WHAT'S MORALITY GOT TO DO WITH IT?

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

The crux of the intermediate position Professor Shiffrin sets out in her characteristically exacting and provocative Article is this: the parties to a contract should be free to choose any terms they want, within the normal bounds of legality; but if what they want is what moral virtue requires of them, the law has an obligation not to make it difficult or impossible to get.[1] In Professor Shiffrin's view, what moral virtue requires of a promisor is (roughly) that she do what she promised to do, unless she has a darned good reason not to.[2] American contract law, she argues, fails to meet its obligation to accommodate the moral actor in a number of respects.[3] Of most concern to Professor Shiffrin are the various contract doctrines that undercut the moral "require[ment] that promisors keep their promises as opposed merely to paying off their promisees."[4]

I have my doubts about Professor Shiffrin's view of what minimal moral virtue requires in the promissory realm. I have doubts as well that Professor Shiffrin has adequately dispatched the "separatist" objection that the morality of promising (mostly formulated in the context of gratuitous promises in the personal realm) has limited relevance to moral and legal norms in arm's-length contracts. At any rate, I think a lot more work needs to be done to convince skeptics (of whom I am one) that these enterprises are bound together by more than a pun on the word "promise."

These disagreements will have to wait for another day. For now, I want to take on board Professor Shiffrin's view of promissory morality and its relevance to the law of contracts, in order to pursue a different concern: whether what she perceives to be a moral failing of contract law might not reduce to mundane problems of contract formation (did the parties know what they were agreeing to?) and interpretation (what exactly were they agreeing to?).

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[1] *See* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708, 712 (2007).

[2] *See id.* at 722.

[3] *See id.* at 710.

[4] *Id.* at 722. As Professor Shiffrin acknowledges, nothing in contract law inhibits a promisor from performing as promised in the contract. The concern here therefore must be solely about the position of the promisee — in particular, whether contract law prevents the promisee from getting legal assurance that the promisor will perform as promised.

Let me start by noting that contract law has by and large already adopted Professor Shiffrin's intermediate position. The argument here is straightforward, and Professor Shiffrin, not surprisingly, has anticipated it. Almost all of contract law is default rules. That means that parties are pretty much free to contract around the law as they wish, and— to address Professor Shiffrin's concern — in particular to insist on terms that mandate what they take moral virtue to require. This is straightforwardly true of the mitigation obligation, the *Hadley v. Baxendale*[5] rule on foreseeability, and the American rule on attorneys' fees. If a party is worried that the default measure of expectation damages will leave her monetarily undercompensated, she can insist on absolute indemnity for all losses that flow from breach, without any obligation on her part to mitigate. If she is worried about the expense and delay in the use of litigation to enforce her rights, she can insist on a forfeiture provision, which would allow her to seize or retain assets unilaterally in the case of breach, and/or require attorneys' fees to be paid by the losing side.

With respect to specific performance in lieu of monetary damages, it is not clear that damages are even the preferred *default* remedy anymore. The language of Section 2-716(1) of the Uniform Commercial Code ("Specific performance may be decreed if the goods are unique or in other proper circumstances"[6]) is flexible enough to accommodate specific performance in virtually any situation in which a nonbreacher could reasonably want it. Indeed, official comment 2 to Section 2-716 encourages such a broad interpretation.[7] The most exhaustive study of equitable remedies to date concludes that in recent decades courts have granted specific performance liberally and that when they have declined to do so, it is virtually always for the sorts of "distinctively legal"[8] reasons that Professor Shiffrin acknowledges the legal system may legitimately take into account.[9] Since parties rarely specify specific performance in the contract, it is hard to assess how much additional deference courts give such a stipulation (although one assumes it would only strengthen courts' presumption in favor of specific performance). The 2003 proposed revisions to the UCC, however, encourage such deference in business-to-business contracts, including in cases in which monetary damages would be deemed "adequate."[10]

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[5] 156 Eng. Rep. 145 (Ex. 1854).

[6] U.C.C. § 2-716 (2005).

[7] See *id.* cmt. 2.

[8] Shiffrin, *supra* note 1, at 733.

[9] DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE 4, 23–24 (1991); *see also* DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 359. 367 (2d ed., 1994); Shiffrin, *supra* note 1, at 733 – 37.

[10] Subsection (1) provides that "In a contract other than a consumer contract, specific performance may be decreed if the parties have agreed to that remedy." U.C.C. § 2-716(1) (Proposed Official Draft 2003). The preliminary official comments make clear this revision is intended to "permit[] parties to

The bar on punitive damages, the cap on liquidated damages, and the requirement of consideration are more complicated cases. Professor Shiffrin is right that all three rules are formally nonwaivable under some or all circumstances. But as a functional matter, parties have very wide latitude to get what they want with respect to all three if they choose their language with care.[11] In the case of punitive damages, it is true, meeting that objective may well require the parties to give up the opportunity to express their moral disapproval of nonperformance within the four corners of the document. But nothing in contract law prevents them from communicating that disapproval through other means (which are, as it happens, the *only* means available in the moral realm): shaming, shunning, publicly besmirching the other side's reputation, etc.[12]

In short, contract law for the most part allows parties to insist on exactly as much virtue in their dealings with others as they want.[13] Of course, some gaps remain between what Professor Shiffrin takes virtue to require and what the law permits. But the gaps are small, and it's hard to

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bind themselves to specific performance even where it would otherwise not be available," *id.* cmt. (1)(b), — that is, even in situations where their legal remedies are "entirely adequate," *id*. cmt (3).

[11] Courts rarely strike down liquidated damages provisions as excessive. When they do, more often than not that result can be traced to extenuating circumstances (for example, opportunistic behavior by the nonbreacher or consequences of breach that the court feels were unintended by the parties). For an excellent summary and analysis of some cases challenging liquidated damages provisions as excessive, see Mark P. Gergen, *A Defense of Judicial Reconstruction of Contracts*, 71 IND. L.J. 45 (1995). In addition, in recent decades a number of states have moved to a strong presumption in favor of the validity of liquidated damage provisions. *See, e.g.*, Cal. Civ. Code § 1671 (West 1978) (covering most nonconsumer contracts); Bigda v. Fischbach Corp., 849 F. Supp. 895 (S.D.N.Y. 1994). Finally, as noted in the text, the bar on "excessive" liquidated damages, like the bar on punitive damages, is usually easy to evade through careful wording of the contract: "Penalty" language is bad. Explanations as to why apparently high liquidated damages are fair compensation for hard-to-estimate losses are good. In addition, either structuring liquidated damages as a prepaid deposit to secure performance (as is standard in real estate contracts), or rephrasing liquidated damages as an alternative form of performance (the "take or pay" contracts discussed below) will usually insulate the term from challenge. *See* Prenalta Corp. v. Colorado Interstate Gas Co., 944 F.2d 677, 680, 689 (10th Cir. 1991); FARNSWORTH, YOUNG & SANGER, CONTRACTS 553 n.2, 554 (6th ed. 2001).

As to the requirement of consideration: it has long been riddled with exceptions, and can virtually always be circumvented through heightened formalities or irrevocable delivery.

[12] Indeed, one of the oddities in Professor Shiffrin's comparing legal remedies unfavorably to "moral remedies" is that the menu of sanctions available in the case of nonperformance is much more constrained in the moral than the legal realm. The literature on the morality of promising is by its nature hortatory. As a result, its focus is (appropriately) on the ex ante obligation to perform, and it has relatively little to say about appropriate responses in the event of nonperformance. While the full panoply of psychological/relational sanctions is available to those who feel they were the victims of immoral promise-breaking, those are the only sanctions available to them. They can get neither specific performance nor monetary damages.

[13] Of course, they are likely to end up paying for a greater expected level of virtue from the other side through a higher contract price — which is one reason why they might opt for the somewhat lesser virtue the default rules would give them. For the record, that people generally must pay for what they get in arm's-length deals is, in my view, one of the chief reasons to be skeptical of claims that the moral obligations imposed by gratuitous promises and those imposed by commercial contracts converge.

see how they add up to a regime that is "difficult for the morally decent person to accept."[14] Professor Shiffrin seems to concede as much when she states that "[c]ontract law does not violate the. . . principle" that it accommodate moral action.[15]

What, then, is the problem? It seems to me two very different things could be bothering Professor Shiffrin here.[16] The first is the worry that the typical individual does not understand most of the collateral terms in the contracts he signs. This is a legitimate and serious concern, particularly when the terms are supplied by unstated default rules to which the parties' consent is inferred from their silence. When the average homeowner hires a carpenter to build bookshelves pursuant to a verbal contract that specifies nothing about performance standards and remedies, does she really understand that the carpenter's obligation to give her what she bargained for — bookshelves built to her specifications — is implicitly limited to expectation damages, which are themselves limited by the substantial performance rule, the *Hadley* rule, inability to collect for hard-to-quantify losses, etc.? If this is indeed what is bothering Professor Shiffrin, it is a very different problem from the one raised by her Article. This problem has nothing to do with the substantive terms of contract law, default or mandatory. It is a garden-variety (albeit serious) procedural problem that is wholly internal to existing contract law: when should apparent consent to stated and implied terms be treated as binding?

The second possibility is that Professor Shiffrin does not really believe it is sufficient for the law to accommodate the morally virtuous act; at least in some cases it must mandate it. In short, perhaps she is a reflectivist after all. While her Article is equivocal on this point, Professor Shiffrin seems to suggest that moral virtue requires that some principles be made nonwaivable.[17] Among those are the principle that breach is "impermissible as opposed to merely subject to a price"[18]; and that illusory promises

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[14] Shiffrin, *supra* note 1, at 710.

[15] *Id.* at 719.

[16] Professor Shiffrin herself suggests the problem is that, while the law does accommodate moral action, it violates her second and third principles: that the rationale for the rule be acceptable to a moral agent, and that the law "be compatible with a culture that supports morally virtuous character," even if it "need not go so far as to enforce moral virtue." *Id.* at 719. Once it is conceded that the law accommodates virtuous action by letting parties contract around the default rule for virtually any terms they wish and for any reason they wish, I am unsure that either of these concerns can carry a lot of moral force.

[17] On the liberal, accommodationist side, Professor Shiffrin states, in various ways, her own view that the "law should not aim to enforce interpersonal morality as such." *Id.* at 710. On the reflectivist side, she distances herself from the view that "legal principles should be . . . divorced from demands of interpersonal morality," *id.* at 714, and expresses doubt that "the contents of promises are . . . utterly up to their makers." *Id.* at 728.

[18] *Id.* at 724.

(that is, promissory noises that in fact bind the speaker to nothing) are morally wrong.[19]

Unfortunately, I do not think that resort to reflectivism can make the case that contract law has failed to do what morality requires. Professor Shiffrin has again anticipated the problem here: we can bring any promise into line with what she takes morality to require simply by rephrasing it. Take the principle that contract law should "— as the norms of promises do — require that promisors keep their promises as opposed merely to paying off their promisees."[20] As Professor Shiffrin acknowledges, if we reinterpret every contract (à la Holmes) as a contract in the alternative — to perform or to pay an amount of money equal to the value of performance — when a party opts for the latter course he has not breached at all.[21] He has simply chosen the second of the two performance options the contract provided. Viewed from that perspective, as Professor Shiffrin acknowledges, "contract law does not treat promises differently"[22] from what morality requires (i.e., to mandate performance). It simply "produces different promises with particular contents."[23] If parties do not like the content supplied by default rules (a Holmesian promise in the alternative), they can supply their preferred content (perform or be subject to a specific performance decree) in its place.

Professor Shiffrin dismisses this "reconceptualization strategy" as unpersuasive, for reasons that (in my view) ultimately boil down to a reassertion of reflectivism, only one level down: "[t]his recharacterization provokes another worry, namely about the assumption that the contents of promises are indefinitely plastic and utterly up to their makers."[24] In short, when she says that it is morally wrong for a contract to permit parties to avoid performance for a price, she means it is wrong however that option is phrased.

I have serious doubts, however, that Professor Shiffrin will stick to her guns on this point. I strongly suspect her moral disapproval of the Holmesian contract in the alternative, like her objection to illusory promises, is highly sensitive to how the contract or promise is phrased. Consider the examples that Professor Shiffrin offers to express her moral doubts about "breach for a price" and illusory promises:

> It is out of bounds to say: "I solemnly promise to X but I may fail to do so if something better comes along; moreover, if it does, you can only expect X's market value from me, although you may need to enlist the help of others to pry it out of my clenched fist. Further, let us now declare that should I fail, it

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19 *See id.* at 728–29.
20 *Id.* at 722.
21 *See id.* at 727.
22 *Id.*
23 *Id.*
24 *Id.* at 728.

> will not be the sort of thing deserving of moral reprobation so long as eventually you are made whole monetarily. Moreover, it is not the sort of thing you may be upset with me over or view as showing my bad character." This is not a full-fledged promise. Its elaboratory remarks defy the language of its opening gambit. They clarify that it *is not* a promise at all, while attempting to elicit the interlocutor's acknowledgment of that fact. Rather, it seems to be the statement of an intention to act, along with an acknowledgment that the statement will, in this context, render the utterer susceptible to one sort of liability at the hands of another. But there is no commitment by the utterer to *do* anything at all. Although one can declare within a promise some of the conditions under which the promised performance may not occur, those conditions cannot coherently extend so far as to include any situation in which the promisor has a change of heart or entertains a better offer.[25]

It seems to me that rhetoric bears much of the weight of the argument here, in two respects. First, the words that Professor Shiffrin puts in the promisor's mouth invite us to find moral unrespectability where perhaps there is none. Second, much of Professor Shiffrin's own discomfort with these utterances I believe would disappear if identical limitations on liability were phrased in a different way.

Take the problem of illusory promises raised by the first clause: "I solemnly promise to X but I may fail to do so if something better comes along." Professor Shiffrin is right to say that this is not a promise "by the utterer to *do* anything at all," but is rather a statement of present intention to act (if even that). But what exactly is the problem with that? Professor Shiffrin's own discomfort seems to rest on the fact that the speaker is purporting to make a promise ("I solemnly promise") while in fact promising nothing. But suppose we omit those loaded words, and rephrase the statement to collapse together the purported act of promising and the content of the promise, to put their combined meaning more straightforwardly: "I'm thinking I'll probably do X, but I have to see what all my options are." Still no commitment to do anything at all, but it is hard to see what is morally objectionable about those statements.

Now take the problem of "breach for a price" raised by the second clause: "[M]oreover, if [I fail to do X], you can only expect X's market value from me, although you may need to enlist the help of others to pry it out of my clenched fist."[26] Put this way, the speaker sounds like a first-class cad — the sort of guy you would be nuts to do business with. But suppose we rephrase those same qualifications in a rhetorically less loaded fashion. Consider the following hypothetical agreements:

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[25] *Id.* at 728 – 29 (first emphasis added).

[26] Professor Shiffrin's hypothetical is a little confusing at this point. She describes this clause as "an acknowledgment that the statement will, in this context, render the utterer susceptible to one sort of liability at the hands of another." *Id.* at 728. But if in fact the promise to do X was illusory (as it surely is on Professor Shiffrin's wording), then the speaker has no liability to the listener at all. For purposes of discussion of the second clause, I will assume the promise to do X was not illusory.

1. Seller hereby grants Buyer an option to buy Blackacre at a purchase price of $500,000, which option is exercisable anytime prior to January 1, 2007. Buyer hereby agrees to pay $20,000 for the option, payable upon signing this agreement. In the event that Buyer elects to go forward with the purchase of Blackacre, the $20,000 will be applied to the purchase price. In the event Buyer elects not to exercise the option, Seller will retain the $20,000.

2. Lender agrees to loan Borrower $500,000 towards the purchase of Blackacre. The loan shall accrue interest at five percent interest per annum, compounded monthly. The principal amount of the loan plus accumulated interest will be payable in level-payment monthly installments over fifteen years. The loan shall be on a nonrecourse basis, secured by Blackacre. In the event that Borrower is in more than three months' default on the loan at any time, Lender may foreclose on Blackacre and sell it at auction, retaining proceeds up to the balance still owed on the loan and turning the rest (if any) over to Borrower. In the event the sale price at auction is less than the outstanding balance Borrower owes on the loan, Lender shall have no further recourse against Borrower.

3. Studio X hereby agrees to retain AM to star in a film project entitled "Our Fair City." Studio agrees to pay AM $750,000 as a retainer, payable in full in sixty days, which shall be AM's to keep whether the movie is made or not. In the event the movie is made, AM will, in addition to the $750,000, receive five percent of net profits from the film. The parties agree that any dispute between them over the terms of the contract or performance by either side will be subject to binding arbitration.

Each of these examples describes a commonplace deal. The first is an option to purchase. The second is a standard nonrecourse loan agreement. The third (a variant on *Parker v. Twentieth Century-Fox Film Corp.*[27]) is a form of a "take or pay" (or "pay or play") clause, giving the buyer of goods or services the option to "take" those services in-kind or pay a stipulated kill fee/retainer. In each case, the agreement is identical in substance to a contract to perform X (buy Blackacre, repay the loan in full, hire AM to perform in Our Fair City), with a liquidated damages provision in the event of nonperformance that is worth substantially less than the expected value of performance.[28] The only difference is rhetorical. Rather than

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[27] 474 P.2d 689 (1970).

[28] Note also that in example 3, AM will "need to enlist the help of others to pry [the $750,00] out of [the Studio's] clenched fist," Shiffrin, *supra* note 1, at 728, if the studio fails to pony up voluntarily, and hence is in exactly the same boat as the promisee in Professor Shiffrin's example. This is regrettable. But the fact that we are often compelled to resort to a costly legal process to secure our

phrasing the obligation to pay money as a "remedy" for breach of promise to perform, my three examples present it explicitly as performance in the alternative. If — as I believe — Professor Shiffrin would not object to any of these three contracts, provided the parties understood what they were agreeing to, why should mere verbal differences change her view on the moral acceptability of a buyout option?

One possible answer is that the very explicitness of the buyout option in each of my examples makes it much more likely that the party that stands to be bought out understands the terms of the deal and regards the buyout option as a perfectly acceptable outcome. In contrast, when faced with a contract that relies on (unstated) default remedies we worry that the parties will assume that the contract carries higher obligations of performance than it really does. Similarly, in a contract that describes the buyout option as "liquidated damages," we worry that the parties will misread the contract to impliedly require a good faith effort to perform, with liquidated damages as a last-ditch compensatory measure if performance proves impossible.

Both of these seem to me very reasonable concerns, although, ironically, they would not help explain what is wrong with the promisor's behavior in Professor Shiffrin's hypo.[29] But I have trouble seeing why they implicate the morality of substantive contract terms. Once again, they seem to reduce to what are essentially garden-variety problems (albeit knotty and important ones) of contract formation and interpretation. It may be that certain terms are so likely to be misunderstood by one side to the contract that they ought to be taken off the table entirely, or at least be subject to disclosure requirements. But the motivation for intervening in that case still has nothing to do with the perceived immorality of the contract term itself.

So, does that mean that morality has nothing to do with contract law? Hardly, in my view. But I think that Professor Shiffrin may be looking for a virtue deficit in the wrong place. Rather than lurking in specific contract terms that offend common decency, I think it resides in how those terms are construed by the parties in practice — in short, in problems of interpretation and intent. Up until now, I have assumed that when the promisee is blindsided by the promisor's actions, it is the result of an innocent (if pre-

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legal rights is hardly unique to contracts. In addition, as examples 1 and 2 suggest, we are not without alternatives. It is often possible to secure one's right to payment by providing in the contract for prepayment or a securitized interest in the promisor's property.

[29] The promisor in her hypo, by rubbing the promisee's nose in the fact that he has promised either nothing at all or (at the most) to pay expectation damages upon a court determination of breach, has left no doubt about the terms of the promise. For the record, my view is that what is troubling about the behavior of the promisor here is precisely the fact that for no good reason he feels impelled to taunt the promisee with the limited nature of his commitment. We naturally and rightly feel that only a complete jerk would do that. But the jerkiness at issue is quite different from the jerkiness of promising to do X and then not doing it.

dictable) misunderstanding about the contract's terms. But what of the promisor whose conduct deliberately and self-interestedly pushes to the absolute limit of what the language of the contract could accommodate — and far beyond what it knows the other side thought that language meant? There are serious reputational costs for that sort of sharp dealing. But most people would think it morally appropriate for the law to intervene as well, by holding each party to a reasonable interpretation of the contract language in light of prior dealings, custom of the trade, etc. And on this point, the law (through the nonwaivable obligation of good faith and fair dealing and various interpretive tools) has been more than happy to mandate what morality is widely taken to require.