HOLMES MAY WELL HAVE BEEN RIGHT AFTER ALL: HOW CONTRACT LAW REFLECTS INTERPERSONAL MORALITY

Sergio Mittlaender Leme de Souza

Max Planck Institute for Social Law and Social Policy[1]

This article presents results from an experiment that estimates that two-thirds of the people perceive breach of contract followed by full compensation for the victim as not immoral. In the absence of compensation, it reveals that individuals perceive breaches that are fair as not immoral, and deem only those breaches that are unfair as immoral. Only a minority of the subjects perceives the moral value of breach in a deontological manner, and virtually no subject perceives breach to be immoral because of a loss of welfare (inefficiency). I argue, based on the obtained results, that contract law reflects individual perceptions of the immorality of breach, being lenient with breaches that are fair in allowing for several defenses such as impossibility and impracticability, but strict with breaches that are unfair in imposing strict liability for loss of expectancy. The law, however, does not impose punitive damages, nor inevitably requires performance by the promisor, and thereby reflects how individuals perceive breach after compensation, from a normative standpoint: as not morally wrong. Compensation makes, for most of us, in case no more than money is at stake, a wrong right, and is hence the fundamental principle and purpose in an award of a remedy for breach of contract.

I. INTRODUCTION

There was, and still is, a manifest confusion among scholars between moral and legal ideas in the law of contract (Holmes 1897, 462). Much of it is due to the scarcity of empirical evidence on how individuals understand the contractual obligation, from a normative standpoint. We do not know how they perceive the moral value of breach (in a deontological or consequentialist manner), both in the absence and in the presence of the payment of compensation for the victim. In this context, scholars rarely consider when and why breach may be morally justified,[2] and fail to see how compensation makes, for most of us, and in case no more than money is at stake, a wrong right.[3]

This article reports results from an online experiment aimed at eliciting how individuals perceive the moral value of breach of *promise* and of *contract*, in the *absence* and in the *presence* of the payment of compensatory damages. Participants were asked whether breach was *immoral* or *not immoral* in different contingencies that disentangle the efficiency or inefficiency, and the fairness or unfairness of the breach.[4] With that, the experiment reveals when individuals perceive

[1] Amalienstraße 33, 80799 Munich, Germany, Mittlaender@mpisoc.mpg.de

[2] As noticed by Atiyah (1981, 142), "few philosophers have attempted to analyze the circumstances in which a breach of promise may be found morally justifiable. When they discuss this question at all, it is usually in terms of trivial cases such as a social promise to meet or dine with a friend, which is broken because the promisor's son is taken ill."

[3] None of the results, conclusions and implications drawn herein are valid outside the case of breach of contract in which no more than the expectation interest is at stake, with no volitional defect, informational asymmetry, violation of a fiduciary duty, or of a proprietary interest. *See* the discussion *infra* in section 5.

[4] *See* infra section II.B for the definition of fairness adopted herein. In brief, it concerns *non-contracted inequality* in the distribution of gains *from the breach in unforeseen circumstances*, and hence excludes, by definition, inequality in the bargain, or in the distribution of gains from performance of the contract.

breach to be immoral, possibly depending some of its consequences, as well as on payment of compensation by the promisor to the disappointed promisee.

Results reveal, firstly, that breach of promise is not always perceived to be morally wrong. Quite on the contrary, whenever breach is fair in avoiding an unequal outcome that parties had never agreed upon, then only a small minority of the subjects think that the breach is immoral. It is when the breach is unfair in creating an unequal and unforeseen distribution that it is perceived by the majority as immoral. Individuals do not perceive the moral value of breach in a deontological fashion, as per Fried (1981, 2007) and Shiffrin (2007, 2010, 2012), nor in a consequentialist manner that considers only welfare as the "good", as per Shavell (2006, 2009). They rather think that breach is immoral when it is unfair and the promisor profits from the breach, while the promisee does not.

Secondly, when breach is followed by the payment of fully compensatory damages, then it is understood to be, by roughly *two-thirds of the subjects*, as *not immoral*. This does not depend on the realized contingency, on the consequences of the breach, or on the motives that lead the promisor to breach. Subjects consistently selected "not immoral" in all different contingencies in which the promisor decided to breach but compensated the promisee for lost expectancy. There is hence evidence that the majority of the individuals perceive the moral value of breach of *contract* in a manner that is compatible with the Holmesian theory of the contractual obligation.

This does not imply that individuals understand that the contractual obligation creates no moral obligation, and that breach is, for them, simply *amoral*. Quite differently, results reveal that individuals perceive breach to be a *wrong in need of redress*. The point is that compensation makes this wrong right. With no loss for the victim, and in the absence of other wrongs (such as loss of benefit or loss of reliance, and violations of fiduciary duties or property rights), then there is nothing wrong, for most of us, with breach followed by the payment of compensatory damages.

There are different implications for the law. Firstly, interpersonal morality does not require promisors to keep *contractual, bargained-for* promises independent of the consequences. It allows them to breach and walk away from the deal in several circumstances, as for example when the promisor would make losses by performance, and the promisee would lose no more than expected and promised gains from trade. If the promisee does not make any upfront payment, nor relies on the promise, then the promisor that breaches and subsequently compensates the promisee for lost profits commits, for most of the subjects, no moral wrong. The moral objection that faults contract law for failing to impose a strict duty to keep promises is hence not justified upon observed interpersonal morality.

Secondly, legal enforcement closely resembles observed moral beliefs. Courts are lenient with those that breach in order to avoid losses, and strict with those that breach to achieve higher profits. While defenses such as impossibility, impracticability, and change of circumstances are all allowed in the first case, there is almost no excuse that can release the promisor from the legal obligation to pay damages in case of a higher outside offer. While courts will often simply rescind the contract in the first case, they will almost inevitably impose the secondary duty to compensate

the promisee even for the loss of those immaterial, promised gains from trade in requiring the payment of expectation damages.[5]

Thirdly, expectation damages seem adequate to enforce the promisor's moral obligation. They allow promisors to breach at their own discretion, and without the need of obtaining consent from the promisee in order to "break free" but, at the same time, they require the promisor in breach to compensate the victim, turning what was wrong into a right, not in theory but in practice. Substitutive relief creates a right and a duty that correspond to promissory rights and responsibility as understood by the majority of the individuals.

The obtained results stand in contrast to those obtained in other recent studies that find that most people view breach, even if fully compensated, as morally reprehensible (Wilkinson-Ryan and Baron 2009). It also provides evidence that parties do not believe that performance is morally required in any contingency if and only parties specified, *or would have specified*, performance in that contingency, had they taken the time to agree on it (Shavell 2006, 2009). Quite on the contrary, only a very small minority of the subjects believes that breach followed by the payment of damages is immoral, in contrast to the claim that "most people" find this morally problematic (Wilkinson-Ryan 2015, 290-91). Additionally, no more than *one* subject out of 190 said that breach was immoral when it was inefficient, and not immoral when it was efficient, as parties would have specified in the hypothetical complete contract, and as assumed by Shavell (2006, 2009).

All those surveys find only differences in averages across treatments. This can be interpret as meaning that people perceive breach in one situation as more or less morally problematic than in the other. For instance, they confirm Wilkinson-Ryan and Baron's (2009, 413) "prediction that subjects would be more sympathetic to a breacher who breaks a contract in order to avoid a loss than to an otherwise identical breacher who breaks a contract in order to accept a more lucrative deal elsewhere." This does not mean that they deem it immoral, or not immoral.

To assess whether subjects perceive breach as immoral or not immoral, in different types of contingencies, and in the absence and in the presence of full compensation for the victim, this article uses a dichotomous scale, as used by Greene and co-authors in their empirical studies of the trolley problem and other personal moral, sacrificial dilemmas (Greene at al. 2001, 2004, 2008). The loss of information incurred with the use of such scale concerns how far one perceives breach to be more or less reprehensible, immoral, justifiable, adequate, or else, and is not of interest herein. The interest lies on whether the breach violates the moral norm of keeping promises, and such a violation of that norm is a dichotomous variable. If the realized contingency amounts to an excusing condition (Rawls 1971, 344), as discussed below, then there is no breach at first place, for one is not to do what one promised. If the contingency does not amount to an excusing condition, then the breach violates the norm. There is nothing such as a half-kept, half-broken promise.[6]

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[5] That is, courts will impose liability for the loss of something that the promisor have never really had, as mentioned by Fuller and Perdue (1936, 53).

[6] Even if the promise was to deliver 30 computers to the university lab next Monday, and the promisor delivers only 15, the promise is not half-kept. The promise was to deliver 30, and it was not kept, and the promisor violated, with

None of these findings or implications is generalizable and applicable to the case when the promisor causes a loss of benefit or a loss of reliance upon the promisee. Those are real harms, and there is the need of further empirical evidence to see how individuals understand breach, from a normative standpoint, in those cases. Moreover, with that sole consequence of breach, the breach does not violate any fiduciary duty, nor any property interest. In the presence of this *other types* of wrongs, the evidence, conclusions, and implications might be different.

This paper is structured as follows. The next section reviews the theories of the contractual obligation that are object of this study, and derives predictions on how individuals will perceive the moral value of breach in the different circumstances studied in the experiment. The third section presents the design of the experiment, and the fourth section reports the results. Implications for the law of contract are presented in the fifth section, and the last section concludes.

II. Theories of Contract and of the Immorality of Breach

A. Promissory Theories

Promissory theories of the contractual obligation hold that, in brief, contracts are promises, and promises must be kept because breach violates the moral norm or the societal convention of promises (Rawls 1955, 1971; Fried 1981). As in any deontological theory, the moral value of the act does not depend on its consequences, but rather only on whether it respects or not the applicable moral norm. And the norm of promising, as advanced by Rawls, states that "if one says the words 'I promise to do *X*' in the appropriate circumstances, one is to do *X*, unless certain excusing conditions obtain." (Rawls 1971, 344).

Among those excusing conditions that release the promisor from the moral obligation to perform are *not* monetary variations in the promisor's payoff from performance or breach (unless, perhaps, they are really extreme). As noted by Rawls (1955:16), "[t]he promisor is bound because he promised: weighing the case on its merits is not open to him … Various defenses for not keeping one's promise are allowed, but among them there isn't the one that, on general utilitarian grounds, the promisor (truly) thought his action best on the whole."

Since all the possible contingencies implemented in the experiment entail mere monetary variations in the payoff of the parties, they do not amount to excusing conditions that release the promisor from the moral obligation to perform. The promisor is bound to keep her word because she voluntarily and autonomously promised to perform, in exchange for a return promise to pay. The prediction is hence that individuals that understand the obligation as per Rawls or Fried, in a deontological manner, will say that breach is wrong in all contingencies.

> Prediction 1. Individuals that understand the obligation in a deontological manner will say that breach is immoral in all implemented contingencies.

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her act, the norm of keeping promises. This becomes clear when one realizes that with only 15 computers one cannot run the experiment scheduled for Tuesday, and delivering half of them is worth nothing to the promisee.

B. Consequentialist Theories

There are different possible theories that base the moral value of an act such as breach upon its consequences. An action that increases the overall "good" in society is moral while an action that decreases it is immoral. Consequentialist theories differ in what they consider to be the "good". Herein, two main conceptions of the good are distinguished. Firstly, the "good" includes welfare, or wealth. Secondly, the "good" includes equality, or fairness.[7]

Shavell recently considered the incompleteness of contracts to argue that breaches that are efficient – i.e., that increase the overall "good", understood as welfare – are morally permissible. When parties have not explicitly discussed a contingency in their agreement, then the moral value of the breach in that contingency depends on whether parties would have agreed on performance in that contingency, had they taken the time to discuss it, and to reach an agreement on it. They would agree that performance is required if and only if performance would generate a net gain, considering the interests of both parties.

In other words, parties would agree on performance if and only if performance is socially efficient.[8] When this is the case, then performance is the right thing to do, and breach is *immoral*. On the one hand, when parties would *not* have agreed on performance in the realized contingency, since it would not bring about an overall gain, being hence socially inefficient, then breach is *not immoral*. This delivers the prediction that individuals that understand the moral value of breach in this manner will perceive breach as not immoral in some contingencies, and as immoral in all the other ones:

> PREDICTION 2. Individuals that understand the obligation in a consequentialist manner that considers the good as consisting in welfare will say that breach is immoral in contingencies where it is inefficient, and not immoral in contingencies where it is efficient.

There are, however, other consequences of breach that individuals may consider in the assessment of its moral value. A very salient one is fairness. Herein, in the context of an incomplete contract celebrated at arms length, and in the absence of any volitional defect and informational asymmetry, unfairness is understood as *non-contracted inequality*. That is, parties are assumed to have agreed on a mutually profitable exchange for a certain price. This price distributes the gains from trade in a certain manner, which can be more or less fair.

When the promisor performs, then she realizes the *contracted* distribution, and even if this is unequal, it is not unfair (as defined herein), for the promisee consented to it. Differently, when the promisor breaches in a non-contracted contingency, then she realizes a distribution parties did not agree upon. The profits belong, by contracts, neither to the promisor nor to the promisee. If the

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[7] Mixed theories could also be considered. An action could be moral if it increases the amount of wealth *and* is fair, or if it increases overall wealth *or* is fair. They have almost no empirical adherence, as observed in the results of the experiment, and are not discussed herein.

[8] Throughout all the article, it is assumed that the contract does not create externalities. Were this the case, then bringing about a net gains for both contractual parties would not be equal to being socially efficient.

promisor breaches to realize higher profits by trading with a third-party, then she implements a certain distribution parties never agreed upon, and to which the promisee did not gave her consent.

Although there is no full-fledge theory that states that breach is immoral when it is unfair, and not immoral when it is fair (Smith 2004, chap. 4.5), such a theory is intuitive and may well explain how individuals perceive the moral value of breach in reality. It is also a consequentialist theory, for it attributes the value of immoral for breaches that lead to an outcome that distributes the gains from trade unequally, and the value of not immoral for breaches that avoid such outcome. The consequence that is determinant for the moral value of the action is not the overall social welfare, bur rather the fairness in the realized distribution.

> PREDICTION 3. Individuals that understand the obligation based on fairness will say that breach is immoral in contingencies in which breach creates non-contracted inequality, and *not* immoral in contingencies where it avoids that type of inequality.

C. The Amorality of Breach

Although there is no theory that explicitly says that promises do not create any type of obligation to perform, individuals may well consider breach of promise as an *amoral* act, and hence as never immoral. Some individuals may believe that promises do not create a moral duty, but rather only allow individuals to coordinate their actions, providing a focal point (Schelling 1960) or a reference point (Hart & Moore 2008) that serves only to ease transactions. Others may believe that promises, when given in exchange for a return promise, in a trade and business transaction, do not create the same type of moral obligation that promises given in familiar contexts create.[9]

> PREDICTION 4. Individuals that understand the obligation as *not* creating a moral duty will say that breach is *not* immoral in all different contingencies.

D. The Holmesian Theory of the Contractual Obligation

Holmes famously held that "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." (1897, 462). The primary duty to perform has no "mystical significance", and "[t]he only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass." (Holmes 1881, 266). When a person enters into a contract in which she promises to perform, for example by delivering a good or providing a service, then this person has an option to perform or to pay damages (Posner 2009, 1350).

The contractual obligation has per Holmes a *disjunctive* structure. If you do precisely what you promised, you fulfill the obligation. If you do not do it, but pay fully compensatory damages, you also fulfill that obligation. In both cases, no blame can be attributed to the promisor, for in both cases she does not breach the obligation that has a disjunctive structure (Posner 2009; Markovits

[9] In fact, those promises are not enforceable under the law, and are not contracts. They may follow a completely different set of (moral) rules that could be distinct from the legal ones, and that would be a reason for why the law leaves those to the exclusive regulation by the moral order.

& Schwartz 2012). Breach of the contractual obligation occurs only when the promisor does not undertake the promised action *and* does not compensate the promisee for losses sustained.

Individuals that understand contracts as per Holmes will say that breach followed by the payment of fully compensatory damages (expectation damages) is not immoral, independent of the type of contingency that materializes. This is because whenever the promisor pays damages, then she performs the obligation, and there is no breach at first place. Breach is then not wrong independent of its consequences other than the loss incurred by the promisee.

> ADDITIONAL PREDICTION (*between treatments without and with compensation*). Individuals that understand the contractual obligation as per Holmes will say that breach is *not immoral* in all types of contingencies if the promisor pays damages.

III. METHOD

In order to investigate how individuals perceive the moral value of breach, participants were asked, in a neutral position where they were neither promisor nor promisee, whether they believed the breach was *immoral* or *not immoral*. They did so in different contingencies that disentangle the efficiency and inefficiency, and the fairness and unfairness of the act. Lastly, they were asked the very same question, in the precise same scenario and in the exact same contingencies, but in the presence of the payment of compensation by the promisor in breach.

III.1. Participants and Design

In total, 190 individuals participated in the experiment.[10] They were recruited to answer a questionnaire at Amazon Mechanical Turk. Empirical studies using this platform are by now widely accepted in the most prestigious journals such as NATURE (e.g. Rand, Greene and Nowak 2012, Hauser et al. 2014) and SCIENCE (e.g. Quoidbach et al. 2013), and have several advantages vis-a-vis other subject pools, including a closer resemblance to the actual U.S. population.

In the obtained sample, the vast majority of the subjects (95%) spent most of their life living in the U.S. The average age of the subjects was 37.4 years (U.S. average is 37.8 years), with 51.5% of males (U.S. proportion is 48.5%).[11] Each subject received $0.75 for completing the survey, which included only 14 questions, and took between 5 and 10 minutes to complete.[12]

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[10] Overall, 203 subjects took part in it, but 13 did not complete it, or did not answer to all the questions. The completion rate was hence of 94%, and those 13 observations are not considered.

[11] 180 subjects spent most of their lives in the U.S., with other 6 in India, 2 in the UK, 1 in Canada, and 1 in Macedonia. I did not ask where they born, or their nationality, for this says little about the legal system and culture they are used to (people change countries). Instead, the question was "In which country did you live most of your life?".

[12] Paolacci et al. (2010) replicated different classical studies in judgment and decision-making at a cost of approximately $1.71 *per hour* per subject and obtained results parallel to those conducted with students in the laboratory. The effect of low stakes has been shown *not* to affect levels of prosociality vis-à-vis those observed in the lab in single prisoners' dilemmas (Horton, Rand, and Zeckhauser 2011) and public good, trust, or ultimatum games (Amir and Rand 2012).

Moreover, the use of such online platform has further advantages in studies involving contracts. Most of the "workers" (as subjects are called) have experience with (service) contracts, for each task that is offered by a "requester", and subsequently accepted by a worker, forms a legally binding agreement. They often encounter instances in which circumstances change, and it becomes costlier for them to perform than they had previously thought. On the other hand, they are also often victims of breach from requesters that did not keep their promises, and instead of paying the workers for their work, simply rejected it.[13]

The scenario posed to them was hence, firstly, *familiar*, for most of them have previously experienced the facts that are involved in it: unforeseen contingencies and breach of contract. It is also quite *generalizable*, for it involves a sale of a good and hence encompasses a simple, recurrent situation that participants can easily grasp. Lastly, it is *realistic*, as the implemented contingencies are not implausible or extreme, hard to imagine or with only a loose connection to real-life situations, but rather possible, common, and not specific. Different from, for instance, trolley problems (sacrificial problems), the dilemma studied herein is less subject to the criticism that it is frivolous, as trolley problems are, or that it lacks psychological realism (Bauman et al. 2014).

The design of the survey is factorial. There were two baselines, *promises* and *contract*, that were implemented in the *absence* and in the *presence* of the payment of compensation. Subjects read the precise same scenario in all treatments, reproduced in its entirety below, with the sole exceptions of the variables under investigation.

In treatment *promises*, subjects read that the seller and the buyer made explicit promises to each other, and could "keep the promise" or not. In the second treatment *contract*, in contrast, all instances of the term "promise" were substituted for "contract", with all of the remaining text kept constant by design. In this way, while subjects were heavily loaded with the context of promises in the first treatment, they were faced with an agreement that completely omitted the term promise in the other treatment. The term "promise" appeared twenty times in the treatment promises without compensation, and another twenty times in the treatment promises with compensation. It never appeared in treatment contract

Moreover, in treatment contract, the term *keep the promise* was substituted for *deliver the good*, and *not keep the promise* was substituted for *not deliver the good* because, as argued by Markovits and Schwarz, telling subjects that nondelivery was a breach of contract excludes the Holmesian hypothesis that nondelivery followed by the payment of damages amounts to performance of the disjunctive obligation (of the option to perform or pay damages) (Markovits and Schwartz 2011, 1955 n. 32).

The scenario is reproduced below in its entirety. As described above, all instances of the term *promise*, present in the first survey, were substituted for the term *contract* in the second

[13] This is in fact extremely easy for requesters to do. After the worker completes a task (performing her part of the deal, for the promised price), then the requester has a certain period of time (usually a couple of days) to accept or reject the work. The requester does not have to provide any reason to reject the work and avoid paying (which could be, for example, a work of poor quality, or an incomplete work).

survey, and are shown between brackets. The sentence between square brackets, "[t]he seller pays $10 in compensation to the buyer", was included only in the treatments with compensation, and is the only difference between those.

> "A seller and a buyer made <promises/ a contract> to trade a good in the future. The seller <promised/contracted> to produce and deliver the good to the buyer, and the buyer <promised/contracted> to pay the agreed-upon price of $20 to the seller.
>
> The seller's costs of production were $10, and the buyer valued the good at $30. Therefore, in the expected situation, both the seller and the buyer would earn $10 from trade. The seller and the buyer did not discuss how circumstances might change between the time they made the <promises/contract> and the time they would have to perform <them/it>.
>
> Before the date of performance, the seller calls the buyer to say that he is *not* going to <keep the promise/deliver the good> to the buyer.
>
> [The seller pays $10 in compensation to the buyer.]
>
> Please tell us whether the seller's act is *immoral* or *not immoral* in these five possible different scenarios:"

Subjects read the scenario and subsequently answered whether breach was *immoral* or *not immoral* in five different states of the world. Afterwards, in a second part, subjects read the exact same scenario with the sole difference that, in this case, the promisor in breach paid compensation to the promisee. They answered whether breach followed by the payment of compensation was *immoral* or *not immoral* in those same five states of the world. Table 1 depicts the treatments.

Table 1. Implemented Treatments

		Part 1	Part 2
Session 1	N = 104	Promises, no compensation	Promises, compensation
Session 2	N = 86	Contract, no compensation	Contract, compensation

Both treatments were posted online at the same time. Subjects could take part in only one of the two. They read a brief explanation of the survey, and proceeded to take part in the research (as explained to them) after giving their informed consent.

III.2. Measures and Outcomes

Subjects reported whether "the seller's act" was "immoral" or "not immoral" in five different contingencies. Under the status quo, circumstances do not change and each party earns $10 in case of performance. The seller earns the price of $20 but spends $10 in the production of the good, and the buyer earns her valuation of the good $30 minus the price of $20 paid for it. In case of breach, the seller does not produce the good, and the buyer does not pay for what she does not receive, and both parties earn nothing.

In state 1, "the seller's cost of production of the good rose unexpectedly to $25."

In state 2 "the seller received an unexpected higher offer of \$25 for the good from a second buyer (who values the good at \$25)."

In state 3, "the seller's cost of production of the good rose unexpectedly to \$35."

In state 4, "the seller received an unexpected higher offer of \$35 for the good from a second buyer (who values the good at \$35)."

After each of those, participants read:

"If the seller <keeps the promise/delivers the good>, then the seller earns \$$\Pi_S^P$ and the buyer earns \$$\Pi_B^P$.

If the seller does not <keep the promise/deliver the good> [and pays \$10 in compensation], then the seller earns \$$\Pi_S^B$ and the buyer earns \$$\Pi_B^B$.

The seller's decision *not* to <keep the promise/deliver the good> [and pay compensation] is □ immoral / □ not immoral."

Π_S^P and Π_B^P were displayed in numbers, and correspond to the seller and the buyer's payoff of performance, and Π_S^B and Π_B^B correspond to the seller and the buyer's payoff of breach, respectively, as shown in table 2 below. In treatments *with compensation*, the payoff of breach changed, for the seller paid ten points in compensation for the buyer. The payoffs Π_S^B and Π_B^B of breach involved hence plus \$10 for the buyer and minus \$10 for the seller. The payoffs Π_S^P and Π_B^P of performance did not change because in case of performance the seller did not pay damages. As in the question posed to participants reproduced above, the sentence between square brackets ("and pay compensation") appeared only in case the seller does not keep the promise (treatment promise) or does not deliver the good (treatment contract), and in the treatment with compensation.

Table 2. Payoffs in the absence of compensation (stars denote equilibrium behavior)

	Seller's decision and related payoffs (seller,buyer)		Consequences of breach *for the buyer*	Consequences of breach *upon SW*	Consequences of breach *upon inequality*
State 1	perform	(-5,10)	does not earn 10	creates inefficiency of 5	avoids inequality of 15
	breach	*(0,0)*			
State 2	perform	(10,10)	does not earn 10	creates inefficiency of 5	creates inequality of 15
	breach	*(15,0)*			
State 3	perform	(-15,10)	does not earn 10	avoids inefficiency of 5	avoids inequality of 25
	breach	*(0,0)*			
State 4	perform	(10,10)	does not earn 10	avoids inefficiency of 5	creates inequality of 25
	breach	*(25,0)*			

In any case of breach, the buyer does not receive the good and thereby does not earn what she expected to earn through the performance of the promise and contract. She does not realize her expectancy. In states 1 and 2, breach is socially inefficient; in states 3 and 4, in contrast, it is socially efficient. In states 1 and 3, breach is fair in avoiding an unequal outcome; in states 2 and 4, in contrast, it is unfair in creating an unequal outcome.

The final outcome of the study is an estimate of the distribution of the types described above in the population. An individual that understands the morality of keeping promises according to one of those theories shall provide consistent answers to the moral value of breach in the respective contingencies, as derived from theory. Table 3 resumes those:

Table 3. Normative Understandings of the Obligation in all States

When is breach immoral?	State 1	State 2	State 3	State 4
Characteristics of breach	Inefficient, Fair	Inefficient, Unfair	Efficient, Fair	Efficient, Unfair
1, Always (deontology)	Immoral	Immoral	Immoral	Immoral
2, When it is inefficient (consequentialism, "good"=welfare)	Immoral	Immoral	Not immoral	Not immoral
3, When it is unfair (consequentialism, "good"=equity)	Not immoral	Immoral	Not immoral	Immoral
4, Never (no moral obligation)	Not immoral	Not immoral	Not immoral	Not immoral

IV. RESULTS

A. When is Breach Immoral in the Absence of Compensation?

Results reveal that individuals perceive breach as immoral when it is unfair and implements an unequal distribution of the gains from trade in which the promisor captures them all. This is an outcome that parties never agreed upon, and that was not consented by the promisee, who remains in the same position that she was before the making of the contract, without realizing any gain or loss for herself.[14] In any case where breach was, in this sense, unfair, then 75-80 percent of the subjects said that breach was immoral, as shown in table 4.

The inefficiency of the act, in contrast, is of minor relevance in that assessment. In state 1, breach was socially inefficient, and only 20-30 percent of the subjects said it is immoral. In contrast, in state 2, breach was equally inefficient, but also unfair, and 75-80 percent said it is immoral. The fact that the overall loss of resources, or the "size of the pie" barely matters for the individual

[14] Parties could have agreed on a lower price, and on the right of the promisor to breach in those cases, in the absence of compensation. The lower price would have remunerated the promisee for the foregone gains, and then this unequal distribution would have been part of the price, and hence remunerated, being thus not unfair, as defined herein. This was not, however, the case in the scenario, where the parties never agreed on the proper course of action in the different contingencies.

assessment of the immorality of the act is reinforced by the answer that subjects gave in states 3 and 4. In state 3, breach was efficient, and 20-30 percent of the subjects said it was immoral. In state 4, breach was equally *efficient*, but 75-80 percent of the subjects said it was *immoral*.

Table 4. Percentage of subjects that reported breach as immoral in the absence of compensation

	Characteristics of Breach	Treatment Promises	Treatment Contract	Fisher's Exact
State 0		57%	59%	$p = 0.42$
State 1	inefficient and fair	21%	34%	$p = 0.04$
State 2	inefficient and unfair	75%	81%	$p = 0.19$
State 3	efficient and fair	22%	30%	$p = 0.13$
State 4	efficient and unfair	75%	81%	$p = 0.19$
Observations		104	86	

In sum, in states 1 and 3, the percentage of subjects that reported breach as immoral was virtually the same, and yet in state 1 breach was inefficient while in state 3 breach was efficient. The same is observed between states 2 and state 4, where the percentages are exactly the same, and yet breach was inefficient in state 2, and efficient in state 4. It is the unfairness of the act that is responsible for a substantially higher percentage of the subjects that perceive the act as immoral.

Moreover, subjects did not perceive explicit promises or contractual duties very differently. Quite on the contrary, the distributions above are quite similar. More individuals said that breach of contract was immoral than breach of promise in all different contingencies, but these differences and small and not significant, with one exception, and with around 100 observations per treatment. The *direction* of the effect, however, points to the fact that individuals perceive the obligation in a contract more strictly than the obligation in an exchange of promises "not put down on paper".

B. When is Breach Immoral in the Presence of Compensation?

Results reveal that in all different types of contingencies, very few individuals saw breach of promise or of contract as immoral when the promisor paid compensation to the promisee. The amount paid, equivalent of expectation damages, compensated the promisee for the gains of trade that she forgoes because of breach by the promisor, and put the promisee in the position she would have been in had the promisor performed. Participants in the position of a neutral observer did not believe that breach was then immoral in virtually all types of contingencies.

Some participants, however, still said that breach was immoral even when followed by the payment of those damages in those states where breach was unfair (states 2 and 4). A considerable minority of 25-30 percent said that breach committed to profit was immoral with the payment of

compensation. In the other contingencies, only a minute share of participants said that the breach was immoral.

Financial compensation changed the perception of the immorality of breach of promises given with consideration. For most of the subjects, it did not matter that there was the violation of the norm of keeping promises. With the transfer of money from the "wrongdoer", promise-breaker to the victim, and the resulting indemnification of the last one, there was nothing wrong with breach followed by compensation for most of the subjects, and in all types of contingencies implemented.

Table 5. Percentage of subjects that reported breach as immoral in the presence of compensation

	Characteristics of Breach	Treatment Promises	Treatment Contract	Fisher's Exact
State 0		19%	13%	$p = 0.16$
State 1	inefficient and fair	13%	6%	$p = 0.06$
State 2	inefficient and unfair	28%	26%	$p = 0.42$
State 3	efficient and fair	13%	9%	$p = 0.32$
State 4	efficient and unfair	30%	30%	$p = 0.54$
Observations		104	86	

Yet again, no substantial differences are observed between the treatment promises and the treatment contract. Observed frequencies are virtually identical, with just one exception in state 1.

C. How do Individuals Understand the Immorality of Breach of Bargained-for Promises?

The use of a dichotomous variable, and the predictions from the different moral theories permit the estimation of the share of individuals that understand the promissory obligation, from a normative standpoint, in a manner compatible with the theories discussed above. Individuals that understand it in a deontological fashion will report that breach is immoral in all implemented contingencies. Those that understand it in a consequentialist fashion, and that consider welfare as the "good" to be maximized, will report that breach is immoral only in those contingencies in which it is inefficient, but not otherwise. Those that consider equity as the determinant of the moral value of the act will say that breach is immoral only in those contingencies in which it creates inequality, but not otherwise. Finally, those that perceive promises as not creating a moral obligation at first place will say that breach is not immoral in all contingencies.

Results presented in table 6 reveal that, in the absence of compensation, half of the subjects think that breach is immoral when it is unfair, and is not immoral when it is fair. It was by far the most preponderant manner to assess the moral value of the breach by subjects. A small but still sizeable share of the subjects perceived breach as always immoral, in a deontological fashion.

There was also a quite comparable share of subjects that perceived breach as never immoral. Each amounted to 15-25 percent of the subjects.

Only one subject said that breach was immoral when it was inefficient, and not immoral when it was efficient, in a consequentialist manner, and considering only welfare as the determinant of the moral value of the act. If subjects had randomized their answers, more than one should have fallen into that category, and they therefore seem to have an aversion to assessing the moral value of breach of promises, even if in a business setting, and given only in exchange for a return promise, in that manner.

Table 6. How individuals understand the obligation without compensation

When is breach immoral?	State 1	State 2	State 3	State 4	Promises	Contract	Fisher's exact (2-sided)
Characteristics of breach	Inef., Fair	Inef., Unfair	Ef., Fair	Ef., Unfair			
1, Always	+	+	+	+	14 %	24 %	$p = 0.059$
2, When it is inefficient	+	+	–	–	1 %	0 %	$p = 0.55$
3, When it is unfair	–	+	–	+	49 %	48 %	$p = 0.48$
4, Never	–	–	–	–	20 %	14 %	$p = 0.17$
Other					15 %	14 %	$p = 0.47$
Observations					104	86	

In the treatment promises, 14% of the subjects said that breach was immoral in all different contingencies, and 24% of them did the same in the treatment contract. While this difference is significant, there are ten tests of differences between treatment promises and contract, including the five presented below. It is hence *expected* that one out of the ten will, by chance, appear as significant at that level, and that is why no importance is attached to this single result herein.

D. How Many Individuals Understand Contracts as per Holmes?

Individuals who understand contracts in a manner compatible with the Holmesian theory will say that breach followed by the payment of compensatory damages is not immoral. Since the payment of the damages amount to performance of the disjunctive obligation, breach followed by that payment is, under the theory, not immoral in all types of contingency that materialize in the game. The inequality, inefficiency, or violation of a norm of keeping promises shall not matter.

The obtained estimate, reported in table 7, is that more than 60% of the subjects understand the contractual obligation in this manner. In treatment promises, 62% of the subjects did so, and in treatment contract, 65% did so.

Table 7. How individuals understand the obligation with compensation

When is breach immoral?	State 1	State 2	State 3	State 4	Promises	Contract	Fisher's exact
Characteristics of breach	Inef., Fair	Inef., Unfair	Ef., Fair	Ef., Unfair			
1, Always	+	+	+	+	8 %	3 %	$p = 0.18$
2, When it is inefficient	+	+	–	–	1 %	1 %	$p = 0.70$
3, When it is unfair	–	+	–	+	17 %	15 %	$p = 0.42$
4, Never	–	–	–	–	62 %	65 %	$p = 0.36$
Other					12 %	15 %	$p = 0.38$
Observations					104	86	

Table 8 resumes the change in the perception of the moral value of breach of "promise" and of "contract" as a function of the payment of compensation. It reveals, firstly, that the number of participants that said that breach was always immoral, or that it was immoral when it was unfair, was much lower in the presence of compensation. In contrast, the number of subjects saying that breach was never immoral, in all contingencies, dramatically increased, providing evidence that they understand the contractual obligation in a manner compatible with the Holmesian theory.

Table 8. Between subjects tests of difference

When is breach immoral?	Promises without comp.	Promises with comp.	McNemar (2-sided)	Contract without comp.	Contract with comp.	McNemar (2-sided)
Characteristics of breach						
1, Always	14 %	8 %	$\chi^2 = 3.3$ $p = 0.07$	24 %	3 %	$\chi^2 = 18$ $p = 0$
2, When it is inefficient	1 %	1 %	$\chi^2 = 0$ $p = 1$	0 %	1 %	.
3, When it is unfair	49 %	17 %	$\chi^2 = 23$ $p = 0$	48 %	15 %	$\chi^2 = 23$ $p = 0$
4, Never	20 %	62 %	$\chi^2 = 39$ $p = 0$	14 %	65 %	$\chi^2 = 44$ $p = 0$
Other	15 %	12 %		14 %	15 %	
Observations	104	104		86	86	

Participants answered four questions in the end of the survey, including (i) age, (ii) gender, and (iii) place of living (reported above). In the last question, they provided their knowledge of the default remedy for breach in the U.S. They were asked: "if a party to a contract does not keep it, what will courts do if the other party files a legal suit?" Table 9 reports the results:

Table 9. Default remedy for breach of contract reported by the subjects

"Order the party in breach to do exactly what the contract requires"	24.3%
"Order the party in breach to pay monetary compensation to the other party"	51.3%
"Do not know"	24.3%

IV. Discussion and Implications for the Law

The relationship between moral perceptions of what is wrong in breach of contract, and the legal norms prescribing remedies for breach has been extensively discussed in the absence of data and empirical evidence on how normal and common individuals understand, from a normative standpoint, the contractual obligation. Empirical evidence cannot add to how individuals *should* perceive and judge that act. It can reveal how they in fact do it, or how it *is* perceived and judged.

The majority of the individuals that took part in the experiment did not perceive the moral value of breach of contractual promises in a deontological fashion, requiring performance by the promisor on moral grounds, and independent of the consequences of the act. The obligation to keep such promises, therefore, seems to be perceived as *contingent*. One could, of course, argue that the fairness of the result determines if the contingency amounts to an excusing condition releasing the promisor from the obligation to perform (Rawls 1971) or not. This would reduce the deontological approach to a consequentialist one where the consequence of the act, in terms of fairness, determines its moral value. And this is not what is intended and assumed in deontological theories.

At the same time, almost no individual believed that only inefficient breaches are immoral, and that efficient ones are not. Attempts to establish the moral value of breach upon the hypothetical complete contract that parties would have made, and ultimately upon the efficiency of the act (Shavell 2006, 2009), albeit well-reasoned and ingenious, lack support among laymen.

Breach is, for most of us, immoral when it is unfair – and breach is not immoral when it avoids unfairness. Most individuals are consequentialists (Greene et al. 2001, 2004, 2008), but, at least in case of breach of contract, it is not the efficiency of the act that determines its moral value, but rather the inequality in the resulting distribution. This inequality, realized in a contingency that was not considered, discussed, or consented, and hence not integrated in the contract, cannot have been part of the price, and is hence not remunerated. Had the parties considered the contingency, and then settled on an agreement that does not integrate it, then although the contract would be incomplete, the contingency would have been part of the price.

In contingencies in which the promisor breaches to avoid high losses, and an unfair and unequal outcome, several defenses are possible in a lawsuit. They include impossibility, impracticability, and frustration of purpose. In all these cases, the promisor that breaches is treated leniently, and must not compensate the promisee for lost profits. Courts will usually rescind the contract, and put parties in the position that they were before the making of the contract. The promisor is not allowed to retain any upfront benefit, and may have to compensate the promisee for reliance losses; she will not, on the other hand, have to compensate the promisee for lost profits, and if the case involves no lost benefit and no loss of reliance, then there is nothing to compensate, and the promisor is not liable for the consequences of her act.

In contrast, in contingencies in which the promisor breaches to make higher earnings by selling the good to a third-party, there is virtually no excuse that can release the promisor from the secondary duty to pay expectation damages. If the promisee did not gave any upfront benefit, nor relied on the promise, then she is still entitled to recover the profits that she would have made had the promisor made good on her word. Breach is, in those circumstances, morally wrong at the eyes of the individuals, and the law, reflecting those, imposes the duty to pay expectation damages, and does not allow for defenses that can lead to the rescission of the contract.

In any case, whenever the promisor breaches but subsequently pays compensatory damages to the promisee, then that act is not, for two thirds of the subjects, morally wrong. Compensation is the fundamental principle and purpose in an award of a remedy for breach (Sedgwick 1847, §2; Anston 1899, §3; Williston 1920, §1338; Corbin 1951, §990; Farnsworth 2004, §12.8). The fact that its payment makes, for most of us, an act that was wrong into one that is not further reinforces the argument that the law closely reflects interpersonal morality.

Since breach of contract followed by the payment of fully compensatory damages is not understood to be, for most individuals, morally wrong, there is no point in aiming at compelling performance by the promisor. As it is well-known, the law does not aim at compelling performance, but rather "purports to reject such compulsion as a goal" (Farnsworth 1970, 1145). The discussion is hence not whether the law should attempt to enforce moral norm or not – it is rather that there is no moral norm that individuals ought to keep *contractual*, bargained-for promises given in exchange for a return promise, in a business interaction, even when the promisor fully compensates the promisee, including even the losses of something that she never really had (lost profits).

There is hence no point in faulting contract law for failing to impose the duty to keep promises in not entitling, by default, promisees to seek specific performance, nor courts to award punitive damages. The last ones are not awarded except in few extreme cases (Restatement (Second) of Contracts, chap. 16, introductory note, 1981), and courts have a strong tendency to strike down liquidated damages clauses that appear to be punitive. Specific performance, on its turn, can only be awarded when monetary damages cannot provide adequate satisfaction for the disappointed promisee (Restatement (Second) of Contracts, §359). When money can compensate the promisee for the losses sustained, then there is no moral or legal basis to force the promisor to do precisely what she had promised to do.

V. Conclusion

The obtained results reveal that contract law, instead of diverging from the moral values of the citizens, as elicited in the survey, in fact closely reflects them. They point to a correspondence, and not to a divergence, between the moral and the legal order. As argued by Seana Shiffrin (2007, 722), "[c]ontract law would run parallel to morality if contract law rendered the same assessments of permissibility and impermissibility as the moral perspective, except that it would replace moral permissibility with legal permissibility and it would use its distinctive tools and techniques to express and reflect those judgments".

Breach is morally permissible, for the subjects, exactly in those circumstances in which it is legally permissible. The promisor that breaches for a just reason, including increases in costs of production, and that successfully claims that performance was impossible or impractical is not liable for the loss of profits incurred by the promisee. She must only compensate the promisee for lost benefits, returning any upfront payment back to the promisee, and perhaps also for losses from reliance investments. If those are not present, then there is nothing to compensate, for the breach was not immoral, as most of us perceive it. Breach is then both morally and legally permissible.

Breach is, on the contrary, morally impermissible when it is committed to achieve higher profits. In those circumstances, the promisor has no defense that can release her from the duty to compensate the promisee even for the loss of expected, promised gains. In this case, the law is strict, and the fair thing to do is to hand over the equivalent of performance. Breach, without the payment of damages, is in those cases both morally and legally impermissible.

With the payment of damages, then breach is both morally and legally permissible. If the promisor refuses to compensate the victim, then the last one can recur to courts to redress breach. Since legal redress makes, for most of use, and in case no more than money is at stake, and no other wrong such as violations of fiduciary or proprietary interests is involved, a wrong right, the law adopts compensation as the fundamental principle and purpose in an award of a remedy for breach. In doing so, the law is apt to achieve its highest purpose: to make a perpetrated wrong into a right – so far as it can do, ex post – by means of legal redress.

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