

Moral Judgment and Moral Heuristics in Breach of Contract

Abstract

Most people have the intuition that breach of contract is morally problematic. In this paper, we collected empirical data in order to provide a more elaborated understanding of moral reasoning about contracts. In a series of web-based experiments, we asked subjects to read scenarios involving economically efficient breaches of contracts. Our results suggest that people are highly attuned to information with moral salience, but relatively insensitive to the economic incentives or the indirect effects of their judgments. Subjects report that breach is morally wrong even when the breacher pays full damages, levy damages at a level higher than expectation value, and indicate that specific performance should be legally enforced. They impose higher damages for cases in which the promisor breaches in order to take a more lucrative offer than cases in which the promisor breaches to avoid a loss. Finally, results suggest that people think that the moral content of a contract is the promise, with the same moral rules that govern personal, non-commercial promises.

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INTRODUCTION

In jurisprudential scholarship, at least two potentially conflicting moral theories of breach of contract exist. One is that a contract is a promise that confers a moral obligation on the parties to perform as specified.¹ The other is the law and economics view, which holds, more or less, that the promise is simply the promise to confer a certain amount of benefit, such that so long as the benefit is conferred in one way or another (performance or money damages), the moral obligations of the contract have been fulfilled.² American contract law does not explicitly endorse one position on the morality of contracts, but in effect it is largely in line with the law and economics view. The penalty for breach is expectation damages, and courts rarely require specific performance.³ This is true irrespective of the motivation for the breach.⁴

In this paper, we undertake an empirical study in hopes of contributing to the ongoing conversation in legal scholarship about the nature of moral obligations in contract law. Recently, Steven Shavell surveyed the moral intuitions of laypeople faced with breach of contracts cases, and found support for the conclusion that breach is not immoral so long as the breaching party is willing to pay full expectation damages.⁵ In this research, we use traditional psychological

¹ See, e.g., P.S. ATIYAH, *PROMISES, MORALS, AND LAW* (1981) and CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* (1981).

² Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970).

³ RESTATEMENT (SECOND) OF CONTRACTS § 264

⁴ E. ALLEN FARNSWORTH, *Contracts* § 12.3 (3rd ed. 1999) (“The principal interest protected by that law is the expectation interest, measured by the amount of money required to put the injured party in as good a position as that party would have been in had the contract been performed... ‘Willful’ breaches should not be distinguished from other breaches.”)

⁵ Steven Shavell. *Is Breach of Contract Immoral?* 56 EMORY L. J. 439 (2006).

methodologies to ask when laypeople consider breach to be immoral, which moral principles and moral heuristics they employ to make that judgment, and to what extent their moral reasoning (be it rational or faulty) affects their legal and financial decision-making.

The studies presented below explore the role of moral intuitions and moral reasoning in judgments about breach of contracts. Most people have the initial intuition that breach of contract is morally problematic.⁶ Here, we are seeking a more elaborated picture of moral judgment in breach of contract in order to shed light on the implications of moral thinking for legal decision-making. Our results suggest that most people are highly attuned to information with moral salience, but relatively insensitive to the economic incentives of contracts or to the indirect effects of their moral judgments. As such, they find breach of contract morally problematic even when the breacher pays full expectation damages. Given the choice to set the penalty for breach of contract, people often specify an amount higher than expectation damages, and further indicate that specific performance should be legally enforced. We find evidence that subjects believe that a contract is a promise to perform as specified, and that breaking a promise is a moral harm in itself, one that cannot be fully remedied with money damages yet should nonetheless be heavily financially penalized. In our analysis of these results, we suggest that subjects are over-reliant on a few moral heuristics. Subjects seem to measure damages in terms of their moral outrage at the betrayal of a breach, ignoring the indirect economic consequences of their choices. We propose that subjects use a promise heuristic in their moral reasoning about breach of contract, using a moral rule about common, personal promises and extending it to commercial contracts.

In Part I of this article, we review arguments from both legal scholarship and

⁶ *Id.* at 455.

psychological research bearing on the question of moral norms and moralistic thinking in decision-making about contracts. Legal scholars and contractarian philosophers draw heavily on inferences based on a rational actor model. Many moral theorists argue that the relevant moral content of a contract is the promise to act in a certain way—e.g., to perform. Scholars in the law and economics tradition, beginning with Holmes, dismiss the question of morality and view the contract as a utilitarian agreement. The content of the promise is not the prescribed action to be taken by each side, but rather the amount of benefit to be conferred upon each party. As long as both parties end up in a position as good as or better than the position that they would have been in had the contractual obligations been fulfilled, the breach is efficient and therefore desirable. Thus, for these scholars, expectation damages are both the appropriate measure of damages and also the correct incentive for the potentially breaching party. In this Part, we also review evidence from psychology and behavioral economics suggesting that the arguments against specific performance are not intuitive to most people. Experiments show that people often use rigid moral rules even when they are not rationally related to the problem at hand. This is particularly the case when one party is deemed to be a bad actor or deserving of punishment. We review empirical research on the concept of “psychological breach” and on the effects of individual perceptions of contract provisions and contract law.

In Part II, we present our empirical research. We wanted to know whether and under what circumstances subjects would find breach of contract acceptable and endorse the expectation measure of damages. Our first study was a basic survey. Subjects read hypothetical fact patterns describing breach of contracts cases; in each case, the breacher would be better off by breaking the contract and paying expectation damages. We asked subjects to indicate the appropriate level of damages. In most cases, they indicated a level higher than expectation. They

further indicated that the breach was morally problematic even after paying full (or more) damages. In Experiments 1 & 2, we hypothesized that subjects were thinking moralistically about the cases, and that they would respond differently depending on the perceived motivations of the breacher. We hypothesized that subjects were relying on a heuristic against profiting from wrongdoing. We found that subjects responded more punitively, in terms of both moral judgment and financial consequences, to cases of willful breach (breach because the breacher is offered more profitable opportunities elsewhere) than to cases in which the breacher faced a potential loss due to an unexpected rise in the cost of performance. In Experiment 3, we wanted to demonstrate the content of the moral harm in breach of contract; namely, the broken promise. We hypothesized that subjects used a moral heuristic against breaking a promise, and that they would respond less punitively to a broken contract that did not involve a broken promise. Our results suggest that when the promise element is eliminated, subjects are much more likely to find the harm morally neutral and to endorse an expectation level of damages.

In Part III, we discuss the results and their implications for legal theory and practice. These results suggest that moral heuristics affect legal decision-making about contracts, and that many people appear to make errors in their moral reasoning when faced with particular kinds of cases. Furthermore, people make moral distinctions between cases treated identically under the law. These results speak to both legal and moral theories that rely on assumptions about human agents as rational actors.

I. NORMATIVE AND DESCRIPTIVE THEORIES OF MORALITY IN CONTRACT

Damages for breach of contract are measured in terms of the subjective expected benefit of the promisee.⁷ In a breach of contracts case, the "victim"/promisee is awarded the full value

⁷ RESTATEMENT (SECOND) OF CONTRACTS § 344; FARNSWORTH, *supra* note 4, § 12.1.

of the benefit of the contract, so her interests are actually advanced to the point that they would have been had the contract been completed, not simply returned to their *ex ante* position, as in a torts case.⁸ Specific performance is rarely awarded, and is reserved for the few cases in which money damages would be unable to redress the promisee's interests.⁹ Furthermore, the breacher's motivation for the breach is mostly irrelevant. There are no legal differences between a case in which a job becomes unprofitable (say, due to a rise in the cost of materials) and a case in which a job simply becomes less profitable due to a more lucrative offer elsewhere.¹⁰

A. *Law and Economics Approach to Contract*

Economic scholars have long touted the efficiency of the rule of expectation damages.¹¹ Under this system, it is not worth it to the promisor to breach the contract unless the cost of performance exceeds the benefit of performance to the promisee. That is, the promisor's own self-interested calculation of costs and benefits of breach integrate the benefit of the contract to the promisee. This forces the promisor to internalize the costs of breach to both parties, and

⁸ FARNSWORTH, *supra* note 4, §12.1.

⁹ *Id.* at § 12.6 (“[E]quitable relief would not be granted if the legal remedy of damages was adequate to protect the injured party.”) *See also*, T. Anthony Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 365 (1978) (arguing that the adequacy test for money damages “draws the line between specific performance and money damages in the way that most contracting parties would draw it were they free to make their own rules concerning remedies for breach and had they deliberated about the matter at the time of contracting.”)

¹⁰ *See Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903) (in which Holmes notes that “if a contract is broken the measure of damages generally is the same, whatever the cause of the breach.”) Damages in contract are meant to be compensatory, not punitive. *See* FARNSWORTH § 12.8 (“it is a fundamental tenet of the law of contract remedies that an injured party should not be put in a better position than had the contract been performed.”) For a judicial argument in favor of the efficiency of this position, *see Patton v. Mid-Continent Sys.*, 841 F.2d 74f2 (7th Cir. 1988) (in which Judge Posner argues that “even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee’s actual losses.”)

¹¹ *See, e.g.*, RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* ch. 4 (3rd ed. 1986); STEVEN SHAVELL, *FOUNDATIONS OF THE ECONOMIC ANALYSIS OF LAW*, 2004.

encourages the promisor only to breach in cases in which the breach would be overall welfare-maximizing. Were the damages set at a lower level the promisor might have an incentive to breach more often and in cases in which the overall welfare of the parties would not be maximized via a breach. If the damages are set at a higher level, or if specific performance is required, promisors may be deterred from breaching in cases in which the cost of performance is higher than the value of the performance to the promisee, which is inefficient on its face. In addition, a higher level of damages increases the promisor's risk; some contractors may be unwilling to pay extra to compensate for this risk, so that contracts that could benefit both parties would not be made.

The economic arguments against the current rules tend to be more pragmatic objections rather than logical arguments. The truth is that most plaintiffs do not garner full expectation damages.¹² Because this is true, breach of contract is easier and less costly than it should be under an optimally efficient system.¹³

B. Moral Theories of Contract

Aside from practical objections to a system that does not always deliver the damages that it promises, there are also moral arguments against breach of contract. That is, we might think that a given breach is efficient but nonetheless immoral or unfair. The traditional moral view holds that a contract is a promise. The promise theory of contract relies on the underlying autonomy of individuals insofar as they can choose to obligate themselves in such a way that courts must respect (e.g., enforce) their self-imposed obligation.¹⁴ Under this theory, expectation

¹² See Shavell, *supra* note 5, at 451.

¹³ *Id.*

¹⁴ See FRIED, *supra* note 1.

damages are justified based on the freely-undertaken promise.¹⁵ Individuals are held liable not just for the harm they have caused with their unfulfilled promise, but for the value of the promise itself. Of course, descriptively speaking, not all promises are enforceable.¹⁶ Some theorists hold this as partial evidence that it is not the promise itself that confers the legal obligation upon the parties, but their consent to be held legally accountable for their promise that makes the promise enforceable.¹⁷ In either case, the notion of a promise is central to a legally enforceable contract, which means that breaching a contract is morally wrong because it requires breaking a promise.

In his recent paper on morality and breach of contract, Steven Shavell suggests that the adequacy or inadequacy of actual damages at law is a key to understanding the morality of breach of contract.¹⁸ His argument is as follows: In most cases, parties do not discuss every contingency, and so there is a good chance that a given situation is not addressed specifically in the terms of a contract.¹⁹ Therefore, "performance is morally required in a contingency if and only if the parties did specify, or would have specified, performance in that particular contingency."²⁰ Shavell argues that the automatic or intuitive response may be to classify all contingencies not explicitly excused by the contract as immoral breach, but that on reflection, there are clearly some cases in which the particular contingency at issue has not been explicitly provided for in the contract but would have been excused had it been written in.²¹ The puzzle is to determine when breach is immoral in the case of incomplete contracts.

¹⁵ *Id.* at 18-20.

¹⁶ Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

¹⁷ See Randy E. Barnett, *Some Problems with Contract as Promise*, 77 CORNELL L. REV. 1022 (1992); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986)

¹⁸ See Shavell, *supra* note 5, at 450.

¹⁹ *Id.* at 441.

²⁰ *Id.* (quoting Oliver W. Holmes, *The Path of Law*, 10 HARV. L. REV. 457, 462 (1897)).

²¹ *Id.* at 455.

Shavell argues that under the expectation measure of damages, breach of contract will occur only insofar as the cost of performance is higher than the value of performance to the promisee, and, furthermore, that in such circumstances we can assume that the complete contract would have excused the promisor from performance. He offers evidence that most people, in fact, implicitly share this theory of contracts. People are more likely to find a breach of contract to be morally acceptable when parties know that the contract would have excused the promisor under the circumstances. Shavell notes that his analysis yields a result similar to the theory of efficient breach, though he argues that this is essentially coincidental since his analysis makes no reference to aggregate social welfare.

The argument, then, is that rational people do not agree to contracts in which they will be forced to perform even when the cost of performance is higher than the benefit to the promisee. As long as damages are set at the level of the promisee's expected benefit—the expectation measure of damages—we can assume that parties will not breach unless the cost of performance exceeds the cost of paying expectation damages. And, if this does happen, it is not immoral, because had the parties written such a contingency into the contract, they would have agreed that the promisor should be excused.

The issue that we will take up in this paper is what it means that the "cost" of performance has become too high. Shavell offers situations like rising costs of materials or unexpected loss of equipment.²² In these cases, something beyond the control of the promisor has happened to make the contract unprofitable. However, in some cases (maybe all cases) we should think of a foregone gain as a cost. So, when the promisor is offered three times as much money to do a similar job, the cost of performance now includes opportunity costs. Shavell

²² *Id.* at 453-454.

seems to mean to include such a case within his definition of cost, and he makes reference to such a case in a footnote.²³ And, in fact, this may be the right argument assuming that both parties are rational. However, Shavell wants to claim that his theory, which relies partially on this assumption of rationality, is in accord, to some extent, with people's moral intuitions.²⁴ It seems plausible, however, that given evidence of the widespread bias of loss aversion²⁵, as well as moral heuristics against profiting from wrongdoing, Shavell's definition will not mirror people's intuitions.

Seana Valentine Shiffrin has recently drawn explicitly on the importance of intuitions about promises for the morality of breach of contract.²⁶ She documents various ways in which contract law is not in accord with the moral rules of promising, and argues that at least some of these divergences are counterproductive for a society in which we want to foster moral agency. Even the promise theory of contracts, for example, claims that expectation damages are justified based on the idea of enforcing self-imposed promissory obligations—but it is not the promise that is enforced, it is the damages remedy for nonperformance. Shiffrin argues that moral norms demand specific performance of a promise, not money damages.²⁷ Contract law does not enforce an agreement that lacks consideration²⁸, but a person would be morally required to fulfill a promise given without expectation of a return benefit.²⁹ A person who promises to do some act is

²³ *Id.*, n. 34 (“Also of possible importance are contingencies in which the seller might be offered a high price to clear snow for someone else.”)

²⁴ *Id.*

²⁵ Daniel Kahneman & Amos Tversky. *Prospect Theory: An Analysis of Decision Under Risk*. 47 *ECONOMETRICA* 263 (1979) (citing studies that people are more sensitive to losses than they are to gains, and that they are highly influenced by the description of the status quo).

²⁶ Seana Valentine Shiffrin, *The Divergence of Contract and Promise*. 120 *HARV. L. REV.* 708 (2007).

²⁷ *Id.* at 723.

²⁸ *RESTATEMENT (SECOND) OF CONTRACTS* § 71

²⁹ Shiffrin, *supra* note 26, at 736.

promising just that, not to either do the act or pay some equivalent. A moral rule would also condemn the intentional promise-breaker, but the legal rule imposes no punitive damages or sanctions for willful breach.³⁰ In the empirical studies reported below, we explore some of these tensions between the moral rules of promise and the legal rules of contract.

C. Norms, Schemas, and Intuitions in Contract Law

Researchers have long noted the importance of intuitions and norms for contractual relationships. Stewart Macaulay introduced empirical research methods to contract law in 1963.³¹ He reported that many, if not most, businessmen evinced a preference for relying on “common honesty and decency” or industry and social norms rather than formal contracts. “Commitments are to be honored in almost all situations; one does not welsh on a deal.”³² More recently, behavioral researchers have begun to elaborate on the notion of what it means to honor a commitment. Sandra Robinson and Denise Rousseau introduced the concept of the “psychological contract,” a construct meant to encompass the beliefs or perceptions of the parties about the conditions of a reciprocal exchange.³³ This is particularly apt in the employment context, their primary focus, because even when a written employment contract exists, it is unlikely to iterate the various contributions, obligations, and inducements that characterize an employer/employee relationship over time. Robinson and Rousseau found that perceived violations of the psychological contract have real effects for employers, including higher turnover and lower employee satisfaction. Like Macaulay’s study, their research suggests that parties look to moral norms governing the unwritten contract to define the notion of performance

³⁰ *Id.* at 738.

³¹ Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

³² *Id.* at 63.

³³ Sandra L. Robinson & Denise M. Rousseau, *Violating the Psychological Contract: Not the Exception but the Norm*, 15 J. ORG. BEH. 245. (1994).

and breach. And, in fact, the central issue seems to be trust; in a separate study, Robinson found that loss of trust mediated the relationship between psychological contract breach and subsequent employee contributions and performance.³⁴

One might object that this research is inapplicable to situations in which a written contract exists. When the contract is explicit, presumably parties are less reliant on their intuitions and schemas to define their rights and obligations. At least one legal scholar has suggested that contract law is responsive to the constraints of bounded rationality. Melvin Aron Eisenberg has argued that many doctrines of contract law, including rules governing liquidated damages, form contracts, and express conditions, can be explained or justified with reference to limits on human cognition.³⁵ In the case of liquidated damages, for example, he notes that it is particularly difficult to calculate the appropriate application of liquidated damages to every breach scenario. Even if it were possible to do so, parties are likely to overestimate the likelihood and the value of performance because they are often overly optimistic and unduly focused on the present intention to perform at the cost of considering possible circumstances that might cause a breach.³⁶

In this paper, we argue that even when a contract is formal and explicit, intuitions and schemas matter. First, they affect parties' perceptions of the written contract. An interesting line of research demonstrates the relevance of contract schemas even in the presence of actual contracts. Dennis Stolle and Andrew Slain studied the effects of exculpatory clauses in contracts

³⁴ Sandra L. Robinson, *Trust and Breach of the Psychological Contract*, 41 ADMIN. SCIENCE Q. 574 (1996).

³⁵ Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STANFORD L. REV. 211 (1995).

³⁶ *Id.* at 227-228.

on consumer behavior.³⁷ They found that exculpatory language in a standard form contract had a deterrent effect on subjects' likelihood to seek compensation, even when, from a legal perspective, it is not clear that the exculpatory clause would be enforceable. Parties' beliefs about the contract were informed by the terms of the contract itself as well as their intuitions or beliefs about contracts in general, namely, that they are enforceable as written.

People's beliefs about contracts may also be affected by their moral intuitions, even when those intuitions are inconsistent or unreasonable. Cass Sunstein has recently catalogued a partial list of moral heuristics—short-cuts, or rules of thumb—that people use in order to make moral judgments.³⁸ A heuristic need not be normatively wrong in an absolute sense; rather, heuristics are just simple rules, often rules that are useful in most of the cases in which they apply. Nonetheless, as Sunstein argues, moral judgments based on these kinds of rules of thumb may be less sound than moral judgments that result from deliberative reasoning.³⁹ In this paper, we will be considering the kinds of heuristics that might affect moral judgment in the field of contracts.

In efficient breach of contract, each party ends up in an equal or better position than she would have had the contract been fulfilled. However, in (idealized) practice, when the promisor breaches in order to take advantage of an opportunity to gain, this means that the promisee gets what she expected, and the breacher gets more than she would have gotten. Thus, it is plausible to frame the promisee's allocation as disadvantageously inequitable, assuming we want to think about fairness in terms of a comparison between these two individuals. Empirical evidence from

³⁷ Dennis P. Stolle & Andrew J. Slain, *Standard Form Contracts and Contract Schemas: A Preliminary Investigation of the Effects of Exculpatory Clauses on Consumers' Propensity to Sue*, 15 BEH. SCIENCES AND THE LAW 83 (1997).

³⁸ Cass Sunstein, *Moral Heuristics*, 28 BEH. & BRAIN SCIENCES 531 (2005).

³⁹ *Id.* at 534-535.

experimental economics and psychology indicates that this framing is, in fact, typical.⁴⁰

Distributive justice, or fairness, is an important factor in many decisions about allocation of resources.⁴¹ This is true even when the “fair” distribution is economically inefficient. For example, in the traditional operation of the Ultimatum game, people reject inequitable offers from a partner, even though the rejection means they will get nothing rather than the small sum they were offered.⁴² The inference, then, is that people prefer to enforce a “fair” distribution, even if it is inefficient (and, in some cases, personally costly).

Arguments from moral theory and arguments from economic theory might agree on the basic premise that rational parties would not agree to a contract in which specific performance were required under circumstances in which the cost of performance is higher than the value of the contract to the promisee.⁴³ In a system in which specific performance were enforced (or the penalty for breach exceeded expectation damages), the cost of contracting would rise. Sellers would either charge more as a result of having to assume more risk, or parties would be unable to reach an agreement, because the risk of being stuck in an unprofitable contract would become too high. Though this argument from rational actor theory may seem obvious to legal scholars, it is quite complicated and, we think, is unlikely to appeal to most people's intuitions. The problem is that in a breach of contract case, the most salient aspects of the breach are the broken promise and the risk of monetary loss to the promisee.

Edward McCaffery and Jonathan Baron have found that people ignore or minimize the long-term or indirect effects of economic policies, and fail to think through the implications of

⁴⁰ See Daniel Kahneman, Jack Knetsch & Richard Thaler, *Fairness and the Assumptions of Economics*, 59 J. BUSINESS 285 (1986).

⁴¹ See Linda Skitka & Phil Tetlock, *Allocating Scarce Resources: A Contingency Model of Distributive Justice*, 28 J. EXPERIMENTAL & SOC. PSYCH. 492 (1992).

⁴² Kahneman, Knetsch & Thaler, *supra* note 40.

⁴³ See Shavell, *supra* note 5; Kronman, *supra* note 9. *But see* Shiffrin, *supra* note 26.

policies with hidden costs, a phenomenon they call “isolation effects.”⁴⁴ In one set of experiments, the authors asked subjects questions about how to pay for a public good like health care. In the first round, subjects favored a tax on business profits over increased income taxes, and they preferred a system of tax deductions to a system in which the government would pay directly for a program. Subjects were then asked a series of question about the effects of the policies that they chose, e.g., what the subject would do if she ran a business that had to pay increased taxes (reduce wages, increase prices, etc.). Subjects were then asked to give their policy preferences again. By prompting subjects to think about the indirect effects of each policy, the researchers were able to affect their policy preferences.⁴⁵ This research suggests that people do not automatically think about indirect or hidden effects of fiscal policies. Rather, they focus on salient cues about immediate effects. The salient issue in a tax policy is "Who pays?" and it looks like an income tax means that I pay whereas a business tax means that someone else pays.⁴⁶ Similarly, in a breach of contract case, it is cognitively easier and more intuitive to frame the interaction in terms of which party bears the burden (and which party reaps the profit) of the immediate breach than it is to take into account the relationship between the penalty for breach and the ability of the parties to reach an agreement in the first place.

Isolation effects may be especially strong in cases with very salient moral cues. Jonathan Baron and Ilana Ritov have studied intuitions about penalties and compensation in tort law.⁴⁷ They presented subjects with scenarios describing tort cases and ask the subjects to indicate how much they would pay. Cases differed in terms of a variety of moral cues (whether the harm was

⁴⁴ Edward McCaffery & Jonathan Baron, *Isolation Effects and the Neglect of Indirect Effects of Fiscal Policies*, 19 J. BEH. DECISION MAKING 1.

⁴⁵ *Id.* at 5.

⁴⁶ *Id.*

⁴⁷ Jonathan Baron & Ilana Ritov. *Intuitions about Penalties and Compensation in the Context of Tort Law*, 7 J. RISK & UNCERTAINTY 33 (1993).

caused by a person or by nature, by an act or an omission), and cases also differed in terms of the deterrent effect on future behavior. Subjects were told either that punishment would deter future malfeasance, that punishment would have no effect at all, or that punishment would overdeter the tortfeasor and decrease its contributions to the social good.⁴⁸ Though subjects were highly sensitive to the moral distinctions, they ignored the information about deterrence altogether, uniformly imposing punishments based on the moral rule that the punishment should be proportionate to the outrageousness of the act, whether the punishment would be useful, pointless, or even harmful.⁴⁹ In breach of contracts cases, people must make similar judgments. Our hypothesis is that they will be highly sensitive to the moral implications of efficient breach, ignoring the incentive effects of various possible policies.

Cass Sunstein has described the "outrage heuristic" in multiple contexts.⁵⁰ The idea is this: "Punishment judgments are rooted in a simple heuristic, to the effect that penalties should be a proportional response to the outrageousness of the act...People's punishment judgments are a product of their outrage."⁵¹ Cass Sunstein, David Schkade and Daniel Kahneman conducted experiments in which they varied the degree of wrongdoing/moral outrage as well as the likelihood of detection.⁵² Like Baron and Ritov, the authors found that subjects' punishment judgments were responsive only to the outrage manipulation, not to the likelihood-of-detection manipulation.⁵³ One particularly relevant instigator of moral outrage is betrayal. Some

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Daniel Kahneman, David Schkade & Cass Sunstein. *Shared Outrage and Erratic Awards: The Psychology of Punitive Damages*, 16 J. RISK & UNCERTAINTY 49 (1998); Cass Sunstein, David Schkade & Daniel Kahneman. *Do People Want Optimal Deterrence?* 29 J. LEGAL STUD. 237 (2000).

⁵¹ Sunstein, *supra* note 38, at 538.

⁵² Sunstein, Schkade & Kahneman, *supra* note 50.

⁵³ *Id.*

researchers have found that people are more averse to risks that come from products designed to promote safety.⁵⁴ This evidence suggested to us that people might also be more averse to losses coming from someone who has promised to confer a benefit (e.g., a promisor) than from someone with a neutral status (say, a negligent tortfeasor).

With the legal, moral, and economic arguments of normative theorists in mind, and in light of evidence from psychology and behavioral economics, we undertook empirical research to examine the nature of moral intuition and moral judgment in breach of contract cases.

II. EMPIRICAL STUDIES

Subjects in all studies were members of a panel recruited over a 10-year period, mostly through their own efforts at searching for ways to earn money by completing questionnaires. Approximately 90% of respondents were U.S. residents (with the rest mostly from Canada). The panel is roughly representative of the adult U.S. population in terms of income, age, and education⁵⁵ but not in terms of sex, because (for unknown reasons) women predominate in our respondent pool (72% in this study).

For each study, we sent email to about 500 members of the panel, saying how much the study paid and where to find it on the World Wide Web. Each study was a series of separate web pages, programmed in JavaScript. The first page provided brief instructions. Each of the others presented a case, until the last, which asked for (optional) comments and sometimes contained additional questions. Each case had a space for optional comments. (We report some comments in the discussion of the results to suggest possible conclusions and implications of the

⁵⁴ Jonathan Koehler & Andrew Gershoff. *Betrayal Aversion: When Agents of Protection Become Agents of Harm*, 90 *ORG. BEH. & HUM. DEC. PROCESSES* 244 (2003).

⁵⁵ Linda Babcock, Michelle Gelfand, Deborah Small & Heidi Stayn. *The Propensity to Initiate Negotiations: Toward a Broader Understanding of Negotiation Behavior*. Manuscript, Carnegie-Mellon University (2003).

quantitative results. Because they were optional, comments were not coded and analyzed systematically.) Otherwise the subject had to answer all questions in order to proceed. The order of cases was randomized (with one exception). The study was removed when about 75 responses had been submitted, with a target of 80. The studies are all available at <http://www.psych.upenn.edu/~baron/tess/>.

A. Survey

1. Methods

Our first questionnaire was a straightforward survey without experimental manipulations. 82 subjects responded to a questionnaire on the World Wide Web.⁵⁶ We presented subjects with a series of breach of contract cases and asked them to indicate the optimal level of damages. Subjects also responded to questions about the moral implications of the breach. As this study was something of a pilot effort, we used six different sets of facts, ranging from a business-to-business contract for the delivery of goods to a contract between a tailor and a bridesmaid.

Below is a sample scenario:

Catherine hires a tailor to make her a dress for her sister's wedding. The dresses she likes tend to retail for \$1,000, which she would be willing to pay if necessary, but she is able to negotiate a lower price with a tailor. The tailor knows that he would need at least \$550 to make this job worth his time, and they agree on a price of \$700. Catherine chooses a pattern and picks out fabric, and is very excited about the dress. However, two weeks after she signs the agreement of sale, the tailor calls to tell her that he will no longer be able to make the dress. The demand for custom-made clothing in the area has recently increased dramatically due to the revitalization of the downtown theater district; the tailor has accepted a very lucrative contract to make costumes for the entire cast of *Les Misérables*.

We asked subjects to indicate the optimal level of damages that the promisor should pay in the event of breach and to report how guilty the promisor should feel for breaching the contract and paying damages instead of performing. The questions corresponding to the previous

scenario were as follows:

Imagine that you are acting as an impartial mediator in this situation, and you must decide whether and how much the tailor should compensate Catherine for breaking their deal. How much should the tailor pay Catherine?

1. No compensation
2. More than nothing but less than \$300
3. \$300
4. More than \$300 but less than \$450
5. \$450
6. More than \$450 but less than \$700
7. \$700
8. More than \$700

Assume the tailor has two options. Legally, he can pay the fee that you have indicated above, or he can honor the contract. Should he feel guilty if he pays the fee and breaks the contract?

Subjects checked a box next to “yes,” “no,” or “not sure.”

Finally, we asked subjects to report on the overall fairness of each possible solution, from no damages to enforced specific performance:

For each of the following options, indicate whether this solution is fair overall:

Tailor breaks the contract, and pays no compensation.

Tailor breaks the contract, and must pay Catherine less than \$300.

...

Tailor breaks the contract, and must pay Catherine more than \$700.

Tailor is not permitted to break the contract, and must do the job."

2. Results

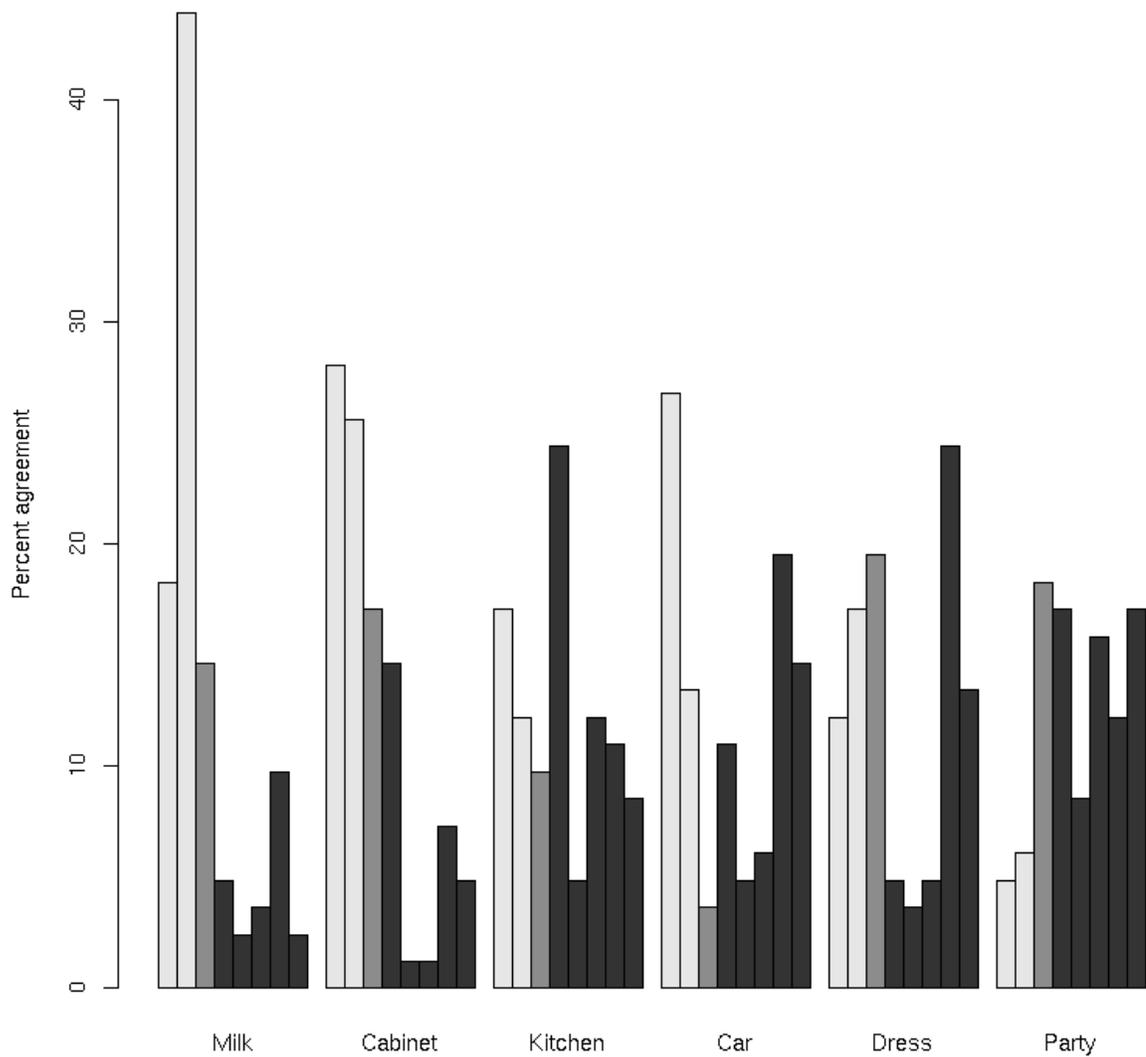


Figure 1 shows the distribution of damages responses for each case on the 8-point scale. The medium gray bar represents expectation damages. It is apparent that, for all cases, some subjects wanted to award more than expectation. This effect was strongest in the "Party" case, in which a restaurant canceled a planned wedding anniversary, although a similar space was available elsewhere (for a higher cost), and in the "Dress" case (shown above), in which a tailor reneged on a contract to make a less-expensive copy of a dress that was available elsewhere. In

both cases, the contractor reneged because a better deal came along. The effect was smallest in the "Milk" case, where a farmer reneges on a contract to sell milk because his costs have increased (and he can sell the milk for more elsewhere, covering the cost).

Sixty (73.2%) of the 82 subjects felt that in at least some cases, mandatory specific performance would be a fair solution, and a few subjects thought that the only "fair" response was to honor the contract. This happened most often in the Party case (8 subjects), the Dress case (6, tied with one other case), and least often in the Milk case (1, tied with one other).

The responses to the question about whether the breacher should feel guilty, even after paying damages, were similar across the 6 cases. On the whole, 35% of the responses were that the breacher should not feel guilty, 16% were unsure, and 49% thought that the breacher should feel guilty even after compensating the promisee. Responses to the guilt question were related to those about the compensation question. When the compensation was less than expectation, subjects endorsed guilt only 27% of the time. When compensation was equal to expectation, they endorsed guilt 57% of the time, and, when greater than expectation, 63%. The rank-order (Kendall's tau) correlation of the compensation response and the guilt response was significant across subjects for 5 of the six cases. Thus, the higher a subject's chosen level of compensation, the higher his estimation of the breacher's guilt upon paying the damages and breaking the contract.

B. Experiments 1 & 2: Moral and Immoral Motives

The results of our survey suggested that subjects often find breach of contract to be morally wrong, even when the breacher pays full expectation damages. We also noted the logically odd result that moral culpability was positively correlated with the amount of damages paid by the breacher; breachers who paid more were also found to be more guilty (in the sense

that subjects thought that feeling guilty was appropriate).

One of the basic questions of this research is whether people are sensitive to morally salient information in breach of contracts cases; initial results suggested that our subjects were using their moral responses in order to evaluate the appropriate penalty for a breach, when its consequences were fully financial. In a set of experiments, we addressed this question more directly by comparing two cases in which the economically relevant facts were identical, but in which the motives of the breacher were different. Thus, in one case, the breacher was breaching in order to avoid a loss caused by the rising cost of materials. In the other case, the breacher wanted to breach in order to take a more lucrative contract elsewhere. Legally and economically, these cases are identical. Thinking about the cases from a moral perspective, though, subjects may take into account the actor's motives. A plausible moral rule (or heuristic, as the case may be) is that a person should not profit from wrongdoing. Thus, we predicted that subjects would impose higher penalties in a breach to gain case than in a breach to avoid loss case, and that they would find the former more morally objectionable than the latter.

It is important to note here that this hypothesis depends on the underlying assumption that subjects will treat gains differently from avoided losses. In both cases, the breacher will make more money by breaking the contract than by honoring it. However, we assume that subjects will be more sympathetic to a contractor facing a loss from the status quo than to the loss that results from a foregone gain. In the first experiment, we used a within-subjects design, so that each subject evaluated the same case in each condition, a breach to gain and a breach to avoid loss. In this kind of experiment, the subject has the opportunity to consciously consider the hypothesis, since it is fairly transparent. In the second experiment, we simply wanted to replicate these results in a between-subjects design. Thus, subjects in this experiment saw either the breach to

gain scenario or the breach to avoid loss scenario, and simply evaluated the situation without comparison to the other condition.

In these experiments, we also investigated some secondary questions. We wanted to know whether the time of the damages negotiation would matter. At the time of contract negotiation, it is plausible that the implications of excessive damages (promisor not agreeing to the contract) would be more salient to the potential promisee, while the moral outrage from the broken promise would be less salient. In fact, if it is the outrage response or the salience of the moral violation, we would also expect subjects to be less punitive at any time before the breach than they are once the breach has occurred.

Finally, we wanted to collect initial data that would help us understand the origins of subjects' punitive attitudes toward breach of contract cases. One possibility was that subjects were not being prompted to think of the economic consequences of their judgments; that they were not calculating the costs in a way that would allow them to see that expectation damages would fully compensate the promisee. Another implication of the misunderstanding hypothesis is that subjects would not see the economic incentives for expectation damages, both from the point of view of general economic welfare and from the point of view of the promisee, who would be unable to secure a contract at all under a system in which the penalties for breach were so burdensome as to be a deterrent to contract at all. Another possibility is that subjects would explicitly choose to impose an additional penalty, reasoning that the breach was a moral harm of some kind and therefore should be discouraged. In Experiment 2, we asked subjects to indicate the optimal level of damages overall, then from an economic point of view, and finally from a moral point of view.

1. Methods

88 subjects participated in Experiment 1; 67% were female.⁵⁷ Subjects ranged in age from 18 to 64, with a median age of 35.5. In Experiment 2, 83 subjects participated with 78% female. Ages ranged from 22 to 69, with a median age of 42.

In Experiment 1, subjects saw three core scenarios, each of which described the facts of a breach of contracts case. The first two scenarios had two versions apiece; in the breach to avoid loss version, the promisor breached in order to avoid an unexpectedly unprofitable performance, and in the breach to gain version, the promisor breached in order to accept a more lucrative contract elsewhere.

To test the effect of timing, the third scenario (the "Party") appeared three times, and each time the circumstances of the damages negotiation was changed. In the first version, a liquidated damages clause was negotiated at the time of contract. In the second version, the promisor approached the promisee with a request to negotiate an amount that would release him from the contract. Finally, in the third version, the breach is a foregone conclusion and the promisee is not invited to negotiate the damages amount; rather, it will be imposed by a third party.

In this study, each subject saw every version of every scenario. After each scenario, subjects answered a series of questions about the case. First, subjects were asked to choose an appropriate amount of damages. We constructed an eight-point scale based on the available numbers in the scenario.⁵⁸ For these cases, subjects could choose among the following 8 options: no compensation; a number between nothing and expectation damages (e.g., "more than 0 but

⁵⁷ There were no significant differences in mean compensation on the basis of subject sex.

⁵⁸ Because we had some concerns that responses would be driven by subjects' anchoring to the figures in each scenario, each point on the scale uses salient numbers from the scenario. This way, when we see subjects choosing one level of damages over another, we can be more confident that they are not simply choosing the most arithmetically straightforward number. In Experiment 3, we replicated these results with open-ended response format.

less than ...”); expectation damages; a number between expectation damages and the difference between the buyer's reserve and the seller's reserve; the difference between the buyer's reserve and the seller's reserve; more than the difference between buyer's reserve and seller's reserve but less than the contract price; the contract price; or a number greater than contract price. For the purposes of analysis, we used the choices as points on a scale from one to eight. Subjects were also asked to indicate to what extent the breacher should feel guilty should he choose to pay the damages and break the contract. Here is a sample scenario with questions:

In January, a homeowner and a contractor negotiate an agreement for the contractor to renovate the homeowner's kitchen. They agree that the contractor will complete the project over the summer. The value of the project to the homeowner (including timely completion) is \$23,000. That is, if she could not find anyone to do it for less than \$23,000, she would not do it at all. The renovator appraises the work and decides privately that he will not do it for less than \$14,000. They negotiate a contract for \$20,000 (to be paid on completion of the project) and agree that the contractor will begin work in June. In May, however, the contractor learns that there is a shortage of skilled renovators in a nearby area, and he could charge much more there for a similar project. He decides to break his contract in order to take other, more profitable work.

Imagine that you are acting as an impartial judge in this situation. You cannot force the contractor to renovate the homeowner's kitchen. Rather, your job is to decide whether the contractor should pay the homeowner to compensate her for the broken contract. How much should the contractor pay to the homeowner? (Choose one)

1. No compensation
2. More than nothing but less than \$3,000
3. \$3,000
4. More than \$3,000 but less than \$9,000
5. \$9,000
6. More than \$9,000 but less than \$20,000
7. \$20,000
8. More than \$20,000

Imagine that the contractor has a choice: to break the contract and pay the homeowner the amount you have specified or to follow the terms of the original contract. To what extent should the contractor feel guilty if he chooses to pay to break the contract? (Choose one)

1. Not guilty at all
2. Somewhat guilty

3. Very guilty

In Experiment 2, we used one of the scenarios from Experiment 1 in a between-subjects study. 40 subjects read a breach to gain scenario, and 43 subjects read a breach to avoid loss scenario.

2. Results

In both within- and between-subjects experiments, subjects imposed higher damages assessments on promisors who were breaching the contract because they had been offered more money elsewhere than on breachers who were trying to avoid taking a loss due to a rising cost of materials. In Experiment 1, in the kitchen renovation scenario, the mean in the breach to gain condition was 3.56, as compared to 3.22 in the avoid loss condition. In the tailor scenario, the mean was 3.97 in the breach to gain condition and 3.55 in the breach to avoid loss condition. These differences were significant (by Wilcoxon tests) at the $p < .05$ level for each scenario separately and also when we analyzed the scenarios in aggregate (comparing subject responses to the breach to gain scenario with responses to breach to avoid loss scenarios, using only whether the response was greater than, less than, or equal to expectation, i.e., the sign of the difference).

In the breach to gain cases, subjects imposed damages at a level significantly higher than expectation (Wilcoxon test based on the sign: $p = .019$), whereas the mean damages assessed for the breach to avoid loss cases was not significantly different than expectation ($p = .49$). The difference between the analyses of the cases is even greater in Experiment 2, where subjects who saw the breach to gain scenario set the damages at a mean level of 4.08, while subjects who saw the breach to avoid loss scenario set the level of damages at 3.14 ($p = .0067$ for the difference, Wilcoxon test).

Subjects imposed lesser damages on the breacher when the damages were negotiated

rather than imposed after the breach. Recall that we used three conditions: a liquidated-damages clause in the contract; a request to be released from the contract; and a simple breach. The mean scale values for compensation (where expectation damages are 3) were, respectively, 4.51, 4.53, and 4.88. The three conditions differed by a Friedman test ($\chi^2=6.58$, 2 df, $p=.0372$). The first two conditions did not differ, but the request and simple breach differed significantly by a Wilcoxon test ($p=.0280$). In sum, subjects favor lower damages when the damages are negotiated in advance, either when the contract is made or the breach is being considered.

Subjects reported that a breach for gain (accompanied by full damages at a level specified by the subject) should make the breacher guiltier than a similar breach committed to avoid a loss, in Experiment 1. On a three-point scale of guilt from not guilty at all to very guilty, subjects assigned a quarter-point (.256) more guilt to breachers-for-gain. The difference was statistically significant ($t = 4.8251$, $df = 87$, $p<.0001$).

We thought that subjects might indicate that the economically optimal level of damages would be lower than the level that they set for the breacher. They did not. In fact, they assessed higher compensation in the economic question than in the original compensation question (higher in 17% of the items and lower in 9%, the difference significant by a t-test across subjects on the sum of the sign of the differences: $t(87)=2.85$, $p=.0054$ in Experiment 1; the result was also significant in Experiment 2).

As we expected, subjects did assign higher damages for the morality question than the original compensation question (higher in 26%, lower in 7%, $t(87)=5.81$, $p<.0001$, in Experiment 1, replicated in Experiment 2).

C. Experiment 3: Is a contract a promise?

In the first two experiments, our results suggested that people often find breach of

contract to be morally objectionable even when breachers pay full expectation damages or more, and that people are often willing to impose damages well above expectation level. In this study, we want to ask what, exactly, is the moral content of a contract. Our hypothesis is that subjects consider a contract to be a promise, and that they employ a moral rule or heuristic that dictates against breaking a promise. One possible view here, of course, is that as long as the promisee is fully compensated, the promise is not broken at all. We think, though, that this is not the view that subjects are likely to take. There is something distasteful about paying one's way out of a moral obligation.

In order to test this experimentally, we compared breaking a contract to causing the same harm without a contract, hence without a promise. Each of three scenarios was presented in two different versions. In one version, subjects read a case of efficient breach, in which the promisor breaks the contract in order to accept a more lucrative contract elsewhere. In the control condition, the same contract is rendered impossible to complete when a third party negligently causes a harm that in turn prevents performance. In this case, we are asking subjects not about the damages that would be paid by the promisor (who is presumably excused from the contract), but rather the liability damages paid by the third party. So, for example, either a contractor breaks the contract to take another job, or a contractor is prevented from completing the contracted-for job because of a gas leak negligently caused by a third party. Thus, in each condition, the financial harm is identical, and the harm is confined to the harm of not being able to realize the benefit of the contract.

In this study, we made several important changes and additions. First, we asked subjects to name the dollar amount of damages themselves, rather than asking them to choose among levels of compensation as in the first two studies. Though this method introduces the problem of

anchoring effects (and subject typing errors), it permits subjects to name an exact amount of damages. Second, we directly asked subjects about the morality of the act of breaching the contract rather than relying on the subjects' assignment of guilty feelings to the breacher (or on the appropriate compensation from a moral point of view). Third, we asked subjects what the promisor *should* do (breach or perform), and whether the law should force the promisor to honor the contract.

1. Method

80 subjects answered a questionnaire on the World Wide Web. 76.3% of subjects were female. Subjects ranged in age from 24 to 79, with a median age of 44. Subjects read seven scenarios and answered questions about each. In this study, there were four core scenarios describing a contract. Below is one example:

Scenario:

The Millers are getting ready to sell their condo. Their real estate agent tells them that their condo will be worth \$10,000 more if they get the floors refinished (and you should assume that the agent is correct). They meet with Todd, from Todd's Hardwood Floors, agree on a price of \$6,000 to refinish the floors, and they all sign the contract. Todd is going to refinish the floors right before the condo goes on the market in early October.

Three of these scenarios were presented in one of two conditions, the promise condition and the no-promise condition.

Promise Condition:

About three days before he is slated to work on the Millers floors, Todd gets an offer to refinish all of the floors in another apartment building. If he accepts this offer, he will make much more money, but he will not be able to refinish the Miller's floors. Todd decides to take the new job and break his contract with the Millers.

No Promise Condition:

About three days before Todd is slated to start working on the Millers' floors, the owners of the next apartment down, the Bakers, are trying to move a gas line in their own condo, even though it is quite dangerous. They do not take proper precautions and the line

breaks, gas leaks, and the Millers' apartment is too toxic for Todd to do his work. The Millers have already moved into their new home, so they are not personally affected by the fumes. However, the fumes are quite toxic in the Millers' condo for more than a week, so Todd is unable to refinish the floors before the condominium goes on the market. (Note that Todd does not need to be compensated, because he gets a similar, highly paying job for the same week once he is released from his contract with the Millers.)

In this study, we blocked the conditions. This means that half of the subjects first saw each scenario in the promise condition, and then saw each scenario in the no promise condition; the other half of the subjects saw the scenarios in the reverse order (first all no-promise, then all promise). Within the blocks, the order of scenarios was random. We did this for two reasons. The first is simply that we thought it would be less confusing for subjects. The second is that it permitted us to do between-subjects analyses of their responses. By looking only at the first block of responses for each subject, we can see their responses unaffected by their implicit comparisons to the other condition.

2. Results

Our between-subjects tests of guilt and morality indicate that subjects thought that a person who caused harm via breaking a contractual promise was more immoral and should feel more guilt than a person who caused harm via negligence. On a 7-point scale where 7 is extremely immoral and 1 is not immoral at all, the average rating of for a negligent wrongdoer was 3.3, and the average rating for a breacher who caused an identical loss was 5.1 (test of the difference is significant: $t=5.281$, $df=74.58$, $p<.0001$). Similarly, on a 7-point scale, subjects on average felt that a negligent wrongdoer's guilt should rate a 3.3, and a breacher's guilt should rate a 5 (Within-subject comparisons were also significant at $p<.001$. Test of the difference is significant: $t=4.686$, $df=76.01$, $p<.0001$).

The responses to the question about damages were open-ended, and their distribution was

highly skewed. Taking the logarithm removed the skewness, but the distributions still had long tails on both sides (i.e., an excess of extreme responses both high and low). Accordingly we report trimmed means (10% on each side) based on the logarithms, but we use nonparametric tests for inference.

Table 1 shows the means for each case in each condition, shown as a ratio of expectation damages (Thus, if the promisee’s expectation was \$1,000 and the average subject response was \$2,000, the ratio is 2. If the average subject response was \$1,000, the ratio is 1. This was based on the antilog of the mean log.)

	Case 1: Refinish Floors	Case 2: Landscape Yard	Case 3: Cater Party
Promise: Mean ratio	1.12	3.12	2.33
No Promise: Mean ratio	0.82	0.79	1.58

We analyzed the difference between the promise and no-promise condition in two ways. First, we looked at our between-subjects measure, comparing the promise responses of the group who saw the promise cases first to the no-promise responses of the group who saw the no-promise responses first. Though the pattern of means and log ratios were consistent with our hypothesis (higher damages in the promise condition), the test of differences was not statistically significant ($t=.4142$, $df=74.99$, $p=.6799$. The Wilcoxon test also showed non-significance.). We then looked at the within-subjects comparison. For this analysis, we simply took the mean of the difference of each subject’s promise and no-promise damages responses. This was a highly significant difference ($t=4.318$, $df=79$, $p<.0001$. Wilcoxon test, $p=.001$), meaning that when they saw both kinds of case, subjects imposed much higher damages overall in the promise cases than in the no-promise cases.

Finally, subjects were also inclined to report that the promisors should honor the contract

rather than pay damages and breach (even though it was clear in every case that the promisor would be better off by breaching). Responses were fairly consistent across cases, with an average of 75.8% of subjects responding that the promisor should honor the contract in a given case. Subjects also indicated that they thought that the law should force the promisor, in many cases, to honor the contract and perform. The average percentage of respondents who thought the law should require specific performance was 66.7%.

II. DISCUSSION & IMPLICATIONS

A. *Interpretation of Findings*

These results indicate that people are quite sensitive to the moral implications of breaching a contract, even when the breach would make at least one person better off and no one worse off than they would be under the terms of the contract. Subjects indicate that money is an insufficient proxy for performance. Subjects often levy damages above the expectation level, and report that a breacher would still be behaving immorally if he paid these high damages and breached the contract. Subjects distinguish between cases in which the promisor seeks to breach in order to avoid a loss of some kind and cases in which the promisor has been given a better offer; they impose higher damages on the latter and indicate that he should feel guiltier for his breach. They are not responsive to the economic incentives or the indirect effects of their judgments of high damages. Subjects report that a promisee should expect lower damages when the penalty for breach is negotiated between the parties and higher damages when the penalty is imposed by a third party. Finally, people think that a contract is a promise. These subjects reported this belief explicitly. They also imposed lower damages, and assigned less moral culpability to the breacher, in cases in which the failure to execute the contract was due to negligence (no broken promise) than cases in which the failure was due to a willful breach

(broken promise).

One of the questions motivating this research was whether breach of contract is judged to be immoral. In every case that we presented, including cases in which the promisor wanted to breach in order to avoid an unexpected loss, a majority of subjects reported that the breach was immoral or that the breacher should feel guilty even after paying the full amount of damages.

But what, exactly, is the moral harm in breaching a contract? In what sense do subjects believe that the promisee is injured, given that he is fully compensated for the breach with money damages? One important issue here seems to be that subjects believe that the promisee has been duped or disappointed in some way, and perhaps money damages will be unable to fully restore their interests. "Squirring out of a contract is dishonest. Period," commented one subject. "Your word should be your bond." For many subjects, it seems clear that a promise to complete a contract is not, as Holmes famously wrote⁵⁹, a promise to pay money damages in the amount of the promisee's expected benefit. A contract is a promise to perform. And, in fact, a majority of subjects reported that the law should force a promisor to perform in line with the terms of the contract. People's "expectation" is that the contract will be fulfilled, not that they will be paid.

Another possibility is that subjects were ignoring the question of money damages when they responded to questions about morality. In these experiments, we asked subjects to set the level of damages and then to imagine that the promisor is willing to pay those damages. The moral culpability of the breacher was positively correlated with the imposed damages. In other words, the more they paid, the more guilty they were (and vice versa). Surely, though, a

⁵⁹ Oliver Wendell Holmes, Jr., *The Path of Law*, 10 HARV. L. REV. 457, 462 (1897) ("The duty to keep a contract...means a prediction that you must pay damages if you do not keep it,--and nothing else....But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics in the law as they can.")

contractor who fully pays for a homeowner's losses is a better moral actor than one who offers no or inadequate compensation. The issue here may be that subjects assume that a contractor who is willing to breach is one who will try to get out of the contract without paying, if not for legal intervention. At first this seems like an actual error. Maybe subjects are actually not reading the morality questions and do not realize that we have stipulated that the breacher pays full damages. This could certainly account for some of our results. It also seems likely, though, that we are seeing subjects indicating their outrage and feelings of betrayal. There is a sense that trust (e.g., the kind of trust conveyed in a hand shake) has been violated, and that this is indeed separate from whatever money damages have been imposed on the breacher.

This issue of betrayal of trust may help to explain the results of our negotiated/imposed damages manipulation. In this manipulation, we found that subjects assigned higher damages to a breacher when the damages were imposed by a third party, than when the parties agree on a fee that the promisor must pay to be released from the contract. Interestingly, in Experiment 1 we did not find a difference between the *ex ante* and *ex post* determination of penalty. It was irrelevant to subjects whether the negotiation of damages took place at the time of contract or the time of breach.

What was highly relevant to subjects was the given reason for the breach of contract. Subjects thought that a breach committed in order to accept another more lucrative offer was more immoral and deserving of higher penalties than a breach committed in order to avoid a contract that had become unprofitable for some reason. Subjects' responses reflected this pattern whether we asked them to judge both cases in comparison or whether we asked two separate groups for their respective reactions to one version or the other. In other words, this was a very robust effect. On the economic theory, the two situations are virtually identical. In both cases, the

breacher faces a loss of some kind, either in real costs or in opportunity costs. This argument did not seem to appeal to our subjects, though. As one subject wrote, “I think it would be wrong for the contractor to cancel once he had agreed to complete a job. Especially since he is only canceling so that he can make more money.” Note that the latter statement is technically true in the case of the breach to avoid loss, too. In that case, the scenario stipulates that this particular job has become more costly due to a rise in the price of materials, so the contractor wants to cancel and take another contract that will be more profitable. But our subjects, like the subjects of other studies, find a loss from the status quo much more objectionable than a foregone gain, and they seem to expect the contractor to behave in line with this bias.

One thing that may be going on here is that subjects may be using a simple rule that says that a person should not profit from wrongdoing. Let us assume that the subjects consider the expected benefit from the contract to be the baseline entitlement of each of the parties. If a promisor realizes that he expected to make a profit but in fact he will just break even, he may breach the contract in order to take another contract in which he can expect more or less the originally-expected profit. In this case, the promisor has to do something morally wrong, but he does not “profit” from it as long as we use the original expected benefit as the baseline. The results of our studies suggest that subjects in this case will, on average, try to put the promisee in the position he would have been in had the contract been fulfilled, thus restoring both parties to baseline wealth. On the other hand, if the promisor realizes that he will be giving up a huge contract somewhere else with a chance to double his profit, his breach will result in a moral harm (breaking a promise) that leads to a profit. This seems quite unfair: one party does nothing wrong and (under the law) remains in the same position while the other party breaks his promise and gets a bonus. One way to rectify this discrepancy is to penalize the promisor at a higher level

such that the morally blameless party does not have to accept a disadvantageously unequal allocation.⁶⁰

B. A Promise Heuristic

The notion of promise is tightly bound to the layperson's concept of contract. Our results suggest that laypeople, like many scholars, think that the moral content of a contract lies in the promise. The concept of a promise, though, presumably has different dimensions in different contexts. When people rely on the traditional concept of promise to make moral judgments about contracts, they seem to apply moral rules from the domain of personal promises to the domain of commercial contracts. Our results in this domain are only suggestive, and we hope they will serve to motivate future research in this area.

Most people seem to think that a contract is a promise in the common sense of the word, and breach of contract is the moral equivalent of a broken promise. Seana Shiffrin adopts this reasoning when she argues that some laws of contract are counterproductive for a society that values moral agency.⁶¹ In a sense, Shiffrin's argument is based on the idea that a promise is a useful heuristic. "The use of a moral concept as shorthand is one way to make legal outcomes more accessible and to facilitate transparency," she argues. However, Shiffrin goes on to argue that the usefulness of the heuristic is justification (in fact, a mandate) for the legal system. "[I]f

⁶⁰ There may be a normative argument here in support of the subjects' position. That argument is this: If the promisor is offered more money by another party, there is a kind of surplus. Why should the promisor not have to share that surplus with the promisee? Economically, it is equally efficient for the promisor to accept the new contract and keep the entire surplus for himself or to take the new contract and to split the surplus profit with the original promisee. There may be other reasons, though, to think that the money should be shared between the parties. We have no evidence that our subjects were drawing on this rationale, but it does suggest a possible normative model that would lead people to set a higher damages level for breach to gain cases. It would not, however, help to explain the increased moral culpability of these breachers once they had paid these elevated penalties.

⁶¹ Shiffrin, *supra* note 26.

we invoke promises, directly or indirectly, we have a duty, taking something of the form of a side constraint, not to act or reason in ways that are in tension with the maintenance of a moral culture of promising."⁶²

This seems problematic, and the problem is illuminated by descriptive evidence about what constitutes the moral culture of promising. To the extent that we want to think about the “culture” as an empirical fact—e.g., what people believe and how they reason about moral problems—it relies heavily on moral heuristics, useful shorthand rules that may lead to faulty or even ridiculous conclusions when they are overgeneralized and misapplied. Take, for example, the situation in which a homeowner has made a contract with a flooring company to have his floors refinished. In this case, we assume that the homeowner has moved out of his home and is preparing to sell it. He is having his floors refinished in order to make a higher profit on the sale of his house. There seem to be good reasons to allow—and almost no reasons to forbid—the flooring contractor to simply pay the homeowner for the projected increased value of the house rather than to finish the floors. But our results show that the “moral culture” of promising would require performance.

The difficulty here may be an over-extension of the use of the idea of a promise. In typical usage, a promise is a promise to perform, not a promise to do something as valuable as performance. If my sister promises to come to my birthday party, it is not morally permissible for her to skip it so she can get her nails done and then to send me a check to cover the lost value of her companionship. One reason that it is not permissible for her to send me a check is because of the nature of our relationship. Most non-contractual promises happen between people in a non-

⁶² *Id.* at 749.

market-based relationship.⁶³ It would be weird and inappropriate to value my sister's company in terms of money. It would even be weird for me to charge her for more obviously market-like services. If she promised to take care of my dog for a day and then broke her promise at the last minute, it would nonetheless be odd for her to pay my kennel fee. This is not the situation, though, with the homeowner and the flooring contractor. Their promises are only commercial in nature, and the sole purpose of the contract is to provide each with a monetary benefit. In one of our studies, a subject wrote, "He will have to pay for his damage, as if money can ease a guilty conscience." This kind of reasoning makes sense in terms of a close relationship. You can't buy love, and we condemn those who would try. But this logic seems misplaced in the context of a contract for market labor.

There is also a sense, though, in which people seem to ignore the logical implications of equating a personal promise to a commercial contract. If my sister, who had promised to come to my birthday party, called me to tell me that she had been offered a free vacation to Hawaii during the week of my birthday, I would almost certainly relieve her of her promissory duty altogether. But if the flooring contractor calls to say he's been offered double the price to do someone else's floors, people seem less inclined to relieve him of his obligation to refinish the floors—even though he, unlike my sister, is going to pay the balance of the expected contractual benefit!

The idea of betrayal is closely linked to the promise heuristic. In this study, we find that subjects impose higher damages when the cause of the lost benefit is the promisor than when the harm is caused by someone who has not made any promises. If a friend promises to keep a secret

⁶³ In psychological terms, we might think of the subjects as applying rules from the communal sharing domain to the market pricing domain. See Alan Page Fiske, *The Four Elementary Forms of Sociality: Framework for a Unified Theory of Social Relations*, 99 PSYCH. REV. 689 (1992).

and does not, I am perfectly justified in feeling betrayed. I trusted her, and she let me down. Sunstein suggests that people may see a betrayal of trust as an independent harm. After all, in this case, that would make sense. Not only is my secret no longer a secret, but I also have a damaged relationship with my friend, which makes me unusually sad and perhaps more reserved in my other friendships. It is not clear, though, that this reasoning is helpful for thinking through breach of contract cases in the legal context. If expectation damages are to be fully enforced, the promisee's interests are protected. We can argue that interpersonal trust is either not required (because external sanctions exist to enforce the legal duties) or is not violated, because when the breacher pays damages he puts the promisee in the position she would be in had the breach not occurred. It seems as though people reason from a premise of trust, but in fact, the point of writing the contract out and making it legally binding is to obviate the need for trust.

Thus, people seem to think that the violation of trust resulting from the broken promise makes breach of contract a moral harm. In our studies, we also find that most people believe that the penalty for breach of contract should be set at a level higher than expectation damages. This conclusion about the penalty need not follow from the moral judgment. For example, many people believe that adultery is immoral but nonetheless do not believe that adulterers should be subject to legal sanctions. In these cases, though, more moral condemnation leads to higher damages. This finding is in line with studies of the outrage heuristic in torts cases. This is true even though there are (or should be) incentives to set damages at a reasonable level. We suggest that our subjects rarely think ahead so as to consider the effects of penalties on future contracts.⁶⁴

C. Implications for the Law

These findings suggest that people's moral intuitions about contract law may make

⁶⁴ See also McCaffery & Baron, *supra* note 24.

breach less frequent than is economically efficient, and may inhibit the parties' ability to settle out of court if there is a breach.

When parties disagree about appropriate damages in light of a breach of contract, they may be less likely to settle out of court and more likely to undertake litigation. A possible implication of our results is that parties will have different ideas about what constitutes a fair resolution. Of course, if people share moral intuitions about appropriate damages in the case of breach, they can simply ignore the law and settle on an amount in line with the moral norm. For at least two reasons, this seems like an unlikely result. First, in many contracts, a firm is more legally sophisticated than the consumer. The contractor knows what damages a court would impose, but the consumer feels surprised and cheated to learn that there is no specific enforcement and no punitive damages. Second, people often have self-serving biases, such that a party whose position is favored by the moral rule will rely on that rule to decide what would be fair, while the party whose position is favored by the legal rule will look there for a determination.⁶⁵

If parties think that a contract is a promise to perform, and not simply to confer a benefit as valuable as performance, they may be less likely to breach at all. For individuals who are not familiar with the rule of expectation damages (and we take this to be most laypeople), this would be true because they believe that they are legally (and morally) obligated to perform. Researchers

⁶⁵ For experimental data in support of this proposition, see Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. ECON. PERSP. 109 (showing experimental evidence that when a party believes she has offered a fair settlement and been rebuffed, she is more likely to suspect the other party of dealing in bad faith, which in turn makes the parties less likely to reach an agreement at all) and Tess Wilkinson-Ryan & Jonathan Baron, *The Effect of Conflicting Moral and Legal Rules on Bargaining Behavior: The Case of No-Fault Divorce*, forthcoming, *Journal of Legal Studies* (showing, in the context of divorce negotiation scenarios, that subjects are less likely to agree that a bargaining position is "reasonable" when the proposing party is believed to be morally culpable).

have found that people believe that exculpatory clauses in contracts mean that they cannot seek compensation.⁶⁶ A secondary finding in that line of research is that even though subjects believed that exculpatory clauses could legally relieve a firm's obligation to compensate its consumers for harms it had caused, they did not think that contracts with exculpatory language were less fair than contracts that left open the possibility of consumer compensation.⁶⁷ Our study offers a kind of extension to these findings. In both cases, subjects thought that the parties were legally and morally bound by the specific language of the contract, even when contract law says that the exculpatory clause is unenforceable or that the promisor can pay rather than perform.

More sophisticated parties may also be deterred from efficient breach because they do not want to offend their customers or get a bad reputation. As we discussed above, empirical research has demonstrated the real effects of psychological breach.⁶⁸ The loss of consumer trust may have financial effects that override the potential profits from the breach, no matter that the consumer's judgment seems irrational. Parties to a contract will have different interactions with one another and with the legal system depending on their beliefs about contracts. These beliefs, in turn, may be partially informed by intuitions imported from the moral domain.

CONCLUSION

"The line between legal and moral guidelines is a very blurry one in my mind," reported one subject. "I don't think a judge can clearly exercise one without the other having some bearing." Our results suggest that the connection between law and morality is not a philosophical abstraction; for most people, it is an entrenched component of their intuitions about legal decision-making. People's moral responses to the scenarios in our studies affected their legal

⁶⁶ Stolle & Slain, *supra* note 37, at 91.

⁶⁷ *Id.*

⁶⁸ Robinson & Rousseau, *supra* note 33.

judgments. Subjects imposed higher damages for parties whom they judged to be more morally culpable. Moral reasoning also led to judgments that the legal system should force specific performance.

Empirical results like those we have presented here have bearing on practical legal matters, including bargaining during contract drafting as well as negotiations over the breach of a contract. These results may also bear on moral theories of breach of contract, as we identify some discontinuities and tensions between intuition and reason.