INTERPERSONAL TRUST AND CONTRACT THEORY REDUX

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ABSTRACT

The proposition that mutual loyalty facilitates the cooperation required for contract performance is a truism, almost a cliché. Jurists have extensively debated the role of honesty, collaboration, and reciprocity for supporting decent contractual relations. Surprisingly, contract law scholars have not yet developed a detailed account of interpersonal trust in a one-shot contract that is outside the frame of relational transactions, or the common understanding of fiduciary relations. While theoreticians acknowledge the significance of interpersonal trust as a core component of any contract theory, they fail to develop a comprehensive understanding of such a concept and how it is integrated into a descriptive approach of contract law. This Article is devoted to exploring the fundamental perceptions of moral, economic, and behavioral interpersonal trust as a basis for establishing a new framework on the role of faith in contract law and theory. I show that consolidating the studies of interpersonal trust in the fundamental assumptions of promissory, efficiency, and fairness theories may fill this void and resolve some difficulties regarding their analytical force of different contract doctrines, as well as provide a better justification for various transactions between a variety of contractor types in different legal systems.

I. INTRODUCTION

The proposition that mutual loyalty facilitates the cooperation required for contract performance is a truism, nearly a cliché.[1] Courts have long emphasized the significance of honesty, cooperation, and reciprocity for maintaining decent contractual relations and discussed their implications for rights and remedies in private law.[2] For example, in November 2014, the

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[1] KATHLEEN GUTMAN, THE CONSTITUTIONAL FOUNDATIONS OF EUROPEAN CONTRACT LAW: A COMPARATIVE ANALYSIS 310 (2014).

[2] This is mostly reflected in the Anglo-American good faith and fair dealing law. *See* U.C.C. § 1-201(b)(20) (AM. L. INST. & UNIF. L. COMM'N 2010) (defining "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing."); Precision Pine & Timber v. United States, 596 F.3d 817, 820 n.1 (Fed. Cir. 2010) ("Both the duty not to hinder and the duty to cooperate are aspects of the implied duty of good faith and fair dealing."); Metcalf Constr. Co. v. United States, 742 F.3d 984, 991 (Fed. Cir. 2014) ("What is promised or disclaimed in a contract helps define what constitutes 'lack of diligence and interference with or failure to cooperate in the other party's performance."); Woods v. WM Car Services Peterborough Ltd. [1981] IRLR 347 (Eng.) ("It is clearly established that there is implied in a contract of employment a term that employers will not . . . conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence

Supreme Court of Canada issued a landmark decision that dramatically influenced the obligations of all parties to commercial contracts in Canada. In *Bhasin v. Hrynew*,[3] a unanimous ruling recognized that good faith contractual performance is a general organizing principle of Canadian common law, and contractual parties are under a duty to act honestly in the performance of their mutual obligations. While the Canadian Supreme Court emphasized that good faith performance does not include in itself a duty to put the interests of the other contracting party first, as a fiduciary does, the Court nevertheless acknowledged that

> Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce. The growth of longer term, relational contracts that depend on an element of trust and cooperation clearly call for a basic element of honesty in performance, but, even in transactional exchanges, misleading or deceitful conduct will fly in the face of the expectations of the parties[.][4]

In other words, the notions of mutual honesty, reciprocity, and cooperation—which ordinary people justly assume to be the building blocks of any conception of interpersonal trust—were perceived as prerequisites for recognizing the principle of good faith in Canadian contract law.

Against this background, it seems surprising that contract law theoreticians have not yet developed a comprehensive account of interpersonal trust in contract law, which is *not* confined to the study of relational transactions,[5] or the conventional understanding of fiduciary possessory relations.[6] Therefore, this Article is devoted to exploring the notion of interpersonal trust in short-term one shot contracts by introducing to the legal audience the philosophy, economics, and psychology studies on this subject. I suggest that the vast literature has considerable implications for reforming core assumptions of promissory, efficiency, and fairness theories of contract law. I intend to show that integrating those insights into various contract theories provides better justification and explanation for various contract doctrines.

I advance the following claims. First, philosophers generally believe that to form interpersonal trust relations between individuals, the reliance by the trustor and competence and goodwill of the trustee are required. These elements are considered prerequisites for generating a betrayal in the case of distrust. Accordingly, I argue that to create an expressive account of

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and trust between employer and employee."); Yam Seng Pte Ltd. v. Int'l Trade Corp. Ltd., [2013] EWHC 111 (QB) HQ11X0072, [135] (appeal taken from Eng.) ("A paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust.").

[3] Bhasin v Hrynew, [2014] S.C.R. 494, para. 60 (Can.).

[4] *Id.*

[5] Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U.L. REV. 854, 883 (1978).

[6] Gregory Klass, *What if Fiduciary Obligations Are Like Contractual Ones?*, *in* CONTRACT, STATUS, AND FIDUCIARY LAW 93, 93–94 (Paul B. Miller & Andrew S. Gold eds., 2016) (demonstrating that fiduciary and contractual obligations share several common features, such as using the same tools for gap filling, the obligations result from voluntary acts, and large parts of these obligations are based on default rules); Daniel Markovits, *Theories of the Common Law of Contracts*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Sept. 11, 2015), https://plato.stanford.edu/entries/contracts-theories/.

interpersonal trust in the frame of promissory theories of contract law, these theories have to reconcile reliance considerations that are associated with betrayal rather than mere disappointment. Such unifying understanding has insightful implications for the ability of promissory theories to justify fundamental doctrines in contract law and remedies. Implications include the determination that expectation damages are the primary remedy for breach of contract; the marginal role that fault considerations have in shaping the promisor liability for breach of contract; and the *Hadley* rule, which holds that promisors are liable only for those consequential damages that could reasonably have been foreseen at the time of the contract's formation.[7]

Second, economic analysis identifies the concept of interpersonal trust in contractual relations with an investigation of risks and loss attitudes, which are grounded on rational and irrational reasoning and motivations. Contract law and economics scholars have demonstrated that the well-known efficient breach may be compatible with moral instincts. However, this Article will show that to provide a meaningful connection between an efficiency and a moral perspective of a contract's breach, economic analysis of law has to adopt a contextual approach that connects the heterogeneity of risks and loss aversion among different kinds of contractual parties in various types of transactions to the contractual duty to perform. Such comprehensive scrutiny may explain when the decision to breach a contract is morally acceptable and justifies awarding monetary damages and when such determination is contradictory to prevalent moral views and requires yielding specific performance.

Third, behavioral theories of interpersonal trust, which study the cognitive process of producing expectations about the other's future performance, have found that appearance-based personal trust signals, such as the nation-state, religion, race, and gender, predict the trustworthiness of unknown partners. Contracts theoreticians have long debated the question whether the concept of equal exchange is solely based on the Aristotelian commutative justice perspective or if it should also be associated with a distributive justice perspective to provide a meaningful interpretation to the role of fairness in contract law. Since behavioral theories discovered that forming contractual trust relations is partly based on socio-economic characteristics, commutative justice perspectives of fairness cannot be isolated from a distributive justice perspective for providing the best fit and justification of the American unconscionability doctrine.

This Article proceeds as follows. In Part I, I introduce the philosophical background of interpersonal trust and its implication for promissory theories of contract law. Part II is devoted to studies of the economics concept of interpersonal trust and their implication for redesigning the theory of efficient breach in a manner that will be compatible with ordinary common-sense morality. In Part III, I discuss behavioral theories of interpersonal trust that study the cognitive process of producing expectations about others' future performance and their relations to commutative and distributive justice perspectives of fairness in contract law. I end this Article with several

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[7] Hadley v. Baxendale (1854) 156 Eng. Rep. 145, 150 (Eng.); RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (Am. Law Inst. 1981).

concluding thoughts regarding future research on the role of trust in contract law and remedies.

II. THE PHILOSOPHICAL FOUNDATIONS OF INTERPERSONAL TRUST AND THE THEORY OF CONTRACTS

In this Part, I present the core philosophical views on the concept of trust while differentiating it from other related concepts that are more commonly applied by ordinary people. Later on, I combine these views with promissory theories of contract law, which concentrate on the compulsory force of promises.

A. A PHILOSOPHICAL ACCOUNT OF TRUST

I begin the discussion on the philosophical meaning of trust by discerning it from other associated and conflated notions that are frequently used by ordinary people.[8] Trust is typically connected with the term of acquaintanceship and prior familiarity. Although being familiar with a person may provide a basis for confidence, it is not a necessary nor sufficient condition for forming such a relationship. Mere familiarity with someone does not imply that he or she is truthful and has the intent or capabilities for us to entrust that person with our personal affairs.[9] We also too often conflate trust and trustworthiness, as if these are merely two different terms for the same phenomenon. Under this view, someone will be trusted when he or she is recognized for his or her trustworthy behavior, which justifies assigning him or her with our personal dealings.[10] Although trustworthiness is a necessary condition for forming a trust relationship, it is not a sufficient one. Sometimes, trust relationships are unequal and asymmetrical. Additionally, there could be related reasons for trusting someone even though his or her competence may be questionable.[11] For instance, we may choose to entrust someone with our matters because of our intense feelings for him or her, even though that person may be regarded as incompetent to deal with our interests and such undertaking may risk our interests. Although there is no dispute that the conceptions of trust discussed above may capture different variants of the concept of trust, a more nuanced and comprehensive approach is in order.

Generally, philosophers believe that trust requires us to be vulnerable to betrayal by others while not constantly monitoring other people's conduct,[12] reflecting well of others, and being optimistic that other parties will not only be competent but also be committed to do what we trust them to do for the right reasons. Although trust may involve creating reliance, many philosophers identify additional factors concerning the motives of the trusted person. In other words, trust is reliance with an extra interpersonal quality

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[8] ROBERT C. SOLOMON & FERNANDO FLORES, BUILDING TRUST: IN BUSINESS, POLITICS, RELATIONSHIPS, AND LIFE 53–57 (2003).

[9] *Id.* at 55.

[10] *Id.* at 56.

[11] *Id.*

[12] Annette Baier, *Trust and Antitrust*, 96 ETHICS 231, 235 (1986) ("The trusting can be betrayed, or at least let down, and not just disappointed. . . . When I trust another, I depend on her good will toward me. . . . Where one depends on another's good will, one is necessarily vulnerable to the limits of that good will. One leaves others an opportunity to harm one when one trusts, and also shows one's confidence that they will not take it."); *see also* Karen Jones, *Trust as an Affective Attitude*, 107 ETHICS 4, 12 (1996).

that sets trust-reliance apart from other types of reliance. Trust is interpersonally notable because when we trust another person, we are susceptible to being betrayed by that person. Therefore, trust is reliance, plus specific conditions that enable the possibility of betrayal. The chance to suffer from betrayal, as a kind of event, is a defining characteristic of trust.[13]

Karen Jones calls for a "will-based" interpretation of trustworthiness, which finds trustworthiness only where the trustee is motivated by his or her goodwill.[14] In a similar vein, Annette Baier's theory of trust supposes that reliance is a necessary condition but is not a sufficient one for creating trust. According to her view, an additional component is required to create trust and it is rooted in beliefs concerning the competence and goodwill of the trustee. Thus, when trusting, the trustor puts the trustee in a position to harm the trustor, although the trustor is confident that the trustee will not take advantage of the trustor's position.[15] Diego Gambetta also accepted the vulnerable and dependent conditions of trust, but replaced the goal of interpersonal cooperation with that of an ultimate net good. Trust, he wrote, occurs when "the probability that [a person with whom we are in contact] will perform an action that is beneficial or at least not detrimental . . . is high enough for us to consider engaging in some form of cooperation with [that person]."[16]

In contrast, "risk-assessment views" of trust provide that people trust other people, who are normally perceived to be self-interested, whenever the trustor assumes that the adverse consequences of relying on others will not materialize For example, according to Russell Hardin, trustworthy people are motivated by their own interests to maintain a relationship with the trustor, which in turn encourages them to encapsulate the trustor's interests into their own interests.[17] Alternatively, Bernard Williams identifies four general motivations people can have for cooperating or relying on one another: fear of sanctions, particular self-interest, a positive evaluation of cooperation, and a positive evaluation of friendly relations.[18]

I wish to turn the discussion to exploring the connection between the conception of interpersonal trust and the obligatory force of contracts as discussed in philosophy literature. A recent account on the connection between trust and commitments was offered by Katherine Hawley.[19] "To understand trust," Hawley writes, "we must also understand distrust, yet distrust is usually treated as a mere afterthought, or mistakenly equated with an absence of trust."[20] In this regard, Hawley wishes to examine "what is the worldly situation to which (dis)trust is an appropriate response?" and "when is it appropriate to have (dis)trust-related normative expectations of

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[13] ANDREW J. KIRTON, MATTERS OF INTERPERSONAL TRUST 45–46 (2018) (Ph.D. thesis, University of Manchester).

[14] Karen Jones, *Trustworthiness*, 123 ETHICS 61, 66–70 (2012).

[15] Baier, *supra* note 12, at 235.

[16] Diego Gambetta, *Can We Trust Trust?*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 213, 217 (Diego Gambetta ed., 1988).

[17] RUSSELL HARDIN, TRUST AND TRUSTWORTHINESS 3–9 (2002); *see also* KATHERINE HAWLEY, TRUST: A VERY SHORT INTRODUCTION 40 (2012).

[18] Bernard Williams, *Formal Structures and Social Reality*, *in* TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 3, 8–11 (Diego Gambetta ed., 1988).

[19] HAWLEY, *supra* note 17, at 48.

[20] Katherine Hawley, *Trust, Distrust and Commitment*, 48 NOÛS 1, 1 (2014).

someone?"[21] Hawley argues that what distinguishes reliance or non-reliance from trust or distrust is that the latter attitudes are only appropriate in the context of commitment. The betrayal-enabling condition Hawley identifies as the foundation of trust is that the trustor believes the trustee has made an interpersonally, normatively binding commitment, via explicitly promising or implicitly encouraging the trustor's reliance on the trustee to act. Therefore, while Baier and Jones argue that trust requires an attitude of optimism or hope that the trustee will be positively moved by the thought that he or she is being trusted, Hawley demonstrates that such motive-based ideas of trust cannot explain distrust, and it is "appropriate to trust or distrust [or] to do something only if that person has an explicit or implicit commitment to do it."[22] Philosophers generally believe that trust encompasses reliance by the trustor and competence and goodwill of the trustee, which may create the conditions for potential betrayal in case of distrust.[23] However, recent writings emphasize faith or optimism that other parties will not only be competent but also be committed to do what we trust them to do. Such faith or optimism could be materialized only if a promissory obligation is involved that can signal to the trustee, the trustor's recognition of the importance that the requested action has for the trustor, and the trustor's willingness to be moved on that basis.[24]

B. PROMISSORY THEORY OF CONTRACT AND TRUST

1. The Integration of Reliance Considerations into Will Theory of Contract

Charles Fried developed the modern will theory in his seminal book *Contract as Promise*.[25] According to Fried, contracts have binding force because promises embrace intrinsic moral value. Contracts are promises; they must be kept as promises must be kept.[26] Thus, contract law is grounded on a "convention . . . of promising," which is a cultural perception that allows one party to be bound to another in a manner that generates expectations and trust between contractual parties.[27] The convention of promising is a necessary condition by which individuals agree on goals and plans by obtaining the collaboration of other free individuals. Fried argues that breaking a promise is an abuse of the trust we had granted when we promised, and as such, it contradicts the Kantian imperative against using people as means for promoting others' objectives.[28]

Although Fried declares that contracts integrate trust, he never explained how trust should be perceived or how contracts involve and produce trust between parties. Accordingly, Fried's substantive arguments about contract

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[21] *Id.* at 9.
[22] *Id.* at 9–11.
[23] Victoria McGeer & Philip Pettit, *The Empowering Theory of Trust*, *in* THE PHILOSOPHY OF TRUST 14, 15 (Paul Faulkner & Thomas Simpson eds., 2017).
[24] *Id.*
[25] CHARLES FRIED, CONTRACT AS PROMISE (2d ed., 2015) [hereinafter FRIED, CONTRACT AS PROMISE]; Charles Fried, *The Ambitions of Contract as Promise*, *in* PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW 17 (Gregory Klass, George Letsas & Prince Saprai eds., 2014).
[26] FRIED, CONTRACT AS PROMISE, *supra* note 25, at 17.
[27] *Id.* at 17.
[28] *Id.* at 16–17.

formation and breach are mainly based on the ideas of freedom.[29] Fried explains that "a promise invokes trust in my future actions, not merely in my present sincerity. We need to isolate an additional element, over and above benefit, reliance, and the communication of intention. That additional element must commit me, and commit me to more than the truth of some statement."[30] Thus, "in both speech and promising there is an invitation to the other to trust, to make himself vulnerable; the liar and the promise-breaker then abuse that trust. The obligation to keep a promise is thus similar to but more constraining than the obligation to tell the truth."[31] Fried relies heavily on Kantian ethics of respect as distinguished from other moral principles such as reliance and harm. Fried explains that we trust people when they make promises to us even in the absence of any act of detrimental reliance. You promise to take me out for a lunch and as a result you incur a duty to do so, even though I have not yet relied. While Fried's claim seems to be intuitive and plausible, it nevertheless conflates trust and distrust. In particular, I may trust your good intentions to eat lunch with me, but am not necessarily vulnerable to any betrayal in case you will not stand for your commitment. Thus, in case you breach your promise to eat lunch with me, no breach of trust has been made because I have not relied on your promise and it did not adversely change my current affairs. Therefore, the sharp distinction between promise, reliance, and harm, as advocated by Fried, is not only questionable from a legal doctrinal perspective but is also doubtful if one actually wishes to understand the notion of moral trust as a core component of Fried's promissory theory of contract. In other words, Fried's rejection of reliance-based theories of contract law is inconsistent with his own emphasis on the notion of trust as a building block of the will theory.[32]

As previously discussed, philosophers assert that betrayal is a test of sorts for whether something is a matter of trust or mere anticipation of another's beneficial or detrimental act.[33] Hawley clarifies that distrust is an appropriate response if the trustor believes the trustee has made an interpersonally binding commitment to acting, via explicitly promising or implicitly encouraging the trustor's reliance on the trustee or promisor to act.[34] This view provides an intermediate form of trust, which connects the expectations that the promisor will faithfully perform his or her obligations and the possibility that the promisee could be betrayed in case of repudiation.[35] Will theory of contract could establish a meaningful understanding of trust only if it incorporates reliance considerations that are

[29] *Id.* at 8–9.
[30] *Id.* at 11.
[31] *Id.* at 17.
[32] *See* Anthony T. Kronman, *A New Champion for the Will Theory*, 91 YALE L.J. 404, 411–12 (1981); *see also* Efi Zemach & Omri Ben-Zvi, *Contract Theory and the Limits of Reason*, 52 TULSA L. REV. 167, 185 (2017) ("Indeed, Fried's own explicit notions of 'trust' and 'respect' appear to be almost synonymous with some of their rivals, seemingly bringing Fried closer to the idea of reliance.").
[33] KIRTON, *supra* note 13, at 27.
[34] *Id.* at 56.
[35] Daniel Markovits & Alan Schwartz, *The Expectation Remedy and the Promissory Basis of Contract*, 45 SUFFOLK L. REV. 799, 803 (2012).

associated with betrayal rather than mere disappointment.[36] Reliance theories of contract argue that granting legal force to a contract is intended to repair the harm caused by reliance on promises, and it is not aimed at providing a legal effect to voluntary obligations as such.[37] Reliance theories argue that the principle of trust, while certainly relevant to contract formation, is not in itself a sufficient condition for the development of obligatory relations. Rather, reliance is the complementary condition necessary for forming such a relationship. As will be demonstrated later on, only a unified theory, which combines promissory and reliance considerations, can entail a meaningful validity to moral trust and provide a persuasive account of contract law and contractual relations.[38] Under this view, promises and contracts share the same instrumental value, facilitate and encourage reliance, and promote cooperation and mutual trust.[39]

However, such construction is exposed to the following difficulty. Consider a contract that is formed between individuals who do not have any trust in each other prior to contracting and will not form any loyalties to each other as a result of the contract. In such a scenario, the formation of contractual dealings might resemble purchasing a lottery ticket in the free market. If the promisor does not perform his or her obligations, the promisee will not be truly surprised because they did not develop any real expectations regarding the faithful conduct of the promisor. However, if the promisor's obligation is carried out contrary to the promisee's expectations, loyal relationships between the parties may be created even though the transaction has already been concluded. Implementing my analysis on this scenario suggests prima facie that in the case of repudiation, the promisee may not be entitled to any redress at all. To resolve this difficulty, I discern between the moral force of such agreement and the remedies that ought to be ruled in case of breach. At the formation stage, the overarching principle that should give force to the obligation created through mutual understanding is that of the free will of the contracting parties. In this level, the law should ensure that the creation of the contract is not a result of lying, threatening, or the use of force. Such behavior violates the independent deontological constraint against lying even when the lie did not materially aggravate the promisee because no reliance was in order.[40] However, to determine whether the promisee is entitled to any remedy when such contract was repudiated, I have to explain why the parallel between creating unfaithful contract relations and buying a lottery ticket is not as straightforward as it seems.

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[36] Clearly, one can argue that the moral conception of trust resembles to some degree the collaborative view of Markovits, who argued that the philosophical foundation of contract may be found in the principle of forming respectful communities of collaboration where contractors treat each other as ends in themselves and refrain from treating each other as mere instrumentalities. *See* Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1462–63 (2004). Although I agree with the view stating the contract facilitates the collaboration between the parties in light of Kantian Ethics, I believe that such collaboration could not be established without meaningful trust relations between the contractual parties. *See also id.* at 1500.

[37] L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 56–57 (1936–37).

[38] PATRICK ATIYAH, PROMISES, MORALS, AND LAW 9 (1981).

[39] Anthony J. Bellia, *Promises, Trust, and Contract Law*, 47 AM. J. JURIS. 25, 32–33 (2002).

[40] SHELLY KAGAN, NORMATIVE ETHICS 106–113 (1998); EYAL ZAMIR & BARAK MEDINA, LAW, ECONOMICS, AND MORALITY 260–261 (2010).

A lottery ticket and the creation of disloyal contractual relations differ in the extent of the stakes involved. Whereas buying a lottery ticket comprises modest costs with very little probability of profit from the transaction, forming a commercial contract includes a variety of reliance investments required to accomplish a performance that both parties will profit from ex-post. While expectation damages may not be justified since the promisee lacks any optimism regarding the promisor's goodwill to perform the contract, reliance damages may still be in order. While the promisee recognizes that any optimism regarding the goodwill of the promisor is not credible, the promissee nevertheless believes that contract performance may be accomplished. For example, the promisor may be motivated to perform the contract since the costs invested by the promisee, in forming the contract, made its execution very easy without requiring any substantial investment by the promisor. While contract performance is not considered to be a result of treating the promisee as an end in himself, in case of repudiation, the promisee should be entitled to reliance damages to redress the promisee's feelings of betrayal following the investment costs incurred in relation to the contract formation. However, if the promisee did not suffer any costs related to the contract formation—and therefore the resemblances to acquiring a lottery ticket may still hold—I suspect that the normative implications of such a scenario are meaningless. If remedies law aims to put the promisee in the position he or she would have been in had the contract been performed (thus protecting the promisee's restitution interest), there is hardly a reason to believe that the promisee will initiate legal proceedings regarding the breach if he or she did not hold any expectation regarding contract performance or incur any reliance costs.

Furthermore, any theoretical construction of unifying promissory and reliance considerations of contract law is exposed to the famous critique suggested by Patrick Atiyah, who claims that courts often enforce non-promissory arrangements based on reliance liability. Promissory estoppel, for example, arises when one person makes a representation of intent or a promise that is intended to be relied upon. The effect of such representation is that the speaker is prevented in law from denying his or her statement regardless of whether consideration was rendered in exchange by the relying person or whether formal contractual relations were eventually formed.[41] Accordingly, the doctrine of promissory estoppel may impose reliance liability on the speaker even if he or she did not have any intent to be bound in formal contractual relations.[42]

I find this argument unconvincing. American contract law requires four elements to be present to invoke the doctrine of promissory estoppel: first, there has to be a clear and definite promise; second, the promisor have had a reason to expect reliance on the promise; third, the promise must have induced such reliance and a consequent, detrimental change of position; and

[41] Patrick S. Atiyah, *The Liberal Theory of Contract*, *in* ESSAYS ON CONTRACT 121, 124–27 (1986); STEPHEN A. SMITH, CONTRACT THEORY 233–35 (2004).

[42] Grant Gilmore predicted that promissory estoppel would ultimately swallow up the traditional, consideration-based theory of contracts to create a single approach of promissory enforcement based solely on reliance. *See* GRANT GILMORE, THE DEATH OF CONTRACT 88 (1974).

fourth, injustice can be avoided only by enforcement of the promise.[43] While the Restatement (Second) of Contracts requires the presence of a definite promise to invoke the doctrine of promissory estoppel, the boundaries between a promise and a mere statement of intent are not very clear, especially when the statement is made in a contractual setting.[44] Even if we accept the suggestion that courts frequently impose contractual reliance liability in the absence of a well-defined promise,[45] I believe that such a practice could be defensible as long as the injustice requirement of the estoppel doctrine will be proffered an adequate account. Generally, the injustice requirement of promissory estoppel has received little attention by judges,[46] and is commonly established by a showing of detrimental reliance on an unambiguous promise.[47] A meaningful interpretation of the injustice requirement can bridge the gap between the promissory and reliance perspectives of the estoppel doctrine. Enforcement of a non-promissory arrangement is justified (even in the absence of a formal exchange of consideration) because the relation between the parties is characterized by an interpersonal trust reflected not only in reliance but also in the competence and goodwill of the speaker, which may create the conditions for potential betrayal in case of distrust.[48] In other words, since non-promissory arrangements are expressed with similar attributes to formal contractual relations, courts appear completely comfortable enforcing such arrangements even if formal consideration does not exist.

This last point is also illustrated within the historical development of consideration in the context of formal exchanges. In the famous case of *Coggs v Bernard*,[49] William Bernard undertook the carrying of several barrels of brandy belonging to John Coggs from Brooks Market, Holborn to Water Street. Bernard's undertaking was gratuitous; he was not offered any payment for his work. As the brandy was being discharged at the Water Street cellar, a barrel was staved, and 150 gallons were lost. Coggs brought an action against Bernard, alleging he had undertaken to carry the barrels but had dropped them through his negligence. Chief Justice Holt made clear that Bernard's responsibility to Coggs was not formally contractual in nature, since he received no consideration. However, Coggs's trust and reliance in Bernard's undertaking was considered by the court to be sufficient consideration to validate a promise and to impose liability for a negligent act

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[43] RESTATEMENT (SECOND) OF CONTRACTS § 90 (Am. Law Inst. 1981).

[44] SMITH, *supra* note 41, at 235–36.

[45] Patrick S. Atiyah, *Contracts, Promises and the Law of Obligations*, in ESSAYS ON CONTRACT 10–21 (1986).

[46] *See* ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 2.19, at 180 (3D ED. 2004); JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS 312 (5TH ED. 2011); Orit Gan, *The Justice Element of Promissory Estoppel*, 89 ST. JOHN'S L. REV. 55, 60 (2015).

[47] ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW AND THEORY 220 (3rd ed., 2002).

[48] Randy E. Barnett, *The Richness of Contract Theory*, 97 MICH. L. REV. 1413, 1423–24 (1999); Charles L. Knapp, *Reliance in the Revised Restatement: The Proliferation of Promissory Estoppel*, 81 COLUM. L. REV. 52, 79 (1981). From a law and economics perception, John J. Chung argued that the doctrine of promissory estoppel should protect interpersonal trust if "(1) the promisee could have determined that the promisor was untrustworthy at a low cost to the promisee; or (2) if the promisee could have avoided the harm resulting from a broken promise by taking preventive measures that cost less than the amount of the potential harm." *See* John J. Chung, *Promissory Estoppel and the Protection of Interpersonal Trust*, 56 CLEV. ST. L. REV. 37, 42 (2008).

[49] Coggs v. Bernard (1703) 92 Eng. Rep. 107, 107 (Eng.).

committed in the course of performing such undertaking.[50] This case was decided well before the establishment of the modern promissory estoppel doctrine, and it demonstrates the willingness of the common law to consider interpersonal trust relations as a similar substitute to contractual formalities required for enforcement. Therefore, the interactions between the speaker and the relying person could not be described as those between completely different strangers; hence, the doctrine of promissory estoppel should be governed by the law of contract and not the law of accidents.

2. Normative Implications

In the following section, I elaborate on the normative implications of integrating reliance considerations into promissory theories' foundations. Several commentators have argued that the will theory fits poorly into existing contract law and cannot provide adequate explanations of current practices of contracting parties and civil courts. Therefore, I aim to show that such integration of reliance theories may better justify and fit the main doctrines of contract law and remedies.

a. The Default Remedy for Breach of Contract

Numerous scholars argue that promissory theories fail to provide satisfactory explanations for why the primary remedy for breach of contract is expectation damages rather than specific performance, which is perceived to more accurately express the moral duty to keep one's promise.[51] Will theory could justify expectation damages as the principal remedy for breach of contract only if it also provides a meaningful weight to reliance considerations. Specifically, promissory-based theories adequately explain why the expectation measure of damages should be given preference over the reliance or restitution measures. Respect for individual autonomy requires that people be allowed to commit themselves to legally binding promises. Alongside autonomy, the moral account of interpersonal trust posits that, to rectify the betrayal caused by breach of contract, the law should provide the promisee with the exact compensation that redresses the losses closely associated with the binding commitment that induced reliance by the promisee. Thus, such redress may be accomplished by awarding the injured party with expectation damages. Integrating the reliance account of moral trust into promissory theories of contract provides an explanation for why the primary remedy for breach of contract cannot be specific performance. Such remedy assumes that parties can easily resume contractual performance following a breach of contract. However, this assumption is doubtful because any trust, which is required to execute contractual obligations, irrevocably vanishes after breach, and the promisee's feelings of betrayal will often prevent any cooperation required for performance. Moreover, even if cooperation is possible following the issuance of the remedy of specific

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[50] David Ibbetson, *Coggs v Bernard (1703)*, *in* LANDMARK CASES IN THE LAW OF CONTRACT 1 (Charles Mitchell & Paul Mitchel eds., 2008).

[51] *See* Nathan B. Oman, *Promise and Private Law*, 45 SUFFOLK L. REV. 935, 942–48 (2012). Charles Fried, however, has argued that expectation damages should be conceived as a majoritarian default remedy rather than a necessary implication of the will theory. *See* Charles Fried, *Contract as Promise: Thirty Years On*, 45 SUFFOLK U.L. REV. 961, 971 (2012).

performance, the restoration of loyalty will be possible only after the contracted obligations are performed to the promisee's satisfaction. Therefore, in this case, the remedy of specific performance can be associated with loyal relationships, although only after the transaction has concluded. Injured parties frequently avoid suing for specific performance due to the expected lapse of time between the filing of a lawsuit and the execution of the final judgment. "Often, the execution of an order of enforced performance years after the agreed time would not even remotely place the injured party in the position she would have been had the contract been duly performed."[52] Under these conditions, we cannot expect that the remedy of specific performance will rectify the promisee's hard feelings following the breach of the contract.

b. The Role of Fault Considerations in Determining Promisor Liability

Generally, contract law does not require the promisee to establish the fault of the promisor as a condition for establishing the promisor's liability for breach of contract.[53] In this regard, Dori Kimel argued that the insignificant role that faults plays in contract law raises a surprising difference between contract and promise.[54] According to Kimel,

> When it comes to fault, the apparent tension naturally concerns the fairly negligible role that fault plays in contract law: if the law of contract is based upon the morality of promise, so the thought goes, moral culpability—in breach, for instance—ought to play as much of a role here as it does there.[55]

However, the negligible role that fault plays in contract law might be puzzling for promissory theories of contract law only when the implications of trust are not fully considered. This has been demonstrated recently by Seana Shiffrin, who argued that the moral benefit of a strict liability regime is that it encourages a more cooperative relation of trust between the promisor and promisee.[56] Specifically, she claimed that such facilitation of trust is a result of the

> [G]uarantee by the promisor that she will deliver a faultless effort *and, further,* in the contingency that performance is obstructed by accident or the fault of third parties, that she will also cover or insure the value of accidental non-performance. (So, we might think of the strict liability contract as involving a promise to perform coupled with a warranty of a result).[57]

Thus, a "strict liability approach may help forge better cooperative relations between the promisor and the promisee, by encouraging greater reliance and trust."[58] Moreover, as previously discussed, because the

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[52] Leon Yehuda Anidjar, Ori Katz and Eyal Zamir, *Enforced Performance in Common-Law Versus Civil-Law Systems: An Empirical Study of a Legal Transformation*, 68 AM. J. COMP. L. 1, 19 (2020); https://doi.org/10.1093/ajcl/avaa006.

[53] RESTATEMENT (SECOND) OF CONTRACTS ch. 11, intro. note (Am. Law Inst. 1981).

[54] According to Kimel, the harm principle provides a legal response to the wrong of breach insofar as it responds to the failure to fulfill an entitlement of the promisee. For the law to respond to the motive for breach would be to enforce the morality of promissory as such, which is regarded as illiberal. Dori Kimel, *The Morality of Contract and Moral Culpability in Breach*, 21 KING'S L.J. 213, 225–27 (2010).

[55] *Id.* at 216.

[56] Seana Valentine Shiffrin, *Enhancing Moral Relationships Through Strict Liability*, 66 U. TORONTO L.J. 353, 355 (2016).

[57] *Id.* at 366.

[58] *Id.* at 365.

conceptions of trust and distrust concentrate on the perceptions of the trustor rather than those of the trustee, the motives and reasons which caused the promisor to repudiate the contract are less significant in determining the contractual liability for breach and amount only to a secondary examination that should be carried out only when damages are quantified.[59]

c. The Hadley Rule

The Hadley principle posits that consequential damages can be recovered only if, at the time the contract was made, the breaching party had reason to foresee that consequential damages would be the probable result of the contract's repudiation.[60] Recently, Seana Shiffrin claimed that promissory theories are not compatible with the Hadley rule. The reason presented is that if one "voluntarily elects to breach one's duty, a case could be made that the promisor should be liable for all consequential damages."[61] I find this argument unpersuasive. The moral conception of trust indicates that the duty to rectify the promisee for the losses incurred as a result of betrayal should be directly associated with the expectations embodied in the specific commitment made by the promisor and those that encouraged the promisee to rely. Since such expectations are formed when the contract between the parties is signed, only consequential damages that reasonably could have been foreseen at the contract's design should be redressed. This is also reflected in the harm principle, which provides that restriction of the promisor's freedom is justified only when it is necessary to prevent loss, and "the use of coercion aimed at redressing it must, other things being equal, involve the minimal cost to the personal autonomy of those against whom coercion is used."[62] Accordingly, compensating the promisee for consequential losses, which are not strictly related to hopes and faiths carried out as a result of a particular commitment, may disproportionally undermine the promisor's autonomy. Because the harm principle stipulates that restraining individual autonomy should be done with minimal coercion, consequential damages that were not reasonably foreseen should not be compensated.

III. THE ECONOMIC FOUNDATIONS OF INTERPERSONAL TRUST AND THE THEORY OF CONTRACTS

In this Part, I explore the economics concept of rational and irrational trust. I discuss the implications of the economic foundations of interpersonal trust on reconstructing the grounds of efficient breach theory to reflect moral trust considerations as well. Such analysis demonstrates that interpersonal trust should be perceived as the connecting scarlet thread between contrasting streams of thought in the literature of contracts theories.

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[59] Shiffrin further claimed that the trust justification for the strict liability regime is in tension with a broad construal of the duty to mitigate, a doctrine that places the burden of self-help on the disappointed promisee. Thus, she suggested to interpret the duty to mitigate narrowly. *Id.* at 371–75.

[60] Melvin Aron Eisenberg, *The Principle of Hadley v. Baxendale*, 80 CAL. L. REV. 563, 570 (1992).

[61] Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708, 724 (2007).

[62] Kimel, *supra* note 54, at 223; DORI KIMEL, FROM PROMISE TO CONTRACT: TOWARD A LIBERAL THEORY OF CONTRACT 103–09 (2003).

A. AN ECONOMICS ACCOUNT OF TRUST

Neoclassical economic thought provides that individuals enter into contractual relations voluntarily, and that each individual can anticipate that carrying out the transaction will provide each with benefits exceeding their costs. Neoclassical economists assume that well-informed rational actors' voluntary contracts will usually lead to efficient exchanges. Thus, when transactions are costless, there is no need for legal contracts between agents or firms.[63] Neoclassical economics assumes that people are selfish and act to maximize their marginal gains. They have an incentive to cheat, so contractual safeguards are required to prevent them from doing so. Accordingly, the necessity of trust derives from the impossibility of constantly monitoring other people's behavior. Since selfish individuals who cannot be observed are aware of this, and recognize the opportunity, there is a fruitful ground for cheating one another. Therefore, trust is based on expectations about choices made by others, which means that in order to correctly form such expectations, the other party's behavior has to be understood and anticipated.[64]

The notion of trust was highly developed by the Transaction Cost Economics school ("TCE"). TCE is mainly attributed to the writings of Ronald Coase, who demonstrated that the decision to use the price mechanism on the market or to internally produce the asset in an organization is based on the transaction costs that arise.[65] These costs originate from information searching, bargaining, and costs of writing the contract. Coase explained that the cost of using the price mechanism is the main cause why firms exist: to reproduce assets at a lower cost than the actual market. Thus, under TCE, markets and firms are simply viewed as alternative governance structures to organize economic transactions. Transactions are only carried out within the firm if the costs of using the price mechanism exceed the costs of internal organization. Generally, in order to facilitate transactions between contractual parties several classes of transaction costs should be minimized, such as information and search costs; bargaining and contract negotiation costs; and monitoring and contract enforcement costs.[66] Moreover, TCE assumes that legal system and court-based enforcement devices that protect property rights are essential to the emergence of modern markets. Thus, exchange can most easily occur if the law clearly defines who holds the property right in a specific asset. Accordingly, the efficiency of markets depends on the institutional environment, informational aspects, and dimensions of the transaction.[67]

TCE was extensively developed by Oliver Williamson, who clarified the meaning of transaction costs by merging different schools of thought, such

[63] JONATHAN MORGAN, CONTRACT LAW MINIMALISM: A FORMALIST RESTATEMENT OF COMMERCIAL CONTRACT LAW 61 (2013).

[64] Mark Casson & Marina Della Giusta, *The Economics of Trust*, *in* HANDBOOK OF TRUST RESEARCH 332, 339–40 (Reinhard Bachmann & Akbar Zaheer eds., 2006).

[65] Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 386–87 (1937).

[66] *See* Oliver E. Williamson, *Transaction Cost Economics*, *in* 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 135, 141, 172–73 (Richard Schmalensee & Robert D. Willig eds., 1989).

[67] For an interesting summary of the literature, see, for example, Justus Haucap, *The Rule of Law and the Emergence of Market Exchange: A New Institutional Economic Perspective*, *in* THE STATE OF LAW: COMPARATIVE PERSPECTIVES ON THE RULE OF LAW 143 (Ulrich von Alemann et al. eds., 2017).

as economizing, internal organization, and contract law. Williamson's theory is founded on two behavioral assumptions that characterize the practice of contracting: bounded rationality and opportunism.[68] The concept of bounded rationality is derived from the writings of James March and Herbert A. Simon who challenged the notion of human rationality as suggested by the concept of homo economicus and argued that there are limits to our thinking capacity and processing as well as the available information, and time.[69] The ability to process information concerning possible alternatives is constrained by the actor's ability to calculate consequences and understand their implications.[70] Williamson states that, "Given bounded rationality . . . it is impossible to deal with complexity in all contractually relevant aspects. As a consequence, incomplete contracting is the best that can be achieved."[71] Opportunistic behavior is the pursuit of self-interest with guile, unconstrained by morality, in which a person takes advantage of incomplete information and contractual gaps. This behavior increases the cost of writing contracts because the parties must anticipate the consequences and create adequate precautions.

Williamson further argued that transactions are characterized by three additional features: uncertainty, frequency, and investment idiosyncrasy.[72] The pattern of uncertainty discusses the risk associated with a transaction, and frequency deals with the problem of time between transactions. Investment idiosyncrasy is considered the most powerful pattern of transactions. It examines whether one party to a contract induces the other to invest in specialized physical capital, which cannot be traded at the same value elsewhere, and it is described as the parties being effectively "locked into" each other. In other words, asset specificity means that investments can create positive returns in a given transaction but have less value outside that transaction. This pattern initiates hazards as opportunistic behaviors can be exploited. Since contracts are incomplete, the need to effectively adapt to varying circumstances appears. Thus, "although both [parties] have a long-term interest in effecting adaptations of a joint profit-maximizing kind, each also has an interest in appropriating as much of the gain as he can on each occasion to adapt."[73] Williamson applies his theory by connecting different transactions and contract forms to a specific governance structure.[74]

The opportunism assumption removes any significance from trust because it shows that trustworthiness, or any level of honesty, and confidence cannot be discerned. While Williamson "do[es] not insist that every individual is continuously or even largely given to opportunism,"[75] he

[68] Oliver E. Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 AM. J. SOC. 548, 553 (1981).

[69] Herbert A. Simon, *Rational Decision-making in Business Organizations*, 69 AM. ECON. REV. 493, 502–03 (1979).

[70] MELVIN A. EISENBERG, FOUNDATIONAL PRINCIPLES OF CONTRACT LAW 162–63 (2018).

[71] Williamson, *supra* note 68, at 553–54.

[72] *Id.* at 555.

[73] Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 242 (1979).

[74] *Id.* at 245–55.

[75] OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 64 (1985). In a later work, Williamson admitted that opportunism may be only occasional. Oliver E. Williamson, *Opportunism and its Critics*, 14 MANAGERIAL & DECISION ECON. 97, 98 (1993).

nevertheless "assume[s] that some individuals are opportunistic some of the time and that differential trustworthiness is rarely transparent *ex ante*. As a consequence, *ex ante* screening efforts are made and *ex post* safeguards are created."[76] Williamson argues that contracting parties are strictly calculative, and that trust is confined to special social relations that exist outside of business contracting. Thus, calculative explanations of behavior provide inherently better estimations regarding actors' conduct than non-calculative alternatives.[77]

Williamson differentiates between "calculative trust" and "personal trust." Calculative trust—a phrase Williamson considers self-contradictory—is based on a rational assessment of the costs and benefits of trusting. Alternatively, personal trust involves no conscious mental calculation, but "is warranted only for very special personal relations that would be seriously degraded if a calculative orientation were 'permitted'."[78] According to this view, rational actors are opportunistic in nature, seek opportunities to maximize their gain at others' expenses, and are untrustworthy as a result. Therefore, governance structures are required in order to mitigate the risks associated with such behavior.[79]

Yet, trust is also related to the concept of reputation. George A. Akerlof observed that in many markets, parties cannot detect all the characteristics of a good at the time of sale. In many third-world markets, this problem is resolved by relying on long-term relationships and the reputations of sellers.[80] Benjamin Klein and Keith B. Leffler argue that, in a free market, sellers of high-quality goods consider their reputations to be assets, which lose value if they choose to supply low-quality goods.[81] This argument can be reformulated as a contract problem in which each party trades off the benefit of breaching against the cost of losing one's reputation.[82] Thus, reputation is valuable because it communicates to actors what to expect of one another, particularly in situations where their conduct or the object that is contracted for cannot be measured accurately.[83] Generally, economists equate trust with cooperation in a one-shot or repeated game of the Prisoner's Dilemma ("PD"). Trust arises in "situations in which the risk one takes depends on the performance of another actor."[84] For example, consider the simultaneous-move and one-sided variation of the PD, called the Trust-Honor Game ("THG"). The THG is considered a benchmark scenario and

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[76] WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, *supra* note 75.

[77] Williamson states that "[p]ersonal trust is therefore characterized by (1) the absence of monitoring, (2) favorable or for-giving predilections, and (3) discreteness. Such relations are clearly very special . . . trust, if it obtains at all, is reserved for very special relations between family, friends, and lovers. Such trust is also the stuff of which tragedy is made." Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J.L. & ECON. 453, 483–84 (1993).

[78] *Id.* at 486.

[79] *See* Karen S. Cook & Jessica J. Santana, *Trust and Rational Choice*, *in* THE OXFORD HANDBOOK OF SOCIAL AND POLITICAL TRUST 253, 259 (Eric M. Uslaner ed., 2018).

[80] George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 488 (1970).

[81] Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 616 (1981).

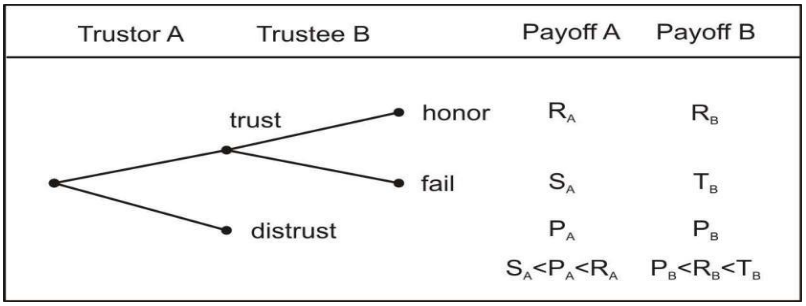
[82] W. Bentley MacLeod, *Reputations, Relationships, and Contract Enforcement*, 45 J. ECON. LITERATURE 595, 595–96 (2007).

[83] Alan D. Morrison & William J. Wilhelm, Jr., *Trust, Reputation, and Law: The Evolution of Commitment in Investment Banking*, 7 J. LEGAL ANALYSIS 363, 371 (2015).

[84] JAMES S. COLEMAN, FOUNDATIONS OF SOCIAL THEORY 91 (1994).

resembles a one-shot interaction between two actors, A (the trustor) and B (the trustee), as described in Figure 1.[85]

Figure 1: The Trust Game



The status quo payoffs are represented as the pareto-inefficient "punishment" outcomes P_A and P_B. Honored trust yields "reward" payoffs R_A and R_B, and failed trust means that the trustor receives payoff of SA, while the trustee can gain a lure payoff of TB. The trustor receives a net gain from honored trust, but may incur loss from a failure of trust (SA<PA<RA). The trustee has an incentive to fulfill trust, but also has a temptation to defect (PB<RB<TB). The only subgame-perfect Nash-equilibrium that exists for this game is for the trustor to always distrust and the trustee to always fail to trust. The surprising prediction from game theory is that a rational trustor would never choose a trusting act, because a rational trustee would always fail trust.[86] A somewhat more complex version of this game is the investment game in which the trustor chooses the degree to which the trustee will be trusted and the trustee chooses the degree to which that trust will be honored. The trustor has an endowment of E1 and chooses part of the endowment to send to the trustee (M1). This investment is then multipaned by *m* and the trustee receives *m*M1. The parameter *m* can be seen as indicating the trustee's returns resulting from the trustor's investment. Afterwards, the trustee chooses an amount K2 to return to the trustor, with o≤K2≤*m*M1. Later, the game ends with the trustor receiving V1=E1-M1+K2 and the trustee receiving V2=*m*M1-K2. This game also illustrates that trust may be risky because the trustor regrets trusting if the trustee turns out to be untrustworthy.[87]

To address such results, several mechanisms were suggested for aligning the incentives of both parties, such as introducing either exogenous or endogenous changes to the preferences of the parties so that they "prefer" to

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[85] Paul Faulkner, *The Problem of Trust*, *in* THE PHILOSOPHY OF TRUST 109, 110–12 (Paul Faulkner & Thomas Simpson eds., 2017).

[86] *See* STEPHAN ROMPF, TRUST AND ADAPTIVE RATIONALITY TOWARDS A NEW PARADIGM IN TRUST RESEARCH 105 (Ph.D. dissertation, University of Mannheim, 2012); https://madoc.bib.uni-mannheim.de/35963/1/Thesis_FinalDraft.pdf. *See also* EYAL ZAMIR & DORON TEICHMAN, BEHAVIORAL LAW AND ECONOMICS 240–43 (2018); Vincent Buskens et al., *Trust Games: Game-Theoretic Approach to Embedded Trust*, *in* THE OXFORD HANDBOOK OF SOCIAL AND POLITICAL TRUST 305, 314 (Eric M. Uslaner ed., 2018).

[87] The description of the investment game in the text is primarily based on Vincent Buskens & Werner Raub, *Rational Choice Research on Social Dilemmas: Embeddedness Effects on Trust*, *in* THE HANDBOOK OF RATIONAL CHOICE SOCIAL RESEARCH 113, 119 (Rafael Wittek, Tom A. B. Snijders & Victor Nee eds., 2013).

cooperate rather than pursue self-maximizing strategies. An example of this is integrating feelings of shame or guilt for dishonest or exploitative behavior. Alternatively, the law can require the parties to enter into a contract that obligates them to cooperate rather than pursue their own personal interests. These contracts may include monitoring with punishment or monitoring with incentive mechanisms. According to the theory of repeated games, trust may develop, and can change incentives, when individuals have repeated contracts and remember the results of the previous ones. If connections are repeated frequently, then there will always be some future encounter in which the promisee, who is cheated, can punish the promisor.[88] An additional option is to rely on social enforcement mechanisms that frequently involve the threat to either nullify the interaction if the other player does not cooperate, or allow the other party to inflict social sanctions against the non-cooperator.[89] Lastly, economics research has explored the institutional and cultural contexts of the connection between contracts and trust. Specifically, it was observed that strong institutional framework facilitates contracting and trust between individuals. For example, Simeon Djankov et al. illustrated that there is enormous variation across nations in the cost of using formal mechanisms to enforce a contract. As a result, parties may choose to rely on informal reputational mechanisms to enforce mutual agreements.[90] Similarly, it was found that players' tendencies to trust may differ across cultures, which may influence parties to form contracts and maintain collaborative relations.[91] These patterns may be related to the different techniques of contract drafting and contractual precautions. For example, contracts in the United States tend to be more detailed than contracts formed in civil law countries.[92]

B. RESTRUCTURING THE EFFICIENT BREACH THEORY TO RESEMBLE PREVALENT MORAL VIEWS

1. A (Very) Short Literature Review

In a seminal article, Guido Calabresi and Douglas A. Melamed discerned between the allocation of entitlements and the remedies for protecting them as two distinct avenues for promoting efficiency. Specifically, they argued that once entitlements are allocated, they can be protected by either property or liability rules. Under a property rule, no one is allowed to deprive the owner of his or her entitlement without the owner's explicit consent; under a liability rule, other people are allowed to do so but must compensate the

[88] Casson & Giusta, *supra* note 64, at 340.

[89] Harvey S. James Jr., *The Trust Paradox: A Survey of Economic Inquiries into the Nature of Trust and Trustworthiness*, 47 J. ECON. BEHAV. & ORG. 291, 299 (2002); Bryan C. McCannon et al., *Contracts and Trust: Complements or Substitutes?*, 14 J. INST. ECON. 811, 813–14 (2018) (finding that both increased contract enforcement and high trusting preferences lead to enhanced rates of contract formation and larger reliance investments, and explaining that individuals who demonstrate higher levels of trust in the standard Trust Game also obtain greater rates of agreements being reached and enhanced contract performance rates).

[90] *See generally* Simeon Djankov et al., *Courts*, 118 Q.J. ECON. 453 (2003).

[91] Paul W. L. Vlaar, *Trust and Contracts: Together Forever, Never Apart?*, *in* HANDBOOK OF ADVANCES IN TRUST RESEARCH 82, 88–89 (Reinhard Bachmann & Akbar Zaheer eds., 2013).

[92] *See* Claire A. Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 79 CHI.-KENT L. REV. 889, 889–90 (2004).

owner for his or her losses.[93] This framework is expressed in contract remedies for breach of contract, as specific performance is considered a property rule, while monetary damages are a liability rule.[94] The economic theory provides that the goal of remedies for breach of contract is to provide optimal incentives for performance and breach that would maximize the joint surplus of the bargain. Accordingly, contractual obligations should be performed if, and only if, the net cost of performance to the promisor is less than the net benefit to the promisee.[95] Thus, providing the promisee with expectation damages (a liability rule) creates adequate incentives for the promisor, because the duty to compensate the promisee obligates "the promisor to internalize the former's disutility in the event of a breach, thereby aligning the promisor's incentives with the social good."[96] Specific performance (a property rule) is perceived as inefficient because it confers a veto power over the breach to the promisee. Due to bilateral monopoly and possible information deficiencies, the promisee may hinder any possible renegotiation between the parties for efficient non-performance.[97] Thus, the doctrine of efficient breach is grounded on the belief that the risk of post-contractual bargaining failure under property rules is greater than the risk of the courts' miscalculation of damages under liability rules.[98] While the effects of remedies on the incentives of the promisor have been carefully analyzed and studied by legal and economics scholars, only a few have explored their effects on the promisee's incentives. For example, Robert Cooter claimed that the promisee's exact incentives to rely on the expected performance are connected to the condition of full compensation for the promisee's losses.[99] Specifically, if the promisee knows that there is a high probability of a breach, he or she might rely as if the likelihood of a breach is zero, knowing that he can secure the benefits of reliance if performance takes place but externalizes its costs to the promisor—who will compensate him for those costs—if a breach happens. Therefore, the assumption of full compensation for the promisee's loss, which is embodied in the efficient breach theory, may carry out suboptimal reliance on contractual performance.[100]

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[93] Guido Calabresi & Douglas A. Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1105–06 (1972).

[94] Gregory Klass, *Efficient Breach*, *in* PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW, *supra* note 25, at 362, 377.

[95] *See generally* Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349, 1349–61 (2009).

[96] Anidjar, Katz & Zamir, *supra* note 52, at 2.

[97] Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1032–33 (1995).

[98] Daphna Lewinsohn-Zamir et al., *The Questionable Efficiency of the Efficient-Breach Doctrine*, 168 J. INST. & THEORETICAL ECON. 5, 7–9 (2012). Numerous scholars have shown the efficient breach argument is valid, as long as damages are fully compensatory. Anthony Kronman argued that when losses are under-compensatory, a specific performance frequently becomes the most efficient remedy, such as in cases of sale of unique goods. *See* Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 352 (1978). Steven Shavell proposed a more nuanced analysis by distinguishing between remedies for breach of contract to convey an existing object, and a contract to produce a new object or to perform certain work. *See* Steven Shavell, *Specific Performance Versus Damages for Breach of Contract: An Economic Analysis*, 84 TEX. L. REV. 831, 831 (2006). Stylized experiments also provide evidence for the preferability of specific performance over expectation damages. *See* Ben Depoorter & Stephan Tontrup, *How Law Frames Moral Intuitions: The Expressive Effect of Specific Performance*, 54 ARIZ. L. REV. 673 (2012).

[99] Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 13 (1985).

[100] *Id.* at 15.

2. The Rationality of Trust and the Assumptions of Efficient Breach Theory

Generally, the literature has well observed that the neoclassical account of efficient breach theory largely ignores transaction costs, such as litigation or settlement costs and information disparities between the parties. The theory assumes that contractual parties are flawlessly rational, and the threat of legal liability is the only reason to perform.[101] However, much less attention has been given to exploring the role of trust within the assumptions of the theory. Generally, neoclassical economics and game theory indicate that the choice to perform or breach the contract is solely driven by self-rational motivations even if cooperation is the desirable alternative. Accordingly, the behavior of the promisee can be conceptualized as a risky decision, involving the integration of probabilities and outcomes. The decision to trust the promisor incorporates two attitudes toward risky prospects—risk aversion and loss aversion—which are complementary aspects.[102] Thus, the probabilities of gain versus loss entail the probabilities of trust appreciation versus trust betrayal—that is, the promisor's trustworthiness. In the case of a trustworthy contracting partner, the probability of a gain is higher and the probability of a loss is lower than in the case of an untrustworthy partner. However, frequently, the probabilities of gain versus loss are inherently unknown and thus have to be estimated or inferred.[103]

The argument therefore suggests that there is a clear connection between the notion of trust and risk. Thus, if the act of trusting is a risky decision, then the law could promote trust by focusing on creating rules that improve transparency and encourage punishment in case of trust-violations. In contrast, if trust is not only about risk, then such rules might be less effective in promoting economic exchange. Recent economic research has demonstrated that trust and risk may be closely related in personal exchange contexts. In other words, if trusting is a risky decision, then policies to promote trust might best focus on creating rules that encourage peer-to-peer punishment of trust-violations. In contrast, if trust is not about risk, then such policies might be ineffective in promoting economic exchange. Several economics studies of investment games have examined whether the inferences regarding trust may be derived from individual attitudes towards risk.[104] Daniel Houser et al. reported that no correlation was found between risk attitudes and the decision to opt out from (invest zero in) trust games. This result does not necessarily suggest that risk attitudes are unimportant to or disconnected from trusting decisions; however, the exact mechanism is yet unclear. Thus, "our results offer rigorous support for the view that motives for trust are not tightly connected to risk attitudes. This leaves open

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[101] Klass, *supra* note 94, at 366–70.

[102] In decision-making research, uncertainty relates to the fact that a decision maker is unfamiliar with the gain versus loss, whereas risk refers to the fact that both a profit or a failure can occur and the decision maker is familiar with the analogous odds. *See* Daniel Ellsberg, *Risk, Ambiguity, and the Savage Axioms*, 75 Q.J. ECON. 643, 646–47 (1961).

[103] Isabel Thielmann & Benjamin E. Hilbig, *Trust: An Integrative Review from a Person–Situation Perspective*, 19 REV. GEN. PSYCHOL. 249, 254–59 (2015).

[104] *See* Daniel Houser et al., *Distinguishing Trust from Risk: An Anatomy of the Investment Game,* 74 J. ECON. BEHAV. & ORG. 72 (2010); Noel D. Johnson & Alexandra A. Mislin, *Trust Games: A Meta-Analysis*, 32 J. ECON. PSYCHOL. 865 (2011).

the possibility that emotional factors such as betrayal aversion . . . play an important role in mediating trusting decisions."[105]

To establish the role of risk attitudes on trust, it is essential to apply a more general framework to risk attitudes than to the expected utility theory. From the perspective of prospect theory, the risk-taking aspect of trust behavior depends on two additional elements: (1) an individual's risk aversion (i.e., the willingness to take a risk as a function of the probabilities of gain vs. loss) and (2) an individual's loss aversion (i.e., the willingness to take a risk as a function of the relation between positive and negative outcomes).[106] Specifically, a risk-averse promisee may require a more substantial subjective probability that the promisor is trustworthy (and therefore expected to honor trust) before actually trusting. In turn, a risk-seeking promisee should be willing to trust even if he or she assumes a smaller probability that the promisor is trustworthy (and accordingly unlikely to honor trust).[107] Loss aversion might affect how an individual assesses the potential gain resulting from an honored trust and the potential loss arising from a betrayed trust. On the one hand, when the promisor behaves trustworthily, trusting is typically accompanied by a potential gain, thus implying that the promisee benefits from trusting. On the other hand, trusting is also necessarily accompanied by a possible loss following from the promisor's opportunity to betray. And if the promisor betrays, the promisee may experience high disutility from non-reciprocated trust to a greater extent than the benefit produced when the promisor behaves trustworthily. Thus, prospect theory implies that analyzing the link between trust and risk preferences based on trust games and the expected utility theory may potentially bias the expected results.[108]

Experimental behavioral economics studies demonstrate that risk aversion alone cannot explain personal willingness to take risks when the chance event is the action of another person rather than nature.[109] In particular, these studies document that people take risks less willingly when the agent of uncertainty is another person rather than nature due to the phenomenon of betrayal aversion. People are more willing to take a risk when facing a given probability of bad luck than to trust when facing an equal probability of being cheated. Betrayal aversion indicates an essential departure from how economists have viewed decision-making under risk in the past because it implies a significant distinction between risk constituted by a social determinant and risk based on interpersonal cooperation. Betrayal aversion occurs where the willingness to pay to avoid playing a lottery increases if the outcome of the lottery depends on the actions of another person. Thus, betrayal aversion is an anticipated negative emotional

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[105] Houser et al., *supra* note 104, at 74.

[106] EYAL ZAMIR, LAW, PSYCHOLOGY, AND MORALITY: THE ROLE OF LOSS AVERSION 6–7 (2014).

[107] *Id.* at 254.

[108] For a study designed to overcome these limitations, see*,* for example, Quang Nguyen et al., *Trust and Trustworthiness Under the Prospect Theory and Quasi-Hyperbolic Preferences: A Field Experiment in Vietnam* (Nanyang Tech. Univ. Econ. Growth Ctr., EGC Report No. 2013/01, 2013) (finding that trust is likely to be motivated by the expectation of reciprocity. Neither risk preferences nor, the degree of risk aversion, nor the degree of loss aversion influence trust significantly).

[109] Iris Bohnet et al., *Betrayal Aversion: Evidence from Brazil, China, Oman, Switzerland, Turkey, and the United States*, 98 AM. ECON. REV. 294, 303 (2008).

experience, which a person is expected to feel if they are abused.[110] Furthermore, research provides that risk aversion is a highly contextual concept, which may differ across different persons or matters, such as financial, health, ethical, or social domains. Therefore, it is questionable whether nonsocial risk aversion such as lottery-based aversion could predict trust-related risk-taking in all situations.[111]

These insights suggest that contracting parties consider whether to perform or breach the contract, and to what extent they should rely on the expected performance, based on rational and irrational reasoning and motivations. Such perception could be explored thoroughly only if economists can design empirical research mechanisms that reflect assumptions that differ substantially from the traditional assumptions of the expected utility theory. However, law and economics proponents have not yet integrated the insights on the development of trust into the efficient breach theory to adjust economic thinking with fundamental moral views. For example, Steven Shavell attempted to harmonize the economic analysis of breach of contract with prevailing moral intuitions.[112] He argues that generally, agreements are incomplete and do not explicitly define whether a specific obligation would apply under every possible contingency. Accordingly, it can be assumed that parties would have exempted the promisor from his or her duty to perform whenever the costs of performance exceed the value of performance to the promisee. Since the promisor typically knows that this is the case, there is nothing immoral in breaching a contract so long as the promisor compensates the promisee for the promisee's expectation interest.[113]

Shavell's argument is troubling because it oversimplifies certain assumptions regarding the contractual relations between the parties without providing satisfying explanations. Shavell's hypothesis concerning the incompleteness of contracts and its inability to precisely regulate any future contingency does not itself indicate that when such a possibility does occur, the promisee would have exempted the promisor from his or her duty to perform. Such understanding ignores the different perceptions of risk and loss aversion between different contractors relating to the decision to perform or breach the contract (whether these risks and losses are perceived according to the traditional expected utility theory or alternatively according to the prospect theory). Moreover, Shavell's hypothesis disregards the implications of different kinds of contractual obligations on the establishment of various risk and loss attitudes. In particular, it can be assumed that risk and loss perceptions will be entirely different when the contract includes a property transaction rather than a commodity conveyance

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[110] Benjamin Ho & David Hoffman, *Trust and the Law*, *in* RESEARCH HANDBOOK ON BEHAVIORAL LAW AND ECONOMICS 294, 308–09 (Joshua C. Teitelbaum & Kathryn Zeiler eds., 2018).

[111] Thielmann & Hilbig, *supra* note 103, at 255.

[112] Steven Shavell*, Why Breach of Contract May Not Be Immoral Given the Incompleteness of Contracts*, 107 MICH. L. REV. 1569 (2009). A more nuanced approach was advocated by Daniel Markovits and Alan Schwartz who argued that contracts between sophisticated parties are best interpreted as providing the promisor a choice between performing the contract's terms or making a transfer to the promisee in the amount of his expectation. *See generally* Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939 (2011).

[113] For an elaborate moral refutation of Shavell's argument, see*,* for example, Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551, 1567–68 (2009).

or service performance. Perceptions will also be different when the contract's objects involve interests that are essential to human maintenance and flourishing, such as health and education, rather than peripheral interests, such as entertainment and indulgence. Additionally, Shayell's hypothesis ignores the consequences of contractual relations that have relational patterns, which may induce the promisee to punish the promisor for breaching or may result in betrayal aversion even when the contract did not stipulate such contingency. Therefore, any attempt to reconcile efficient breach theory with deontological morality must adopt a contextualist approach, which connects the duty to perform the contract to the heterogeneity of risk and loss aversion in various types of deals, diverse cultural and political settings, and different environments. Such conceptualization may provide better explanation when breaching a contract may constitute an immoral act and justify awarding the remedy of specific performance and when such behavior will be compatible with moral intuitions yielding expectation damages.

IV. THE BEHAVIORAL FOUNDATIONS OF INTERPERSONAL TRUST AND THE THEORY OF CONTRACTS

While the expected utility theory of economics assumes that the act of trusting involves an assessment of risks and losses, psychological research has investigated several related behavioral factors that are associated with the cognitive process of such evaluation. In this Part, I discuss the psychological findings on the establishment of trustworthiness expectations and consider their implications for fairness theories of contract law.

A. A PSYCHOLOGICAL ACCOUNT OF TRUST

The social psychological literature distinguishes between two types of trust: specific trust and generalized trust. Specific trust is the expectation that the other person will cooperate and includes the perception of the other's attitudes and personality traits, which are assumed to enable cooperation. Generalized trust is defined "as an expectancy held by an individual or a group that the word, promise, verbal or written statement of another individual or group can be relied upon."[114] The assumption of "zero baselines" trust stipulates that in everyday situations, people "simply suspend[] belief that the other is not trustworthy and behave[] as if the other has similar values and can be trusted."[115] However, theories of "dispositional trust" focusing on interindividual differences in trusting behavior assume that certain factors within individuals predispose them to trust or distrust others. Accordingly, people develop a generalized expectation of other people's trustworthiness in response to their personal history of trust-related

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[114] Julian B. Rotter, *A New Scale for the Measurement of Interpersonal Trust*, 35 J. PERSONALITY 651, 651 (1967).

[115] RANDY BORUM, THE SCIENCE OF INTERPERSONAL TRUST, 10 (2010), https://scholarcommons.usf.edu/mhlp_facpub/574; Gareth R. Jones & Jennifer M. George, *The Experience and Evolution of Trust: Implications for Cooperation and Teamwork*, 23 ACAD. MGMT. REV. 531, 535 (1998).

experiences over their lifetime.[116] Therefore, people often begin in a position of trust, not at zero baseline. People begin at a positive or negative level of trust due to some interrelated factors, such as the trustor's attitude and personality, which may influence the trustor to be more trusting or suspicious of others generally.[117] The existence of institutional arrangements—such as law and enforcement—may cause the trustor to feel more protected against the danger of harm or betrayal, just as their absence might increase feelings of vulnerability. Prior information about the trustee, such as knowledge of their reputation or past behavior, can influence initial baselines of trust. Cognitive and perceptual shortcuts—such as stereotypes, rapid judgments, or responses to facial descriptions—may operate immediately for the trustor, even if they are entirely outside of the trustor's conscious awareness.[118]

Scholars have focused their attention on the Big Five personality model, which represents human personality by five broad features. The Big Five personality framework includes openness, conscientiousness, extraversion, agreeableness, and emotional stability, and addresses the functions associated with employing interpersonal trust.[119] Researchers assume that a significant complementary process in trust-related decision making is the cognitive processes associated with deliberation, thoughts, and beliefs.[120] The cognitive process of producing expectations about another's future performance is grounded on three different sources of information: trust signals, prior trust experience, and social projection.[121]

Trust signals are pieces of evidence a trustor might use to draw inferences about a trustee's honesty and integrity. Whereas personal trust signals refer to individual characteristics of the trustee, such as outside appearance or social category, situational trust signals relate to aspects of a specific trust situation, such as the inclination to betray. It was found that individuals from different cultures seem to agree that faces with high inner eyebrows, asserted cheekbones, wide chins, and shallow noses appear more trustworthy than faces with low inner eyebrows, shallow cheekbones, thin chins, and a deep nose pattern.[122] These appearance-based personal trust signals are used by ordinary people to predict the trustworthiness of unknown partners, even if these judgments may turn out to be incorrect in the future.[123] In addition, several sociodemographic variables, such as education, income, salary satisfaction, subjective feelings of deprivation, and

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[116] ROMPF, *supra* note 86, at 62–65.

[117] Julian B. Rotter, *Generalized Expectancies for Interpersonal Trust*, 26 AM. PSYCH. 443, 445 (1971).

[118] BORUM, *supra* note 115, at 11.

[119] For a review of the research on the connection between Big Five personality model and interpersonal trust, see, for example, Matthew Cawvey, et al., *Biological and Psychological Influences on Interpersonal and Political Trust*, *in* THE OXFORD HANDBOOK OF SOCIAL AND POLITICAL TRUST 119, 128–32 (Eric M. Uslaner ed., 2018); Peter Thisted Dinesen & René Bekkers, *The Foundations of Individuals' Generalized Social Trust: A Review*, *in* TRUST IN SOCIAL DILEMMAS 77, 82–83 (Paul A. M. Van Lange et al., eds., 2017).

[120] Daniel J. McAllister, *Affect- and Cognition-Based Trust as Foundations for Interpersonal Cooperation in Organizations*, 38 ACAD. MGMT. J. 24, 25–30 (1995).

[121] Thielmann & Hilbig, *supra* note 103, at 256–58.

[122] Béla Birkás et al., *Cross-Cultural Perception of Trustworthiness: The Effect of Ethnicity Features on Evaluation of Faces' Observed Trustworthiness Across Four Samples*, 69 PERSONALITY & INDIVIDUAL DIFFERENCES 56, 59–60 (2014).

[123] Nicholas Rule et al., *Accuracy and Consensus in Judgments of Trustworthiness from Faces: Behavioral and Neural Correlates*, 104 J. PERSONALITY & SOC. PSYCHOL. 409, 421 (2013).

unemployment, have been perceived as predictive factors for forming interpersonal trust relations.[124] Moreover, several researchers have found that trustors place higher trust in strangers who belong to the same groups as the trustees, a phenomenon termed as group-based trust.[125] In contrast, situational trust signals relate to aspects of the situation that might affect someone's trustworthiness independent of that person's general integrity. For instance, it was found that the likelihood to betray relates to the trustee's conflict of interest.[126] In such cases, trust betrayal produces considerably higher results for the trustee than trust recognition. Thus, a trustor might expect a relatively high likelihood of trust betrayal and should be less willing to trust the other.[127]

Prior trust experience influences peoples' trust behavior in similar situations, mostly through altering their expectations about others' trustworthiness.[128] For example, customers whose trust had been betrayed in an online transaction generalized their weakened trust toward all merchants, whereas customers whose trust had been rewarded maintained their general trust in merchants. Accordingly, trusting is a "learned behavior" to some extent, as it is partly based on previous experiences with others' trustworthiness.[129]

Social projection is a "judgmental heuristic that leads people to expect that others will behave as they themselves do."[130] Social projection provides that people predict another's trustworthiness by projecting their cooperation and fairness preferences onto the other. Based on this prediction of another's integrity, people might then decide whether it is reasonable to trust. An honest individual would expect others to be trustworthy as well, thus considering trust reasonable due to a high expected probability of trust recognition. In contrast, an uncooperative individual would expect others to be uncooperative as well, therefore considering trust unreasonable due to a highly anticipated likelihood of betrayal.[131] In the next Part, I discuss fairness and distributive justice theories of contract law and demonstrate how the psychological insights discussed above can resolve the specific controversy between contract law theoreticians.

B. CONTRACTUAL FAIRNESS, DISTRIBUTIVE JUSTICE, AND BEHAVIORAL TRUST

The principle of contractual fairness suggests that for a contract to be just, equal values must be exchanged; if the exchanges do not constitute similar benefits, the deal is not just.[132] However, the principle of fairness does not suggest that the contractual enforcement is restricted only to bargains

[124] Dinesen & Bekkers, *supra* note 119, at 89.
[125] Michael J. Platow et al., *Two Experimental Tests of Trust in In-Group Strangers: The Moderating Role of Common Knowledge of Group Membership*, 42 EUR. J. SOC. PSYCHOL. 30 (2012).
[126] Thielmann & Hilbig, *supra* note 103, at 257–58.
[127] Id. at 257.
[128] Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1761 (2001).
[129] *Id.*
[130] Joachim I. Krueger & Melissa Acevedo, *Social Projection and the Psychology of Choice*, *in* THE SELF IN SOCIAL JUDGMENT 17, 18 (Mark D. Alicke, David A. Dunning & Joachim Krueger eds., 2005).
[131] Thielmann & Hilbig, *supra* note 103, at 258–59.
[132] Todd D. Rakoff, *The Five Justices of Contract Law*, 2016 WIS. L. REV. 733, 741–48 (2016).

that are technically equal as such. Rather, it maintains that contracts that have a large discrepancy in price or conditions are deemed to be invalid.[133] This view is embodied in the doctrine of unconscionability, which justifies a refusal to enforce bargains if one of the parties is considered to have too much bargaining power or somehow abuses that power to the detriment of the weaker contractual party.[134] This inquiry asks whether one of the parties inequitably or unfairly abused its power to impose superior contract terms upon the weaker party.

Unlike the American position, the UK common law has not adopted the doctrine of unconscionability for annulling the performance of a contract.[135] However, in the 1975 Court of Appeal case *Lloyds Bank v. Bundy,* Lord Denning suggested implementing the principle of unconscionability in English contract law. Specifically, he noted that

> the English law gives relief to one who, without independent advice, enters into a contract [upon terms which are very unfair] or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other.[136]

Thus, according to Lord Denning, the doctrine of inequality of bargaining powers should be conceived as a manifestation of the unconscionability principle, which provides relief to a severely weak bargaining party who was obliged to unfair terms. Nevertheless, the principle of inequality of bargaining power was later rejected in *Alec Lobb v. Total Oil*.[137] There, Lord Dillon noted that “the inequality of bargaining power must be a relative concept.” [138] For refusing to enforce a contract, an “extortion, or undue advantage taken of weakness, an unconscientious use of the power” must be established.[139] While English case law has rejected the principle of unconscionability, there are nevertheless several statutory provisions that regulate inequality of bargaining power, such as the Unfair Contract Terms Act of 1977.[140]

The American common law has emphasized that mere disparity of bargaining strength is not enough to make a case of unconscionability, and something more is required.[141] Therefore, courts look for contract terms that are “harsh,” “unfair,” “unreasonable,” “one-sided,” or “oppressive” to imply

[133] *Id.* at 740–48.

[134] U.C.C. § 2-302, cmt. 1 (Am. L. Inst. & Unif. L. Comm’n 1977) (“The principle [of unconscionability] is one of the prevention of oppression and unfair surprise and not the disturbance of allocation of risks because of superior bargaining power.” (internal citations omitted)).

[135] Nat’l Westminster Bank PLC v. Morgan [1985] 17 HLR 360, 373, [1985] UKHL 2, 10 (Eng.) (“In the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining power.”).

[136] Lloyd’s Bank Ltd. v. Bundy [1975] Q.B. 326, 339 C-D (Eng.).

[137] Alec Lobb (Garages) Ltd. v. Total Oil Gr. Brit. Ltd. [1983] 1 W.L.R. 173, 181 E-F (Eng.).

[138] *Id.* at 183.

[139] *Id.* at 182 G-H.

[140] For additional statutory provisions in the UK that regulate inequality of bargaining power see, for example, Blake D. Morant, *Contractual Interpretation in the Commercial Context*, *in* COMPARATIVE CONTRACT LAW: BRITISH AND AMERICAN PERSPECTIVES 248, 265 (Larry A. DiMatteo & Martin Hogg eds., 2016).

[141] Adams v. John Deere Co., 774 P.2d 355, 359 (Kan. App. 1989).

fundamental unconscionability.[142] In this regard, American case law has identified several problematic attributes of superior bargaining powers that support judicial intervention. For example, courts discussing bargaining-power disparities examine primarily whether, at the time of contracting, a party could have procured a similar contract from another entity.[143] Courts have found bargaining-power differences in cases in which one party did not provide the other party with meaningful opportunity to negotiate the contract's terms.[144] In this regard, courts have also considered bargaining-power disparities when one of the parties belongs to certain groups of persons that experience a higher risk of poverty, social exclusion, and discrimination as well as their economic role (seller or consumer and corporation or individual).[145] *Williams v. Walker-Thomas Furniture Co.* is one of the first cases in the country on unconscionability.[146] The ruling declared that courts in the District of Columbia could decline to enforce a sales contract if the bargain was "unconscionable," such as when there is "an absence of meaningful choice" for one party along with "terms which are unreasonably favorable to the other party." Williams, a single mother of seven on public support, had bought some household goods on credit from a local furniture store. When she defaulted after paying most of the debt, the store maintained the right to repossess the goods Williams had obtained during the previous five years. The court found that the store's contract was "unconscionable" and therefore unenforceable.[147]

I wish to connect the above discussion on the principle of unconscionability to the role of fairness and distributive justice in contract law. Recently, James R. Gordley and Hao Jiang argued that fairness in contract law should be perceived exclusively in terms of the Aristotelian commutative justice. Commutative justice is achieved when the performances the parties exchange are economically equivalent, so that ex-

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[142] Basulto v. Hialeah Auto., 141 So. 3d 1145, 1160–61 (Fla. 2014) ("In the typical case of consumer adhesion contracts, where there is virtually no bargaining between the parties, the commercial enterprise or business responsible for drafting the contract is in a position to unilaterally create one-sided terms that are oppressive to the consumer, the party lacking bargaining power."); Rodriguez v. Raymours Furniture Co., 93 A.3d 760, 766 (N.J. Super. Ct. App. Div. 2014), rev'd 225 N.J. 343 (2016) ("[A] contract is unenforceable if its terms are manifestly *unfair* or *oppressive* and are dictated by a dominant party."(emphasis added)).

[143] *See* Barnes v. N.H. Karting Ass'n Inc., 509 A.2d 151, 154 (N.H. 1986) ("[A] disparity in bargaining power may arise from the defendant's monopoly of a particular field of service, from the generality of use of contract clauses insisting upon assumption of risk by all those engaged in such a field, so that the plaintiff has no alternative possibility of obtaining the service without the clause; or it may arise from the exigencies of the needs of the plaintiff himself, which leave him no reasonable alternative to the acceptance of the offered terms."); Spears v. Ass'n of Ill. Elec. Coops., 986 N.E.2d 216, 223 (Ill. App. Ct. 2013). For a recent discussion, see, for example, Max Helveston & Michael Jacobs, *The Incoherent Role of Bargaining Power in Contract Law*, 49 WAKE FOREST L. REV. 1017, 1025–26 (2014).

[144] Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1172 (9th Cir. 2003) ("Ingle had no meaningful opportunity to opt out of the arbitration agreement, nor did she have any power to negotiate the terms of the agreement.").

[145] Layne v. Garner, 612 So. 2d 404, 408 (Ala. 1992) ("While it is true that a court may rescind a contract, or a portion of a contract, for unconscionability, '[r]escission of a contract for unconscionability is an extraordinary remedy usually reserved for the protection of the unsophisticated and uneducated.'").

[146] Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449–50 (D.C. Cir. 1965); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960).

[147] In the same vein, in James v. National Finance, LLC, 132 A.3d 799, 803 (Del. Ch. 2016), a woman was given a loan at an interest of 800%. She sued the lender on the grounds that the loan contract was unconscionable. In its 2016 ruling, the Delaware Court of Chancery ruled that the loan contract was null and void because it was unconscionable.

ante, neither party has been put in a better position. The transaction is fair when the parties are exchanging performances of equal economic value and each one receives a performance of more significant personal benefit than the one given in return. Their analysis of fairness integrates some tools of economic analysis. Specifically, an exchange contract is Pareto efficient if the risk that a party will be worse off eventually is imposed on the party who is best able to bear the risk and to be compensated for bearing it. Thus, if the contract is Pareto efficient, it should be conceived as a fair transaction. Accordingly, the initial distribution of resources among the contractual parties is irrelevant to contracts, which has to be perceived in terms of commutative justice alone.[148] Moreover, they suggest that to redress maldistribution of resources, one cannot examine the fairness of a contract between a particular worker and his employer. One has to take measures that affect the share of resources that workers receive, for example, by establishing a minimum wage—"yet that [distributive] injustice is not one that the law of contract can correct."[149]

To consider Gordley and Jiang's argument, I wish to discern between two different understandings of promoting distributive justice through contract law provisions.[150] According to the "weak" version of distributive justice, contractual undertakings should be interpreted and regulated in a manner that will not exacerbate the unjust distribution of resources. This form of intervention is not necessarily intended to improve the condition of underrepresented social groups through private law tools; rather it focuses on guaranteeing that their living situations will not worsen. According to the "strong" version of distributive justice, jurists and policymakers should employ contract law tools to directly improve the state of living of discriminated and social excluded populations. Under this view, jurists should acknowledge the distributive nature of contract rules that indicate a policy choice regarding how the legal relationship between the parties should be ordered, or, more accurately, how the relative advantages and disadvantages of contract law rules should be divided between the parties. For example, even where specific default rules are contracted around by the parties, it is the distributive starting conditions established by courts and legislatures that will partly define how much the parties can negotiate and how much they will be required to pay each other to change the default terms.[151]

Analyzing the connection between commutative and distributive justice in light of behavioral theories of trust explains why these two concepts are nevertheless interrelated and can hardly be separated. Behavioral approaches of trust provide that people often begin a position of trust, not at a zero baseline, but at a negative level trust due to some interrelated factors, which are a result of cognitive and perceptual shortcuts. In particular, it was found that appearance-based personal trust signals, such as the nation of origin,

[148] James Gordley & Hao Jiang, *Fairness and the Law of Contract*, 2020 MICH. STATE L. REV. (forthcoming 2021) (manuscript at 2–3), https://ssrn.com/abstract=3324001.

[149] *See id.* at 49–51.

[150] For a discussion on the weak and strong views of incorporating distributive justice principle in contract law, see, for example, Kevin A. Kordana & David Tabachnik, *Rawls and Contract Law*, 73 GEO. WASH. L. REV. 598, 598–600 (2005).

[151] Marco Jimenez, *Distributive Justice and Contract Law: A Hohfeldian Analysis*, 43 FLA. STATE U. L. REV. 1265, 1316 (2016).

religion, race, and gender are used by ordinary people to predict the trustworthiness of unknown partners. Several other sociodemographic variables, such as education, income, and employment are also important factors for predicting the extent of contractual trust. Gordley and Jiang believe that fair exchange is Pareto efficient as long as a party will be compensated for bearing the risk of being worse off ex-post. However, designing such contractual terms is conditional upon the extent of interpersonal trust between the parties which in turn is partly based on appearance and socio-demographical attributes. When such qualities are present, jurists could assume that the parties did not design contractual terms aimed to compensate for the risk of being worse off ex-post. Moreover, in case of socio-demographical characteristics, we can predict that the party who has a strong bargaining power acted for designing the contract's terms in a manner that will unjustly reimburse them ex-post for engaging in contractual relations they did not entirely trust ex-ante. Thus, we can reasonably expect for such contracts to be inefficient and unfair on their merits.

As Schwartz has rightly demonstrated, even the state of poverty of one of the parties may undermine the fairness and efficiency of the transaction.[152] Since poor people generally are not able to pay for contractual clauses insuring against certain risks, they may well agree to assume risks that they will not be compensated for even if materialized ex-post. Furthermore, poverty may indicate less access to information necessary to make an educated evaluation of contract terms, including those relating to a one-sided assumption of certain risks. Thus, "the terms on which individuals are free to contract may depend descriptively, morally, and legally on the socio-economic positions of the parties."[153] Such conclusion may at least justify embracing a weak version of distributive justice, which provides that interpersonal entitlements should be regulated in ways that do not exacerbate distributive injustice. Furthermore, people perceive the same output as more or less fair, depending on which reference group they compare themselves or others to. Many deprived parties incorrectly assume that such a result is just and fair because other disadvantaged group members normally contract on similar terms. Social psychologists have extensively investigated people's judgments of justice and fairness in various settings.[154] The social-psychological study of trust and fairness asserts that people perceive they are treated fairly when the ratio between their received outcomes and their input is equal to the rate between the accepted results and the contributions of the other parties. When people are treated unfairly and less favorably than others, a person's sense of both fairness and self-interest are infringed, which leads to greater irritation. A typical key to people's judgment of fairness is the role of social comparison. Whether one embraces equity, equality, need, or any other distribution criterion, its implementation requires comparisons with

[152] Alan Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1056 (1977).

[153] Aditi Bagchi, *Distributive Justice and Contract*, *in* PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW, *supra* note 25, at 193, 195.

[154] Daphna Lewinsohn-Zamir, *The Choice Between Property Rules and Liability Rules Revisited: Critical Observations from Behavioral Studies*, 80 TEX. L. REV. 219, 227 (2001).

others.[155] Therefore, deprived contractual parties will rarely initiate legal proceedings in connection with unconscionability in contractual relations. Because those parties generally do not litigate their case, constraining contracts to ex-post exogenous principles of distributive justice may not ensure that social disparities will not be expanded. Therefore, this result may justify adopting a stronger view that enlists a contract as a tool to pursue more equitable distributions. Such a view is reflected in the extensive federal regulation of alternative financial services that are marketed to lower-income and credit-impaired consumers. Financial products falling into this category include traditional payday loans, pawnbroker loans, installment loans, subprime credit cards, automobile title loans, income tax refund products, and credit substitutes like rent-to-own financing.[156]

After all, it seems that the methodological framework of procedural and substantive unconscionability examinations embraces at least a weak version of distributive justice that aims to void any contractual agreement that increases unjust allocations of resources. To determine whether a contract is procedurally unconscionable, American courts have examined factors relating to the processes of the contract's formation, such as a party's education and socio-economic background, which imply the extent of sophistication and bargaining power.[157] Factors courts have considered include: using complex language when phrasing clauses that is incomprehensible to a layman or language that diverts his attention from the problems raised within clauses, or the rights given up through those same clauses; hiding clauses that are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract; or using printed form or boilerplate contracts drawn up by the party in the strongest economic position, and offered on a take it or leave it basis to the party in a weaker economic position.[158] Such circumstances imply that the party who holds strong bargaining power does not trust the deprived party in any meaningful sense since the latter does not belong to the same socio-economic group of the former (group-based trust). In this case, the party who holds substantial bargaining power may take advantage of the alienage of the deprived party by constructing inefficient and unfair contract conditions, which even extend beyond price terms.[159] Accordingly, the concept of substantive unconscionability tests the substance of the exchange by scrutinizing a significant cost-price disparity or excessive price,[160] limitations of remedies and disclaimers of warranties, and inclusion of penalty clauses.[161] Therefore, integrating behavioral insights of interpersonal trust in the Pareto

[155] ZAMIR & TEICHMAN, *supra* note 86, at 102–04.

[156] For an extensive survey of the American regulation of credit consumer protection law, see, for example, Thomas A. Durkin et al., CONSUMER CREDIT AND THE AMERICAN ECONOMY 415–583 (2014).

[157] Frostifresh Corp. v. Reynoso, 274 N.Y.S.2d 757, 759 (Dist. Ct. 1966).

[158] *See generally* Colleen McCullough, *Unconscionability as a Coherent Legal Concept*, 164 U. PA. L. REV. 779, 787–99 (2016).

[159] *See generally* Albert Choi & George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665, 1696–1728 (2012).

[160] REDUS Peninsula Millsboro, LLC v. Mayer, C.A. No. 8835-VCN, 2014 WL 4261988, at *5 (Del. Ch. Aug. 29, 2014); SAMUEL WILLISTON & RICHARD A. LORD, WILLISTON ON CONTRACTS § 18:15 (4th ed. 1990).

[161] The two dimensions of unconscionability do not function as separate elements of a two-prong test. The analysis is unitary, and it is generally assumed that if more of one is present, then less of the other is required. *See* FARNSWORTH, *supra* note 46, § 4.28, at 585.

efficiency conception of fairness articulated by Gordley and Jiang explains the unavoidable connection between the commutative and distributive justice of contract law as it is demonstrated in the two dimensions of unconscionability.[162]

V. CONCLUDING THOUGHTS FOR FUTURE RESEARCH

This Article was devoted to developing an interdisciplinary account of interpersonal trust in short-term contracts and its implications for contract theory and contract law design. While theoreticians certainly acknowledge the significance of interpersonal trust as a core component of any contract theory, they fail to develop a comprehensive understanding of such a concept and how it is integrated into an interpretive approach of contract law. Thus, our analysis proposed to outline the fundamental perceptions of moral, economic, and behavioral interpersonal trust as a ground for establishing a new framework on the role of interpersonal trust in contract law. Moreover, combining the studies of interpersonal trust in the fundamental assumptions of promissory, efficiency, and fairness theories of contract law may fill this void and resolve some difficulties regarding their ability to provide coherent explanations of different doctrines and practices.

To assess the effectiveness of the proposed interdisciplinary framework on interpersonal trust to produce consistent and practical policy implications and recommendations, I believe that scholars should distinguish between three different modes of analysis. First, researchers should take into consideration the effect that different types of contracting parties can have on the formation of interpersonal trust in a specific transaction. For instance, several studies indicate that while contracts are typically seen as morally binding promises, contracts between individuals are associated more strongly with promises than are contracts between firms and organizations.[163] As a result, breach of contract by an individual is seen as a moral transgression, while the same behavior by an organization is viewed as a legitimate business decision.[164] Indeed, these findings do not indicate that organizations are generally expected to behave with lower moral standards than individuals,[165] rather they imply that the conception of interpersonal trust should be perceived differently when contracts between firms are involved.[166]

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[162] Therefore, I concur with Rakoff who denied that one can separate concerns about commutative and distributive justice. *See* Rakoff, *supra* note 132, at 737–38.

[163] Uriel Haran, *A Person–Organization Discontinuity in Contract Perception: Why Corporations Can Get Away with Breaking Contracts but Individuals Cannot*, 59 MGMT. SCI. 2837, 2838 (2013).

[164] This issue was recently explored by Matthew A. Seligman, *Moral Diversity and Efficient Breach*, 117 MICH. L. REV. 885 (2019), who discussed the asymmetry between individuals and firms regarding their approach to breach of contract. Specifically, he suggested to adopt a mandatory exit clause which will allow individuals to breach the contract and pay fee equivalent to expectation damages.

[165] However, behavioral experiments demonstrated that people tend to believe that organizations are more unethical than individuals, even when both agents engage in identical behaviors. *See, e.g.*, Arthur S. Jago & Jeffrey Pfeffer, *Organizations Appear More Unethical than Individuals*, 160 J. BUS. ETHICS 71, 75–76 (2019).

[166] Haran, *supra* note 163, at 2850–51.

Second, scholars should acknowledge the direct effect that the type of transaction may have on forming interpersonal trust between individuals.[167] Put differently, while certain personal transactions involve inherent trust and confidence, other more commercialized dealings may not inevitably encompass a high degree of trust as a necessary condition for their performance. Furthermore, when the contract is complex and initiated for a considerable period of time, a close collaboration between the parties is required to bring its provisions to execution. Thus, when one-shot contracts share more comparable features to those of relational contracts, they may entail similar treatment regarding the appropriate remedies when they are breached.[168] However, in case of breach, the mere existence of controversy regarding the parties' rights and obligations should not always suggest that interpersonal trust could not be regenerated. This is especially true when reperforming the contract does not require close collaboration between the promisor and the promisee.

Third, scholars should recognize that interpersonal trust in contracts may play a special (and very often dissimilar) role when considering the political, cultural, and socio-economic foundations of various legal systems.[169] In particular, previous literature has clearly demonstrated that to understand contractual terms and their purposes, we should pay nuanced consideration to the parties' socio-cultural background and experience.[170] Considering such contextual influences could provide better protection to the reasonable contractual expectations of the parties.[171] Reflecting those contextual factors also may determine when a particular behavior can undermine interpersonal trust between the parties or alternatively reinforce it as a means for effective performance. Therefore, rather than exclusively perceiving the manifestation of interpersonal trust in terms of commonsense morality or economic efficiency, jurists should examine how the parties' conduct is related to their unique socio-cultural background before determining their exact mutual obligations and responsibilities. While the present Article made a significant theoretical contribution to understanding the concept of interpersonal trust in short-term contracts, it appears that empirical research will provide a better understanding on the practice of this phenomena by carefully discerning between the three levels of analysis discussed above.

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[167] The concept of transaction types is generally related to the work of Karl Llewellyn. *See* Larry A. DiMatteo & Blake D. Morant, *Contracts in Context and Contracts as Context*, 45 WAKE FOREST L. REV. 549, 564 (2010).

[168] Yehuda Adar & Moshe Gelbard, *Contract Remedies – A Relational Perspective*, *in* THE ORGANIZATIONAL CONTRACT: FROM EXCHANGE TO LONG-TERM NETWORK COOPERATION IN EUROPEAN CONTRACT LAW 269, 277 (Stefan Grundmann, Fabrizio Cafaggi & Giuseppe Vettori eds., 2016).

[169] Marjorie Florestal, *Is a Burrito a Sandwich?: Exploring Race, Class, and Culture in Contracts*, 14 MICH. J. RACE & L. 1, 8–9 (2008).

[170] *See generally* Nancy S. Kim, *Reasonable Expectations in Sociocultural Context*, 45 WAKE FOREST L. REV. 641 (2010).

[171] *Id.* at 645–52.