophisticated and rational” and “make the contractual choices that maximize their expected profits.” Daniel Markovits & Alan Schwartz, Essay, *The Expectation Remedy Revisited*, 98 VA. L. REV. 1093, 1093 (2012) (citing Markovits & Schwartz, *supra* note 5, at 1055–56). That limitation is critical in this Article's analysis.

would prefer a contract that permits the promisor to perform or pay damages. They then infer from that economic logic that sophisticated parties *actually agree* to a contract in the alternative even when the contract is facially unqualified.⁵⁴ This conflicts with Shavell's view, according to which the parties *would* have agreed to a term permitting efficient nonperformance—but, because the contract is silent on the matter, did not *actually* come to that agreement. In Markovits and Schwartz's interpretation, by contrast, contracts that may appear on their face to not provide an option to pay instead of perform in fact include such an option.⁵⁵ As a result, paying expectation damages is not actually a breach at all—but rather an alternative way of performing the contract.⁵⁶

Jody Kraus's convergence theory takes the second approach to the revisionist move: focusing on the contractual promise's implicit moral remedies rather than reinterpreting the substantive scope of that promise. Kraus's core insight is that individuals retain control over not only the content of their primary promise, but also the secondary moral obligations that arise from a party breaking that primary promise. In other words, in making a promise we get to decide not only what we promise to do but also what we owe each other if we break that promise. His defense of the expectation remedy rests on the claim that “most contracting parties will find it mutually beneficial to permit the promisor, *both legally and morally*, to pay damages as an alternative to performing the promised act.”⁵⁷ His approach thus makes a revisionist move of its own. In his view, sophisticated “parties use the remedial default rules of contract to specify a *morally* acceptable alternative to performance of their promised act instead of writing an explicit alternative

54. Markovits & Schwartz, *supra* note 5, at 1987 (“In the typical case, the promisee’s expected return from contracting is maximized under contracts that make alternative promises. Promisees thus should be taken to have made such contracts unless the evidence proves otherwise.”).

55. *Id.* at 1978 (“[T]he transfer term arises out of the parties’ *actual* intentions and not just out of intentions that it would be rational for them to have or fair to impute to them.” (emphasis added)). Markovits and Schwartz suggest that “[t]he transfer promise is memorialized in the liability rule contract through the price term” and thus, by agreeing to a facially unqualified contract at a particular price, the parties implicitly and “in fact” agree to a promise in the alternative. *Id.*

56. On that basis, Markovits and Schwartz lay claim to the assertion in the title of their article:

Under the hypothesis, a promisor who fails to deliver the promised goods or services but instead transfers the gain to her promisee *performs* rather than breaches. The promisor breaches only if she *neither delivers nor pays*. A breach in this sense contradicts the promisee’s actual expectation—to receive goods or money—and thus reduces agents’ incentives to organize their economic affairs under contracts. On this view, ‘efficient breach’ theory not only is vacuous; ‘efficient breach’ itself is a myth, because no true breach is efficient.

Id. at 1948–49 (third emphasis added) (footnote omitted).

57. Kraus, *supra* note 4, at 1638 (emphasis added).

promise contract.”⁵⁸ Thus, even when a contract is facially unqualified, “many parties—and most commercially sophisticated parties—will intend and understand the promisor to be discharging his *moral* obligation by compensating the promisee, rather than paying damages for breach of a moral obligation.”⁵⁹ Kraus’s version of the convergence theory differs from Shavell’s or Markovits and Schwartz’s view because, according to Kraus, failing to perform the obligation under a contract remains a moral wrong. But Kraus proposes that, for many parties, the moral remedy for that wrong is simply payment.⁶⁰

Each revisionist’s move directs focus on reinterpreting the content of a facially unqualified contract. At this stage in the debate, it appears that everyone agrees that there is a moral obligation to do whatever the contract requires. The disagreement focuses instead on what those requirements are.⁶¹ Divergence theorists say contracts require people to perform.⁶² Convergence theorists say contracts require people only to perform or pay.⁶³ As Barbara Fried remarked, “Those intuitions may well be right much of the time. But right or wrong, they are an exercise in contract interpretation, not first-order morality.”⁶⁴ The state of the philosophical debate thus invites an empirical inquiry into how contracting parties themselves understand the scope of the promises they make and receive in contracts. In the next Part, this Article turns to the existing attempts to answer that question.

II. THE ASYMMETRY IN MORAL BELIEF ABOUT BREACH

The philosophical debate between correspondence theorists and divergence theorists is a dispute about the moral scope of the promise generated by a facially unqualified contract. Divergence theorists hold that the promise

58. *Id.* (emphasis added).

59. *Id.* (emphasis added).

60. *See id.* at 1635 (“Expectation damages can be justified as the law’s best guess about the remedial moral duty that most promisors would prefer.”).

61. *See* Markovits & Schwartz, *supra* note 51, at 27 (“Whereas these issues are framed . . . as concerning the law’s choice of contract remedies, they in fact concern the parties’ choice of contract terms” and thus that “the assessment of the expectation remedy [does not] turn on substantive economic or moral arguments [but rather] on how best to interpret party intent.”).

62. *See* Klass, *supra* note 35, at 147 (“If Markovits and Schwartz’s moral argument is to succeed, the dual-performance hypothesis must be an empirical interpretive claim. . . . [S]ophisticated parties must in fact understand their contracts to commit them not to perform the action term *simpliciter*, but to perform the action or the transfer term. . . . Markovits and Schwartz do not explain why parties choose to express their contracts using language that does not correspond to their understanding of the commitment.”); Shiffrin, *Must I Mean What You Think I Should Have Said?*, *supra* note 42, at 171–72 (“[W]hy not think that the better interpretive strategy is to look at what people actually said . . . rather than at what the model suggests they should have said?”).

63. *See* Markovits & Schwartz, *supra* note 5; Shavell, *supra* note 1.

64. Barbara H. Fried, *The Holmesian Bad Man Flubs His Entrance*, 45 SUFFOLK U. L. REV. 627, 629–30 (2012).

is, like the face of the contract, unqualified. Correspondence theorists hold that the promise is, like their interpretation of the contract, a promise in the alternative—either with respect to the primary obligation to perform or to the secondary obligation regarding the moral remedy for breach. Moral belief about the scope of the promise arising from a facially unqualified contract will govern that party's breaching behavior, to the extent a party is motivated by their moral beliefs. Differing moral beliefs about breach among different types of parties accordingly leads to differing breaching behavior by those parties.

Recent empirical and theoretical research sheds important light on actual contracting parties' moral beliefs about the permissibility of breach. The empirical research has focused on individuals' moral attitudes and demonstrated that most individuals view breach of contract as morally wrong. The research further demonstrates that those attitudes and the resulting propensity to breach are sensitive to a range of contextual variables. A core implication of the empirical research is that individuals appear to judge the scope of the moral obligation under a contract on the basis of the express terms of that contract. The research regarding the moral attitudes and breaching behavior of commercially sophisticated parties, by contrast, rests largely on theoretical considerations. In particular, scholars argue that contracting parties who satisfy certain "domain assumptions" regarding their "rationality" and other features will breach and pay damages rather than perform when the breach would be efficient. Although it remains an open empirical question which and how many contracting parties satisfy those domain assumptions, it seems plausible that many commercial parties will.

A. *Individual Moralistic Performers*

The empirical evidence "suggests that people have a preference for keeping promises per se."⁶⁵ But questions remain regarding how that preference manifests in the context of contracts. Do individuals perceive a contract to give rise to a promise, the violation of which is morally wrong? And if so, is that promise one simply to perform or merely to perform or to pay? Steven Shavell reported the first empirical study on individual attitudes toward breach of contract.⁶⁶ He presented subjects with several scenarios detailing a particular breach of contract. After each scenario, subjects categorized the breaching party's behavior as "(1) definitely unethical; (2) somewhat unethical; (3) neither ethical nor unethical; (4) somewhat ethical; [or] (5) definitely ethical."⁶⁷ One scenario presents a breach in which the cost of performance rose substantially and the description of the scenario did not mention that the breaching party would pay damages to his counterparty. The average of the subjects' score of the breaching party's conduct was 2.41, which lies be-

65. Vanberg, *supra* note 1, at 1468.

66. Shavell, *supra* note 1.

67. *Id.* at 453.

tween “somewhat unethical” and “neither ethical nor unethical.”⁶⁸ Only 7.3% of subjects scored the conduct as “somewhat ethical,” and none scored it as “definitely ethical.”⁶⁹ Over 92% thus scored the breach as either unethical to some degree or ethically neutral. Shavell accordingly concluded that in most individuals’ view, “the breach of a contract is seen as what it appears to be: a violation of a promise and thus having a morally inappropriate aspect.”⁷⁰

Shavell’s remaining scenarios added factual context to this original scenario in order to test that context’s effect on the subjects’ attitudes about the breach. One such scenario stated that the breacher would pay compensatory damages as required by contract law. Subjects on average scored this breach 3.56, between ethically neutral and somewhat ethical.⁷¹ The key implication is the significant increase in individuals’ perception of the morality of breach when they are expressly informed of the payment of damages as a consequence of nonperformance.

Subsequent studies confirm and elaborate on Shavell’s initial results. Tess Wilkinson-Ryan and David Hoffman’s studies confirmed Shavell’s principal finding. They concluded that “ordinary people think that breach is morally wrong and believe that contract damages should reflect the ethical culpability of the breaching party.”⁷² When subjects were permitted to pick any amount as the appropriate measure of damages in a typical breach of contract case, they assigned the proper measure of damages for breach to be 2.19 times the expectation interest.⁷³ Even with that supercompensatory award, subjects still rated breach as over 5 on a scale from 1 (“not immoral”) to 7 (“extremely immoral”).⁷⁴ Three-quarters reported that the breacher ought to perform rather than pay damages in ordinary contracts, and two-thirds believed that a court ought to enforce specific performance.⁷⁵ Wilkinson-Ryan and Hoffman subsequently recreated these core results.⁷⁶ These experiments thus “demonstrate that most people believe that a contract is a promise to perform as agreed.”⁷⁷

Further studies show that individuals are significantly more likely to breach, and significantly less likely to view breach as immoral, if the contract

68. *Id.*

69. *See id.*

70. *Id.*

71. *Id.* at 455.

72. Wilkinson-Ryan & Hoffman, *supra* note 1, at 1004.

73. *See* Wilkinson-Ryan & Baron, *supra* note 1, at 420–21.

74. *Id.* at 417–20.

75. *Id.* at 420.

76. *See, e.g.,* Wilkinson-Ryan & Hoffman, *supra* note 1, at 1022–31.

77. *Id.* at 1015. Wilkinson-Ryan and Hoffman also demonstrate several framing effects, under which subjects’ moral responses vary according to the factual context of a breach. For example, they found that subjects viewed breach to gain as a greater moral wrong than breach to avoid loss and that subjects viewed intentional breach as a greater moral wrong than unintentional harms. *Id.*

explicitly contemplates breach and specifies its remedy. Frameworks that make incentive structures explicit lead individuals to navigate those incentives through more self-interested behavior than they would with identical but implicit incentive structures.⁷⁸ In an experimental setting, game players are less likely to behave altruistically and more likely to act self-interestedly when the game permitted their counterparty to punish that noncooperative behavior.⁷⁹ Such sanctions may shift individuals from viewing noncooperative behavior as morally prohibited to viewing it as permitted and priced. In a classic experiment, researchers observed that parents with children in day-care were paradoxically more likely to pick their child up late when the facility imposed an explicit fine compared to when the facility had a policy of discouraging, but not fining, late pickups.⁸⁰ Wilkinson-Ryan hypothesizes that liquidated-damages clauses function like those “small sanctions” by “making the sanction for breach explicit within a contract.”⁸¹ Individuals “who saw a contract with a liquidated-damages clause were more willing to breach” than individuals who saw an otherwise-identical contract without such a clause.⁸² Subjects reported that they would breach a contract without a liquidated-damages clause only if offered a premium of between 75% and 100% over their liability in damages.⁸³ In other words, subjects said they would breach only if doing so gained them close to double what they would have to pay in the expectation remedy. By contrast, subjects reported that they would breach a contract with a liquidated-damages clause for a smaller premium of between 25% and 50% over their liability in expectation damages.⁸⁴ Subjects’ willingness to breach a contract with a liquidated-damages clause remained even if the damages clause functioned as a penalty clause by awarding their counterparty damages greater than the harm they suffered.⁸⁵ Subjects’ breaching behavior responded to the presence of a liquidated-damages clause because they believed breaching such a contract was less wrongful and immoral, and less harmful to the breacher’s reputation, than breaching a contract without a remedial clause.⁸⁶

The empirical work thus supports three conclusions. First, individuals tend to view breach of contract as morally wrong. Second, although most individuals believe breach is immoral, there remains heterogeneity in individuals’ moral beliefs because a substantial minority appears to take a

78. See Samuel Bowles, *Policies Designed for Self-Interested Citizens May Undermine “The Moral Sentiments”*: Evidence from Economic Experiments, 320 *SCIENCE* 1605, 1608 (2008).

79. See, e.g., Ernst Fehr & Bettina Rockenbach, *Detrimental Effects of Sanctions on Human Altruism*, 422 *NATURE* 137, 138 (2003).

80. See Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 *J. LEGAL STUD.* 1, 7 (2000).

81. Wilkinson-Ryan, *Liquidated Damages*, *supra* note 1, at 636, 652.

82. *Id.* at 659.

83. *Id.*

84. *Id.*

85. *Id.* at 660–61.

86. *Id.* at 663–64.

Holmesian view of breach. Third, individuals tend to define the scope of the moral obligation generated by a contract on the basis of the express terms of the contract. They perceive a facially unqualified contract as generating a promise to perform, rather than an option to perform or to pay. By contrast, the presence of a remedial clause like a liquidated-damages clause increases some subjects' willingness to breach in part because those subjects interpreted the clause to put their counterparty on notice that breach was possible. In this respect, some subjects may have understood the liquidated-damages clause to alter the substantive content of the promise so that nonperformance was no longer a violation of a moral obligation. Most individuals thus reject the convergence theorists' view that facially unqualified contracts generate only a promise in the alternative.

B. *Sophisticated Holmesian Breachers*

Scholars largely agree that "sophisticated" commercial actors, like large companies, breach contracts in accord with the Holmesian view.⁸⁷ Those parties understand their contracts, even if facially unqualified, to implicitly include the option to decline to perform and to pay expectation damages instead. Accordingly, when faced with the possibility of efficiently breaching, a sophisticated commercial party will breach. Markovits and Schwartz observe that a "firm is more likely to exhibit behavior consistent with the maximization of monetary returns than an individual responding to a questionnaire."⁸⁸ That consensus comports with common sense. Commercial actors aim to create wealth within the confines of the law. Corporations and other business organizations are designed with that aim in mind, and the law imposes duties on corporate officers to seek to maximize profits.⁸⁹ It then

87. See, e.g., Kraus, *supra* note 4, at 1638 ("While the promisor's payment in lieu of performance is legally denominated 'breach' and payment of 'damages,' the efficient breach hypothesis supposes that many parties—and most commercially sophisticated parties—will intend and understand the promisor to be discharging his moral obligation by compensating the promisee, rather than paying damages for breach of a moral obligation."); Markovits & Schwartz, *supra* note 5; Schwartz & Scott, *supra* note 5, at 550.

88. Markovits & Schwartz, *supra* note 5, at 1955 n.32.

89. See, e.g., *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919); see also Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015) ("[D]irectors must make stockholder welfare their sole end, and . . . other interests may be taken into consideration only as a means of promoting stockholder welfare."); Stephen Bainbridge, *Opinion, A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015, 6:46 AM), <https://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/a-duty-to-shareholder-value> (on file with the *Michigan Law Review*). But see *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2771 (2014) ("While it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so."); LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012).

stands to reason that commercial actors would approach the decision of whether to breach a contract with the same cold calculus. That decision may account for secondary consequences of breaching, like reputational harms, that complicate the calculus beyond the immediate benefits of breaching balanced with liability for expectation damages. But those secondary effects refine rather than displace commercial actors' decision to further their economic interest. It seems reasonable to suppose, then, that while individuals are more often moralist performers, sophisticated commercial actors are more often Holmesian breachers.

The empirical evidence supporting that view, however, is sparse. Several empirical studies indicate that, at least in certain industries, commercial actors tend *not* to breach even if it is in their immediate economic interest to do so.⁹⁰ Those nonbreaching commercial parties may simply be accounting for reputational effects, which may be particularly powerful in commercial contexts in which markets are dominated by repeat players. There is also evidence that some decisionmakers for commercial actors take ethical considerations into account in deciding whether to breach. But the existing empirical studies have focused on particular markets that may be peculiarly sensitive to reputational effects. Moreover, certain industries like the diamond trade may be dominated by individual rather than organizational decisionmaking and may therefore reflect individuals' moral views to a greater extent than they represent a common view among commercial actors. As a result, the existing empirical data may reflect exceptions to a Holmesian commercial consensus. Although that interpretation of the data is plausible, it remains speculative.

Scholars instead base their view that commercial actors are usually Holmesian on theoretical considerations. Markovits and Schwartz limit their dual-performance hypothesis to "sophisticated and rational" parties that "make the contractual choices that maximize their expected profits."⁹¹ These "domain assumptions" force them to concede that "the conclusions they imply hold only in the domain they accurately describe."⁹² Accordingly, "real parties would make the contract that 'model parties' make only if, and to the extent that, real parties resemble the model parties and the other model assumptions hold."⁹³ Although they "claim that the set of real parties that resemble model parties is not trivial,"⁹⁴ they elaborate no further basis for that

90. See, e.g., David Baumer & Patricia Marschall, *Willful Breach of Contract for the Sale of Goods: Can the Bane of Business Be an Economic Bonanza?*, 65 TEMP. L. REV. 159, 171-72 (1992) (empirical data indicates that members of the business community disapprove of deliberate breach even when efficient).

91. Markovits & Schwartz, *supra* note 53, at 1093.

92. *Id.* at 1094.

93. *Id.*

94. *Id.*

empirical claim.⁹⁵ In earlier work, Schwartz and Robert Scott offered some considerations in support of the “traditional[] assum[ption] that firms attempt to maximize expected profits.”⁹⁶ They note that the reasons for doubting that a legal actor is self-interested apply to individuals more readily than to firms because a “firm is directed by its owners, who often are shareholders” and “[s]hareholders prefer their firms to maximize profits.”⁹⁷ As a result, “[f]irms . . . will choose to maximize profits unless the managers who run them cannot be controlled by the shareholders who own them.”⁹⁸ And although a firm’s managers may exploit its shareholders by diverting its wealth to themselves, they are unlikely to do so by failing to breach a contract when it would be in the firm’s interest to breach.⁹⁹ Moreover, according to Schwartz and Scott, firms are less likely to fall victim to the cognitive errors that behavioral economics has revealed plague individuals because the competitive marketplace disciplines underperforming firms and firms are structured to engage in group rather than individual decisionmaking.¹⁰⁰ They therefore conclude that although not “all firms all the time pursue profit-maximizing . . . owners and the market put systematic pressure on firms to behave optimally; hence, it is a plausible working assumption that firms rationally pursue the objective of maximizing profits.”¹⁰¹

Thus, there are persuasive theoretical considerations supporting the conclusion that sophisticated commercial actors, especially firms, breach as Holmesians. But robust empirical evidence supporting that claim remains wanting. It appears beyond doubt that at least some commercial actors are Holmesians, and it seems likely that a greater portion of commercial actors than individuals are Holmesians. Nonetheless, to the extent empirical doubt endures regarding which and how many commercial parties are Holmesian, the existence of the asymmetry in moral belief and breaching behavior between individuals and commercial actors remains probable but uncertain.

95. Klass, *supra* note 35, at 147 (“One wants some empirical evidence for Markovits and Schwartz’s empirical interpretive claim. . . . [A]nalytic truths about economic models [are not] interpretations of what people in the world outside those models intend or say.”).

96. Schwartz & Scott, *supra* note 5, at 550.

97. *Id.*

98. *Id.* at 550–51.

99. Schwartz and Scott do not consider the possibility of contracts between a firm and its managers, but such contracts are independently regulated by corporate law to prevent inappropriate self-dealing. Because corporations and their officers are thus incentivized to refrain from abusing such transactions, Schwartz and Scott may argue that firms will avoid such abuse.

100. *Id.* at 551–52 n.18.

101. *Id.* at 551.

III. NORMATIVE IMPLICATIONS OF THE ASYMMETRY IN MORAL BELIEF ABOUT BREACH

The asymmetry in moral belief and breaching behavior implicates important normative concerns, particularly that individuals and sophisticated commercial parties view the moral matter differently. The normative concerns extend beyond those arising simply from the fact that some parties breach their contracts. If breaching a contract is morally wrong because it involves breaking a promise, then sophisticated commercial parties' pervasive practice of breaching is a pervasive moral wrong. But that moral wrong does not depend on which parties breach and which do not. Moreover, this Article's analysis does not presuppose an answer to the ultimate philosophical question of whether breach is immoral—on that, it remains agnostic. This Article thus approaches the diversity of moral belief differently than scholars who view certain attitudes as “heuristic errors that the law should reject or try to overcome.”¹⁰² Nor does it assume that “lay judgments about [contract] ought to be endorsed and embodied in the law.”¹⁰³ The analysis diagnoses the normative problems that flow solely from the fact of moral disagreement and identifies ways the legal system can adapt to the presence of the asymmetry.

This Part analyzes those implications using two normative frameworks: first, economic efficiency; and second, fairness and distribution. These normative frameworks correspond to the approaches adopted by many of the participants in the debate about orthodox contract doctrine's remedies. The first, economic efficiency, appeals to scholars like Shavell, Markovits, Schwartz, and others who support various aspects of orthodox contract doctrine on the ground that those aspects tend to lead to Pareto-optimal distributions and maximize aggregate social welfare. The second, fairness and distribution, appeals to scholars for whom nonconsequentialist moral considerations trump efficiency. Because both normative frameworks condemn the asymmetry, scholars should condemn the asymmetry as well, regardless of their view on the underlying philosophical question on the morality of breach.

A. *Economic Efficiency*

The initial economic implications of the asymmetry in moral belief about breach are straightforward: individual moralists forgo efficient breaches that would be Pareto optimal and that would increase overall social welfare. Consider the example in which a seller promised to plow snow from a buyer's driveway for \$10. Suppose the seller's time and labor are worth \$8 to

102. Richard Craswell, *When Is a Willful Breach “Willful”? The Link Between Definitions and Damages*, 107 MICH. L. REV. 1501, 1506 (2009) (internal quotation marks omitted). To be clear, Craswell does not endorse that view but rather recognizes it as a possible approach to divergent lay opinions about intentional breach of contract. *Id.*

103. *Id.*

him, so the benefit on his side of the bargain is \$2. Suppose further that the buyer valued the service at \$15, and thus her expectation damages in the event of breach would be \$5 (\$15 less the \$10 price of plowing). If the promisor's car breaks down and emergency repairs would cost him \$100,¹⁰⁴ then he fails to achieve a Pareto-optimal outcome and thus fails to maximize aggregate social welfare by performing his promise and paying for the emergency repairs out of a sense of moral obligation.¹⁰⁵ If he performed, the buyer would realize her surplus of \$5, the net of her \$15 valuation of the plowing less the \$10 price. But the seller would realize a loss of \$98—the \$10 payment for plowing less the \$100 cost of repairs and the \$8 value of his time and labor. The aggregate social welfare relative to the ex ante baseline is thus negative \$93. By contrast, if the seller had breached: the buyer would still realize her \$5 surplus through expectation damages, and the seller would avoid net loss of \$98 and instead lose only \$5 through his damages liability.¹⁰⁶ Thus, breaching results in no change from the ex ante baseline compared with performing, which results in a steep loss of \$93. For all parties, then, promise-breaking pays.

Accounting for the welfare effects of the moral sentiments may alter these results, but only at the margins. The economic calculations in this snow-plowing example have not yet accounted for the frustration and perhaps even moral outrage the buyer may experience upon breach. She may feel frustration from the visceral disappointment of not receiving the performance on which she had counted. She may separately feel moral outrage at the fact that she was the victim of a broken promise. The seller, for his part, may feel guilty about breaking his promise and disappointing his buyer.¹⁰⁷ All these moral sentiments count in the calculus of social welfare, and

104. Assume emergency repairs are much more expensive than ordinary repairs but are necessary to perform the service in time to be useful.

105. Put in terms of Pareto optimality, both the seller and the buyer would prefer a legal rule that permitted the seller to pay rather than perform in this contingency. The seller would prefer a legal rule permitting him to pay because doing so would allow him to avoid the high cost of repairs. The buyer would also prefer that legal rule because a legal rule that required performance would raise the purchase price to account for the seller's potential increased cost if his car breaks down. Because the buyer's surplus is much less than the potential cost of emergency repairs, that increased purchase price would not be worth it to the buyer.

106. Accounting for the surplus captured by the person who repairs the car will not alter these results in cases in which breaching will maximize truly aggregate—as opposed to merely bilateral—social welfare. Suppose that the car repairman would realize a \$10 surplus by selling his emergency repair services for \$100. The promisor's breach would then result in aggregate social welfare of only negative \$83 relative to the ex ante baseline, which is better than the negative \$93 calculated by excluding his surplus but still far worse than the breaching outcome of \$0 relative to the ex ante baseline.

107. Some may argue that if the seller opts to perform his promise rather than breach, then this choice demonstrates that his welfare must have been higher by performing rather than breaching due to the effects of the moral sentiments. See generally KAPLOW & SHAVELL, *supra* note 32. If this were true, then individuals' moral aversion to breach would maximize at least their own welfare. Because expectation damages should, in theory, compensate a disappointed promisee enough to put him in the same position he would have been with perfor-

their inclusion makes breach less advantageous than it would have been in their absence. In some cases, that difference may be dispositive by rendering breach more harmful than performance. If, in our example, the feelings of moral outrage and guilt were so intense that they amounted to the equivalent of negative \$100, then performing would maximize aggregate social welfare by avoiding the negative moral sentiments. But in most cases, the moral sentiments will not be so intense that their inclusion in the calculus of social welfare would make a difference in whether breach is ultimately efficient. As a result, consideration of the moral sentiments means at most that somewhat fewer cases present genuine opportunities for efficient breach than it may appear if we failed to account for those sentiments.

But a moral aversion to breach may actually enhance efficiency by preventing opportunistic breaches. A breach is opportunistic “when one party attempts to reap ‘the benefit of the bargain without bearing the agreed-upon cost.’”¹⁰⁸ In other words, an opportunistic breacher attempts to breach for his own gain even though that breach will reduce aggregate social welfare. To accomplish this, he must “exploit[] the inadequacies of purely compensatory remedies.”¹⁰⁹ To illustrate an opportunistic breach, adjust the parameters of the snow-plowing example so the emergency repairs cost only \$3. Performing rather than breaching would then maximize aggregate social welfare because the seller’s net loss from performing remain lower than the buyer’s surplus. Performing would cost the seller \$8 in his time and labor

mance, it would follow that individuals’ decisions not to breach would be Pareto optimal and maximize aggregate social welfare after all.

This argument rests on the view, often called psychological egoism, that individuals are always most motivated to pursue what they perceive to maximize their welfare. This view is thus descriptive regarding the motivations of actual people, as opposed to normative egoism, which holds that people *ought* to pursue their self-interest. The psychological egoist account accordingly rejects, apparently on a priori grounds, the possibility of genuinely morally motivated or altruistic conduct. Moral philosophers have largely rejected this view of moral psychology. See, e.g., 1 JOSEPH BUTLER, FIFTEEN SERMONS PREACHED AT THE ROLLS CHAPEL (London, W. Bostham 1726); Joel Feinberg, *Psychological Egoism*, in REASON & RESPONSIBILITY 501, 501–12 (Joel Feinberg ed., 3d ed. 1975); THOMAS NAGEL, THE POSSIBILITY OF ALTRUISM 84–87 (1970). Nor is there convincing empirical evidence supporting the claim that individuals are typically psychological egoists. See Stephen Stich et al., *Altruism*, in THE MORAL PSYCHOLOGY HANDBOOK 147, 200–01 (John M. Doris et al. eds., 2010).

Moreover, even if individuals are psychological egoists, some approaches to the regulation of contracts that facilitate breach will nonetheless increase welfare relative to the status quo baseline. Consider, by way of analogy, a psychological egoist who believes she must sacrifice a leg in order to do what is right. If her feelings of guilt resulting from doing wrong are sufficiently great, she maximizes her welfare by sacrificing her leg. But it would be better still if she did not have to choose between her leg and her morals. Similarly, if a legal regime induces individual moralists to believe they may breach a contract without acting immorally, that legal regime increases welfare relative to the status quo under which those individuals face the choice between breaching while suffering the guilt of acting wrongly and keeping their contracts and losing the advantages of efficient breach. See *infra* Section IV.B.

108. Klass, *supra* note 32, at 371 (quoting *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 751 (7th Cir. 1988) (Posner, J.)).

109. *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 751 (7th Cir. 1988) (Posner, J.).

plus \$3 in emergency repairs and would yield a payment of \$10, resulting in a net loss of \$1. The buyer's surplus from performance remains \$5, thus yielding aggregate social welfare of \$4 relative to the ex ante baseline. Breaching, by contrast, would result in the seller paying \$5 in expectation damages with no other costs and the buyer receiving that \$5, thus yielding aggregate social welfare of \$0 relative to the ex ante baseline. Performance thus remains the efficient outcome. But if the seller recognizes that "only a lunatic or a fanatic sues for \$30,"¹¹⁰ much less \$5, he may breach safe in the knowledge that the buyer will never sue him to recover her expectation interest. That breach is inefficient because it results in lower aggregate social welfare—\$0 relative to the ex ante baseline rather than the \$4 surplus relative to the ex ante baseline that performance would yield. But the seller may breach anyway because breaching is better *for him* if he does not have to pay expectation damages.

The prospect of opportunistic breach by individual moralists reduces the economic inefficiency created by the asymmetry in moral belief. Because opportunistic breaches reduce aggregate social welfare, economic theory recommends discouraging or even prohibiting them. Posner thus concludes that "[i]f a promisor breaks his promise merely to take advantage of the vulnerability of the promisee . . . we might as well throw the book at [him]."¹¹¹ Legal scholars have therefore supported supracompensatory damages for inefficient, opportunistic breaches on economic grounds.¹¹² Individuals' moral belief that breach is wrong prevents them from breaching opportunistically. That moral belief may even counsel against opportunistic breach more strongly than other types of breach. For example, opportunistic breaches are typically avoidable, whereas efficient breaches may be driven by practical or absolute necessity.¹¹³ The asymmetry may thus accomplish through internal moral motivation what doctrine struggles to induce through economic incentives: the socially optimal level of opportunistic breaches, zero.

Nonetheless, the possibility of opportunistic breach does not defeat the conclusion that the asymmetry in moral belief is problematic on grounds of economic efficiency for several reasons. First, even accounting for the social costs of opportunistic breaches forgone because of individuals' moral beliefs, the asymmetry creates net economic inefficiency so long as those costs are smaller than the potential benefits associated with forgone efficient breaches.

110. *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.).

111. POSNER, *supra* note 32, at 105.

112. See Craswell, *supra* note 102; William S. Dodge, *The Case for Punitive Damages in Contracts*, 48 DUKE L.J. 629, 654–62 (1999); Nicholas J. Johnson, *The Boundaries of Extra-compensatory Relief for Abusive Breach of Contract*, 33 CONN. L. REV. 181, 187–88 (2000).

113. In our snow-plowing example, the moralist may excuse the seller from his promise of performance if the cost to him becomes sufficiently high. The greater the burden on the promisor, the more likely morality is to excuse breaking the promise. But the greater the burden on the promisor, the more likely it is that his net loss outweighs the promisee's surplus from performance. For that reason, morality is more likely to excuse efficient breaches than opportunistic breaches.

And there is reason to believe that benefits of forgone efficient breaches outweigh their costs. For example, refusing to breach mortgage contracts likely cost underwater homeowners billions of dollars. The same moral impulse not to breach a contract may also lock individuals into rental-housing, employment, and consumer contracts that individuals could breach efficiently. The costs of individual moralists engaging in opportunistic breaches may, by contrast, be relatively modest. Many consumer contracts are drafted to authorize the commercial party to impose fees like late fees, cancellation fees, and other surcharges that serve both to deter breach and to ensure adequate compensation for the commercial party if the consumer does breach. That automatic transfer in the event of breach substantially reduces the availability of opportunistic breaches to individual moralists.

Moreover, there is no reason to think that the costs of opportunistic breach would be especially high or that the benefits of efficient breach would be peculiarly lacking for individual moralists as opposed to commercially sophisticated breachers. As a result, if the costs of opportunistic breach outweigh the benefits of efficient breaches for individual breachers, then the same likely holds for commercially sophisticated breachers. If so, then the asymmetry would still be problematic. But in that case, instead of individuals' puritanical moral beliefs about contract inefficiently preventing breaches, the problem would be sophisticated commercial parties' libertine moral beliefs about contract permitting too many opportunistic breaches.

Second, doctrinal reforms may independently solve the problem of opportunistic breaches. For example, imposing punitive damages for opportunistic breach may both penalize those breaches and provide sufficient incentive to bring suit. In our snow-plowing example, suppose a court would impose punitive damages of \$1000 if the seller breached opportunistically. That damages award may be sufficient for the buyer to sue, and the resulting liability would render breaching no longer in the seller's interest. Moreover, the mere threat of that liability may discipline the seller from opportunistically breaching by altering his incentives. This doctrinal solution faces challenges, particularly practical obstacles to courts determining when a breach was opportunistic and thus warrants punitive damages.¹¹⁴ Nonetheless, punitive damages would attack the problem globally by deterring opportunistic breaching by any party, not just the individual parties whose moral beliefs may now dissuade them from such breaches.¹¹⁵ Once opportunistic breaches are adequately deterred using other doctrinal tools, the economic inefficiency of the asymmetry in moral belief remains to be addressed.

114. See Craswell, *supra* note 102, at 1509.

115. Crafting doctrine to prevent opportunistic breaches only by individuals and not those by sophisticated commercial parties would also raise nonefficiency distributional concerns. This Article addresses distributional issues in the next Section.

B. *Fairness and Distribution*

The asymmetry in moral belief about breach also raises serious fairness and distributional concerns. Those concerns arise both vertically and horizontally. That is, they arise both in the context of contracts *between* individual moralist performers and sophisticated Holmesian breachers and in the context of contracts *among* individual moralists. Consider a vertical contract between an individual moralist and a commercially sophisticated Holmesian: the counterparties' asymmetric moral beliefs lead them to view the same facially unqualified contract differently. The individual moralist will view herself as morally bound to perform, while the sophisticated Holmesian will view the contract as offering an option not to perform if breaching is advantageous. The sophisticated Holmesian's decision to breach does not directly harm the individual moralist—by hypothesis, the breacher will pay expectation damages that put the individual in as good a position as she would have been in had the Holmesian performed. But by breaching when it is advantageous, the Holmesian exercises an option to increase its wealth. The individual moralist, by contrast, does not exercise a corresponding option to increase her wealth by breaching. The aggregate result of those divergent responses is that sophisticated Holmesians increase their wealth while individual moralists do not.

A simple model of a contract between an individual moralist and a sophisticated Holmesian illustrates the potential for unfair and distributionally problematic results. Suppose the seller in the snow-plowing scenario is a Holmesian breacher business, and thus it will breach its contracts whenever it is efficient to do so. We can further assume that the seller breaches efficiently but not opportunistically and will pay its liability for expectation damages willingly and without litigation.¹¹⁶ Suppose further that the buyer is an individual moralist, and so she will not willingly breach her contracts in any circumstances. If the Holmesian seller's car breaks and emergency repairs would cost \$100, the seller will breach. By breaching, the Holmesian seller has improved its welfare (via avoiding a loss) by \$93. The same result holds if the Holmesian seller breaches to take a better opportunity rather than to avoid an unexpected cost. Suppose that a new buyer offers the Holmesian seller \$30 to plow his driveway, and the seller has time to plow only one of the two driveways. The Holmesian seller would breach its contract with the original buyer, pay expectation damages to the original buyer for a loss of \$5, and plow the new buyer's driveway for a total gain of \$17 (\$30 less the \$5 in expectation damages and the \$8 value of his time and labor). By breaching, the Holmesian seller is thus \$15 better off than it would have been had it performed its original contract. In either case, the Holmesian seller has increased its welfare by breaching.

116. That assumption is, of course, unrealistic. But the model demonstrates that even if the Holmesian breacher is ideal in this respect, the asymmetry generates unfair distributions due to the parties' divergent approaches to breach. Adjusting the model to include a more realistic Holmesian who will not pay damages unless sued would exacerbate the effect.

By contrast, the individual moralist buyer will not breach her contract either to avoid a loss or to seize a new opportunity for gain. Suppose the buyer does not have the money on hand to pay the seller for its plowing services. She feels a moral obligation not to breach, and therefore she secures a high-interest payday loan to cover the \$10 cost of the plowing. She must repay the \$10 principal plus \$10 in interest next month. Her total cost to avoid breaching the contract is thus \$20, in exchange for which she gets a benefit of plowing that is worth \$15 to her. The decision not to breach thus results in a \$5 loss to her welfare. If she had breached, however, she would have owed only \$2 in expectation damages to the seller. As a result, her morally motivated decision to perform lowered her wealth by \$3. The same result holds if we alter the example so she foregoes a breach that would permit her to take advantage of an opportunity rather than to avoid a loss. For example, suppose she could have instead spent the \$10 on a ticket to a surprise performance of her favorite musician. She cannot afford both to buy the ticket and to pay for the plowing she previously contracted to buy. Although she valued the once-in-a-lifetime opportunity to see her favorite musician at \$500, she forgoes that substantial surplus because she believes that breach is morally wrong.

Individual moralists' aversion to breach generates further distributional inequalities in the context of contracts among individuals. This effect is illustrated by contrasting two types of "horizontal" contracts; that is, contracts between two parties of the same moral type—individual-to-individual and firm-to-firm. Imagine two snow-plowing contracts: one between an individual moralist seller and an individual moralist buyer, say a handyman and a homeowner contracting for the plowing of the homeowner's driveway; and another between a Holmesian seller and a Holmesian buyer, say a snow-plowing firm and a large chain restaurant contracting for the plowing of the restaurant's parking lot. Because the handyman and the homeowner are individual moralists, neither will breach even if it were efficient to do so. Thus, the handyman will incur the high cost of emergency repairs to his car in order to keep his promise to plow the driveway, and the homeowner will remain in the contract even if she no longer needs her driveway plowed or if she could devote the money owed to a more beneficial use like buying once-in-a-lifetime concert tickets. Individual moralists as a class thus forgo advantageous opportunities to breach their contracts with other individual moralists, and as a class their wealth is accordingly less than it would be if their moral beliefs did not render them averse to breach.¹¹⁷

By contrast, the Holmesian snow-plowing firm and the Holmesian chain restaurant will breach whenever it is efficient for either to do so. For example, the Holmesian snow-plowing firm will breach rather than pay for the high cost of emergency repairs to its equipment. Similarly, the Holmesian

117. Recall that breaching would, by hypothesis, not reduce the welfare of the breaching party's counterparty because expectation damages would fully compensate the counterparty for the lost welfare due to nonperformance.

chain restaurant will breach rather than keep the contract if the restaurant will be closed anyway because of a shortage of food supplies. Commercially sophisticated Holmesian breachers will breach their contracts with other parties, including contracts with other Holmesian breachers, whenever it is in their interest to do so. As a result, sophisticated Holmesian breachers are economically better off as a class than they otherwise would have been. The aggregate effect of that divergent breaching behavior with respect to horizontal contracts is that sophisticated Holmesian breachers get richer by breaching their horizontal contracts, whereas individual moralists do not, thus increasing the overall distributional inequality between Holmesian breachers and individual moralists.

These stylized examples demonstrate the potential distributional impact of the asymmetry in moral belief about breach: the sophisticated Holmesians get richer by breaching while the individual moralists do not. The distributional impact compounds as these asymmetric breaches repeat over time and among many Holmesian breachers and individual moralists. In aggregate, these divergent breaching tendencies may generate substantial inequalities in wealth between the class of sophisticated Holmesian breachers and the class of individual moralists. Because the class of sophisticated Holmesian breachers consists of firms and other commercial parties, that dynamic magnifies preexisting distributional inequalities. The asymmetry in moral belief thus leads to a regressive change in the distribution of resources.

The distributional effect of the asymmetry would be illusory, however, if firms priced individual moralists' aversion to breach into their contracts.¹¹⁸ Because individual moralists interpret a facially unqualified contract to require them to perform, their counterparties can be confident that they will receive performance. That assurance is valuable. As a result, in a competitive marketplace firms will pay more (or charge less) for contracts with an individual moralist. Consider the market for cell phone service. Providers traditionally charge less for a multiyear contract than they charge for a month-to-month contract. That decrease in price reflects the competition among firms for customers who agree to purchase many months of service. Now consider two competing firms: Firm A believes its customers will breach the multiyear contract whenever it is efficient for the customer to do so, and Firm B correctly believes its customers will tend to refrain from breaching on moral grounds.¹¹⁹ Firm B therefore believes the average number of months that customers will remain in a contract is higher than the number Firm A believes. Because firms can profitably offer service at a lower per-month price the more months a customer will remain in a contract, Firm B believes it can profitably offer a lower per-month price than Firm A. Because customers demand cell phone contracts with lower per-month prices, Firm B captures

118. See Richard Craswell, *Passing On the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1991).

119. The example in the text does not account for express cancellation fees, a common feature in multiyear consumer contracts. See, e.g., *infra* note 140 and accompanying text.

an increasing share of the market. And because Firm B's customers in fact tend to refrain from breaching on moral grounds, Firm B remains profitable. Competition, in turn, drives all firms to match Firm B's lower per-month price. The actual market for cell phone service exhibits this dynamic: providers pay close attention to their "churn" rate, which is the rate at which customers discontinue service.¹²⁰ Many factors affect a customer's propensity to discontinue their cell phone contract, including the availability of better alternatives and behavioral irrationality. But a moral aversion to breach would be evident if implicit in that rate, and so the market for cell phone service prices individual moralists' belief into the cost of the contract.

Although competition may produce a lower price that will mitigate the pernicious distributional effects of the asymmetry in moral belief, it is unlikely to eliminate it, especially in markets in which it may have the greatest impact on individuals. Market failures may often impede competition to price in the moral aversion to breach. To price that aversion, firms must first know how frequently an individual will be faced with the possibility of breaching efficiently (or opportunistically) and how probable it is that an individual will actually breach. Firms likely lack knowledge on both questions. In many markets, individuals' opportunities for advantageous breach arise irregularly. In this regard, the market for cell phone service may be an outlier. Consider, for example, the mortgage market. Firms failed to price in subprime borrowers' propensity to default.¹²¹ Part of the reason for that failure is that the market conditions that prompted the wave of defaults was unprecedented, so firms lacked a historical basis to determine how many borrowers would be forced to default.¹²² Similarly, firms lacked a historical basis to estimate how many borrowers would decline an opportunity to default advantageously, for moral or other reasons.

Firms likely face similar challenges in other markets. Businesses may have little basis to guess how frequently a customer will be presented with a better way to spend her money that requires her to breach her consumer contract, or how frequently an employee will be presented with an unexpected professional opportunity that requires her to breach her employment contract. Nor will they have adequate knowledge to estimate how frequently the moral aversion to breach will prevent people from breaching in those circumstances. The empirical evidence demonstrates that the magnitude of the moral aversion to breach is sensitive to the factual context of the contract. For example, the resecuritization of a mortgage loan makes people less likely to believe it is morally wrong to breach the mortgage contract.¹²³ But a firm may lack experience with the particular factual context of its contracts

120. See *infra* note 140 and accompanying text.

121. See Bar-Gill, *supra* note 10, at 1080–81 n.13.

122. See Jennifer E. Bethel et al., *Legal and Economic Issues in Litigation Arising from the 2007–2008 Credit Crisis*, in *PRUDENT LENDING RESTORED: SECURITIZATION AFTER THE MORTGAGE MELTDOWN* 163, 185 (Yasuyuki Fuchita et al. eds., 2009).

123. See Wilkinson-Ryan, *Breaching*, *supra* note 1, at 1580–81.

to know the strength of individuals' moral aversion to breaching their contracts. In the absence of knowledge either about the regularity of individuals' opportunities for advantageous breach or the magnitude of their moral aversion to doing so, firms are unable to price their counterparties' moral beliefs into their contracts. The pricing mechanism may thus fail to eliminate the asymmetry's distributional effect between individuals and commercial parties.

Moreover, even if the pricing mechanism were successful in eliminating the distributional effect between the class of individual moralists and the class of commercial Holmesian breachers, it would exacerbate the distributional effects among individuals with varying moral beliefs. Although individuals tend to believe that breach of contract is morally wrong, not all individuals hold that belief.¹²⁴ As a result, although most people will refrain from breaching when it is in their interest to do so, some will breach. In the absence of the pricing mechanism, this heterogeneity would introduce a distributional inequality between individuals who believe breach is morally wrong and those who do not. Just like sophisticated commercial actors, individuals with Holmesian moral beliefs would get richer by breaching.

Thus, the introduction of the pricing mechanism actually makes that inequality worse rather than better. Firms will reduce prices based on their estimate of how frequently their individual counterparties will breach. Because firms likely lack the ability to distinguish between individual moralists and individual Holmesians, they will reduce prices for all customers based on an average rate of breach. As a result, firms will distribute the savings they reap from individual moralists' aversion to breach across all their individual counterparties. Individual Holmesians will thus pay a lower price than they would have in the absence of the pricing mechanism, but they will continue to breach when it is in their interest to do so. Individual moralists, meanwhile, bear the entire cost of their moral aversion to breach (through their forgone advantageous breaches) but will reap only some of the gains through a price reduction. The distributional effect among individuals is particularly problematic because it is plausible to suppose that wealthier and better educated individuals are more likely to view contracts in commercial, Holmesian terms. Thus, the pricing mechanism compounds the regressive effect of the asymmetry in moral belief in such a way that rich Holmesian individuals get richer.¹²⁵ As a result, the pricing mechanism is at best an incomplete resolution of the distributional problems attributable to the asymmetry in moral belief about breach.

124. See *supra* Section II.A.

125. Cf. Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1266–68 (2003); Oren Bar-Gill & Omri Ben-Shahar, *Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law*, 50 COMMON MKT. L. REV. (SPECIAL ISSUE) 109, 115 (2013) (“The poor, the elderly, the less educated—those for whom the protections are enacted in the first place—lack the information, sophistication, and the resources. And yet, they bear an equal share of the cost.”).

IV. ACCOUNTING FOR THE ASYMMETRY IN CONTRACT LAW

The law of contracts should account for the asymmetry in moral beliefs about breach. It is unlikely that the phenomenon of moral diversity will dissipate, and so long as it endures, the existing legal framework will lead to economically inefficient outcomes and unfair distributions. No prior research has addressed ways that the law can adapt to the existence of the asymmetry in moral belief.¹²⁶ This Article surveys the possibilities. The traditional tools of contract law are judicial doctrines applied *ex post* in the event of litigation, particularly the crafting of remedies for breach. But *ex post* judicial intervention is unlikely to solve the problems posed by the asymmetry in moral belief and may introduce greater harms than it alleviates. *Ex ante* regulation of contracts holds greater promise. Although disclosure requirements, the mainstay of proposals for the regulation of contracts, may have little impact, direct regulation of the substantive terms of contracts may be effective. Requiring contracts to contain an express provision stating an option not to perform and to pay instead may align the individual moralists' and sophisticated Holmesians' perception of the moral obligation under the contract, thus eliminating the effects of the asymmetry in moral belief.

A. *The Limits of Ex Post Judicial Intervention*

1. Adjusting the Damages Measure

One way to attack the problems resulting from the asymmetry in moral belief about breach is to adjust doctrine to encourage individual moralists to breach more often. The pernicious effects of the asymmetry arise only because the asymmetry in moral belief in turn causes an asymmetry in breach-

126. Rebecca Stone has addressed a related but critically different phenomenon. In two recent articles, Stone has offered an economic analysis of law accounting for “internalizers.” Rebecca Stone, *Economic Analysis of Contract Law from the Internal Point of View*, 116 COLUM. L. REV. 2005 (2016) [Stone, *Economic Analysis of Contract Law from the Internal Point of View*]; Rebecca Stone, *Legal Design for the “Good Man,”* 102 VA. L. REV. 1767 (2016). The asymmetry in moral belief about the permissibility of breach is critically different from a party’s motivation to comply with the law as such. Internalizers are “agents who adopt legal rules as reasons for action even when their self-interest (and other things they care about) dictates doing otherwise.” Stone, *Economic Analysis of Contract Law from the Internal Point of View*, *supra* at 2008. Stone recognizes that whether an internalizer will be motivated to perform rather than pay expectation damages depends on the prior interpretive question of what the primary legal norm of contract law requires. *Id.* at 2028–29. She further recognizes that internalizers may view that norm as requiring performance or may view it “disjunctively” to require either performance or payment. *Id.* at 2028–31. Ultimately, she adopts the view that internalizers will view their legal obligations disjunctively. *Id.* at 2030 (“Although none of these considerations is decisive on its own, together they lend support to a perform-or-pay interpretation of a promisor’s duties.”). Her analysis accordingly does not address the question at the center of this Article: how the law should respond to the existence of those who—contrary to Stone’s internalizers—believe themselves morally bound to perform. This Article and Stone’s work are thus complementary, by addressing the ways the law of contract can and should adapt to the presence of legal actors who diverge from the Holmesian “bad man” in different ways.

ing behavior. If the law could induce individual moralists to breach like sophisticated Holmesians, then the problem might be solved.

This approach is unlikely to be effective and would probably introduce greater problems of its own. Individual moralists are unresponsive to the economic incentives provided by expectation damages: it is already in their economic interest to breach efficiently, but their moral beliefs block them from doing so. Wilkinson-Ryan's research indicates that some individual moralists may be willing to breach but only for a large premium.¹²⁷ To adjust doctrine to take advantage of that moral flexibility would require providing individual moralists with a greater economic incentive to breach. The law cannot affect the breacher's prelegal incentive structure—it cannot make the snow plower's emergency repairs less expensive, and it cannot make the buyer's alternative opportunity to see a concert more beneficial. Instead, the law can improve the breacher's incentives only by decreasing the individual moralist's liability for damages.

That doctrinal adjustment would often be ineffective because some individual moralists may refuse to breach at any price. Even for those individual moralists who would breach if offered enough money, reducing their liability for breach to zero may not be enough. Wilkinson-Ryan's studies suggest that individuals would breach a facially unqualified contract only if offered approximately double their liability in expectation damages.¹²⁸ At that threshold, their net liability would be the equivalent of a benefit equal to their expectation damages. Reducing their damages liability to zero would then prompt individuals to breach efficiently, when and only when their benefit from breaching is greater than their counterparty's lost surplus. If the individual moralist requires a premium any higher than that, even reducing their damages liability to zero would provide insufficient incentive for them to breach.

In any event, reducing damages liability would be unfair, inefficient, and morally suspect. It would be unfair because it would necessarily require that individuals' counterparties be undercompensated. Although sophisticated Holmesians as a class benefit economically from the asymmetry in moral belief, that does not mean that any given Holmesian has benefited. As a result, undercompensatory damages cannot be justified on redistributivist grounds. Reducing damages would also be inefficient because it would induce some parties to breach too often. If the reduced damages measure applied universally, then sophisticated parties would breach opportunistically whenever it was in their interest because they would never have to pay damages. Even if the reduced damages measure applied only to individuals rather than to firms as well, courts lack the tools to distinguish between individuals who hold moralist views and those who do not. As a result, courts could not target the availability of the reduced-expectation remedy only to moralists. That inability creates the further perverse consequence that those marginal indi-

127. Wilkinson-Ryan, *Liquidated Damages*, *supra* note 1, at 659.

128. *Id.*

viduals who are induced to breach are those whose moral views can be trumped by economic incentives, while those who stick to their moral guns continue to refuse to breach. The law should be wary of rewarding that moral flexibility. Finally, even those individuals who decide to breach because of their reduced damages liability would do so against their moral beliefs. Crafting contract law to cause people to act in ways they deem immoral introduces further problems. In addition to the negative welfare effects of negative moral sentiments like guilt, this approach would exacerbate the concerns of scholars like Shiffrin that the law should not make it more difficult for people to act virtuously.

2. Adopting Specific Performance

The other ex post approach is to adopt specific performance as the remedy for breach. Instead of attempting to induce individual moralists to behave as sophisticated Holmesians, this approach attempts to require sophisticated Holmesians to perform as moralists. Courts could either impose specific performance as a mandatory rule or set it as a default rule. Neither response is a warranted solution to the problems created by the asymmetry in moral belief.

Imposing specific performance as a mandatory rule may partially ameliorate the asymmetry, but it would do so at an unacceptably high price. Specific performance would aim to eliminate the consequences of the asymmetry by forcing all parties to perform, aligning sophisticated Holmesians' behavior with that of individual moralists. But this would be unlikely to make more than a modest impact on the problem. Individuals bring relatively few cases to force performance, often because of the costs of litigation relative to the reward in damages.¹²⁹ Because expectation damages are calibrated to be the monetary equivalent of performance, adopting specific performance as the remedy for breach provides no greater incentive to sue. Moreover, many individuals already falsely believe that contract doctrine requires performance in the case of breach,¹³⁰ so changing the law to conform to that false belief would not lead those individuals to sue. Nor is the change in remedy likely to change significantly sophisticated Holmesians' breaching behavior by changing their incentives. Specific performance as a remedy could discipline parties into refraining from breach only insofar as those parties believed a court would ultimately order them to perform. If a potential breacher thought that likely, then it would choose to perform in order to avoid the costs of litigation. But that disciplining mechanism works only to

129. What rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a \$30.22 claim? See, e.g., *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 365 (2011) (Breyer, J., dissenting); *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) ("The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30.").

130. Matthew A. Seligman, *The Error Theory of Contract*, 78 MD. L. REV. 147, 166–77 (2019).

the extent that potential breachers fear suit, and sophisticated Holmesians can reasonably assume that the threat of litigation is low because of the practical impediments to suit.

Even to the extent that adopting specific performance as a mandatory rule would be effective, it would be so only by forcing inefficient performance or requiring costly and often impractical renegotiation. There are few corresponding gains to offset those costs. In a case where the threat of specific performance induces a potential breacher to perform, its counterparty will be better off only if that counterparty would not have received expectation damages under the current regime. But a potential breacher would only rarely be disciplined into performing by the threat of specific performance but not by the threat of expectation damages. Performance may, of course, be far costlier to the breacher than expectation damages. But for that threatened remedy to adjust the potential breacher's behavior, there must be a sufficient likelihood that its counterparty will sue. And, as discussed above, in a wide range of contexts litigation is unlikely. Finally, to the extent that sophisticated Holmesians are indeed disciplined into performing, that change in behavior would lead to higher costs to individuals because firms will increase prices to account for the increased costs from compelled performance. The cost of eliminating the asymmetry would thus be borne by the individual moralists who are already disadvantaged by their moral views.

Specific performance as a default rule, by contrast, may exacerbate rather than eliminate the pernicious consequences of the asymmetry in moral belief. To the extent that parties retain specific performance as the remedy for breach rather than expressly adopt a different remedy, the same negative consequences follow as with adopting specific performance as a mandatory rule. But sophisticated Holmesians would likely draft around the default rule. It is always in the sophisticated Holmesian's interest to avoid performance because expectation damages are always cheaper in those cases in which a Holmesian would opt to breach. After all, if performance were cheaper than payment then the Holmesian would not have any reason to breach in the first place. Many contracts between sophisticated Holmesians and individual moralists, such as consumer contracts, are adhesion contracts drafted by the sophisticated party. The result would be the doctrinal status quo recreated in the express (but likely opaque) provisions of the contract. At the same time, unsophisticated parties would be unlikely or unable to draft around the default rule when it was in their interest to do so. Accordingly, adopting specific performance as a default rule would do little to address the asymmetry.

B. *The Limits of Ex Ante Disclosure Requirements*

Disclosure requirements on contracts between sophisticated Holmesians and individual moralists show only modest promise as a response to the asymmetry in moral belief. Disclosure requirements aim to adjust individu-

als' behavior without restricting freedom of choice.¹³¹ Scholars have proposed disclosure requirements as responses to consumers' imperfect rationality¹³² because well-designed disclosures can lead consumers to make better decisions in contracting. For example, the Truth in Lending Act requires lenders to disclose the annual percentage rate (or APR) for certain credit products. There is some evidence that this requirement increases consumers' attention to the costs of credit contracts and thereby enhances competition, which results in lower rates.¹³³ Regulators rely on disclosures to achieve these same results in a wide variety of other markets as well.

A disclosure requirement may be slightly effective in prompting more individual moralists to breach efficiently. The disclosure could inform individuals that the law provides for compensation in the event of breach. In that respect, it would operate similarly to existing disclosures, like the APR disclosure, that aim to inform consumers of a contract's true cost. Those existing disclosures, however, aim to influence consumers' behavior by facilitating better self-interested reasoning. For example, the APR disclosure helps consumers to comparison shop between lenders to find the lowest-cost, highest-benefit loan.

A disclosure that breach will result in expectation damages, by contrast, could help individual moralists engage in better moral reasoning. The disclosure would not seek to convince individuals to become Holmesians and believe that breach is morally permissible. Such direct moral persuasion is unlikely to be successful; there are few models of successful attempts by the government to change the moral views of its citizenry by direct advocacy. Rather, the disclosure could highlight an empirical fact—the existence of compensatory damages—that may change individuals' moral conclusions about breach. Shavell's data illustrates the potential for such a disclosure. Recall that subjects rated breach as "midway between somewhat unethical and neither ethical nor unethical" in a scenario that did not mention that the nonbreaching party would receive compensatory damages.¹³⁴ By contrast, they rated breach as ethically neutral to somewhat ethical when the presentation of the scenario expressly informed them that the breacher would compensate the nonbreaching party "as contract law says is required."¹³⁵ Accordingly, disclosing the fact of compensatory damages could change individuals' moral deliberations and thereby induce more of them to breach efficiently.

131. See Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211 (2003); Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron,* 70 U. CHI. L. REV. 1159 (2003).

132. See, e.g., Bar-Gill, *supra* note 10.

133. *Id.* at 1142. Bar-Gill also explains the limitations of the APR disclosure in the subprime mortgage market and offers proposals to increase its efficacy. *Id.* at 1143–50.

134. The average score for this scenario was 2.41 on a scale from 1 ("definitely unethical") to 5 ("definitely ethical"). Shavell, *supra* note 1, at 453.

135. *Id.* at 454–55.

But there are significant limitations to the disclosure approach to solving the asymmetry in moral belief about breach. Disclosure requirements in general are only somewhat successful in overcoming the information and rationality deficits at which they are traditionally targeted.¹³⁶ This is due, in no small part, to the fact that many people don't read legally required disclosures.¹³⁷ In addition to the shortcomings of disclosure requirements in general, a disclosure requirement aimed at inducing individual moralists to breach efficiently faces further limitations. Shavell's data, for example, indicates only that subjects informed of the availability of compensatory damages on average rated a breach as somewhat ethical. One plausible reason why, suggested by Wilkinson-Ryan,¹³⁸ is that compensation solves only part of the moral problem people see with breach—a broken promise paid for with reparations is still a broken promise.

It thus appears likely that a significant number of individuals will continue to view breach as morally wrong even after they are informed of the availability of expectation damages. Some people may view breach as morally wrong only because they falsely believe that the victim would go uncompensated, which they reasonably view as unfair. For those people, disclosing the availability of compensation would provide them with accurate information about the law so they would conclude that, by their preexisting moral framework, breach is not immoral after all. But others—indeed, plausibly most people—view breach as immoral for the simple reason that it involves breaking a promise, and even compensation is inadequate to make breach moral. For these people, disclosing the availability of damages would not change the moral status of breach in their eyes. Thus, a disclosure requirement would likely leave a substantial number of individual moralists unmoved.

C. *The Promise of Mandatory Exit Clauses*

1. Exit Clauses as Promises-in-the-Alternative

These traditional strategies fail because they do not address the underlying issue: varying moral belief about breach. Increasing a damages award at best simply induces people to breach notwithstanding their moral beliefs. That approach has predictable collateral damage: even if people who are morally averse to breach are properly incentivized, people (or firms) with different (or no) moral beliefs will be over-incentivized to breach. Similarly, adopting specific performance leaves the asymmetry in moral belief intact but reverses its practical implications, forcing Holmesians to perform even when it would be inefficient for them to do so. Disclosure requirements

136. See, e.g., OMRI BEN-SHAHAR & CARL E. SCHNEIDER, *MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE* (2014).

137. *Id.* at 10–11.

138. Wilkinson-Ryan, *Liquidated Damages*, *supra* note 1, at 663–64.

won't alter the behavior of those who believe breach is wrong simply because it means breaking a promise, which probably includes most individual moralists.¹³⁹ At best, disclosure might assuage those who think breach is wrong only because they don't realize the other party will be compensated.

The better strategy is to attack the source of the problem: to change the underlying moral facts so that an individual's moral beliefs align with firms' breaching behavior, thereby eliminating the asymmetry at its roots. Individual moralists who are unreceptive to the financial incentives offered by adjusting the damages remedy and to the effect of disclosure requirements will breach efficiently only if they believe that doing so abides by the promise they made when they entered the contract. To induce those individuals to breach efficiently, the law would have to align their perception of the contractual promise to Holmesians' perception of the contractual obligation.

The best way to accomplish such an alignment is a legal requirement that contracts include an express exit clause. A mandatory exit clause will induce a shift in moral perception by reframing the choice of whether to perform or pay. An exit clause is an express contractual term granting a right to exit the contract and pay the monetary equivalent of damages. That contractual term can be phrased as a "right" or "option" to "cancel," "exit," or "terminate" the contract. The critical feature of an exit option is that it frames the decision to pay instead of perform as consistent with the contractual obligation rather than as breaking it. For example, a cell phone contract might include the following exit clause:

The subscriber has a right to cancel this service contract at any time prior to the end date of the service contract. If the subscriber exercises that right under this contract, the subscriber will pay the provider a cancellation fee of \$250.¹⁴⁰

An express exit clause is similar to, but critically different from, a liquidated-damages clause. A liquidated-damages clause specifies in the contract itself a party's monetary liability if it breaches. For example, a liquidated-damages clause in a cell phone contract might state:

139. See Wilkinson-Ryan & Baron, *supra* note 1, at 412–20 (presenting results of empirical studies indicating most people find breach of contract morally objectionable).

140. This exit clause is modeled after Verizon's standard cellphone service contract agreement, which includes the following term: "If your line of service has a contract term and you cancel that line, or if we cancel it for good cause, during that contract term, you'll have to pay an early termination fee." See *My Verizon Wireless Customer Agreement*, VERIZON, <https://www.verizonwireless.com/legal/notices/customer-agreement/> [<https://perma.cc/5NPM-Q69G>]. The contract then specifies the amount of the "early termination fee," which begins at \$350 and decreases each month of the "contract term." *Id.* Scholars have noted the "high churn rates in the cell phone market." Oren Bar-Gill & Rebecca Stone, *Mobile Misperceptions*, 23 HARV. J.L. & TECH. 49, 68 (2009) (reporting churn rates "between 13% and 31% a year in 2007"). High churn rates—that is, the percentage of subscribers who cancel their service before the expiration of the contract—may indicate that subscribers view paying an "early termination fee" as absolving them of a moral obligation to stay in the service contract.

If the subscriber breaches this contract by terminating it during the contract term, the subscriber will pay the provider compensation of \$250.

An exit clause is thus structurally similar to a liquidated-damages clause because both specify how much money must change hands if a party chooses not to continue in the contract.¹⁴¹ But the critical difference is that the exit clause, unlike the liquidated-damages clause, does not portray payment as a form of breach.

The requirement that contracts include an express exit clause is probably best implemented through statute or regulation, rather than by a court-created rule. A court-created rule, perhaps limiting the enforceability of contracts to those that include an exit clause, could in principle incentivize firms to include such clauses. But because so few consumer contract breach cases are litigated, firms' incentives to abide by an ex post judicial rule would be substantially weakened. The problem would be amplified because consumers would have little way of knowing that they even had a contractual right being violated, because of the violation stems from the absence of a term in the contract.

An ex ante regulatory requirement is the more straightforward approach. There is precedent for similar regulatory requirements. Perhaps the most well-known ex ante regulations of contracts are disclosure requirements. State and federal law, both by statute and by agency regulation, impose disclosure requirements on a wide variety of contracts. For example, the APR disclosure requirement in the Truth in Lending Act requires that the interest term be prominently presented to the borrower.¹⁴² Such disclosure requirements do not regulate the substance of the contract's terms and in that respect differ from a mandatory exit clause. But the Truth in Lending Act also includes a requirement that very closely mirrors the sort of mandatory exit clause under consideration here. Section 1635 of the Act creates a "right to rescind" certain home equity loans within three days of their consummation or the delivery of the Act's required disclosures, whichever is later.¹⁴³ Federal Reserve Board regulations require that lenders provide notice

141. In practice, consumer contracts may include clauses that are phrased somewhere on a continuum between a pure liquidated-damages clause and a pure exit clause. Other consumer contracts may reference "minimum term agreements" without making clear what, if any, fees or liquidated damages would be due upon terminating the contract. See, e.g., *Comcast Agreement for Residential Services*, XFINITY, <https://www.xfinity.com/corporate/customers/policies/subscriberagreement> [<https://perma.cc/5K3K-KPSV>] (stating "you may terminate this Agreement for any reason at any time" "[u]nless your Service(s) are subject to a minimum term agreement" without addressing terms of early cancellation for such services). That contracting reality illustrates the complexity of the moral framing of contracts. This Article's discussion focuses on the "pure" examples at either end of the continuum because they isolate individuals' moral reactions to those benchmarks.

142. See Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 87 & n.282 (2008).

143. 15 U.S.C. § 1635(a) (2012) ("[T]he obligor shall have the right to rescind the transaction until midnight of the third business day following the consummation of the transaction or

to borrowers of this right to rescind and forms by which borrowers can exercise this right.¹⁴⁴ Section 1635 is limited: it applies only to home equity loans¹⁴⁵ and not to purchase-money loans,¹⁴⁶ and the right to rescind can be exercised only within three days of the lender delivering the Act's required disclosures about the terms of the mortgage.¹⁴⁷ Despite these limitations, the effect of the statutory right to rescind—combined with an express disclosure stating that right to rescind in the loan documentation—approximates a regulatory intervention requiring the right to rescind as an express term of the contract.

The mortgage market illustrates how the proposed regulatory requirement might work. The regulator—either Congress by statute or the Consumer Financial Protection Bureau by regulation—could require purchase-money mortgages to include an express term creating a right to exit the mortgage contract, subject to the remedies already available to the lender under the law. That term might state:

You have a right to cancel this mortgage at any time. If you exercise this right, you will be required to pay the lender back the balance of the loan. If you cannot afford to pay back the balance of the loan, state law may require you to turn over the property as you would in a foreclosure.¹⁴⁸

Exiting the mortgage contract would no longer constitute breach; instead, the contract's express terms provide an option to exit, equivalent to what otherwise would constitute breach.¹⁴⁹ As a result, the borrower would never perceive a moral obligation to continue to “perform”—that is, to continue to make his or her monthly payments—rather than to exercise the contractual option to exit the contract and turn over the house. Accordingly, in contrast to homeowners' behavior in the aftermath of the housing crisis,

the delivery of the [disclosures required by the Act], whichever is later, by notifying the creditor, in accordance with regulations of the [Federal Reserve Board], of his intention to do so.”)

144. Right of Rescission, 12 C.F.R. § 226.23(a)–(b) (2018) (Regulation Z of the Federal Reserve Board); see *Jesinoski v. Countrywide Home Loans, Inc.*, 135 S. Ct. 790 (2015) (holding borrowers exercise the right to rescind by “notifying” the lender and need not file a lawsuit); Frank A. Hirsch Jr. & Richard A. McAvoy, *Life After Jesinoski: The New ‘Wild West’ of TILA Rescission*, CONSUMER FIN. SERVS. L. REP., Feb. 13, 2015, at 4; Milan Prodanovic, *Hiding in Plain Sight: Jesinoski and the Consumer’s Right of Rescission*, 10 DUKE J. CONST. L. & PUB. POL’Y SIDEBAR 141 (2015). This Article’s author was among the counsel representing the petitioners in *Jesinoski*.

145. That is, loans for which borrowers offer a house they already own as collateral to secure funds they can use for home improvements or other purposes.

146. That is, loans with which the borrower uses the proceeds of the loan to purchase the home that subsequently serves as collateral.

147. 15 U.S.C. § 1635(a).

148. Because of the gravity of the financial decision to exit a mortgage, the prudent regulator might also include a recommendation that the borrower consult a lawyer or mortgage counselor before deciding whether to exercise the right to exit.

149. In the case of mortgages, the remedy provided for by the contract and the background law is foreclosure of the home serving as collateral for the loan rather than payment of expectation damages. That complication does not affect the broader point.

many more borrowers might exit mortgage contracts when it is in their economic interest to do so.¹⁵⁰

The strategy of mandating an exit clause draws on two well-developed concepts: information-forcing rules and choice architecture. An information-forcing default rule is “any contract default rule that favors one party in order to induce the other party to a transaction to disclose particular information.”¹⁵¹ Such rules aim to solve information asymmetries by setting the default to whichever legal rule the better-informed party tends *not* to prefer, which can be overridden only by revealing the relevant information. So, for example, in the classic contracts case *Hadley v. Baxendale*, the plaintiff knew that a delay in delivery of a critical replacement part would leave its mill shut down and thus cause extensive harm.¹⁵² But the court limited recovery to foreseeable harm unless the plaintiff had put the defendant on notice of the atypical risk of extensive harm.¹⁵³ Thus we have a default rule limiting recovery to expectation rather than actual damages. But this is merely a default—parties can get around it by communicating the value of performance to their counterparty, which in turn promotes efficient contracting.¹⁵⁴ J.H. Verkerke recently extended the concept of information-forcing defaults to argue that some “clause-forcing” rules, which incentivize the more sophisticated party to draft a contract to include a particular term, can serve a similar function when the less-sophisticated party is ignorant of the applicable legal rule.¹⁵⁵ For example, the UCC imposes an implied warranty of merchantability, which a seller can override only with a clear statement disclaimer.¹⁵⁶ The contract term disclaiming the warranty itself shares information

150. See White, *supra* note 16.

151. J.H. Verkerke, *Legal Ignorance and Information-Forcing Rules*, 56 WM. & MARY L. REV. 899, 910 (2015). Information-forcing default rules are a type of “penalty default.” See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989). The other type, a negotiation-forcing default rule, selects a default rule that *neither* party prefers in order to induce the parties to negotiate. Verkerke, *supra* at 911.

152. (1854) 156 Eng. Rep. 145, 146–47; 9 Ex. 341, 343–44.

153. *Id.* at 151–52 (limiting recover to harms either “reasonably . . . considered . . . [as] arising naturally, i.e., according to the usual course of things” from the breach, or might “reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it”).

154. See Ayres & Gertner, *supra* note 151, at 95–107.

155. Verkerke, *supra* note 151, at 903 (clause-forcing rules “encourage[] sophisticated parties to provide legal information to the comparatively poorly informed individuals with whom they do business”).

156. See U.C.C. § 2-314 (AM. LAW INST. & UNIF. LAW COMM’N 2012) (imposing implied warranty of merchantability as a default term “if the seller is a merchant with respect to goods of that kind”); *id.* § 2-315 (“Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller’s skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.”); *id.* § 2-316(3)(a) (“[A]ll implied warranties are excluded by expressions like ‘as is,’ ‘with all faults’ or

about the applicable legal rule with the less sophisticated party. If the default rule did not require the warranty, then sophisticated parties would remain silent in their contracts and less sophisticated parties would remain ignorant of their legal rights.

A mandatory exit clause is superior to a traditional information-forcing default rule in this context. A mandatory rule, just like a default rule, can serve the same information-forcing function by requiring contracts to include the term communicating information. But a default rule in favor of specific performance has drawbacks that a mandatory exit clause does not. An information-forcing default rule of specific performance would require contract drafters either to accept that remedy or, more likely, to include a contract term setting damages as the remedy for breach. That ultimate outcome appears similar to that of a rule mandating an exit clause, but a mandatory exit clause is a better solution for two reasons. First, contract drafters could override a default rule of specific performance with an express clause simply setting damages as a remedy for breach. But such a term would not reframe the choice for an individual moralist because it still portrays departure from the contract as a form of breach. Second, a mandatory exit clause is superior to a specific performance default rule on traditional majoritarian grounds.¹⁵⁷ Setting the default to a rule that few if any parties prefer imposes unnecessary (if modest) transaction costs in contracting and, if parties fail to insert the remedy clause (either due to high transaction costs or inadvertence), could result in parties trapped in a contract inefficiently governed by specific performance.¹⁵⁸

A mandatory exit clause thus shares an information-forcing function with Verkerke's clause-forcing rules by communicating a legal rule—that the individual can leave the contract and pay instead—to the less sophisticated party through the text of the contract, but the mandatory clause is superior to a traditional information-forcing default rule of specific performance. Yet a mandatory exit clause does more than just convey the applicable legal rule in the way a liquidated-damages clause does. An exit clause reframes the choice of whether to pay rather than stay in the contract in a way that can influence individual moralists' decisions beyond just telling them a legal fact that they don't already know. Such reframing is an exercise in choice architecture.¹⁵⁹ As Cass Sunstein explains, "When people make decisions, they do so against a background consisting of choice architecture."¹⁶⁰ Choice architecture involves, among other things, the way options are presented to the

other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty . . .").

157. See generally Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999).

158. See Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 614–15 (1998).

159. See RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE* 81–100 (2008); Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200–03 (2006).

160. Cass R. Sunstein, *The Ethics of Nudging*, 32 YALE J. ON REG. 413, 417 (2015).

person making the choice. Accordingly, a choice architect “has the responsibility for organizing the context in which people make decisions.”¹⁶¹ For example, the design of a grocery store, including the placement of healthy versus unhealthy options, affects what food people choose to purchase. By placing healthy foods on shelves at eye level and unhealthy food on shelves near the floor, the designer of the grocery store can influence people to buy more healthy food than they would if the shelf placements were reversed. The same food options are available, but the way they are presented affects how likely people are to choose them.

Mandating an exit clause, like other exercises in choice architecture, preserves precisely the same legal options available under a facially unqualified contract. The background law permitted breach and payment of damages under the latter, and the express terms of the contract permit the same under the former. Accordingly, under a contract with an exit clause, an individual can still choose either to perform the primary obligation under the contract or to pay. Neither option is more difficult or expensive to select than it was under the facially unqualified contract. Performance is precisely as costly under a contract with an exit clause as it was under the facially unqualified contract, and nonperformance is, if anything, less burdensome because the exercise of an express contractual option to exit would not require burdensome litigation or settlement negotiations. Nonetheless, individual moralists may be more likely to exercise the express option not to perform¹⁶² than they would be to breach a facially unqualified contract because of the difference in framing of the various options.¹⁶³ Thus the requirement to include an express exit clause can influence individuals’ decision whether to perform or to pay without removing their ultimate freedom to make that choice.

But a mandatory exit clause does not merely reframe the moral choice: it changes the moral facts on the ground, at least in the eyes of the individual moralist. It presents the choice of whether to pay or stay in a way that alters the moral status of that option by elevating what was a background legal option—breach and pay damages—into an explicit contractual option. It thus differs importantly from traditional interventions in choice architecture, which typically aim to address the cognitive shortcomings of bounded rationality—such as judgment errors like optimism bias stemming from cognitive heuristics and biases that lead people to draw erroneous conclusions on which they then base their choices.¹⁶⁴ By contrast, an express exit term seeks to address not a cognitive bias but the variance in substantive moral view. Because individual moralists judge the substantive scope of their contractual

161. THALER & SUNSTEIN, *supra* note 159, at 3.

162. By “perform,” I mean perform the primary obligation under the original facially unqualified contract—for example, to plow a driveway. Under a contract with an express exit option, declining to “perform” the original primary obligation would qualify as performance rather than as breach. See Markovits & Schwartz, *supra* note 5, at 1947–48.

163. See *infra* Section IV.C.2 for a discussion of the efficacy of mandatory exit clauses.

164. See Jolls & Sunstein, *supra* note 159.

promise by the express terms of the contract, an express contract-in-the-alternative generates a promise-in-the-alternative. As a result, a contractual term creating an express right to exit and pay a fee changes individual moralists' perception of their substantive moral obligations under the contract. Thus, although the express term does not change the legal landscape on which individuals choose whether to breach—thereby differing from traditional information-forcing clauses—it does change the moral landscape, at least according to the individual moralists. This intervention can be thought of as a kind of moral choice architecture,¹⁶⁵ in which the intervention changes the substantive moral status of an individual's options in a way that frees him to act in a way that is practically and economically equivalent to conduct he believes is morally prohibited.

Reframing the moral choice by mandating an exit clause can resolve the consequences of the asymmetry in moral diversity about breach. The underlying economic incentives to breach remain unchanged by including an exit clause with a corresponding exit fee set at the right level. A contract with an exit clause, a contract with a liquidated-damages clause, and a contract with neither clause are all economically identical if the exit fee and liquidated-damages amount are set to the amount a court would award in expectation damages for breach.¹⁶⁶ Under any of the three contracts, a party can either (a) perform the primary obligation under the contract or (b) pay its counterparty an amount of money that is, by hypothesis, the same in each case.

But these three economically identical contracts yield different moral framings. A facially unqualified contract, with neither an exit clause nor a liquidated-damages clause, presents paying rather than staying in the contract as breach of the contract and therefore a breach of the promise. A contract with a liquidated-damages clause makes explicit the financial conse-

165. The “moral choice architecture” discussed in the text differs critically from the “behavioral ethics” discussed in management literature. Behavioral ethics aims to understand how individuals decide whether to act in accord with generally accepted moral norms, and to identify the extent to which bounded rationality may influence people to act immorally. See Linda Treviño et al., *Behavioral Ethics in Organizations: A Review*, 32 J. MGMT. 951 (2006). For example, because of loss aversion individuals may be more prone to lie or cheat to avoid a loss than to secure a gain. See Gilles Grolleau et al., *Cheating and Loss Aversion: Do People Cheat More to Avoid a Loss?*, 62 MGMT. SCI. 3428 (2016). Although framing the outcomes variously as a gain or a loss affects people's tendency to lie, no one—including the individuals whose propensity to lie is affected by that framing—thinks it is more morally acceptable to lie to avoid a loss rather than to secure a gain. By contrast, moral choice architecture involves changing the substantive moral status of an option by altering its framing. At least by the lights of individual moralists, it is morally forbidden to breach a facially unqualified contract, but it is morally permissible to “breach” a functionally (if not morally) equivalent contract-in-the-alternative.

166. This equivalence requires several further assumptions: that there are no transaction costs like litigation and that parties are able to anticipate the amount of expectation damages a court would award. Note that the former assumption—a lack of transaction costs like litigation—makes a facially unqualified contract more appealing to a breaching party than it would be in reality. Litigation costs would reduce the net recovery under a facially unqualified contract, and so relaxing the assumption of no transaction costs would allow the exit fee to be set lower than the gross amount of expectation damages to maintain economic equivalence.

quences of breach, but it does not purport to change the fact that nonperformance of the primary obligation in the contract constitutes breach. And so, in the opinion of the individual moralist, the liquidated-damages clause does not change the moral scope of the contractual promise.¹⁶⁷ An exit clause, by contrast, converts a facially unqualified contract into an express contract-in-the-alternative. As a result, declining to perform the primary obligation under the contract and instead paying a set exit fee no longer counts as (and will not be perceived by individual moralists as) breach. With an exit clause, paying constitutes (and will be perceived by individual moralists as) an alternative way of performing the contract. Exercising the right or option to exit the contract and paying the fee thus satisfies the promise individual moralists believe they made when they entered the contract. When the exit fee is set to the amount of expectation damages, the individual moralist will then exercise the contractual right to exit when, and only when, doing so is efficient. That change in moral framing thus aligns the moral perspectives of individual moralists and Holmesian firms. Both will breach, or exit, the contract when doing so is efficient.¹⁶⁸

Of course, an exit clause, like a disclosure, can affect a party's beliefs and behavior only if the party reads it.¹⁶⁹ The presence of an exit clause does not reframe the decision to leave a contract if the party contemplating breach (or exit) doesn't know the term is in the contract. That fact could limit the effectiveness of a mandatory exit term requirement, but there are reasons for optimism. First, consumer common knowledge tends to incorporate ubiquitous features of contracts, whether those features are legally required or not. For example, most consumers know that cell phone contracts include terms that permit early termination of the service in exchange for a fee.¹⁷⁰ This sort of common knowledge can rapidly incorporate changes in industry-standard contracts. Airlines began charging fees for checked bags and extra leg room only recently, but those fees are already widely known among consumers. Second, individuals are particularly likely to be aware of their contractual rights in the sorts of contracts for which the decision of whether to breach is most consequential. The mortgage context again serves as a telling example. Mortgage contracts are among the most lengthy and complicated contracts that people encounter, and homeowners (sometimes with the assistance of credit counselors or lawyers) are often aware of their legal right to rescind a

167. Though, as Wilkinson-Ryan suggested, people's moral aversion to breach may be lessened when presented with a contract with a liquidated-damages clause because its presence puts the nonbreaching party on notice of the prospect of breach. See Wilkinson-Ryan, *Liquidated Damages*, *supra* note 1, at 636.

168. The presence of an exit clause may also deter opportunistic breaches by individuals by spelling out the consequences of nonperformance, thereby making it easier for a firm to secure compensation.

169. See BEN-SHAHAR & SCHNEIDER, *supra* note 136, at 10–11 (noting limitations of mandatory disclosure requirements).

170. See *supra* note 140.

mortgage precisely because of the magnitude of its stakes.¹⁷¹ And third, even if an exit clause yields only limited improvement with respect to the problem of the asymmetry in moral belief, the presence of an exit clause is unlikely to create any new problems. An exit clause, calibrated to include a fee equivalent to expectation damages, does not alter parties' legal rights or responsibilities. And so, to the extent parties are unaware of an exit clause's presence in a contract, the clause is simply inert.

Because a legal requirement mandating an exit clause retains the substance of the contracting parties' legal options, seeking to alter individual moralists' behavior only by morally reframing those options, neither efficiency-based nor autonomy-based theories of contract have principled grounds to reject a mandatory exit clause. Contract theorists committed to promoting efficiency or increasing welfare should welcome a mandatory exit term because it would result in individual moralists breaching their contracts (or more precisely, exiting their contracts) when it would be efficient for them to do so, thus increasing social welfare. Moreover, this strategy achieves the increase in social welfare while also ameliorating distributional inequalities by leveling up. That is, a legal framework that mandates exit clauses will increase the welfare of the less-advantaged group relative to the status quo without decreasing the welfare of the better-off group. This is because, by hypothesis, sophisticated Holmesians would be fully compensated by any new efficient exits by individual moralists. Indeed, a mandatory exit clause simply makes explicit the convergence theorists' implicit revisionist move. Shavell, Markovits, and Schwartz deployed that revisionist move to interpret or imply into facially unqualified contracts precisely the same term that this regulatory proposal would require contracts to include as an express term. Autonomy-based theories of contract, like Fried's or Kraus's, can also embrace the requirement that contracts include an exit clause. Such a clause would resolve fairness and distributional concerns that autonomy-based theorists are likely to care about. And importantly, the clause achieves those ends without abridging autonomy because parties are still free to perform or to pay,¹⁷² just as they are now. My proposal simply mandates an express contractual term that creates an option, which the party can choose not to exercise, and mirrors a background legal option both parties already possessed.

A divergence theorist like Seana Shiffrin, however, might advance a substantial objection based on the moral character of contractual promises. Shiffrin argues that contract law's traditional expectation remedy can be justified only on the basis of rationales that undermine a morally decent person's conception of a promise.¹⁷³ The foundation of that objection is that the proposal forces individuals to make promises-in-the-alternative by requiring

171. See Lea Krivinkas Shepard, *It's All About the Principal: Preserving Consumers' Right of Rescission Under the Truth in Lending Act*, 89 N.C. L. REV. 171 (2010).

172. Again, for simplicity of expression, "perform" here means "perform the primary obligation under the contract."

173. Shiffrin, *supra* note 24, at 719.

that they make contracts-in-the-alternative rather than truly and facially unqualified contracts.¹⁷⁴ That objection, whatever its merits against the law's expectation remedy for unqualified contracts, fails to undermine the case for the proposal of a required mandatory exit term. Shiffrin's argument against the traditional expectation remedy is that it reflects the law's endorsement of the view that it is morally permissible to break an *unqualified* promise and merely pay off the disappointed promisee. But the law, should it adopt the proposal, would not depend on such a contestable moral rationale. Rather than suggesting it is morally permissible to break a promise and pay off the promisee, it would instead require parties to make promises in the alternative that *morally and legally permit* payment in lieu of performance. Even if it were morally wrong to break a promise and pay off the counterparty, the proposal ensures that individuals (like their sophisticated Holmesian compatriots) may pay rather than perform *without* breaking a promise.

Shiffrin might modify her objection to claim that promises-in-the-alternative are morally inferior to unqualified promises and that as a result the proposal would force people to live their lives less virtuously. This modified objection focuses not on the fact that the exit term is mandatory but rather on the particular content of the mandatory term. A qualified promise-in-the-alternative, Shiffrin might argue, is morally inferior to the more fulsome promises individuals currently take themselves to have made: the "worry" that "the contents of promises are indefinitely plastic and utterly up to their makers."¹⁷⁵ As Shiffrin elaborates:

It is out of bounds to say: "I solemnly promise to do X, but I may fail to do so if something better comes along; moreover, if it does, you can only expect X's market value from me . . ." . . . Although one can declare within a promise some of the conditions under which the promised performance may not occur, those conditions cannot coherently extend so far as to include any situation in which the promisor has a change of heart or entertains a better offer.¹⁷⁶

In Barbara Fried's reconstruction of Shiffrin's worry, "when she says that it is morally wrong for a contract to permit parties to avoid performance for a price, she means that it is wrong however that option is phrased."¹⁷⁷

Perhaps the most natural response to this version of Shiffrin's complaint is simply to reject the intuition.¹⁷⁸ But there is perhaps more merit to

174. *Id.* at 740–49.

175. *Id.* at 728.

176. *Id.* at 728–29.

177. Barbara H. Fried, Response, *What's Morality Got to Do with It?*, 120 HARV. L. REV. F. 53, 57 (2007).

178. As Fried explains, Shiffrin's "rhetoric bears much of the weight of the argument here" because "much of Professor Shiffrin's own discomfort with these utterances I believe would disappear if identical limitations on liability were phrased in a different way." *Id.* at 58. In other words, Fried suggests the intuition driving Shiffrin's objection is not, as Shiffrin suggests, that all promises-in-the-alternative are morally inferior regardless of how the option to

Shiffrin's concern (as reconstructed by Fried) than may meet the eye. The moral character of some promises depends essentially on their unqualified nature. Consider, for example, a marriage contract. Despite the perhaps cynical modern realization that divorce is always an option, the moral character of a marriage contract—and thus, on the individual moralist's view, of a marriage promise—would be fundamentally compromised if it were converted by legal fiat into a contract and promise in the alternative. Even if that express exit term to the marriage contract simply corresponded to a pre-existing legal option of divorce, the promise that arose from that marriage contract-in-the-alternative would be importantly different from—and by most noncynics' lights, morally inferior from—a typical unqualified marriage contract.

But such contracts are a rarity. Most contracts—and in particular the class of contracts to which the proposal is meant to apply—formalize commercial transactions. And in the commercial context, it is hard to maintain that contracts-in-the-alternative undermine the moral character of the corresponding commercial promise simply by virtue of being qualified to permit payment in lieu of performance because, in large part, the underlying function of the promise was already founded on the transfer of money. So commercial contracts-in-the-alternative do not dishonor the promise by pricing an exit, because the unqualified contract itself already priced the promise. As a result, no one could plausibly think it is less morally virtuous to opt for a cell phone contract with an explicit exit fee than an unqualified cell phone contract that lacked such a provision. Thus, a regulatory requirement that commercial contracts include such a term does nothing to force us to live less virtuously. Rather, the requirement could solve serious economic and distributional problems while preserving individual autonomy.

2. Experimental Evidence on Exit Clauses

In theory, then, a mandatory exit clause can solve the problem of the asymmetry in moral belief about breach in a way that should satisfy both efficiency and autonomy theories of contract. The remaining question is whether an exit clause is actually effective in doing so. To answer this, I conducted two experimental studies to test people's likelihood to leave a contract when it was in their financial interest to do so.¹⁷⁹ The first study tested

pay is presented. The intuition is rather only that promises merely to perform-or-pay are morally inferior when the promisor presents that alternative promise in a morally repugnant manner. And a regulatory requirement that contracts contain an exit term hardly constitutes the sort of moral repugnance.

179. The study participants were recruited via Amazon Mechanical Turk (MTurk) and were compensated \$1 for participating in the experiment. MTurk is an increasingly standard platform for social scientists conducting social science research that offers promising external validity. See Connor Huff & Dustin Tingley, "Who Are These People?" *Evaluating the Demographic Characteristics and Political Preferences of MTurk Survey Respondents*, RES. & POL., July–Sept. 2015, at 1, 8 ("[R]espondents on MTurk are not all that different from respondents on other survey platforms.").

how likely people were to leave a contract with an exit clause, a contract with a liquidated-damages clause, and a facially unqualified contract with neither an exit clause nor a liquidated-damages clause. The second study tested people's responses in the particular context of mortgages by asking participants how willing they would be to exit a mortgage contract with an express exit clause versus breach a mortgage contract without such a clause.

The empirical findings of these studies support the conclusion that exit clauses shift individuals' moral perceptions by reframing the decision to pay rather than perform. The results of the first study, reported below, indicate that people are significantly more willing to exit a contract and pay a fee than they are to breach a contract and pay damages. The results of the second study, also reported below, indicate that people are also significantly more likely to exercise an express exit clause in a mortgage when it is in their financial interest to do so than they are to default on a mortgage when default has identical legal and economic consequences. Participants' comments in both studies suggest that the reason for this difference is that exercising a contractual option to exit a contract does not involve breaking a promise and is therefore not immoral.

Methodology. The first study's design is based on a similar study conducted by Wilkinson-Ryan, which tested whether people would be more willing to breach a contract with a liquidated-damages clause than a contract without a liquidated-damages clause.¹⁸⁰ Wilkinson-Ryan found that participants would be willing to breach a facially unqualified contract only if offered approximately twice the amount of money it would take to make breach and performance financially equivalent.¹⁸¹ By contrast, participants reported that they would breach a contract with a liquidated-damages clause for only approximately 1.35 times the amount of money it would take to make breach and performance financially equivalent.¹⁸² Participants indicated that the presence of a liquidated-damages clause altered their views on the moral permissibility of breach because it suggested the nonbreaching party was on notice that breach was a possibility.¹⁸³ Moreover, as with a disclosure requirement, the presence of a liquidated-damages clause ensures that subjects know that the nonbreaching party will receive compensation. Wilkinson-Ryan's data also show that participants continued to require a substantial premium over the amount required to make breach and performance equivalent in order to breach a contract with a liquidated-damages clause.

My first study randomly assigned 722 participants to one of three variations of a vignette. The vignettes tell the participant that he or she has agreed to a contract to sell concert tickets to a music fan for \$200, but after the con-

180. Wilkinson-Ryan, *Liquidated Damages*, *supra* note 1, at 663–64. For a detailed description of Wilkinson-Ryan's methodology, see *id.* at 655–69.

181. *Id.* at 658–60.

182. *Id.*

183. *Id.* at 664.

tract is signed another buyer offers to pay \$500 for the tickets. Like Wilkinson-Ryan's study, Scenario 1 presented participants with a control condition: the vignette with a facially unqualified contract, in which participants were told the law of contracts would award the original buyer \$100 in compensation in the event of breach.¹⁸⁴ Also like Wilkinson-Ryan's study, Scenario 2 presented participants with a liquidated-damages clause condition: the same vignette, except with a contract that included a clause setting liquidated damages at \$100.¹⁸⁵ I supplemented her study design by adding Scenario 3: a contract that includes an exit clause creating a "right to cancel" the contract if the participant pays a "fee" of \$100.¹⁸⁶ After reading the vignette, participants were asked how likely they would be to breach (or exit) the con-

184. The full text of Scenario 1 read:

Imagine you purchased tickets to a concert by a very popular musician. Unfortunately, due to a family commitment, it turns out you won't be able to attend the concert. You decide to sell the tickets through a local website where music fans often buy and sell concert tickets. You and a buyer named Smith sign a contract to sell the tickets for \$200.

The day before the concert, another music fan named Jones contacts you and offers to buy the tickets for \$500. The concert is sold out and no other tickets are available on the website. If you break your contract with the original buyer Smith, the law of contracts will require you to pay Smith \$100 as compensation for the cost of the babysitter he had booked for the evening.

In total, if you break your contract with Smith and sell the tickets to Jones instead, you will make \$400 (\$500 from the sale to Jones, minus the \$100 you would owe Smith). If you don't break the contract with Smith, you will make only \$200.

How likely are you to break the contract with Smith and sell the tickets to Jones instead?

- (1) Very unlikely.
- (2) Somewhat unlikely.
- (3) Neither likely nor unlikely.
- (4) Somewhat likely.
- (5) Very likely.

185. The text of Scenario 2 was identical to the text of Scenario 1, except instead of telling participants the law of contracts would impose liability, it told participants the contract included the following liquidated-damages clause: "If the seller of the tickets breaches this contract for any reason, he or she will compensate the ticket buyer Smith in the amount of \$100 to cover the cost of the babysitter Smith will book for the evening."

186. The text of Scenario 3 was identical to the text of Scenario 2, except it replaced the liquidated-damages clause with the following exit clause:

"The seller of the tickets has a right to cancel this contract for any reason. If the seller exercises the right to cancel this contract, he or she will pay the ticket buyer Smith a fee in the amount of \$100 to cover the cost of the babysitter Smith will book for the evening."

In addition, instead of asking participants how likely they were to "break" the contract with Smith, it asked them: "How likely are you to exercise the right to cancel the contract with Smith and sell the tickets to Jones instead?"

tract. Once participants answered the question with respect to one of the three scenarios, they were presented with the other two scenarios in turn to answer the same question. This design permits both interpersonal comparisons, how unprimed participants respond to the first scenario they saw, and intrapersonal comparisons, how a single individual responds to each of the three scenarios. The study concluded by asking participants to comment on whether breach of contract is immoral and whether the presence of an exit clause makes a difference morally.

The second study tested participants' propensity to breach or exit a home mortgage. It randomly assigned 243 participants to one of two scenarios. Both scenarios told participants that they owned a house with a mortgage whose balance was substantially greater than the market value of the house and that as a result it was in their financial interest to stop making payments on the mortgage. Under Scenario A, participants were told the mortgage was "a standard mortgage" contract and that if they stopped making payments on the mortgage they would have to turn over the house to their lender in accordance with "real estate law."¹⁸⁷ Under Scenario B, participants were told the mortgage included an express exit clause that specified both that they had a "right to terminate" the mortgage and that if they exercised the right to terminate they would have to turn over the house to the lender.¹⁸⁸ The legal and financial consequences were thus identical between the scenarios. After each scenario, participants were asked how willing they would be to stop making payments and to turn over the house to the lender. As with the first study, after participants answered the question with respect to one scenario, they were presented with the other scenario and asked the

187. The full text of Scenario 1 (excluding answer choices) read:

Please imagine you purchased a house using a standard mortgage. The value of real estate has decreased significantly since you bought the house. Due to the steep decline in the real estate market, the market price of your house is now much less than the remaining balance on your mortgage. As a result, it is in your financial interest to stop making payments on the mortgage and turn over the house to your mortgage lender pursuant to the real estate law.

How likely are you to stop making payments and turn over the house to your lender?

188. The full text of Scenario 2 (excluding answer choices) read:

Please imagine you purchased a house using a mortgage with the following clause:

"You have a right to terminate this mortgage at any time. If you choose to exercise the right to terminate this mortgage, you will be required to turn over the property that secures the mortgage to your lender."

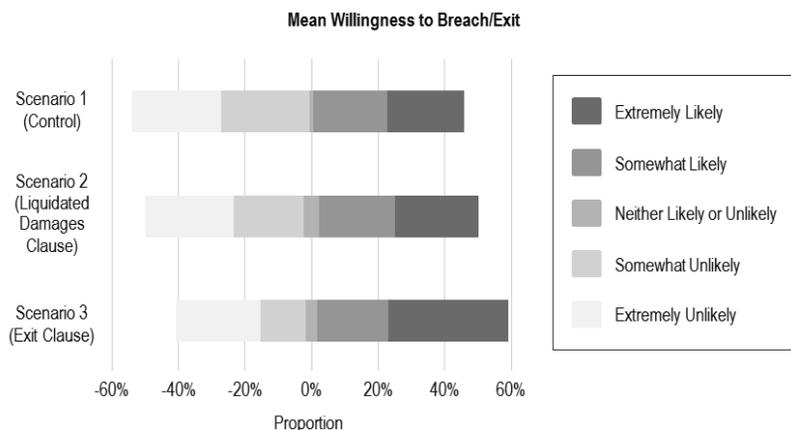
The value of real estate has decreased significantly since you bought the house. Due to the steep decline in the real estate market, the market price of your house is now much less than the remaining balance on your mortgage. As a result, it is in your financial interest to stop making payments on the mortgage and turn over the house to your mortgage lender pursuant to the clause in your mortgage contract.

How likely are you to stop making payments and turn over the house to your lender?

same question to allow for intrapersonal comparisons. And like the first study, it concluded by asking participants to comment on whether breach of contract is immoral and whether the presence of an exit clause makes a difference morally.

For both studies, participants' responses were coded for statistical analysis. A response of "very likely" was assigned a value of 5; "somewhat likely" a value of 4; "neither likely nor unlikely" a value of 3; "somewhat unlikely" a value of 2; and "very unlikely" a value of 1.

Results. The results of the first study show that the presence of an exit clause had a significant effect on participants' willingness to breach or exit a contract. Looking first at the interpersonal data,¹⁸⁹ participants were more likely to exercise an exit clause than to breach a contract with a liquidated-damages clause or a contract with neither. Participants' mean response to Scenario 1, in which the contract had neither an exit clause nor a liquidated-damages clause, was 2.88. Participants' mean response to Scenario 2, in which the contract had a liquidated-damages clause, was 2.98. Finally, participants' mean response to Scenario 3, in which the contract had an exit clause, was 3.29. Those data are summarized in the following chart:



The difference between participants' mean responses to the exit clause scenario and the control scenario was 0.41,¹⁹⁰ while the difference between their mean responses to the liquidated-damages scenario and the control scenario was statistically insignificant and only 0.1.¹⁹¹ The data thus suggest that the effect of an exit clause is four times as powerful as the effect of a liq-

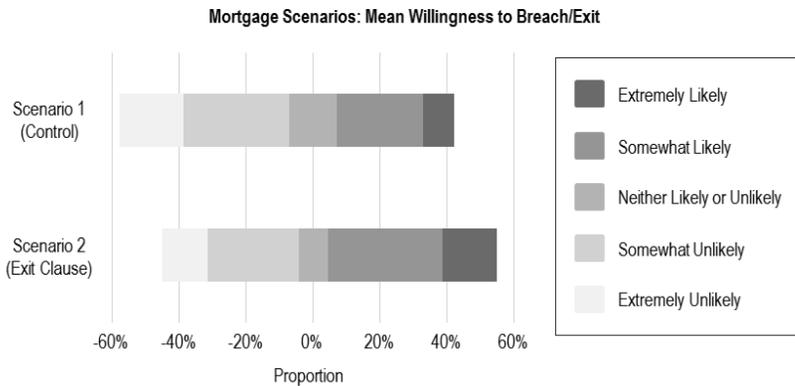
189. That is, comparing participants' responses to the first scenario they viewed.

190. The difference between participants' responses to the exit clause scenario and the control scenario was statistically significant ($t = -2.7904$, $df = 480.71$, $p\text{-value} = 0.005474$).

191. The difference between participants' responses to the liquidated-damages clause scenario and the control scenario was not statistically significant ($t = -0.70461$, $df = 479.35$, $p\text{-value} = 0.4814$).

uidated-damages clause.¹⁹² The data also showed a strong intrapersonal effect.¹⁹³ On average, a participant’s response to the exit clause scenario was .43 higher than his or her response to the control scenario.¹⁹⁴

The second study showed that the presence of an exit clause in a mortgage contract had a similarly significant effect. Looking first at the interpersonal data, participants were more likely to exercise an exit clause in a mortgage contract than to breach a mortgage contract. Participants’ mean response to Scenario A, in which the participants considered a standard mortgage contract without an exit clause, was 2.74. Participants’ mean response to Scenario B, in which the mortgage contract had an exit clause, was 3.15. Those data are summarized in the following chart:



The difference between participants’ mean responses to the exit clause scenario and the control scenario was again 0.41.¹⁹⁵ The data also again showed a strong intrapersonal effect. On average, a participant’s response to the exit clause scenario was 0.30 higher than his or her response to the control scenario.¹⁹⁶ The effect of an exit clause on the decision whether to stay in the mortgage contract affected a substantial proportion of participants: the percentage of participants who were either “extremely likely” or “somewhat likely” to breach a mortgage contract was 35%, while the percentage of participants who were either “extremely likely” or “somewhat likely” to exercise an exit clause in a mortgage contract increased to 53%.¹⁹⁷ In other words, the

192. Because both effects are based on finite sample sizes, and therefore subject to confidence intervals, the relative magnitude of those effects could be somewhat higher or lower.

193. That is, comparing how individual participants responded to all three scenarios.

194. The single-value p-test showed this effect was statistically significant ($t = 10.088$, $df = 721$, $p\text{-value} < 2.2 \times 10^{-16}$).

195. The difference between participants’ responses to the exit clause scenario and the control scenario was statistically significant ($t = -2.4007$ $df = 240.93$, $p\text{-value} = 0.01712$).

196. The single-value p-test showed this effect was statistically significant ($t = 4.5562$, $df = 242$, $p\text{-value} = 0.000008265$).

197. The difference in percentages was statistically significant ($t = -2.8379$, $df = 240.9$, $p\text{-value} = 0.004928$).

presence of an exit clause shifted 18% of participants to be somewhat or extremely likely to leave an underwater mortgage who otherwise would be unwilling to breach.

These results indicate that a mandatory exit clause can successfully align the moral perceptions of individual moralists with firms' Holmesian perspective on breach. That impact could have substantial practical implications, particularly in consumer contracts and mortgage contracts. By aligning individuals' moral belief about exiting the contract with the breaching behavior of Holmesians, a mandatory exit clause could free consumers and borrowers from contracts to which they feel morally bound when exit would release them from substantial economic burdens. If 18% more of the millions of homeowners whose mortgages were underwater in the aftermath of the housing crisis had exercised a right to exit those mortgages, homeowners in aggregate might have saved billions of dollars. But the moral point is perhaps more sharply stated when we focus on individuals: each homeowner might have saved tens or even hundreds of thousands of dollars. For most people, especially those whose financial situation was already precarious, that would have been a life-changing financial salvation.

CONCLUSION

The moral diversity of beliefs about the permissibility of breach creates significant social and moral costs. The asymmetry in moral belief between individuals and sophisticated parties like firms results in inefficient outcomes and unfair distributions. This Article addressed the implications of the asymmetry and evaluated prospects for legal reform to address those implications. Traditional doctrinal tools to calibrate legal actors' incentives by adjusting the remedies for breach are unlikely to make much headway in the problem. Disclosure requirements probably will not help much either. The most promising approach is a mandatory exit term that explicitly permits payment instead of performance. Because an express exit term would alter the substantive scope of individual perceptions of moral obligations to keep contractual promises, these individuals may be more likely to breach efficiently. That modified breaching behavior would respect individuals' moral views while resolving both the inefficiency and unfairness that asymmetry in moral belief creates under the legal and regulatory status quo. Experimental evidence bears out that theoretical conclusion: people are significantly more likely to exercise an exit clause in a contract when it is in their financial interest than they are to breach a contract, even when the economic consequences are identical. These results point the way to a promising solution to an underappreciated public policy problem in the regulation of contracts.