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How Law Frames Moral Intuitions The Expressive Effect of Specific Performance

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HOW LAW FRAMES MORAL INTUITIONS: THE EXPRESSIVE EFFECT OF SPECIFIC PERFORMANCE

Ben Depoorter* & Stephan Tontrup**

Some contract theorists favor specific performance as the appropriate remedy for contract breach. According to ethical theorists, specific performance reinforces the moral obligation that promises should be kept. Some economists argue that specific performance promotes efficient contract bargaining. This Article challenges this conventional wisdom, showing that moral evaluations and the willingness to bargain are themselves strongly affected by whether specific performance is available as a default remedy or not.

Our insight is based on a novel, original empirical study. This Article presents the results of an experiment that measures and compares decisions and motivations involved with the performance, breach, and enforcement of valid legal contracts that participants signed with each other. We provided one group of participants with a default remedy of specific performance while another group could prevent the breach of contract without relying on a legal default. We observed that, when specific performance was the default remedy, participants decided to sacrifice a substantial part of their earnings in the experiment in order to obstruct an efficient breach. Our results indicate that the specific performance default triggered conflicting moral intuitions about contract breach among contracting parties. Specific performance made the ethical norm to adhere to the contract more salient to promisees, while promisors focused on the efficiency of the breach.

Based on these findings, our study challenges fixed, deontological viewpoints on the immorality of contract breach. In providing a dynamic and empirically grounded understanding of the ethics of contract breach, our study highlights the

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influence of legal frames on moral intuitions. Our findings also question the alleged efficiency benefits of specific performance. By inducing deontological rather than utilitarian intuitions about contract breach, a specific performance default likely has the effect of making negotiations involving efficient breaches more difficult.

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INTRODUCTION

A long-standing controversy exists regarding whether courts should grant relief to a disappointed contract promisee in the form of damages or specific performance.¹

1. EDWARD YORIO, CONTRACT ENFORCEMENT: SPECIFIC PERFORMANCE AND INJUNCTIONS 23 (1989) (“[T]he split among legal scholars suggests that the comparative

Under American law, a damage remedy is the applicable default rule,² injured contract parties have a right to damages for unexcused breaches by promisors.³ If damages are adequate to protect the expectation interest of the injured contract party, courts will not award specific performance or an injunction.⁴ Influenced by the economic approach to law, contract scholars reached a consensus in the early 1980s that the expectation damage remedy is the appropriate default remedy for a breach of contract.⁵ Expectation damages, it was argued, induce breach only if the cost of performance for the promisor exceeds the value of performance for the promisee.⁶ As a result, performance occurs if and only if it is efficient.⁷ By enhancing efficient breach, the expectation damage remedy prevents excessive performance when the costs of performance outweigh the value of performance or when the promisor could sell to a higher outside bidder.⁸ Other scholars have argued in favor of damage remedies⁹ because performance is often more intrusive and harmful to personal freedom than the damage remedy.¹⁰ Following Mill's harm principle,¹¹ performance should be

efficiency of specific performance and money damages is an issue likely to remain unresolved.”).

2. For an overview of equitable relief for breach of contract under the Anglo-American legal system, see generally JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 16.1–.6 (4th ed. 1998); ALLAN FARNSWORTH, *CONTRACTS* § 12.4–.7 (3d ed. 1999); YORIO, *supra* note 1, at 16.

3. RESTATEMENT (SECOND) OF CONTRACTS § 346 (1981).

4. *Id.* § 359.

5. See Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 343 (1984) (“The bulk of the scholarship on efficient remedies has concerned the award of money damages, and a consensus has been reached on the form of damages that is most likely to promote economic efficiency.”).

6. *Id.* at 360.

7. John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 278 (1972); Robert L. Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284–86 (1970).

8. The original statements of this positive relationship between economic efficiency and breach of contract are: Barton, *supra* note 7, at 278–79; Birmingham, *supra* note 7, at 284–86; Robert L. Birmingham, *Damage Measures and Economic Rationality: The Geometry of Contract Law*, 1969 DUKE L.J. 49, 70 (1969). See, e.g., A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 25–36 (1983) (discussing how expectation, reliance, and restitution damages affect breach behavior); Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73 CALIF. L. REV. 1432, 1463–64 (1985) (providing an economic analysis of contract remedies); Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 11–19, 29–37 (1985) (examining the influence on investments in precaution); Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 470 (1980) (providing an economic model of the effects of damage measures on breach behavior).

9. CHARLES FRIED, *CONTRACT AS PROMISE* 21 (1981) (proposing that expectation damages are the “normal and natural measure for contract damages”).

10. See Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 778–79 (1983); J.E. Penner, *Voluntary Obligations and the Scope of the Law of*

awarded only when the less intrusive remedial measure of damage compensation cannot fully redress the harm caused by the violation of the promisee's rights.

Some modern contract theorists, however, favor specific performance as the more appropriate default remedy.¹² Specific performance is the fulfillment of the performance due in the contract as nearly as practicable, by the party in breach.¹³ Two very distinct strands of scholarship advocate specific performance as a default remedy. First, ethical theorists favor a specific performance default, because it aligns with the moral obligation that promises should be kept. Second, under the consent theory of contracts, for instance, contract rights cannot be waived unilaterally, unless the contract specifies otherwise.¹⁴

Other scholars promote specific performance on economic grounds.¹⁵ From an efficiency perspective, expectation damages may impose unnecessary costs.¹⁶ If contracting parties are rational, they will design an optimal contract and courts should enforce these terms "rather than give the parties an option

Contract, 2 LEGAL THEORY 325 (1996) (cautioning that specific performance may interfere with personal freedom).

11. According to Mill's harm principle the actions of individuals should be restricted only in order to prevent harm to other individuals. JOHN STUART MILL, *ON LIBERTY* (1869).

12. RESTATEMENT (SECOND) OF CONTRACTS § 357 cmt. a (1981).

13. *Id.*

14. See Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 300 (1986) (arguing that the enforceable nature of a contract's promise derives from a party's objectively manifested consent to the transfer of his rights); see also Randy E. Barnett, *Contract Remedies and Inalienable Rights*, 4 SOC. PHIL. & POL'Y 179, 180, 195–201 (1986) ("[M]y thesis will be that the normal rule favoring money damages should be replaced with one that presumptively favors specific performance unless the parties have consented to money damages instead."); *id.* at 195 (putting forward a proposal to place the burden of arguing against specific performance on the guilty breacher); Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CALIF. L. REV. 975, 1019 (2005) ("Actual specific performance should be awarded unless a special moral, policy, or experiential reason suggests otherwise in a given class of cases, or the promisee can accomplish virtual specific performance [a commodity that the promisee could not in good faith reject as an equivalent of the breached performance]."); Daniel Friedmann, *The Performance Interest in Contract Damages*, 111 L.Q. REV. 628 (1995).

15. See, e.g., Anthony Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 355–59 (1978) (arguing that specific performance is reserved for disputes involving valuation problems such as those involving unique goods); Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 277 (1979) ("[T]he compensation goal implies that specific performance should be routinely available."); Ulen, *supra* note 5, at 346 ("[C]ourts should make specific performance the routine remedy . . .").

16. For a summary of the literature, see Paul G. Mahoney, *Contract Remedies: General*, in 3 ENCYCLOPEDIA OF LAW & ECONOMICS 117, 122 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000); Thomas Ulen, *Specific Performance*, in 3 THE NEW PALGRAVE DICTIONARY OF LAW AND ECONOMICS 481 (Peter Newman ed., 1998).

(expectation damages) when they did not bargain for it."¹⁷ Moreover, expectation damages may induce socially wasteful breaches of contracts because courts tend to underestimate the value of performance to promisees.¹⁸ By contrast, specific performance forces a promisor to negotiate with the promisee to seek removal from his or her contractual duties.¹⁹ To some economists, specific performance eliminates much of the ethical concerns about efficient breach.²⁰ First, it leaves the decision of whether a breach can take place with the innocent promisee. Second, because the promisee knows exactly the value of performance, contracts will be breached only on terms that meet or exceed the promisee's interest in the original contract.

In this Article, we claim that contract scholarship overlooks an important interdependence between contract norms and default remedies. When scholars argue that the morality of performance or bargaining benefits are a sufficient justification for specific performance, they ignore how moral evaluations and bargaining costs are themselves strongly affected by whether specific performance is available as a default remedy. When expressed as a legal default, the legal right to insist on performance increases a promisee's sense of entitlement and resentment against breach.

We posit that specific performance as a legal default may create aversion against breach even when performance is inefficient. This insight is based on empirical evidence that we obtained in a novel study for this Article.²¹ We conducted an incentive-compatible laboratory experiment where participants signed and performed valid legal contracts that were legally enforceable.²² Participants understood that their decisions would impact their earnings as stipulated in the contract(s) that they entered into with other participants.

Participants entered into a contract that stipulated a joint task (adjustment of sliders on a computer screen) and the distribution of gains when the contract was completed. While one of the participants (the promisee) commenced the contractual task, his or her counterpart (the promisor) received an outside offer from a third party that would require the promisor to breach the original contract. The outside offer presented an opportunity for efficient breach: The gains realized

17. Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 880 n.14 (2003) (description of the literature). While the traditional law and economic position was motivated by *ex post* efficiency, based on assumptions about a fully informed judiciary, the more recent position holds *ex ante* efficiency out to be more important, while relaxing some of the assumptions about the accuracy of judicial information.

18. Schwartz, *supra* note 15, at 271 (“[T]he remedy of specific performance should be as routinely available as the damages remedy.”).

19. *Id.* at 279.

20. Ulen, *supra* note 5, at 365.

21. We most are grateful to our colleague Francesco Parisi for suggesting and encouraging us to examine empirically the effect of default remedies on efficient breach.

22. This methodology increases the external validity of the findings. It is considered more reliable than data obtained in survey questionnaires that always measure hypothetical rather than actual behavior.

by the new offer were more than sufficient to fully compensate the expectation damages of the promisee.

We measured the decisions and motivations of participants regarding the performance, breach, and enforcement of the legally enforceable contracts entered into by participants. First, a promisor had to decide whether she would breach or honor the original contract. Second, a promisee could enforce the original contract or accept damage compensation. After we observed the behavior of the participants, we examined their motivations in three additional stages of the experiment. First, we provided promisors and promisees with an endowment that could only be used to make a donation to the other contract party. We measured how the actions of one contracting party influenced the amount the other party donated. Second, participants could generate additional income by making a wager on the prediction that the other party would breach or enforce the original contract. Third, we used questionnaires to ask participants what motivated their behavior in the experiment.

Our experiment focused on the availability of specific performance as the default remedy. All promisees in the experiment could prevent the breach of contract without relying on a legal remedy. A promisee could always instruct that the outside offer be withdrawn.²³ But one group of participants could also prevent breach by relying on a specific performance default.²⁴ In other words, all contracting parties could enforce the contract, but only one group of participants in the experiment could do so on the basis of the legal remedy.²⁵

A number of interesting findings emerged. First, we observed that, when specific performance was the default remedy, promisees demonstrated a strong preference to enforce the original contract. In fact, participants sacrificed a substantial part of their earnings in the experiment to obstruct the efficient breach when specific performance was available.²⁶ By comparison, promisees in the control group did not object to the efficient breach. The mere availability of specific performance caused players in the experimental group to insist on the inefficient performance.

Second, we observed substantially smaller donations whenever promisees were entitled to specific performance. This suggests that when specific performance is the applicable default, efficient breaches induce stronger resentment and even a desire to punish the promisor.

23. In the language of experimental design, this is the control group.

24. This is the experimental group.

25. Although, both groups could enforce the contract; only the basis of enforcement was different.

26. Because it assured players of a certain payment of €5, all players in the experiment were strictly better off if they accepted compensation (expectation damages) from the breaching party. As we explain in more detail below, this assumption holds unless participants have extreme beliefs about the other party's performance of the task. *See infra* text accompanying note 121.

Third, the results show that the specific performance default triggered conflicting moral intuitions about contract breach among contracting parties. Specific performance made the ethical norm to adhere to the contract more salient to promisees, whereas promisors focused on the efficiency of the breach. Promisees adopted the principled position that promises must be kept and strongly resented the efficient breach, whereas promisors evaluated the contract on utilitarian grounds and were much more accepting of efficient breaches of the contract.

Finally, our data indicated that promisors failed to anticipate how the specific performance remedy created resentment about the efficient breach among promisees.²⁷

This Article contests both the economic and deontological argument for specific performance. First, we advance an empirical understanding of the ethics of contract breach. Deontological concepts of contract theory often assume that individuals have a principled aversion against promise breaking.²⁸ As an empirical matter, it appears from our study that the moral obligation to keep one's promise is context dependent. Individuals seem to have conflicting and contradicting moral intuitions about contract breach that can be triggered by the legal frame. A default of specific performance makes the ethical norm to perform the contract more salient.²⁹ When specific performance was available, breach was evaluated negatively in light of fairness considerations regarding cooperation and defection. Without the specific performance default, participants in our study perceived the breach in a more utilitarian sense, focusing on the gains from trade. The results of the survey questionnaires confirm that the default remedy triggered the moral intuitions of promisees and induced a sense of entitlement.

Second, we offer new insights into the relative transaction costs generated by different remedies for breach of contract.³⁰ Specifically, our findings challenge the notion that a specific performance default remedy leads to "more mutually beneficial promises . . . exchanged at a lower cost than under any other contract

27. This effect was observed among promisors who justified the decision to breach the contract on the basis of the efficiency of the breach and mutual benefits involved. See *infra* Part III.G.

28. Fried, *supra* note 9, at 14–17; Peter Linzer, *On the Amoralism of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 111 (1981).

29. Specifically, a lawmaker's decision to implement specific performance as the default remedy might be perceived as a collective commitment to performance as the relevant norm. For more on this interpretation, see *infra* Part IV.C.

30. See William Bishop, *The Choice of Remedy for Breach of Contract*, 14 J. LEGAL STUD. 299, 300 (1985) ("[T]he optimum structure of the default rules will in the end turn on differences in the magnitudes of the transaction costs generated by different rules."); Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 952 (1982) ("Whatever 'direction' towards or away from efficiency . . . [a damage or specific performance remedy] has depends entirely upon the relative transaction costs each will generate.").

remedy.”³¹ Although some economic theorists argue that specific performance is the favored remedy if no significant bargaining impediments are present, we posit that the availability of specific performance may negatively affect bargaining conditions in the following ways: First, instead of viewing contractual rights as a means to an end, a legal remedy itself may create intrinsic value in carrying out contractual promises. Second, by boosting the salience of performance, a specific performance default may cause promisees to insist on performance even when it is in their material interest to accept the efficient breach. Third, when specific performance has an expressive effect on the moral intuitions of contract promisees,³² the resulting opposition to breach increases the burden on promisors when they negotiate to obtain release from inefficient contractual obligations. A promisor must compensate the promisee not only for the material costs of breach. The promisor must also obtain forgiveness for violating the statutory entitlement to performance. If the contract breach is perceived as an insult, material compensation might not be satisfactory.³³ In other words, by fueling promisees’ moral aversion to breach, specific performance might lead parties into conflict rather than negotiation. Overall, because the economic case for specific performance largely rests on the ability of parties to renegotiate a mutually beneficial outcome, our findings weaken the efficiency argument in favor of specific performance.

The Article proceeds as follows. In Part I, we provide a brief historical review of the leading perspectives on optimal contract remedies. Part II describes the design and implementation of our study. In Part III, we report and discuss our findings. Part IV derives policy implications for contract theory in particular and legal regulation more generally.

I. OPTIMAL CONTRACT REMEDIES

One of the central tenets of contract law is the so-called compensation principle: Contract law has been designed to provide compensation in the case of breach of contract.³⁴ Ideally, remedies in contract law put a disappointed promisee in as good a position as she would have enjoyed if the promisor had performed.³⁵

31. Bishop, *supra* note 30, at 343–44.

32. Following scholarship on the expressive function of the law, by expressing a collective commitment, laws may cause individuals to internalize the values embodied in the law or lead them to coordinate their behavior using the law as a benchmark for what is deemed socially appropriate behavior. *See, e.g.*, Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585, 607–08 (1998); Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649 (2000); Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2022 (1996).

33. Legal rights are not always “commensurable”: individuals are reluctant to trade the legal entitlement for material compensation. *See infra* Part IV.D.

34. *See, e.g.*, U.C.C. § 1-106(1) (1972) (“[R]emedies . . . shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . .”); RESTATEMENT OF CONTRACTS § 329 (1932).

35. In addition to expectation damages, contract law also recognizes the following potential interests of a contract promisee: the “reliance interest” (interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as

Two different contract remedies potentially achieve this purpose: a damage payment imposed upon the breaching party (legal relief) or a court order to deliver the promised performance (equitable relief).

A long-standing controversy exists regarding whether it is preferable for courts to grant relief in the form of damages or specific performance.³⁶ This question has fascinated scholars, commentators, and courts for several decades, but it also resonates in a global comparative law perspective. Interestingly, the legal rules on remedies for breach of contract differ significantly not only between Anglo-American and civil law systems but also across different countries in both systems.³⁷ For instance, under Anglo-American law, specific performance is an exceptional remedy,³⁸ but under German law it is the general remedy for a breach of contract.³⁹

promisee would have been in had the contract not been made) and the “restitution interest” (interest in having restored any benefit that promisee has conferred on the other party). RESTATEMENT (SECOND) OF CONTRACTS § 344(b)–(c) (1981). The economic literature has likewise concluded that specific performance is efficient in terms of providing the right incentives with regard to reliance, restitution, and the formation of efficient contracts. See Ulen, *supra* note 5, at 481.

36. The discussion takes us back to the turn of the previous century when Oliver Wendell Holmes claimed that the common law should move away from a moral interpretation of contract:

The 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. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can.

Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897); see also *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 543–44 (1903) (one of Holmes’s first Supreme Court opinions). *But see* Steven Shavell, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439 (2006) [hereinafter Shavell, *Breach Immoral?*]; Steven Shavell, *Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, 107 MICH. L. REV. 1569, 1579–80 (2009) [hereinafter Shavell, *Breach Not Immoral*].

37. For information on specific performance across different countries in Europe and in the rest of the world, see generally Guenter H. Treitel, *Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)*, in 7 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW § 16-7 to -39 (Arthur von Mehren ed., 1976); KONRAD ZWIGERT & HEIN KOTZ, *INTRODUCTION TO COMPARATIVE LAW* 472–83 (Tony Weir trans., 3d rev. ed. 1998).

38. CALAMARI & PERILLO, *supra* note 2, § 16.1 (“The primary relief that the Anglo-American legal systems offer is substitutionary relief, normally damages. . . . Specific performance is an extraordinary remedy . . .”).

39. ZWIGERT & KOTZ, *supra* note 37, at 472–74. More accurately, substitute performance is the remedy for non-unique goods. This applies even to obligations to deliver property, notwithstanding the fact that specific performance is considered to be the normal remedy. *Id.* at 472. The procedure described in § 883-6 of the Code of Civil Procedure (the bailiff taking the chattel from the debtor) is only applicable if no positive action of the promisor is required (such as ordering or specifying the goods).

In this Part, we briefly review the basic framework of contract law default remedies before documenting the shift in focus from expectation damages to specific performance in contract law scholarship.

A. Contract Remedy Defaults

Under American law, an injured contract party has "a right to damages for any breach by a party against whom the contract is enforceable unless the claim for damages has been suspended or discharged."⁴⁰ A damage remedy is the applicable default.⁴¹ If damages can be considered adequate to protect the expectation interest of the injured contract party, courts will not award specific performance or an injunction.⁴²

Parties can select specific performance as the preferred remedy in their contract, but specific performance is never a *right* of contracting parties;⁴³ rather, it is an equitable remedy applied at the discretion of the court.⁴⁴ Courts generally apply the inadequacy-of-damages test before awarding specific performance. According to this test, equitable relief is denied if a compensatory award provides adequate protection of the injured party. Expectation damages are inadequate, for instance, when it would be difficult to determine the value of the contract performance, where a suitable substitute cannot be purchased, or where the party in breach lacks adequate financial resources. Courts generally grant specific performance as a remedy in cases that involve sales of "unique goods"⁴⁵ or cases

40. RESTATEMENT (SECOND) OF CONTRACTS § 346 (1981).

41. For an overview of equitable relief for breach of contract under the Anglo-American legal system, see generally CALAMARI & PERILLO, *supra* note 2, at §§ 16.1–6; FARNSWORTH, *supra* note 2, at § 12.4–7.

42. RESTATEMENT (SECOND) OF CONTRACTS § 359 (1981).

43. YORIO, *supra* note 1, at § 19.2 (noting that "a clause in a contract providing for specific performance . . . does not by itself bind a court to grant the agreed remedy," and discussing reasons why a court might not choose to enforce such a provision); see FARNSWORTH, *supra* note 2, at § 12.6.

44. "Specific performance of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty." RESTATEMENT (SECOND) OF CONTRACTS § 357 (1981). "[S]uch a remedy may be considered in exercising discretion under the rule stated in § 357." *Id.* at § 359(3) ("[I]t must be remembered that specific performance is not a matter of right, even when the plaintiff's evidence establishes a contract valid at law and sufficient for the recovery of damages. Ordering specific enforcement of a contract is a matter within the sound judicial discretion of the court. . . . [T]he plaintiff was required to show the good faith and equities of its own position, and the trial chancellor, in weighing the equities, was entitled to consider whether a decree of specific performance would work an unconscionable advantage to the plaintiff or would result in injustice."); *Pub. Water Supply Dist. v. Fowlkes*, 407 S.W.2d 642, 647 (Mo. App. 1966); *accord*, *Green, Inc. v. Smith*, 317 N.E.2d 227, 233 (1974) (cited in Schwartz, *supra* note 15, at 272).

45. U.C.C. § 2-716(1) (1999) ("Specific performance may be decreed where the goods are unique or in other proper circumstances."). See, e.g., *Triple-A Baseball Club Assocs. v. Ne. Baseball, Inc.*, 832 F.2d 214, 224 (1st Cir. 1987) (finding that a contract for sale of minor league baseball franchise was "unique in character and cannot be duplicated") (cited in FARNSWORTH, *supra* note 2, at 175).

in which damages are difficult to assess.⁴⁶ Instead of ordering specific performance, a court may issue an injunction ordering a party to refrain from certain acts. A classic example is *Lumley v. Wagner*.⁴⁷ Upon breach of a contract that granted exclusive performance rights to a theater company, an opera singer was issued an injunction restricting her from performing before a live audience during the original contract period. However, even if a disappointed promisee is able to show that there is no adequate remedy at law, specific performance is not a foregone conclusion. Promisors can raise a number of defenses against specific performance that are not available against a damages award.⁴⁸

By contrast, many civil law countries take the opposite approach with regard to contract default remedies. The standard formulation in civil law contract codes is that specific performance is the routine applicable remedy.⁴⁹ Compensatory damages are reserved for situations where performance is impossible due to exigent circumstances. German law is the clearest example.⁵⁰ Specific performance is the general remedy for breach of contract in Germany.⁵¹ Accordingly, depending on whether a contract involves moveable or immovable property, a court can order the seizure of the object or ejection of the seller from the subject land.⁵²

While black-letter law suggests a strong contrast between common law and civil law systems, in practice, courts in both systems deviate from the default remedy whenever it is deemed appropriate. American courts will forsake expectation damages when performance is relatively straightforward or particularly valuable to a disappointed promisee. Similarly, courts in civil law countries regularly apply the non-default damage remedy.⁵³ Steven Shavell has explained these patterns by distinguishing contracts to produce services or goods

46. *Triple-A Baseball*, 832 F.2d at 224.

47. (1852) 42 Eng. Rep. 687 (Q.B.).

48. These defenses include inadequacy of consideration, lack of security for the promisee's performance, the promisor's unilateral mistake, and the difficulty a court would have in supervising a specific performance decree. See FARNSWORTH, *supra* note 2, § 12.6-7.

49. ZWEIGERT & KOTZ, *supra* note 37, at 472-74.

50. *Id.*

51. *Id.* Specific performance is applied even to contracts involving personal services. Pragmatically, of course, enforcement is often impossible in such instances.

52. *Id.* at 473-74.

53. See Janwillem Oosterhuis, *Industrialization and Specific Performance in the German Territories During the 19th Century*, in THE RIGHT TO SPECIFIC PERFORMANCE—THE HISTORICAL DEVELOPMENT 97 (J. Hallebeek & J.H. Dondorp eds., 2010) (explaining how nineteenth-century Germany merchants preferred to switch to other sellers rather than wait for a court to impose specific performance on the original promisor); Henrik Dan Lando & Caspar Rose, *On the Enforcement of Specific Performance in Civil Law Countries*, 24 INT'L REV. L. & ECON. 473, 476 (2004) (showing that promisees tend to prefer cover transactions above specific performance whenever they have the choice in civil law countries).

and contracts to deliver goods.⁵⁴ Offering a “production cost” explanation, Shavell argues that contracting parties generally prefer that courts apply a damage remedy to contracts for the production of things or for providing services.⁵⁵ Because the costs of performing production or service agreements can be much higher than anticipated, a strict application of a specific performance remedy imposes serious risk on a seller; pricing those risks would drive up the costs to the buyer as well because the seller would seek a higher price to insure against the risk and costs of non-enforcement.⁵⁶ By contrast, specific performance is a more effective remedy for contracts involving the conveyance of property. Because the goods already exist, such contracts generally do not impose production cost uncertainties of similar magnitude.⁵⁷

Next, we review the broader contract law literature on default remedies. As we describe below, a broad range of literature discusses the relative advantages and disadvantages of various default remedies for contract breach. We first review the evolving economic perspective, as well as non-utilitarian, deontological viewpoints on contract breach.

B. Theoretical Perspectives on Contract Breach Remedies

Influenced by the economic approach to law, modern contract scholarship reached a consensus in the early 1980s that damages are the appropriate default remedy for broken promises.⁵⁸

At least two key arguments influenced this perspective. First, scholars in law and economics took a favorable position toward expectation damages, arguing that this remedy enabled promisees to breach a contract when it was economically efficient to do so. Accordingly, because the expectation damage remedy forces the promisor to compensate the promisee for the total expected value of the contract, the contract will be breached only if the cost of performance to the promisor exceeds the value of performance to the promisee.⁵⁹ As a result, promisors breach if and only if it is socially beneficial—that is, when the breaching promisor stands to gain more from the breach than the promisee stands to lose.⁶⁰ Meanwhile, the expectation damage remedy places disappointed promisees in as good a position as they would have enjoyed if the promisor had performed. Thus, the breach is acceptable to all parties. At the same time, by enhancing efficient breach, expectation damages prevent excessive performance—namely, when the costs of performance outweigh the value of performance or when the promisor could sell to

54. Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 TEX. L. REV. 831, 831–57 (2006).

55. *Id.* at 841–46.

56. *Id.* at 843–46.

57. *Id.* at 833–34.

58. See Ulen, *supra* note 5, at 343 (“The bulk of the scholarship on efficient remedies has concerned the award of money damages, and a consensus has been reached on the form of damages that is most likely to promote economic efficiency.”).

59. *Id.* at 360.

60. Barton, *supra* note 7, at 282; see also Birmingham, *supra* note 7, at 284.

a higher outside bidder.⁶¹ By contrast, excessive performance would be harder to avoid under a default remedy of specific performance. Because an unbridled right to specific performance provides a promisee with a veto option to stop the breach,⁶² it confers considerable power over a promisor that faces high compliance costs.⁶³ If specific performance was routinely available, promisors who wanted to breach would often be compelled to “bribe” promisees to release them from their obligations.⁶⁴ Negotiations under specific performance might be more complex and strategic than when breaching promisors merely face the costs of compensating promisees for their damages.⁶⁵ As a result, specific performance can generate higher transaction costs or, if negotiations fail, it might lead to inefficient outcomes. Second, performance is likely to be unsatisfactory to a promisee if it is complex and costly to evaluate. A reluctant promisor is more likely to deliver a defective performance when a court coerces the performance.⁶⁶ Because “the defectiveness of complex performances is sometimes difficult to establish in court,”⁶⁷ specific performance might not always be satisfactory to a disappointed promisee.

By contrast, some contract scholars favor specific performance as the appropriate standard remedy for contract breach.⁶⁸ The case for specific

61. See *supra* note 8.

62. Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365, 1405–08 (1982) (pointing out that this might conflict with the interests of courts to attain fair and balanced outcomes).

63. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 88–89 (2d ed. 1977) (defending current law on efficiency grounds); Kronman, *supra* note 15, at 360–69 (same); E. Allan Farnsworth, *Damages and Specific Relief*, 27 AM. J. COMP. L. 247, 249–51 (1979).

64. Schwartz expects however that promisees would seldom abuse this power because promisees have more to gain from accepting a damage award when such award “would be even approximately compensatory.” Schwartz, *supra* note 15, at 278.

65. On “post-breach” negotiation cost savings of a damages remedy, see POSNER, *supra* note 62, at 88–89. Other commentators have made similar arguments. See Kenneth W. Clarkson et al., *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351, 360 n.32; Yorio, *supra* note 62, at 1365.

66. Schwartz, *supra* note 15, at 277.

67. *Id.* Additionally, Schwartz argues that timing aspects of performance may make a damage remedy more appealing to a promisee:

Further, when the promisor’s performance must be rendered over time, as in construction or requirements contracts, it is costly for the promisee to monitor a reluctant promisor’s conduct. If the damage remedy is compensatory, the promisee would prefer it to incurring these monitoring costs. Finally, given the time necessary to resolve lawsuits, promisees would commonly prefer to make substitute transactions promptly and sue later for damages rather than hold their affairs in suspension while awaiting equitable relief.

Id.

68. See, e.g., *supra* note 15. For an empirical test of the efficiency of specific performance, see Yair Listokin, *The Empirical Case for Specific Performance: Evidence from the IBP-Tyson Litigation*, 2 J. EMPIRICAL L. STUD. 469 (2005) (observing positive stock market response to unusual specific performance award in merger conflict). More

performance rests on two very distinct normative grounds: the utilitarian perspective of the economic analysis of the law and deontological viewpoints that condemn contract breach as per se immoral.

The economic argument for specific performance as the routine remedy for breach of contract is based on three principal assumptions. First, expectation damages are regarded as unnecessary and potentially costly. If contracting parties are rational, it is argued, they will design an optimal contract, and courts should enforce their terms “rather than give the parties an option (expectation damages) when they did not bargain for it.”⁶⁹ By contrast, specific performance forces a promisor to negotiate with the promisee to be absolved from his or her contractual duties.⁷⁰ Because promisees will only accept measures of compensation that meet or exceed the expected value of the original contract, specific performance eliminates much of the concern regarding both the perceived immorality of efficient breach and the occurrence of inefficient breaches.⁷¹

Second, by inducing private bargaining, specific performance removes the burden on courts to assess the accuracy of damage claims. Promisees generally possess better information than courts as to the costs that a breach imposes on them, the adequacy of damages, and the difficulties of coercing performance. Also, because promisees generally know more about their promisors than courts do, they are in a better position to decide whether the default remedy of specific performance will induce a satisfactory performance or whether they would prefer compensation for their damages.

Third, the case for specific performance is strengthened if it is reasonable to assume that judicial damage awards systematically under-compensate

recent criticism on the protection of contract rights on the basis of liability rules include: Richard R. W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568, 573–74 (2006); Eisenberg, *supra* note 14, at 1017; Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559, 581–88 (2006); Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 1–13 (1989). One notable exception is Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939, 1948–61 (2011) (arguing that expectation remedies imply “transfer or trade” understanding among contracting parties).

69. Posner, *supra* note 17, at 880 n.14 (description of the literature).

70. Kronman, *supra* note 15, at 366–67.

71. Note that this conclusion follows from the conventional assumption that specific performance (as a property rule) promotes bargaining. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092 (1972). Recent literature suggests that the case for property rules is not so one-sided as once assumed. See Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement To Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1032 (1995) (suggesting that liability rules have an information forcing effect that improves bargaining outcomes in certain situations). But see Louis Kaplow & Steven Shavell, *Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Talley*, 105 YALE L.J. 221 (1995) (providing a critical review of the various arguments offered by Ayres and Talley).

promisees.⁷² Some costs of contract breach, such as emotional distress for instance, are not recoverable under law.⁷³ Other costs are recoverable in theory only. Many incidental costs are hard to monetize and claim. For instance, although a disappointed promisee is entitled to recover the costs incurred in finding a substitute and negotiating a new deal, it is hard to put a dollar amount on such costs. As a result of evidentiary problems, disappointed promisees may be prevented from recovering the exact amount that they stood to gain from the contract.⁷⁴ Consequently, promisors may sometimes breach when their gains from breach exceed the damages a court will assess, even though this is less than the full cost the breach imposes on the promisees. If this happens, damages induce inefficient breaches that make promisors better off but promisees worse off.⁷⁵

Anthony Kronman has argued that specific performance is especially appealing when a breached contract concerns “unique goods.”⁷⁶ When the subject of a contract is the delivery of a unique work, such as artwork, courts face serious information costs. It might be next to impossible to verify the accuracy of a promisee’s claim as to the personal value in obtaining the work. In these cases, a damage remedy is likely inaccurate. If the court grants the market price, this might be below the actual value to the promisee; whereas, if the court bestows the (claimed) personal value to the promisee, this likely overestimates the actual value, especially because this would create an incentive for the promisee to exaggerate her personal valuation. In such instances, requiring performance is beneficial because it is fully compensatory and relatively costless—that is, requiring that the

72. Eisenberg, *supra* note 14, at 989–97 (detailing ways in which damages under-compensate). “The compensation goal implies that specific performance should be routinely available. This is because damage awards actually under-compensate in more cases than is commonly supposed.” Schwartz, *supra* note 15, at 277 (arguing also that demands for specific performance are an indication that damages would under-compensate because otherwise most promisees would find other opportunities to do it).

73. Schwartz, *supra* note 15, at 278.

74. *Id.*

75. *Id.*

76. Kronman, *supra* note 15, at 355–65. Kronman classifies as “unique” those objects for which courts would have great difficulty identifying substitutes. *Id.* at 365. Because of the “volume, refinement, and reliability of the available information about substitutes for the subject matter of the breached contract.” *Id.* at 362. More recently, Paul Mahoney has applied option theory to explain the usefulness of specific performance as applied to unique goods. Paul G. Mahoney, *Contract Remedies and Options Pricing*, 24 J. LEGAL STUD. 139 (1995). Mahoney argues that damage remedies be designed in a manner analogous to options under which a buyer may purchase entitlement to performance. *Id.* at 139. In this analogy, the option expires at the date when the deadline for performance was set in the contract. *Id.* at 143. The value of the option is the price of the damage award. *Id.* With regard to unique goods (such as a valuable painting), risk-averse parties might choose to avoid speculation or being subject to price fluctuations. *Id.* at 154–55. Specific performance is a more adequate remedy in that case: By removing the option of the seller to pay damages, the contract effectively becomes a hedged commodity. *Id.*

original artwork be delivered to the promisee avoids the valuation and information cost issues entirely.⁷⁷

As this overview illustrates, the economic analysis of contract remedies focuses on transaction and information cost arguments. A damage remedy removes the need for bargaining but may induce opportunistic breach. Specific performance removes the fear of under-compensation but forces the breaching party into negotiations. In this framework, the optimal remedy depends on a trade-off between information costs (which favors specific performance) and transaction costs (which favors damage compensation).⁷⁸

The traditional economic approach to contract law stands in contrast to other perspectives on contract breach that build on non-utilitarian, deontological considerations about the fairness, ethics, and social norms involved with contractual duties.⁷⁹ These positions question the permissibility of contract breach on a principled basis. Some commentators emphasize the moral duty of a contractual promise, arguing that legal systems should discourage breach unless specific mitigating circumstances exist.⁸⁰

When economic and deontological scholars favor specific performance as a default, they arrive at this conclusion on the basis of very different premises. Law and economics scholars encourage efficient breach. If private bargaining is assumed to proceed smoothly, a specific performance remedy will not prevent efficient breaches; it simply ensures that the promisee (rather than a court) gets the final say on the appropriate compensation before the promisor is absolved from his or her contractual duties.⁸¹ Deontological proponents of specific performance

77. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 93–94 (1989) (seminal contribution on default rules).

78. The textbook case, *Peevyhouse v. Garland Coal & Mining Co.*, serves as the classic illustration of the various factors in consideration. 382 P.2d. 109 (Okla. 1962). When Willie and Lucille Peevyhouse entered into a lease agreement with the Garland Coal & Mining Company, they inserted a clause in the lease under which Garland promised to engage in restoration and remediation work on the property at the end of the lease. *Id.* at 111. When the lease expired, the Garland Coal & Mining Company refused to perform the contractually provided restoration work on the grounds. *Id.* The court excused the mine company from the work because the cost of performance (\$29,000) was disproportionate to the resulting increase in market value of the land (\$300). *Id.* at 112. On the one hand, the damage award makes sense if we are concerned about a potentially unbalanced outcome: A specific performance remedy provides the Peevyhouses with a veto right against a damage payment, such that a potentially wasteful performance might occur if no agreement is reached. *See id.* On the other hand, if we acknowledge the issue of information costs involved in accessing the subjective value that performance has for the contracting parties, it is likely that the \$300 award under-compensates: The Peevyhouse family likely valued restoration more than what was reflected in the market appreciation of the land. *See id.*

79. *See infra* Part IV.A.

80. *Id.*

81. Additionally, if a promisor's expected benefit from a breach of contract were sufficient to fully indemnify the disappointed promisee, it would be socially wasteful to adhere to the contract. Ulen, *supra* note 15. *But see* Friedmann, *supra* note 68, at 5–8

argue that voluntary renegotiations are the only morally acceptable way to suspend a contractual obligation.⁸²

This Article challenges both the economic and deontological argument for specific performance. First, we argue that, by impacting the moral acceptability of efficient breach, the applicable remedy affects the likelihood that private bargaining will lead to the socially optimal outcome. When provided as a default remedy, the legal right of specific performance forms the moral intuitions of contract promisees. The resulting sense of entitlement may create resentment against compensation for contract breach, even when performance would be inefficient. The overlooked interdependency between contract norms and default remedies complicates the utilitarian question of whether promisees should be awarded relief in the form of damages or specific performance. While most economic theorists favor specific performance if no significant bargaining impediments are present, we posit that the availability of specific performance may itself negatively affect bargaining conditions. If a specific performance as a default remedy provokes moral aversion against breach, promisors face a steeper challenge when negotiating to obtain release from inefficient contractual obligations. They must compensate the promisee not only for the material losses, but they must also obtain forgiveness for violating the statutory entitlement to performance. Contract breach might be perceived as an insult that cannot as easily be absolved by material compensation.⁸³ Because the economic case for specific performance largely rests on the ability of parties to renegotiate a mutually beneficial outcome, our findings weaken the efficiency argument in favor of specific performance.

Second, the endogenous nature of moral intuitions suggests that individuals are not principally opposed to contract breach. Rather, the default remedy influences the moral acceptability of contract breach. As an empirical matter, it appears that the ethical norm of promise keeping is highly context-dependent.⁸⁴ Individuals seem to have a set of conflicting and contradicting moral intuitions that can be triggered by the legal frame.

(challenging the viewpoint that a legal system merely puts a “price” on unlawful behavior that can be “bought” by the offender).

82. Economists disagree, stating that contract breaches are not immoral when one recognizes that contracts are necessarily incomplete. When a party breaches a contract because of an unforeseen contingency, nothing predetermines who should bear the contractual responsibility. Shavell, *Breach Immoral?*, *supra* note 36, at 439; *see also* Shavell, *Breach Not Immoral*, *supra* note 36 at 1579–80.

83. Legal rights are not always “commensurable”: individuals are reluctant to trade the legal entitlement for material compensation. *See infra* Part IV.D.

84. In a recent article, Yuval Feldman and Doron Teichman use survey questionnaires to document the role of moral commitments and social norms of individuals. *See* Yuval Feldman & Doron Teichman, *Are All Contractual Obligations Created Equal?*, 100 *GEO. L.J.* 5, 32 (2011) (showing that the moral commitment to perform is less strong for standard form or contracts containing ambiguous terms).

In the next Part, we present our study and report the results in greater detail. We closely examine the interaction between contract remedies, moral attitudes toward efficient breach, and the actual behavior of contracting parties.

II. CONTRACT BREACH, REMEDIES, AND ENTITLEMENT: AN EXPERIMENT

A. Introduction

This Part describes our empirical study. We provided participants with an opportunity to sign a legally valid contract. The contract described a joint task. Once the initial contract was signed, one of the contracting parties (the promisor) received an offer to enter into a different, more lucrative contract with a third party. The promisor could only perform one contract, so she had to decide between performing on the already-signed contract and breaching this commitment by signing a new contract with the third party.

If a promisor decided to breach the contract, the original promisee had to decide whether she wanted to enforce the original contract or accept compensatory damages. Promisees could enforce the original contract by demanding that the outside offer be withdrawn. In one of our two experimental groups, some promisees could also enforce the contract by relying on a default remedy of specific performance. We analyzed how the availability of specific performance influenced the enforcement decisions and the moral judgments of the contracting parties.

B. Methodology and Procedures

Experimental methodologies have strengths and weaknesses. Although laboratory experiments enable researchers to control outside influences and analyze causal relationships carefully, the artificial setting of such studies makes them susceptible to the criticism that the results are not always meaningful for understanding real-world phenomena.⁸⁵ For instance, in experimental studies involving contracts, the decisions and consequences are usually presented in hypothetical terms. Participants are aware that they do not sign a real contract. Additionally, the reliability and external validity of these studies are reduced further because the decisions impose no practical monetary consequences for participants.⁸⁶ Such hypothetical approaches reduce the reliability and external validity of the results.

In our study we increased the realism and external validity of the results by using four measures. First, we made the experiment more realistic by

85. David De Cremer & Daan van Knippenberg, *How Do Leaders Promote Cooperation? The Effects of Charisma and Procedural Fairness*, 87 J. APPLIED PSYCHOL. 858, 860 (2002).

86. See, e.g., Tess Wilkinson-Ryan & Jonathan Baron, *Moral Judgment and Moral Heuristics in Breach of Contract*, 6 J. EMPIRICAL LEG. STUD. 405 (2009) (survey-based experimental evidence).

introducing monetary incentives.⁸⁷ Participants understood that their decisions would impact their earnings as stipulated in the contract(s) that they entered into with other participants.

Second, we introduced an important and novel methodological innovation. Participants were informed that they were signing real contracts with each other on the basis of the German Civil Law code, sections 301, 241 BGB.⁸⁸ Additionally, participants were reminded that they were legally bound by the contracts, which were enforceable in public courts.⁸⁹ This aspect of the study made the decisions of participants more reflective of the actual consequences that would occur in real-life interaction.⁹⁰ More generally, this approach enabled us to combine the virtue of realism from field studies with the advantage of the strictly controlled environments found in laboratory studies.⁹¹

Participants were aware, of course, that the anonymity of the laboratory setting would make enforcement impossible for them. In order to enforce the contract in a court of law, participants would need to obtain the identity of their contractual partner. Participants realized that their contracting partner was present, but they were unaware of their names and could not identify them. Additionally, a double-blind procedure ensured that the researcher was not able to tell whether participants were contractual partners in the experiment.

Third, we required participants to perform a real task in the laboratory to fulfill their contractual duties. Although prior studies treat performance as a hypothetical issue, a breach of contract is more realistic to participants if performance is an actual possibility. Additionally, the fact that both parties were

87. Depending on their decisions during the experiment, participants stood to gain an average of €12.

88. Section 241 (Duties arising from an obligation) of the German Civil Code (BGB) reads:

- (1) By virtue of an obligation an obligee is entitled to claim performance from the obligor. The performance may also consist in forbearance;
- (2) An obligation may also, depending on its contents, oblige each party to take account of the rights, legal interests and other interests of the other party.

BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Jan. 2, 2002, BUNDESGESETZBLATT [BGBl.] I, § 241. We applied the German Civil Code because the experiment was conducted in Germany. As discussed in Part I, specific performance is the default rule in Germany. In the experiment we made the German legal default more salient in the experimental condition by specifying to promisees that they can rely on the specific performance remedy.

89. Individuals in experiments are more likely to comply with actual, legally valid contracts. See Stephan Tontrup et al., *The Expressive Function of Contracts* (2010) (unpublished Max-Planck working paper series) (on file with author).

90. Although we cannot replicate the full reality of the outside world inside the laboratory context, we did bring into the laboratory the most important factor under examination: the contract. Exit interviews with participants confirmed that they understood that they had closed real contracts instead of hypothetical contracts.

91. Steven D. Levitt & John A. List, *Field Experiments in Economics: The Past, the Present, and the Future*, 53 EUR. ECON. REV. 1 (2009).

involved with the contract performance further enhanced the degree of realism. This aspect of the design resembles more closely the mutual duties typically shared by contracting parties.

Finally, we ensured that participants in the experiment were not merely students. By including workers or employees from the public and the private sectors, our observations are based on a sample that includes a broad segment of the general public.

C. Contract Formation

We assigned participants to different roles: A (promisor), B (promisee), and C (outside bidder). The participants were presented with the option of signing a binding contract to perform an individual task with a shared objective that results in a joint monetary payoff for both contracting partners.⁹² The goal of the task was to position a slider on a computer screen at the middle point of a scale (indicated at point 50 on a scale of 0 and 100).⁹³ A total of 48 sliders appeared on the screen. While each slider was initially positioned at 0, a click of the mouse stopped the slider at any integer location between 0 and 100. The final position of the slider was displayed only when participants stopped its movement. The participant could readjust the slider an unlimited number of times. The computer program displayed the number of sliders that were positioned correctly. To complete the task successfully, A and B together had to position 120 sliders in total.⁹⁴ The participants had ten minutes to complete the task.

Upon completion of the task, A and B could sell their joint work to the experimenter for a total amount of €10. The €10 was split on the basis of the terms stipulated in a contract entered into between participants A and B prior to the execution of the task.⁹⁵ We provided participants with the basic content of each of the available contracts, allowing the contracting parties to choose between a few different terms.⁹⁶ The participants selected from one of the following contract conditions:

92. In the language of experimental studies, parties become “players of a game” involving “real effort” tasks.

93. On the methodology applied for this task, see David Gill & Victoria L. Prowse, *A Novel Computerized Real Effort Task Based on Sliders* (Institute for the Study of Labor, IZA DISCUSSION PAPER 5801, 2009), available at <http://ssrn.com/abstract=1732324>.

94. The task is successfully completed regardless of the distribution of the correctly positioned sliders. Any combination that totals 120 is sufficient to successfully complete the task.

95. If one party refused to participate, they both earned nothing from the contract, but the breaching party had to give the other compensation. Compensation consisted of the amount that the other party would have earned if the contract had been fulfilled. The actual amount again depended on what payment scheme the parties stipulated in the contract they agreed upon.

96. We are aware that this design is more complicated than exogenously imposing all terms. Still, by offering a few standard forms to choose from, participants were alerted to the fact that they were concluding a legally valid contract. We believe that this

Contract 1—Merit-Based Contract: This contract divided the payoff exclusively on the basis of the individual performance of the contracting parties. If the contracting parties successfully completed the task by adjusting the sliders at least 120 times, the total pay off of €10 was distributed between the parties depending on the proportion of sliders that each player adjusted individually. For example, if A adjusted 70 sliders while B adjusted 60 sliders, A would earn €5.40 and B would earn €4.60.

Contract 2—Equal Division Contract: This contract split the earnings independently of the individual contribution to the total amount of successfully positioned sliders. Each party thus earned €5 as soon as the parties managed to adjust 120 sliders correctly overall.

Contract 3—Graduated Division Contract: Like Contract 2, this contract divided the earnings evenly unless the faster party correctly adjusted at least 50% more sliders than the slower party. If, for example, A adjusted 100 sliders, while B only adjusted 30, the contracting parties were paid in proportion to the results.

The different contracts were selected on the basis of the following procedure: One participant offered the terms of contract (1, 2, or 3) and the other participant agreed or declined. A valid contract required the agreement of both parties. If B rejected A's contract offer, the initiative to offer terms switched to B. If the parties failed to reach an agreement on the selection of a contract, the experiment ended for this pair of participants. Each participant received a flat fee of €4 for attending the experiment. Additional earnings depended on the decisions of participants in the experiment.

D. Outside Offer: Efficient Breach Opportunity

While B completed the task of positioning the sliders, A received an attractive outside offer (option) from a third participant (C). Participant C offered to pay Participant A €15 to engage in the joint task involving the adjustment of 80 sliders.⁹⁷ If A accepted the contract offer of C, A would not be able to perform the contract with B. As a result of breaching the contract with B, A would relinquish the expected payoff she would have received under the terms of her contract with B.

If A breached the contract, B received €5 as compensation for the breach (as opposed to the €5 he could have earned from the contract if the task was completed correctly). A could either accept or reject the third-party offer. Once A accepted the offer from C, B was informed about the intended breach of the contract by A and that B would be compensated with €5 in case of breach.

The third party, C, was able to make offers to one player of each pair of contractual partners, either A or B. Participant C earned €1 for each successfully executed and performed contract with A players: Although C owed €15 to A as a

increase of external validity and realism outweighs the enlarged complexity of the experiment.

97. To complete the original contract between A and B, subjects had to adjust a total of 120 sliders. The outside offer from C requires that only 80 sliders be adjusted.

result of the contract, C obtained €16 by selling the outcome of the performances to the experimenter.

If a contract was not completed, C neither earned money, nor had to pay €15. In cases where the contract was enforced using specific performance, or if C was asked to withdraw her offer, the experimenter did not propose to buy the performance outcome. Instead, the offer was withdrawn automatically.

E. Enforcement by the Contract Promisee: The Experimental Manipulation

We divided promisees (participants in the role of B) into two groups.⁹⁸ In the specific performance experimental group, B could exercise the specific performance remedy, forcing A to carry out the contractual obligations. Although this was the applicable default rule,⁹⁹ it was explicitly clarified in the contract that a default of specific performance applied to the contract. This provided B with three options (action choices). Option 1 allowed A to breach the contract and to receive damage compensation for the full expectation value of the contract. Option 2 relied on specific performance to enforce the original contract with A. Option 3 prevented the breach by instructing the third party, C, to withdraw the outside offer.

In the control group, the specific performance remedy was not available to B. However, as was the case in the specific performance experimental group, B was able to prevent the breach (see Option 3 above) by instructing the third party (C) to withdraw the offer. Again, B was informed that the third party would withdraw the offer if requested to do so. Alternatively, B could allow the breach (Option 1 above).

Note that the financial benefits of the informal enforcement (Option 3) and legal enforcement (Option 2) options are identical: The third-party offer would be withdrawn automatically in both instances. Only the nature of the remedy was different: In the experimental group, B had a *legal* right to prevent breach on top of having the power to prevent the breach without using the legal remedy; in the control group, B had no legal right to insist on performance but could still demand that C withdraw the outside offer. With this design, we sought to isolate the effect the right of specific performance had on participants' decision-making. We asked participants in both groups whether they believed that their partner would enforce the contract or not. We asked Player A to make a wager on their prediction. Participants could select any amount, but had to bet at least one cent. If the estimation was correct, the player received twice the wagered amount. If the estimation proved incorrect, the wagered amount would be lost. Participants retained the remainder of the 100 cents that they did not wager. Bets should reflect the confidence of a participant's prediction.

98. We implemented two conditions; both groups received different treatments.

99. Under German law, specific performance follows from section 241 and is the legal default unless parties explicitly rule it out. BURGELICHES GESETZBUCH [BGB] [CIVIL CODE], Jan. 2, 2002, BUNDESGESETZBLATT [BGBl] 42, as amended, § 241 (Ger.).

F. Donations Round

Once the players made their decisions in the contract stage of the experiment, we introduced participants to a surprise second section of the experiment.¹⁰⁰ Both parties received an endowment of 100 cents, and they were asked to decide how much they wanted to donate to the other party. Participants were informed that this was a “costless” donation—regardless of the selected amount, the participants would not retain the remaining amount of money. Therefore, donations below 100 cents could be regarded as a form of punishment. Employing the strategy method,¹⁰¹ we asked the A participants how much they would transfer if their contractual partner B¹⁰² had enforced the contract or allowed the breach. Similarly, we asked B participants to specify a transfer amount assuming that A had declined the outside offer or breached the contract.

This stage of the experiment examined how much each participant disapproved of the actions of their contract partner. If promisees strongly resented the breach, they might not make any donations or might transfer only a small amount. Similarly, promisors could communicate their disapproval of a promisee’s decision to obstruct the breach by lowering their donations. The donation decisions provide more direct information about the judgments of participants. Previously, participants might have accepted compensation, even though they resented the efficient breach, because they preferred to protect their financial interests. In this stage, participants could communicate their judgment without bearing any financial burden.

G. Predictions

The original contract carried certain risks for participants: contracting parties that failed to successfully complete the slider task risked losing the entire earnings. Because B cannot exclude the possibility that the contract task may fail (note also that this depends on A’s action in completing the slider task),¹⁰³ a rational actor should allow the breach of Contract 2 (equal division). Because this contract splits the earnings independently of the individual contributions, the most

100. Although it was announced that the experiment consisted of two stages, the design was not revealed.

101. In the “strategy method,” a participant is requested to react to the various possible actions of her partners in the game. Similarly, in this stage of the experiment participants know that only one of the possible outcomes will materialize. The strategy method was introduced in Reinhard Selten, *Die Strategiemethode Zur Erforschung Des Eingeschränkt Rationalen Verhaltens Im Rahmen Eines Oligopolexperimentes [The Strategy Method to Explore the Limited Rational Behavior in Oligopoly under One Experiment]*, in *BEITRÄGE ZUR EXPERIMENTELLEN WIRTSCHAFTSFORSCHUNG* 136 (Heinz Saueremann ed., J.C.B. Mohr 1967).

102. Subjects retain their original contractual partners throughout the experiment (no re-matching).

103. Note that B and A are strangers who have not met prior to the experiment. Player B has no prior notion of the likelihood that A will be able to complete the task successfully.

a participant could expect to gain from this contract is €5.¹⁰⁴ Any rational B participant seeking to maximize her financial payoff should have allowed the breach because it assures a certain €5 payoff.¹⁰⁵ This statement applied more strongly if the B player was risk averse.¹⁰⁶

Along the same lines, allowing A to breach was more beneficial if B had entered into Contract 3 (graduated division),¹⁰⁷ unless B had highly optimistic expectations of obtaining a higher payoff by performing the task. We minimized the potential for overly optimistic expectations by explaining in detail the slider task before the experiment. We highlighted the considerable difficulty and randomness involved in positioning the sliders correctly. We emphasized that positioning 50% more sliders than A (which was necessary to obtain more than €5) is next to impossible.

The situation was different if B had entered into Contract 1 (merit-based).¹⁰⁸ Here, B potentially faced a loss by absolving A and accepting the €5 as compensation. If B expects to perform better than A, it is disadvantageous to allow the breach. As we report in more detail below, given the degree of unpredictability and randomness involved with the contract task, participants never selected Contract 1 in the experiment.

The experimental setting created a conflict between the material interests of the contract party, on the one hand, and the protection of the contractual obligation, on the other.¹⁰⁹ When participants selected Contracts 2 or 3, they should have, for the reasons described above, preferred compensation over enforcement.

We predicted that participants in the specific performance experimental group would forgo the certain €5 payoff in order to have their *legal entitlement* respected.¹¹⁰ More specifically, we expected that the assignment of the specific

104. This contract splits the earnings independently of the individual contribution in the total amount of successfully positioned sliders. Each party thus earns €5 as soon as the parties manage to adjust 120 sliders correctly overall.

105. Of course, it cannot be ruled out that some B participants regarded the successful completion of the task and contract as self-evident. Even in such instance, however, B should be indifferent about allowing the breach or not.

106. Risk aversion describes the preference of some individuals to prefer a bargain with a more certain, but possibly lower outcome over bargains with a higher, but more uncertain payoff. See Kenneth J. Arrow, *The Theory of Risk Aversion*, in ASPECTS OF THE THEORY OF RISK BEARING 90 (Yrjö Jahnssonin Saatio ed., 1965).

107. This contract divides the earnings evenly unless the faster party correctly adjusts an additional 50% more sliders than the slower party. See *supra* Part II.C.

108. The Contract 1 option divides the payoff exclusively on the basis of the individual performance of the contracting parties.

109. On the expressive effect of contracts, see Tontrup et al., *supra* note 89 (observing contract compliance even when enforcement is impossible).

110. Of course, €5 is a relatively small amount. One might object that results might not hold up in high-stakes situations. Note, however, in cross-cultural experiments, for instance involving ultimatum games, experimental game theory results have proven to be very robust also in high-stakes situations. See, e.g., Lisa A. Cameron, *Raising the Stakes*

performance remedy would cause participants in the experimental condition to reveal a stronger preference to enforce the contract than respondents in the control group. This main effect can be captured in the following hypothesis.

Hypothesis 1: Participants who have a right to specific performance will enforce the contract more often than participants in the control group.

A breach does not make any of the contracting parties worse off.¹¹¹ In fact, in a Contract 2 setting, the breach presents a Pareto improvement. Player B should welcome the breach because it results in a certain payoff of €5. On the other hand, the efficient breach creates friction with the deontological norm that promises must be kept. Our experiment was designed to examine the interaction between utilitarian and deontological norms. Generally, when normative criteria are ambiguous, the economic experimental literature has demonstrated that individuals tend to adhere to the norm that best serves their self-interest.¹¹² Moreover, individuals tend to expect others to adhere to those norms, even when it is not in the self-interest of the latter.¹¹³

Following prior literature, we expect that the breaching party will favor the Pareto norm and will expect that the contracting partner will reason accordingly and thus absolve her partner from the contractual duties. We assume that this expectation will be influenced by whether specific performance is available as a default remedy. The presence of specific performance should weaken the expectation that the breach will be permitted. Along these lines, we also assume that participants will be less confident¹¹⁴ that the other party will permit the breach when specific performance is the default remedy.

in the Ultimatum Game: Experimental Evidence from Indonesia, 37 *ECON. INQUIRY* 1 (1999). The effect sizes in our experiment are comparable to the rates of rejection of offers in traditional ultimatum games. Our scenario is not fundamentally different from either of these prior experiments. In the ultimatum game, subjects respond to a violation of a distributive fairness norm. From these factors, it appears not unlikely that our results might hold in high-stakes situations.

111. A Pareto improvement makes at least one individual better off without making anyone worse off. See DREW FUDENBERG & JEAN TIROLE, *GAME THEORY* 18–23 (1st ed. 1983).

112. On self-serving biases in normative judgments, see Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 *J. ECON. PERSP.* 109, 110–16 (1997); see also James Konow, *Fair Shares: Accountability and Cognitive Dissonance in Allocation Decisions*, 90 *AM. ECON. REV.* 1072, 1088 (2000).

113. Self-serving assessments of fairness are likely to occur in morally ambiguous settings in which competing “focal points” are salient. Examples are public-good games with asymmetric windfall endowments. For instance, agents with the higher endowment expect the other party to invest an equal amount, whereas the party with the lower endowment expects proportional contributions. A violation of the expectations is perceived as unfair by both parties. See Laurent Denant-Boemont et al., *Punishment, Counterpunishment and Sanction Enforcement in a Social Dilemma Experiment*, 33 *ECON. THEORY* 145, 165–66 (2007).

114. We will examine this by looking for a treatment effect in the confidence measure.

Hypothesis 2: Participants overestimate the willingness of their counterpart to accept compensation and allow the breach of contract.

When the original contract is breached by one of the parties, players A and C obtain extra gains from the trade, whereas B is at least no worse off and can always obstruct the breach. The only difference between the experimental and control groups is the nature of the remedy: While B's in both groups can prevent the breach, only one group also has the legal right to obstruct the breach. Even though the effect of the contract breach is identical to B players in both groups, we expect that they will resent the breach especially when the legal remedy is available. As described above,¹¹⁵ we added a stage in the experiment where participants could make costless donations to one another. If participants feel more entitled to performance because they have a legal right to performance, we expect a stronger resentment of the breach than compared to when players merely have the actual power to prevent breach. We assume that the default remedy of specific performance increases the perceived violation caused by the breach, inducing higher levels of punishment.

*Hypothesis 3: The sense of entitlement created by the right of specific performance increases the subjects' sensitivity to the contract breach and, consequently, reduces the transfer amounts.*¹¹⁶

Finally, we expect retaliation by A players when the efficient breach is obstructed. As explained above, participants can be expected to react adversely to the breach of contract. While the breaching party should focus on the gains of the efficient breach, the victim of the breach may have less regard for the joint gains due to his or her sensitivity to the deontological aspects of the contract breach. These contrasting perceptions of the normative conflict should shed light on the difficulties involved in negotiating a breach of contract.

Hypothesis 4: B players will condemn the breach, whereas A players will resent the obstruction of the gains of trade.

H. Procedures

We conclude this Part with a brief summary of the procedures used in our study. The experiment was partially computerized in z-Tree.¹¹⁷ Subjects were recruited using ORSEE.¹¹⁸ Experiment and pilot studies were conducted in

115. See *supra* Part II.F.

116. Note, if only the breach is triggering punishment rather than assigning the specific performance right, we should see no treatment effect.

117. z-Tree (Zurich Toolbox for Readymade Economic Experiments) is a software package widely used to conduct economic experiments. See Urs Fischbacher, *z-Tree: Zurich Toolbox for Ready-made Economic Experiments*, 10 EXPERIMENTAL ECON. 171 (2007), available at <http://www.iew.uzh.ch/ztree/index.php>.

118. ORSEE is a Web-based Online Recruitment System, specifically designed to organize economic experiments. Participants subscribe and receive an e-mail that announces the time and date of the experiment. Ben Greiner, *An Online Recruiting System for Economic Experiments*, in FORSCHUNG UND WISSENSCHAFTLICHES RECHNEN 79 (Kurt Kremer & Volker Macho eds., 2003).

Germany at the Max Planck Institute of Economics in Jena and at the Laboratory for Experimental Economics at Bonn University. A total (N) of 166 individuals participated in the experiment. We divided participants in two groups (treatments): the Specific Performance experimental group and the No Right to Enforce control group. Subjects received a show-up fee of €4, and none of the subjects earned less than €9. The experiment lasted 45 minutes. We collected 36 observations for each set of participants. We examined the main effect of whether participants insisted on enforcing the contract or accepted the breach. As confirmed in our prior pilot studies, relatively few participants decided to adhere to the original contract after receiving the outside offer. We excluded from the analysis those pairs of participants in which the promisor, A, had decided not to breach the contract.¹¹⁹

III. FINDINGS: THE EXPRESSIVE EFFECT OF LEGAL RULES

In this Part, we report the findings of our study. Briefly summarized, we observed that almost all promisors (A players) breached the original contract but also expected to be discharged from performance upon payment of expectation damages. In response, most promisees (B players) tended to enforce the original contract when specific performance was the default remedy. Promisors did not expect that promisees would enforce the contract. The lower donations suggest that efficient breaches induced more resentment among promisees when a specific performance remedy was available.

A. Compliance with the Original Contract

As expected, nearly all participants breached the original contract with the original promisee (B). The experiment was designed to encourage breach: A promisor (A) is aware that, far from being detrimental, the breach is at least mildly beneficial to the promisee as well. Damage compensation is preferable to the promisee even if she is risk neutral. Risk aversion about the task reinforced the self-interest in breaching the contract.¹²⁰

B. Enforcement by the Promisee

We compare the frequency of enforcement by promisees across our two treatments. In Hypothesis 1, we posited that participants would enforce the contract, especially when specific performance was the default remedy.¹²¹

The results can be summarized in a simple 2 x 2 contingency table.

119. The even number of 36 observations in both treatments is coincidental.

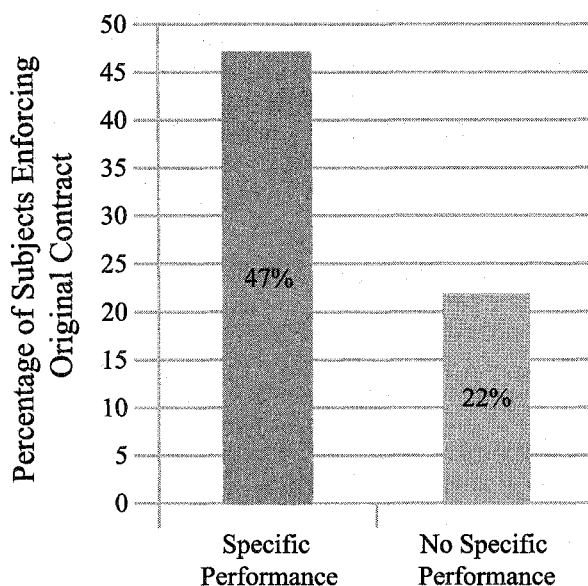
120. See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 *ECONOMETRICA* 263 (1979). Above, we clarified that this holds for Contracts 2 and 3. See *supra* Part II.G.

121. We use the term enforcement here in the broad sense of inducing performance by the promisor. Where necessary, we distinguish between legal enforcement (on the basis of specific performance) and the informal enforcement measure (causing withdrawal of the outside offer).

Table 1. Enforcement Decisions & Availability of Specific Performance

	Specific Performance	No Specific Performance
Enforcement	17	8
No Enforcement	19	28

As illustrated in Figure 1 below, we obtained strong, statistically significant evidence for Hypothesis 1.¹²² Participants in the specific performance experimental group enforced the contract more than subjects in the control group.

Figure 1. Percentage of Subjects Enforcing the Original Contract: Specific Performance v. No Specific Performance

Additionally, all of the 17 participants who enforced the contract in the specific performance experimental group enforced the contract on the basis of the legal default—no one relied on the non-legal enforcement option (where the third party would withdraw the offer).

Despite the fact that the contract breach was Pareto efficient—making at least one individual better off without making anyone worse off—most participants in the specific performance experimental group obstructed the

122. A 2 x 2 Pearson's chi-square test yielded a score of 10.356, a strongly significant effect with a two-tailed p-value of $p=0.001$, which is below our level of significance of $\alpha=0.05$. Because we had only six observations in the No-Right/Enforcement cell of our contingency table, we confirmed our results with Fisher's exact test. The test yielded a significant result: A two-tailed p-value of $p=0.010$, which is below our test level of $\alpha=0.05$, the one-tailed p-value being $p=0.005$.

breach.¹²³ This suggests that respecting the contract (*pacta sunt servanda*) is an important value to promisees when the contractual obligations are protected by a default of specific performance.¹²⁴

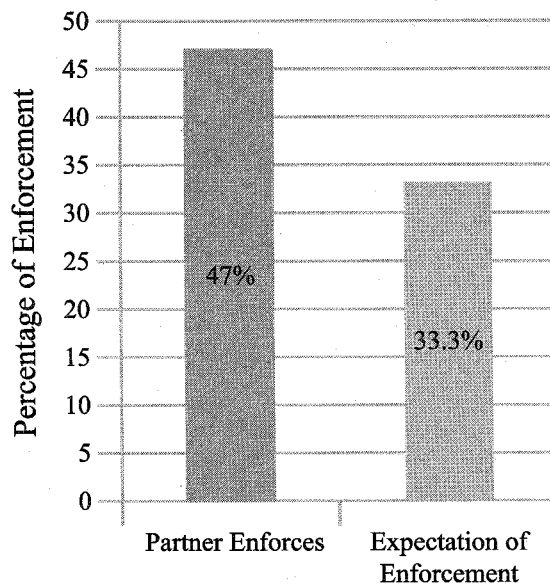
C. The Breaching Party's Expectations About Enforcement

In Hypothesis 2, we predicted that when promisors (participants in the role of A) breached the contract, they would underestimate the negative reaction of the promisee (B) to the efficient breach. We compared the results of the enforcement expectations of promisors (A) with the actual decisions of the promisees. We display the data in a 2 x 4 contingency table:

Table 2. Actual v. Expected Enforcement

Participants Choose to Enforce the Contract	Specific Performance Condition	Specific Performance Condition: Expected Enforcement	No Specific Performance Condition	No Specific Performance Condition: Expected Enforcement
Yes	17	9	8	6
No	19	27	28	30

Figure 2. Specific Performance: Asymmetry of Actual v. Expected Enforcement



123. See *supra* Table 1.

124. Also, we observed a small but insignificant difference in the amount of B participants who declined the outside offer (four in the No Right to Enforce group and seven in the Specific Performance group).

In support of Hypothesis 2, we find significant evidence of a disparity between the expectations of contracting parties when specific performance was the remedy.¹²⁵ Promisees enforced more often than promisees had expected. Interestingly, expectations and enforcement decisions matched each other perfectly in the control group (no specific performance). These findings suggest that when there was a specific performance default, promisees regarded efficient breaches as much more objectionable than promisors. Also, promisors failed to anticipate the influence of specific performance on a promisee's decision to enforce the contract.

D. Confidence in Estimations

We measured the confidence of: (1) promisees' predictions whether their promisor would breach the contract; and (2) promisors' predictions whether they would be held to the original contract by their promisee.

We observed a significant but small treatment effect: When the contract specified specific performance, participants were less confident (investing a mean amount of 46.9 cents) than when no specific performance was provided (54.8 cents).¹²⁶

This result suggests that participants in the specific performance group were less confident, as compared to participants in the control group, that their contractual partner would accept compensation and release them from performance. Even though participants in the control group failed to anticipate that the promisee would enforce the contract when specific performance was the default, their confidence in the expectation that they would be released from the original contract dropped significantly when specific performance applied.¹²⁷

E. Costless Donations After Breach or Performance

In Stage 2 of the experiment, both parties received an endowment of up to €1 that they could donate to the other party. Regardless of the selected amount, the participants would not retain the remaining amount of money. Implicitly, by transferring lower amounts, participants were able to indicate their disapproval with the behavior of the other party.

To avoid misunderstandings, we explicitly clarified in the instructions that no one would retain the residual amount. We asked promisees to indicate how

125. A 2 x 2 Pearson's *chi*-square test yielded a score of 3.853, a significant effect with a two-tailed *p*-value of $p=0.049$, which is below our significance level of $\alpha=0.05$. We confirmed our results with Fisher's exact test. The test yielded a significant result, a one-tailed right *p*-value of $p=0.042$, which is below our test level of $\alpha=0.05$.

126. To test for significance, we conducted a *t*-test for independent samples. We found a two-sided result of $p=0.057$ (one-sided result $p=0.029$), with a confidence level of $\alpha=0.05$.

127. Because most breaching promisors expected to be relieved from the original contract, we have fewer observations for participants that expected enforcement. The level of confidence here seems relatively consistent across treatment groups (56.8 cents in the experimental group and 57.5 cents in the control treatment), but given the small number of observations we should not try to draw conclusions from this result.

much they would donate if the contract was breached and when it was fulfilled.¹²⁸ We compared the results for our two treatments. We observed that participants donated lower amounts if the contract was breached when specific performance was the remedy (a mean transfer of only 37.05 cents).¹²⁹ By contrast, when specific performance was not available an average transfer of 60.38 cents occurred.¹³⁰

When participants assumed that the promisor decided not to accept the outside offer, the donations were especially large.¹³¹ Only small differences existed between the experimental (a mean of 92.72 cents) and the control group (85.27 cents).

The donation stage allows us to better understand the motives of contract enforcement. If a promisee harbors no resentment but simply wants to protect her right to enforce the contract, she might do so and still donate the full amount of money or at least some large fraction of it. But if a promisee strongly disapproves of the breach, it might be reflected in much smaller donations.

The findings indicate that efficient breach generated considerable resentment when specific performance was the default remedy. In that case, promisees donated only one-third of the endowment—that is, they preferred to relinquish two-thirds of the endowment rather than have it end up in the hands of the promisor. Interestingly, when specific performance was not applicable as the default, promisees did not react as adversely to an efficient breach.

Also, when the promisee was informed that the contract was not breached, participants donated much larger sums to the promisor. This is puzzling because in our setting, the promisor *and* promisee are better off financially if the contract is breached. By breaching, the promisor removes the uncertainty that the promisee has regarding the successful completion of the task and the €5 payoff.¹³² This suggests that the intrinsic value of contract performance outweighed some of the financial benefits of the contract when a default of specific performance applied.

128. We employed the strategy method in this stage of the experiment: subjects state contingent choices for every potential decision that they face. *See* Selten, *supra* note 101, at 136–68.

129. While subjects could only make binary choices in the rest of the experiment, here the participants made use of the opportunity to quantify their approval more precisely in the continuous measure (0–100 cents). In contrast to our expectation to get polar transfers—either you approve the breach/enforcement or you do not—participants often indicated amounts in the order of 90 or 75 cents.

130. A t-test for independent samples showed a one-tailed p-value of $p=0.037$ with $\alpha=0.05$.

131. In fact, the donations were so high that it caused a ceiling effect in both the treatment and control groups. A ceiling effect occurs when there is no window to find a treatment effect. Here, for example, the maximum is 100 cents. In order to obtain a significant effect relative to the 88.72 cents, participants would need to transfer some amount above 100 cents, which is impossible given that the endowment is only 100 cents.

132. We distinguish of course between Contracts 1, 2, and 3. *See supra* Part II.C.

Finally, the experiment also measured the disapproval of the breaching promisor when the disappointed promisee had obstructed the efficient breach. We asked participants to consider a donation while imagining that the breach was accepted and the contract was enforced. We compared the transfers in both hypothetical situations and across the experimental and control groups.¹³³ When promisors assumed that the breach was accepted, they transferred 86 cents. By contrast, when the efficient breach was denied they transferred only 22 cents. So, despite being subject to a valid, enforceable contract, promisors who breached the contract resented the other party for insisting on fulfillment of the contract. This result demonstrates how deep the normative conflict is between the contracting parties when specific performance is available. Each contracting party disapproves of the other's decision.

F. Motivations of Promisees

To shed light on the motivations of each of the participants, we presented promisees (B players) with an open format questionnaire at the conclusion of the experiment.¹³⁴

We asked the promisees about their motivations when they enforced the contract in the specific performance condition. Almost all respondents stated that contracts should be fulfilled (15/17).

Some respondents indicated that they sought to protect themselves from the violation of their legal right (10/17). A little over half of the respondents indicated that they did not want their investments in the task to be pointless (9/17).

Participants who allowed the breach were motivated primarily by the certain payoff of €5 (13/19) and acknowledged that they could help the other party without suffering a loss (15/19).

Participants in the control group appeared to have a motivation that the other participants in the experimental group did not share. Some deemed compensatory damages as a fair outcome (7/36). This suggests that the legal framework influenced fairness benchmarks. When specific performance was available, participants evaluated breach negatively in light of fairness considerations regarding cooperation and defection. Without the specific performance default, participants perceived the breach in a more utilitarian sense, focusing on the gains from trade.

Overall, contract enforcers focused on the moral aspects of the breach, whereas participants who allowed the breach were more focused on the gains from trade that would result for themselves and their contractual partner. Two independent raters (student assistants) classified the motivations, which we termed

133. A two-tailed t-test yielded a p-value of $p=0.000$ with $\alpha=0.05$.

134. We are aware that the responses might represent *ex post* rationalizations of prior choices and that deliberation would not uncover the unconscious reasons that drove the subject's motivations during the experiment. Nevertheless, the resulting qualitative evidence aligned well with the behavioral data and the motivations we provided in our hypothesis as driving factors for the entitlement effect of the default remedy.

deontological for those participants who insisted on keeping the contract per se and *utilitarian* for those who focused on the gains from trade. The motivations fit to the behavioral data. Significantly more participants reported having a deontological motivation for their decision when specific performance applied. By comparison, in the control group a majority indicated that utilitarian motives influenced their decisions.¹³⁵ To summarize, participants' moral intuitions about contract breach depended on the particular institutional legal setting. Individual decisions were not fixed by moral priors but were instead affected by the legal framework.

G. Motivations and Expectations of Promisors

We also presented questionnaires to promisors (A players) in order to understand the motivations for breaching the contract or declining the outside offer, and to gauge the expectations of promisors.

Participants in the specific performance experimental group (n=27), who held the expectation that the other party would allow the breach, emphasized that the other contracting partner had nothing to lose by allowing the breach (22/27). A majority of respondents added that promisees should prefer the guaranteed €5 payoff over the uncertain payoff that would result in the case of performance (15/27). Some participants emphasized that the promisee should not object to the breach because "money is money," regardless of whether it was earned from the original contract performance or as compensation resulting from breach (10/27).

Only a few participants (n=9) expected enforcement by the promisee. When expected, promisors believed that enforcement might be induced by a sense of betrayal (6/9) and/or a desire to punish the breaching party (5/9). A majority indicated that they expected that the other party might resent not being able to share more in the additional gains obtained by the promisor and would thus seek to foil these gains by blocking the trade with C (5/9). Finally, two participants indicated that they expected that the promisee would enforce the original contract without feeling guilty about spoiling the additional gains of trade, because the legal default justified it. It is remarkable that so few participants anticipated the entitlement effect of specific performance.

The motivations of participants, as obtained from our questionnaires, nicely matched our behavioral data: Promisors approached the breach from a strictly utilitarian framework, focusing nearly exclusively on the gains from trade. All but one promisor provided utilitarian justifications for their decision to breach the contract. We observed little difference across the treatments, which suggests that specific performance did not significantly affect the motives of promisors.¹³⁶ This stands in contrast to the deontological viewpoints of promisees when specific performance was the default.¹³⁷

135. The comparison of both treatments is based on a Fisher test $p=0.03$.

136. The comparison based on a Fisher test was $p=0.00$.

137. See *infra* Part IV.A.

Finally, promisors seemed to expect that promisees would not enforce the contract. By failing to recognize how the entitlement effect influences promisees' moral evaluation of the breach, promisors perhaps assumed that the enforcement preference of the promisee was motivated by mere spite. As a result, promisors seemed to punish their contractual partner by withholding costless donations in the final round. Meanwhile, promisees focused on the ethical obligation to perform the contract. When the promisor had breached the contract, promisees likewise punished their contractual partner by withholding costless donations to the promisor. As we discuss in more detail in the next section, these competing normative viewpoints on contract breach likely complicate private bargaining between parties.

IV. DISCUSSION AND POLICY IMPLICATIONS

A. *The Contextual Nature of Immoral Breach*

The sanctity of a promise is considered a strongly resonant moral principle.¹³⁸ Most individuals believe that breaking a promise is immoral.¹³⁹

Although it is well recognized that legal and moral obligations do not always coincide,¹⁴⁰ there is some consensus that a legally valid contract also imposes certain moral obligations on a promisor.¹⁴¹ Indeed, cultural psychologists

138. On the moral obligations that result from making promises, see, for example, JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* 308–10 (1st ed. 1980) (the binding force of promises is justified by promises' coordination providing attributes); FRIED, *supra* note 9, at 14–17 (a promisor incurs a moral obligation by intentionally invoking a social convention whose purpose is to cause others to expect the promised performance); DAVID HUME, *A TREATISE OF HUMAN NATURE* bk. 3, pt. 2, § 5 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2007) (1739); IMMANUEL KANT, *GROUNDWORK OF THE METAPHYSIC OF MORALS* 90 (H.J. Paton trans., Harper & Rowe 1964) (1785) (promise-keeping is one of four illustrations of the categorical imperative: Keeping promises would make promising, and the very purpose of promising, itself impossible, "since no one would believe he was being promised anything"); IMMANUEL KANT, *GROUNDWORK OF THE METAPHYSIC OF MORALS* 15, 32, 38 (Mary J. Gregor ed. & trans., Cambridge Univ. Press 1997) (1785); Joseph Raz, *Promises and Obligations*, in *LAW, MORALITY AND SOCIETY* 210, 222 (P.M.S. Hacker & Joseph Raz eds., Clarendon Press 1977) (promises bar factors that might otherwise be a reason not to perform the contractually described actions ("exclusionary reasons")); JOSEPH RAZ, *THE MORALITY OF FREEDOM* 42–69 (1st ed. 1986); DAVID ROSS, *THE RIGHT AND THE GOOD* 16–47 (Philip Stratton-Lake ed., 2002) (1930); J.L. MACKIE, *ETHICS: INVENTING RIGHT AND WRONG* 110–11, 116–18, 184–85 (1st ed. 1977) (deriving from Hobbes and Hume the notion that it is in a promisor's self-interest to keep his word); John Rawls, *Two Concepts of Rules*, 64 *PHIL. REV.* 3, 14 (1955) (a promise removes from a promisor certain preferences not to perform, although these might otherwise be perfectly proper grounds on which to refuse to make a promise in the first place).

139. See *infra* Part IV.A.

140. A moral obligation is something we ought to do or refrain from doing, evaluated on one or more normative criteria of justice. A positive legal obligation, by contrast, is an obligation that a legal system enforces.

141. For empirical evidence, see, for example, Feldman & Teichman, *supra* note 84, at 31–32 (showing that moral evaluations about contract performance are affected by

have identified the rule of contract as one of only three universal moral norms.¹⁴² A broad field of philosophy of contracts scholarship has attempted to describe and define the source of contract as a moral obligation.¹⁴³ Several principles are invoked to justify the use of legal force to enforce legally binding contracts: consent,¹⁴⁴ will,¹⁴⁵ expectations,¹⁴⁶ reliance,¹⁴⁷ efficiency,¹⁴⁸ fairness,¹⁴⁹ and bargaining.¹⁵⁰

non-monetary aspects, such as the source of uncertainty regarding damage payments and the type of contract); Wilkinson-Ryan & Baron, *supra* note 86 at 405 (providing survey-based experimental evidence). Scholars have defined the potential overlap between moral and legal obligations as “valid legal obligations”—namely, obligations that are morally appropriate to enforce. See, e.g., Larry A. DiMatteo, *The Norms of Contract: The Fairness Inquiry and the “Law of Satisfaction”*—A Nonunified Theory, 24 HOFSTRA L. REV. 349, 377 (1995) (proposing that contract law serves values such as “certainty of contract, predictability, morality, fairness, and justice”); Lon L. Fuller, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630, 644–48 (1958); H. L. A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 621–24 (1958); Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551, 1564 (2009) (“The idea that performance matters is a difficult point to support directly. It is the sort of position toward which one tends to be drawn by instinct rather than led by explicit direction.”). *But see*, e.g., P.S. ATIYAH, PROMISES, MORALS, AND LAW 172–215 (1st ed. 1981) (expressing the view that contracts are promises but that neither are a source of obligation); LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 155–223 (1st ed. 2002); Shavell, *supra* note 8, at 466–69; Shavell, *Breach Immoral?*, *supra* note 36, at 439. See also STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 304–12, 338–55, 638–40 (2004); Shavell, *Breach Not Immoral*, *supra* note 36, at 1570 (When recognizing that contracts are unavoidably incomplete, intended promises should be kept but not unintended ones. Arguing that, if a contingency is not explicitly addressed in the contract, then the moral duty to perform in the contingency is governed by what a completely detailed contract addressing the contingency would have stipulated.)

142. In a recent paper, Tontrup et al. observe that promises are broken more easily than contracts. See Tontrup et al., *supra* note 89. For additional experimental evidence of promise-keeping as a moral commitment, 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).

143. As Randy Barnett describes, “the principal task of legal theory . . . is to identify circumstances when legal enforcement is morally justified.” Barnett, *supra* note 14, at 299. Determining the moral character of obligations is the province of political philosophy. See LON FULLER, THE MORALITY OF LAW 1–2 (rev. ed. 1969); ROBERT NOZICK, PHILOSOPHICAL EXPLANATIONS 503 (1981) (“Political philosophy . . . is mainly the theory of what behavior legitimately may be enforced, and of the nature of the institutional structure that stays within and supports these enforceable rights In no way does political philosophy or the realm of the state exhaust the realm of the morally desirable or moral oughts.”). See generally ROBERT S. SUMMERS, LON L. FULLER 78–86, 123–26 (1984) (biography including discussion of Fuller’s view of contracts).

144. Following this theory, “the consent of the rights holder to be legally obligated is the moral component that distinguishes valid from invalid transfers of alienable rights in a system of entitlements.” Barnett, *supra* note 14, at 299. As such, legal enforcement is morally justified because the promisor voluntarily performed acts that conveyed her intention to create a legally enforceable obligation by transferring alienable

Moral criteria are often used to advocate for particular remedies for breach.¹⁵¹ The consent theory of contract law, for instance, considers contract breach unethical. This is because once a contract is consented to the legal entitlement to performance belongs to the promisee.¹⁵² From this vantage point, specific performance provides the more obvious remedy for most, but not all, instances of breach. Similarly, normative, utilitarian theories of wealth maximization are applied in the law and economic literature to argue both in favor of and against specific performance as the appropriate remedy for breach.¹⁵³

Our study does not set out to contest any particular philosophical perspective on contract breach. Nor do we aim to develop a new philosophical theory on the moral foundations of contracts. Rather, our study provides

rights. *Id.* at 304 (“The consent that is required is a manifestation of an intention to alienate rights.”); see also P.S. ATIYAH, PROMISES, MORALS, AND LAW 177 (1981) (“[P]romising may be reducible to a species of consent, for consent is a broader and perhaps more basic source of obligation.”).

145. ATIYAH, *supra* note 144.

146. A promise may give rise to expectations in the promisee and the fact that nonperformance would disappoint those expectations may count as a reason favoring performance. For examples of this theory, see Pall S. Ardal, *And That's a Promise*, 18 PHIL. Q. 225, 233–37 (1968); Jan Narveson, *Promising, Expecting, and Utility*, 1 CAN. J. PHIL. 207, 213–20 (1971); see also R. S. Downie, *Three Accounts of Promising*, 35 PHIL. Q. 259, 263–64 (1985) (attributing this argument to Adam Smith).

147. Theorists who focus on the promisee's reliance include: L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 53–56 (1936); Neil MacCormick & Joseph Raz, *Voluntary Obligations and Normative Powers*, 46 ARISTOTELIAN SOC'Y. 59, 62–63 (Supp. Vol. 1972); see also HENRY MATHER, CONTRACT LAW & MORALITY 10 (1999) (arguing that enforcement is necessary to protect relying promisees or other persons from serious harm resulting from detrimental reliance). *But see* Richard Craswell, *Against Fuller and Perdue*, 67 U. CHI. L. REV. 99, 154–61 (2000) (critiquing the classic classification of damages in expectation, reliance, and restitution and proposing a novel division into remedies above expectation, remedies that approximate expectation, and remedies below expectation).

148. See Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1265–66 (1980) (enforceable contracts increase social utility by enabling reliance by contracting parties).

149. See *supra* Part I.B.

150. See *supra* Part I.B.

151. As Richard Craswell has pointed out, however, philosophical theories of contractual obligations do not necessarily provide direct answers on specific issues in contract law, such as the optimal interpretation of contracts or the content of substantive rules in contract law. “As that literature is concerned with the question of how promises could bind even in the best of circumstances, its focus is implicitly limited to cases where there is no question that a promise has been made, and no difficulty in determining the exact content of the promised action.” Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 505 (1989) (arguing that much of the current philosophical debate about the binding force of promises is irrelevant to contract law's choice of background rules).

152. Barnett, *supra* note 14, at 311.

153. See *supra* Part I.B.

descriptive insight into the moral beliefs that individuals hold about contract breach. In this regard, our findings provide some empirical grounding for the utilitarian concept of efficient breach.¹⁵⁴

Our experiment was designed so that the conditions most relevant to the moral judgment of a breach of contract were held constant throughout the experiment. Efficient breach generated the same surplus in all conditions, identical expectation damages were guaranteed, contracts were based on clear consent expressed by both parties, and identical bargaining procedures were applied throughout.¹⁵⁵

Even when participants were better off financially if they accepted compensation (expectation damages), disappointed promisees in the specific performance experimental group generally insisted on performance of the contract. Although all players were able to prevent breach and obtain performance, the mere availability of a default remedy of “specific performance” caused players in the experimental group to forsake the certain €5 payoff in order to have their legal entitlement respected.¹⁵⁶

On first glance, contract enforcement could be understood as a way to retaliate against the promisor’s decision to breach the contract. Promisees decided to forsake their immediate material interests in compensation, but perhaps they derived some utility from acting spitefully. Indeed, the decision not to make costless donations to the other party suggests that contract breach generated considerable resentment.¹⁵⁷

There are several possible reasons why a promisee might object to the efficient breach: a promise was broken, the original promisee does not get to share in the gains generated by the outside offer, or no prior permission was asked of the promisee. These circumstances were present in both groups of participants, yet only the group with the specific performance default regarded the breach as immoral.¹⁵⁸ This suggests that the specific performance default specifically generated a sense of entitlement, fueling the observed actions.

Because promisees objected more strongly to the efficient breach when the default remedy was specific performance, our results suggest that the latent legal remedy caused a strong moral objection to the efficient breach. Although the default did not affect a promisee’s financial payoffs, it made contract breach more objectionable if specific performance applied. In other words, not all efficient

154. In this regard, our experiment provides information for sociological and bottom-up normative theories of morality in contract obligations.

155. See *supra* Part II.

156. See *supra* Part III.B.

157. See *supra* Part III.E.

158. Similarly, other regarding preferences do not fully account for the observed differences between the experimental and control group. If concern for C drives the result in the control group, something must explain that this concern is muted in the experimental group. Note again that promisees in the control groups (no default remedy of specific performance) were able to likewise prevent the breach. Once the promisee expressed this desire, the third party withdrew the outside offer.

breaches are treated the same—a breach of contract is deemed more objectionable in a legal context where a promisee is assured of specific performance as the default remedy. Even though contracting parties have the freedom to contract around the remedy, the selected default defines how the breach of contract is perceived. One possible interpretation is that a default of specific performance makes the ethical norm to perform the contract more salient.¹⁵⁹

In a fascinating article, Charles Goetz and Robert Scott noticed a tendency of courts to transform default rules into mandatory rules.¹⁶⁰ Goetz and Scott observed that courts treat legislatively created defaults as presumptively fair, resisting alternative rules. Our data indicates that a similar effect is at work with regard to promisees in our experiment. When provided with the opportunity to make costless donations, participants in the specific performance default group showed remarkably strong punishment sentiments.¹⁶¹ Anonymous questionnaires confirmed that these promisees harbored a strong sense of resentment against the efficient breach. Overall, our results suggest that lawmakers' choice of the default remedy affects contracting parties' moral evaluation of contract breaches. In other words, moral intuitions are endogenous to the applicable legal rule; law itself frames the moral intuitions. From the questionnaires conducted at the conclusion of the experiment, we learned that promisors and promisees adopted different moral frameworks when evaluating possible justifications for breach. Promisors seemed to adhere to the wealth-maximizing criterion, focusing on the gains from efficient breach to justify breach upon payment of expectation damages.¹⁶² Promisees, on the other hand, focused on the immoral aspects of the contract breach and the unequal distribution of the gains resulting from the contract breach.¹⁶³

In the remainder of this Article, we further explore the dynamics and causes of this effect. We also discuss the policy implications.

159. Specifically, a lawmaker's decision to implement specific performance as the default remedy might be perceived as a collective commitment to performance as the relevant norm. For more on this interpretation, see *infra* Part IV.C.

160. Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 263–64 (1985); see Randy E. Barnett, *Some Problems with Contract as Promise*, 77 CORNELL L. REV. 1022, 1025 (1992) (expressing criticism that a moral theory of promising alone would have courts enforcing purely moral commitments, “which is tantamount to legislating virtue”).

161. See *supra* Part III.E. Compare mean transfer of 37.05 cents (experimental specific performance group) versus average transfers of 60.38 cents (control group).

162. According to wealth maximization theory, justice is best served by maximizing aggregate wealth. See RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* 115 (1981).

163. Distributive justice concerns itself with the way benefits and burdens are distributed. See JEFFRIE G. MURPHY & JULES L. COLEMAN, *PHILOSOPHY OF LAW* 165 (rev. ed. 1990).

B. The Entitlement Effect of Specific Performance

As described above, a specific performance default influenced the moral evaluation of contract breach. But what made the resentment so strong that promisees decided to forsake the immediate benefits of the damage remedy in favor of the more uncertain return from performance?

One potential explanation for this fascinating result is that the contractual default of specific performance may have created a sense of entitlement among promisees. When specific performance is the official legal remedy, promisees felt more entitled to the performance of the contract. As a result, contract breach and damage compensation became less acceptable.

A rich body of evidence in cognitive psychology shows that individuals place a higher value on items or opportunities that they possess than those they have the option to possess.¹⁶⁴ The endowment effect is commonly explained by the observation that losses loom larger than gains,¹⁶⁵ a bias also known as “loss aversion.”¹⁶⁶ In this context, scholars have argued that remedies are not neutral as to the outcome of negotiations. Even if transaction costs are low and parties are free to bargain, the legal status quo might affect the end result because the initial allocation of rights may influence the value of the underlying resource.¹⁶⁷

The endowment effect has also been documented in the context of legal rules and enforcement. For instance, in their classic review of behavioral effects, Christine Jolls, Cass Sunstein, and Richard Thaler suggest that parties who are awarded a legal privilege by a judge are unlikely to bargain away this right, even if the opposing litigant values the entitlement more strongly, because they are likely to believe they have earned the endowment.¹⁶⁸ In a theoretical contribution, Russel Korobkin has suggested that contracting parties may view substantive default rules as status quo endowments. Because individuals tend to prefer “the status quo to alternative states, they are likely to prefer the default term, whatever it may be, to

164. For this reason, the endowment effect is often described as the gap between the willingness to pay (“WTP”) and the willingness to accept (“WTA”). See Elizabeth Hoffman & Matthew L. Spitzer, *Willingness to Pay vs. Willingness to Accept: Legal and Economic Implications*, 71 WASH. U. L. Q. 59, 64, 89–90 (1993).

165. Kahneman & Tversky, *supra* note 120, at 279.

166. See, e.g., Jack L. Knetsch & J. A. Sinden, *Willingness to Pay and Compensation Demanded: Experimental Evidence of an Unexpected Disparity in Measures of Value*, 99 Q. J. ECON. 507, 509–20 (1984) (providing evidence on loss aversion in experiment involving buying and selling of lottery tickets); Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay–Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005) (presenting methodological clarifications).

167. Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990).

168. Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1497–1501 (1998); see also Ward Farnsworth, *Do Parties to Nuisance Cases Bargain After Judgment? A Glimpse Inside the Cathedral*, 66 U. CHI. L. REV. 373, 381–91, 421 (1999) (documenting the remarkable absence of post-judgment bargaining in nuisance cases).

other options, all other things being equal.”¹⁶⁹ Finally, Jeffrey Rachinski and Forest Jourden showed, on the basis of questionnaires involving hypothetical nuisance disputes, that endowment effects are stronger with regard to resources that are protected by property rules than by liability rules.¹⁷⁰

Our study provides a novel extension of the endowment effect. Rachlinski and Jourden described how property rule protection may induce an increased concern about conservation of natural resources (protection of ponds for migratory birds, rare plants, etc.).¹⁷¹ This suggests that the legal framework influences how people value the property. In our study, by contrast, right holders appear to experience violations of their right as a cost in and of itself. Note that the goal of the original contract was to earn money. By rejecting damage compensation and enforcing the original contract, promisors passed up on the opportunity to immediately accomplish this goal with absolute certainty. Instead of viewing their contractual rights instrumentally as a means to an end, the right itself attained intrinsic value to promisees when specific performance was available. The immediate material effects of the breach of contract were no longer the exclusive concern of promisees—the violation of the *legal right* imposed a psychological cost and, consequently, a preference for enforcement.

This suggests that even if transaction costs are low and parties are free to bargain, the initial allocation of rights affects the value parties assign to their rights.¹⁷² The entitlement effect causes contracting parties to value the right to

169. Russel Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 675 (1998) (questioning claims of optimality based on revealed preference in light of the status quo bias with regard to substantive contract law rules).

170. Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541, 1545 (1998). Our Article shares some common ground with this project. But there are important differences even beyond the major distinctions in subject matter (property law remedies as opposed to contract law *default* remedies) and the methodology of the empirical investigation (hypothetical rather than actual decision-making with real contracts and payoffs). As described in the text above following this footnote, we offer a different interpretation of the results (entitlement effect rather than basic loss version). In contract law, a rule that permits the promisor to breach provided that compensation is paid to the promisee is a liability rule. See *Kronman*, *supra* note 15, at 352. By contrast, specific performance works as an injunction in the sense that the promisee has the right to insist on performance unless the promisor negotiates a voluntary transfer of the entitlement. YORIO, *supra* note 1, at § 1.2; see *supra* notes 26–27 and accompanying text. In this regard, our findings extend some of the insights made in the context of property and liability rules in property law disputes.

171. Rachlinski & Jourden, *supra* note 170.

172. In this regard, the endowment effect modifies the findings of the Coase Theorem that initial allocations of rights do not impact the end result if transaction costs are low. *Id.* at 1545 (“The endowment effect itself implies that a fundamental aspect of the Coase Theorem is wrong—the initial allocation of a right appears to change people’s preferences. If the endowment effect depends upon injunctive relief, however, Coase accurately described rights protected by liability rules, but inaccurately described rights protected by property rules.”); see R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

performance independently from the instrumental purpose of the specific contract. In our study, the entitlement effect was so strong that promisees enforced the contract, even though they would be better off financially if they agreed to receive the compensatory damage award.¹⁷³

C. Specific Performance as an Expressive Default

Our results suggest that legislatively-created defaults are regarded as presumptively fair by promisees, causing them to find fault with later deviations from the defaults.

A related strand of literature states that legal rules, especially if formulated by lawmakers that are perceived to be legitimate, have an expressive effect and align individual preferences with the goals expressed in the enacted norms.¹⁷⁴ One of the most prominent concepts to emerge from this literature is the so-called “expressive function of the law.”¹⁷⁵ By expressing a collective commitment, it is argued, laws can cause individuals to align their behavior with legal commands.¹⁷⁶ Although rational choice theory generally assumes that

173. In contract law, a rule that permits the promisor to breach provided that compensation is paid to the promisee is a liability rule. See Kronman, *supra* note 15, at 352. By contrast, specific performance works as an injunction in the sense that the promisee has the right to insist on performance unless the promisor negotiates a voluntary transfer of the entitlement. YORIO, *supra* note 1, at § 1.2; see *supra* notes 26–27. In this regard, our findings extend some of the insights made in the context of property and liability rules in property law disputes. See *supra* note 78.

174. When law creates a focal point by expressing values that might tip norms to a new equilibrium, this process may create a social norm or internalize a normative value. See GARY S. BECKER, ACCOUNTING FOR TASTES 225–30 (1996); Cooter, *supra* note 32, at 585. The idea of law as a focal point that coordinates expectations among citizens is explored further in McAdams, *supra* note 32, at 1649.

175. See, e.g., Matthew D. Adler, *Expressive Theories of Law: A Skeptical Overview*, 148 U. Pa. L. Rev. 1363 (2000); Matthew D. Adler, *Linguistic Meaning, Nonlinguistic “Expression” and the Multiple Variants of Expressivism: A Reply to Professors Anderson and Pildes*, 148 U. PA. L. REV. 1577, 1582 (2000); Elizabeth S. Anderson & Richard H. Pildes, *Expressive Theories of Law: A General Restatement*, 148 U. PA. L. REV. 1503, 1505 (2000) (law has a normative value based on what it expresses, independent of its consequences); Robert D. Cooter, *Three Effects of Social Norms on Law: Expression, Deterrence and Internalization*, 79 OR. L. REV. 1, 22 (2000); see *supra* note 32.

176. Dan M. Kahan, *What Do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591, 597 (1996); Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943, 958–61 (1995); Jason Mazzone, *When Courts Speak: Social Capital and Law’s Expressive Function*, 49 SYRACUSE L. REV. 1039, 1040–44 (1999); Richard H. Pildes, *Why Rights Are Not Trumps: Social Meanings, Expressive Harms, and Constitutionalism*, 27 J. LEGAL STUD. 725, 725–26 (1998); Paul H. Robinson & John M. Darley, *The Utility of Desert*, 91 NW. U. L. REV. 453, 471–73 (1997); Sunstein, *supra* note 36, at 2022; Janice Nadler, *The Effects of Perceived Injustice on Deference to the Law* (Feb. 23, 2000) (unpublished manuscript) (on file with the Virginia Law Review Association). For a more formal, economic account, see Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 VA. L. REV. 1577, 1593–94 (2000); Cooter, *supra* note 32, at 585–96.

individuals have independent and stable preferences,¹⁷⁷ behavioral science literature has presented convincing evidence that, far from being fixed and stable, individuals' preferences are influenced by non-substantive factors, such as the way possible options are framed, the presence of sunk costs, and the presence of prior cues or anchors.¹⁷⁸ Similarly legal rules can work as anchors, causing individuals to eventually internalize the preferences embodied in the legal rule. Individuals comply with legal commands (e.g. do not smoke in public, clean up after your dog) not merely because of the fear of possible sanctions, but because individuals either internalize the preferences stated in the law or hold the belief that others have done so.¹⁷⁹ The mere expression of the "socially desirable" behavior can set a focal point that coordinates individual behavior in society. From this perspective, our experiment demonstrates that legal default remedies can influence the normative viewpoints of contracting parties.¹⁸⁰

The entitlement effect and the expressive function of the law may work simultaneously to shape the preferences of the right holder. More specifically, if the expressive effect increases the perceived legitimacy of the assigned right it likely strengthens the sense of entitlement among right holders.

Interestingly, the phenomena of entitlement and expressive law are regarded as having very different welfare effects. While the entitlement effect is

177. See Dan Ariely et al., "Coherent Arbitrariness": *Stable Demand Curves Without Stable Preferences*, 118 Q.J. ECON. 73, 73 (2003) ("Economic theories of valuation generally assume that prices of commodities and assets are derived from underlying 'fundamental' values" attached to those commodities.").

178. For an overview, see Jolls et al., *supra* note 168, at 1497–1501.

179. An alternate viewpoint on the expressive function of the law, regards the effect of law to be that of coordinating the behavior of others. Legal rules, in this perspective, do not necessarily change the preferences of individuals, as much as they alter the expectations of what others will do. In this manner, legal commands can work as focal points. The seminal contribution is Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1650–53 (2000). For an experimental analysis of coordination or framing as a cause of behavioral changes induced by legal regulation, see Iris Bohnet & Robert Cooter, *Expressive Law: Framing or Equilibrium Selection?*, (HARVARD UNIVERSITY, KENNEDY SCHOOL OF GOVERNMENT, Working Paper Series, RWP03-046, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=452420.

180. In this regard, this Article extends to contract default remedies, the notion that "[p]erhaps society learns what to value in part through the legal system's descriptions of our protected spheres." Mark Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. CAL. L. REV. 669, 695 (1979) (noting that "[p]erhaps society learns what to value in part through the legal system's descriptions of our protected spheres"); Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 933–39 (1996). The content of contract default rules can change the preferences of contracting parties over time by stamping the imprimatur of the legal system on certain substantive rules. The expressive power of legal rules has also been suggested in the context of substantive default rules in contract law. See David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1879 (1991) ("[I]n some instances, application of the rule will persuade parties that it is correct . . .").

considered as a possible impediment to value-maximizing transactions,¹⁸¹ the expressive effect of the law is generally heralded in the literature as benevolent because it reduces the costs of enforcement.¹⁸² Our study suggests that the expressive function may also be costly. Even when promisees would have been strictly better off by accepting damage compensation, we observed that participants in the specific performance experimental group decided instead to impede the socially beneficial outcome. By enforcing the original contract, promisees blocked the mutual gains from trade between the promisor and C. Although all players were able to prevent breach and obtain performance, the mere availability of a default remedy of “specific performance” caused promisees to forsake the certain €5 payoff.¹⁸³ Specific performance dissipated the gains of trade between the promisor and C.¹⁸⁴

D. Specific Performance and Moral Transaction Costs

Specific performance has been understood to facilitate bargaining¹⁸⁵ because clear property rights foster efficient trading.¹⁸⁶ Our findings suggest, however, that the right to performance may become a value in itself. The contractual duty to fulfill the agreement may become more important than the goal of the contract itself, which is a good outcome. We have shown that a specific performance default can induce deep resentment against contract breach, whereby the breach might be perceived as an insult that cannot as easily be traded for material compensation.¹⁸⁷

181. See *supra* note 175.

182. See, e.g., Dhammika Dharmapala & Richard H. McAdams, *The Condorcet Jury Theorem and the Expressive Function of Law: A Theory of Informative Law*, 5 AM. L. & ECON. REV. 1, 4 (2003). See also Richard H. McAdams & Janice Nadler, *Testing the Focal Point Theory of Legal Compliance: The Effect of Third-Party Expression in an Experimental Hawk/Dove Game*, 2 J. EMPIRICAL LEGAL STUD. 87, 116–17 (2005) (showing that law enables coordination problems by allowing individuals to form expectations about what others are likely to do).

183. Another potential explanation is that parties have trouble agreeing on an alternative to the default. Given that the choice of the remedy was a unilateral decision by the promisee, this interpretation is less relevant in the context of our experiment. Randolph Sloof et al., *On the Importance of Default Breach Remedies*, 163 J. INST. & TH. ECON. 5, 19 (2007) (observing that parties often remain loyal to the default remedies because they fail to agree about possible alternatives).

184. It must be recognized, of course, that enforcing the contract default may create additional value to the promisee. When taking into account emotional and symbolic factors involved with contract breach, the promisor’s value in performance may well exceed the monetary gains involved with the alterative.

185. See *supra* note 173.

186. POSNER, *supra* note 63, at 88–89.

187. Legal rights are not always “commensurable”: individuals are reluctant to trade the legal entitlement for material compensation. See Sunstein, *supra* note 180, at 943–44 (suggesting that people may be unwilling to accept money as compensation for allowing a disagreeable outcome that is not normally measured in monetary terms). See generally MARTHA NUSSBAUM, *THE FRAGILITY OF GOODNESS* 294, 296 (1986) (noting Aristotles’

As has been pointed out in the literature on incommensurable rights, individuals are sometimes reluctant to trade their legal entitlement for material compensation or otherwise demand a premium to compensate for the compromise of entering into such a transaction.¹⁸⁸ As a result, it might become difficult for a promisor to convince a promisee to voluntarily accept damage compensation in lieu of performance. If courts enforce the default,¹⁸⁹ it may prevent some efficient breaches. If promisors anticipate a difficult negotiation process, some promisors might turn away more lucrative opportunities that necessitate breaching the original contract.

Returning to the economic literature on specific performance,¹⁹⁰ our observations question the comparative advantage of specific performance highlighted in the current literature. If the remedy of specific performance triggers deontological moral viewpoints about contract performance, efficient breach will be more difficult. Rather than fostering utilitarian goals of contract law, specific performance complicates private bargaining and the attainment of economically maximizing transactions.

CONCLUSION

In this Article, we have argued that the current literature on contract law underestimates the effect of legal rules on moral intuitions.

This Article adds to an emerging literature that suggests default rules are not merely starting points for parties that may then bargain around the default. In line with our findings, the empirical evidence suggests that individuals rarely bargain around default rules. Regardless of the substantive outcome, a majority of individuals stick with the default.¹⁹¹ Several theoretical explanations have been

position on the impossibility of measuring goods against one another given the plurality of values).

188. See Kelman, *supra* note 180, at 694–95; Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779, 835–40 (1994). For some economic speculation about the reasons for the discomfort, see Eric A. Posner, *The Strategic Basis of Principled Behavior: A Critique of the Incommensurability Thesis*, 146 U. PA. L. REV. 1185, 1200–07 (1998); Farnsworth, *supra* note 168, at 397–98 (offering incommensurability as a possible explanation for the observed lack of post judgment bargaining in nuisance disputes).

189. See Goetz & Scott, *supra* note 160, at 73 (courts tend to do so).

190. See *supra* Part I.B.

191. The impact of defaults is documented for instance in the literature on the impact of defaults on 401(k) participation savings rates, rollovers, and asset allocation. For example, when employees are automatically enrolled in their 401(k) plan, only a tiny fraction opt out; while, when employees are not automatically enrolled, less than half enroll. See, e.g., James J. Choi et al., *Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance*, 16 TAX POL'Y & ECONOMY 67, 67–113 (James M. Poterba, ed., 2002); James J. Choi et al., *For Better or For Worse: Default Effects and 401(k) Savings Behavior*, in PERSPECTIVES ON THE ECONOMICS OF AGING 81, 83 (David Wise, ed., 2004), available at <http://www.nber.org/chapters/c10341.pdf>; Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. ECON. 1149, 1184–86 (2001).

offered to explain the so-called “stickiness” of default rules: drafting and other transaction costs,¹⁹² path dependence due to learning and network effects,¹⁹³ the fear that negative inferences will be made from proposals to deviate from the legal default rule,¹⁹⁴ a lack of agreement over alternatives,¹⁹⁵ status quo preference,¹⁹⁶ and the cognitive limitations of contracting parties.¹⁹⁷ As we have demonstrated, default remedies matter for another reason. When expressed as a legal default, the legal right to demand performance creates a sense of entitlement. In some instances, concern with infringement of the legal right might become more important than the original, value-maximizing goals of the contract.

Our study sheds new light on the actual behavior and motivations of contracting parties. The results provide insight into perception of contractual obligations in various institutional settings. In doing so, our insights can help to build more accurate models of contractual behavior and may prove helpful in the design of legal rules and institutions that promote efficient contracting.

192. Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 741 (1992) (pointing out contractual inefficiencies due to the non-verifiable nature of hidden characteristics of the more informed party).

193. Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 729–34 (1997) (discussing network externalities and learning effects).

194. Parties might stick with the default because of fear that proposing an opt-out from the default will dissuade his potential counterparty from entering into the agreement. See, e.g., Omri Ben-Shahar & John A. E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651, 652, 661 (2006) (claiming that the stickiness problem of defaults is potentially broader and more prevalent than previously perceived); Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDISC. L.J. 59, 70–73 (1993) (exploring the possibility that contracting parties form adverse judgments when they receive proposals to alter default norms); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615, 628–29 (1990) (for instance, the limited liability default is stickier than an unlimited liability default because only with the former does an opt-out reveal the shipper’s high idiosyncratic value of performance); Kathryn E. Spier, *Incomplete Contracts and Signalling*, 23 RAND J. ECON. 432, 432–35 (1992) (presenting a formal model of the signaling effects of bargaining proposals involving adverse inferences in negotiations).

195. Sloof, *supra* note 183.

196. Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 675 (1998).

197. See Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 3–4, 13–15 (2006); Richard R. W. Brooks et al., *Contracts as Frames: Why Loss Frames Increases Effort*, 168 J. INST. & TH. ECON. 62, 81 (2012).
