An Information-Production Theory of Contract Law

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ABSTRACT: Contract law affects behavior not just directly, by ordering damages, but also indirectly, by providing information on how the parties to the dispute behaved. Information from litigation can then help third parties decide whether to do business with the disputants going forward. Contract law thus affects behavior by shaping reputations and facilitating market discipline. This Article examines contract law's liability standards, defenses, and remedies doctrines from an information-production perspective, and generates the following three contributions.

First, the information-production perspective clarifies an efficiency-based justification for the stark divide between contract liability (strict liability) and tort liability (negligence). A negligence regime comes with higher administrative costs relative to strict liability, but also with the promise of more granular information on how the parties behaved. In torts, the informational benefits of negligence over strict liability are pronounced and often justify its higher administrative costs. In contracts, by contrast, strict liability often comes with distinct informational benefits of its own, producing information on parties' tendency to overpromise. The Article spotlights the surprisingly common contractual contexts where strict liability produces more reputation-relevant information than negligence, as well as contractual contexts where the informational benefits of negligence are too marginal to justify its higher administrative costs.

Still, in many other instances, learning that the promisor overpromised in the past is not necessarily indicative of the likelihood that she will overpromise in the future. This is where the Article's second contribution comes in, exploring when contract law veers from its fault-free baseline to probe the parties' effort,

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preparedness, technological know-how, and integrity. By applying the information-production perspective to contract law's "islands of fault," the Article revisits time-honored puzzles, such as the "inverted hierarchy" of contract interpretation, the intractability of excuses, and judicial hostility toward liquidated damages clauses.

The Article's final contribution is in outlining concrete policy implications. Recognizing that contract litigation subsidizes the production, certification, and diffusion of information carries important lessons for regulators, such as when to allow mandatory arbitration provisions; for judges, such as when to grant protective orders or rights of action for nominal damages; and for academics, such as how to assess the optimality of private ordering. It also puts a thumb on the scale against recent calls to personalize contract law. Tailoring different default rules to different contractual parties would hurt the ability of market actors to compare between potential contractual partners, thereby dampening reputational discipline.

INTRODUCTION

The Restatement (Second) clarifies that fault plays no role in contract liability.[1] A promisor is strictly liable for nonperforming regardless of how much care she took.[2] In tort liability, by contrast, victims need to prove that injurers did not exercise due care.[3] What explains this stark divide between the two major branches of private law? Why is contract liability fault-free, whereas tort liability is fault-based?

Existing attempts to answer this fundamental question fall into three categories, with none of them being satisfactory.[4] First, some contracts scholars question the premise: There is no great divide between torts and contracts because contract liability is fault-based too.[5] Contract law doctrines of interpretation, excuses, and remedies frequently call on courts to assess the fault of the promisor, or so the argument goes.[6] Such an argument does not really make the puzzle go away, but only kicks it up one level. Granted, both systems are mixed: Contract law contains elements of fault, and tort law contains elements of strict liability.[7] Yet they are mixed very differently. To generalize, in tort law the victim must show that the wrongdoer was at fault in order to obtain damages, whereas in contract law the wrongdoer must show that she was not at fault in order to avoid paying damages.[8] We are back to square one, then: What explains the divide in how contracts and torts employ fault?

1. RESTATEMENT (SECOND) OF CONTS. ch. 11, intro. note (AM. L. INST. 1981).

2. 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.8, at 195–96 (3d ed. 2004).

3. ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 196 (6th ed. 2012).

4. Roy Kreitner, *Fault at the Contract-Tort Interface*, 107 MICH. L. REV. 1533, 1533 (2009) (decrying the lack of detailed accounts of this fundamental question).

5. Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract*, 107 MICH. L. REV. 1381, 1381 (2009) ("The Restatement's oft-quoted assertion about the nature of contract liability is one of the most imprecise generalizations ever made about the common law of contract."); MELVIN A. EISENBERG, FOUNDATIONAL PRINCIPLES OF CONTRACT LAW 173–75 (2018).

6. George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225, 1311–12 (1994) (on remedies doctrines); Melvin Aron Eisenberg, *The Role of Fault in Contract Law: Unconscionability, Unexpected Circumstances, Interpretation, Mistake, and Nonperformance*, 107 MICH. L. REV. 1413, 1419, 1422–24 (2009) (on excuse and interpretation doctrines).

7. One classic example of no-fault compensation in tort law is dangerous and uncommon activities, such as blasting. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 20 cmt. e (AM. L. INST. 2010).

8. EISENBERG, *supra* note 5, at 174; Eric A. Posner, *Fault in Contract Law*, 107 MICH. L. REV. 1431, 1432 (2009) [hereinafter Posner, *Fault in Contract Law*].

A second type of accounts acknowledges the divide, and justifies it based on basic principles of consent and sanctity of contracts.[9] The idea is that only strict contract liability can mirror the promise that was initially given. When a person takes upon herself a certain standard of behavior (say, to deliver a good at a specified date), it is only right that the legal system will hold her to that standard.[10] Strict contract liability leaves it in the parties' hands to set the standard for what is actionable. Tort liability, by contrast, is not bargained for, but rather imposed by the government on nonconsenting parties.[11] It is therefore only right that parties will not be liable in torts unless proven to be at fault. The problem with these accounts is that they overjustify: They cannot explain the numerous pockets of fault that permeate contract law. Emphasizing how strict liability promotes individual choice and predictability does not clarify when and why contract law nevertheless veers away from strict liability and employs fault.

Finally, some law-and-economics scholars acknowledge the divide but claim that it cannot be justified on efficiency grounds. To them, both branches of private law try to do the same thing, namely, incentivize precaution.[12] Both contract and tort law should choose the liability rule that makes the parties internalize the harms that they impose on others. And there is no reason to assume *a priori* that contract liability should be fault-free and tort liability fault-based.[13] Having found no internal logic in the way that the two branches of private law grew apart, these scholars explain the divide as a historical accident in how U.S. private law developed.[14] But this account is factually inaccurate. In fact, many other legal systems around the world share similar features: (1) their contract and tort systems contain some elements of fault, but (2) each system employs fault differently, in the sense that in contracts, plaintiffs usually need not prove fault on the part of defendants (it is rather defendants who need to prove they were not at fault).[15] It is unlikely that all these legal systems err. Accordingly, we must take the divide between torts and contracts seriously and aim at clarifying justifications for it.

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9. Stefan Grundmann, *The Fault Principle as the Chameleon of Contract Law: A Market Function Approach*, 107 MICH. L. REV. 1583, 1587 n.21 (2009) (compiling references).

10. BRIAN H. BIX, CONTRACT LAW: RULES, THEORY, AND CONTEXT 142–43 (2012).

11. Kreitner, *supra* note 4, at 1540.

12. Omri Ben-Shahar & Ariel Porat, *Foreword: Fault in American Contract Law*, 107 MICH. L. REV. 1341, 1341 (2009).

13. Indeed, prominent law-and-economics scholars have long called for tort law to adopt more strict liability elements, and for contract law to adopt more negligence-based elements. *See, e.g.*, Saul Levmore, *Richard Posner, the Decline of the Common Law, and the Negligence Principle*, 86 U. CHI. L. REV. 1137, 1142–43 (2019) (describing the conventional view).

14. Posner, *Fault in Contract Law*, *supra* note 8, at 1444; Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349, 1352 (2009) [hereinafter Posner, *Let Us Never Blame a Contract Breaker*].

15. Grundmann, *supra* note 9, at 1586–87.

This Article offers a novel justification for the role of fault in contract law, which can be summed up in two words: information production. Private law affects behavior not just directly, by imposing legal sanctions, but also indirectly, by producing information on how the parties to a dispute behaved. Information produced during litigation can then help third parties decide whether they want to keep doing business with the disputants going forward. In other words, private law affects behavior by shaping the reputations of the parties to the dispute.

Pertinently here, the way that each branch of private law employs fault affects the quality and quantity of information that is being produced. Elsewhere, two of us argued that in torts, a fault-based liability rule produces much more granular and reputation-relevant information than a no-fault rule.[16] We concluded that the prevalence of negligence over strict liability in torts can be justified on efficiency grounds.[17] But the same logic does not extend to contracts. In contracts, the most reputation-relevant piece of information is a person's propensity to keep her promises.[18] Outside observers who choose among potential contractual partners would like to learn about the ability and intentions of each potential party to deliver on time the precise quality of goods specified. Contract litigation under strict liability implicates exactly this question, namely, the gap between what the defendant promised and what she delivered. Market actors can then use information from litigation to decide whether to do business or change their contract terms with defendants who were exposed in litigation as overpromising and underdelivering.

To illustrate, consider the contract law classic *United States v. Wegematic Corp.*[19] In 1956, the Federal Reserve Board contracted an electronics manufacturer to develop and implement a state-of-the-art digital computing system.[20] When the manufacturer failed to deliver, the government sued and won.[21] Pertinently, the oft-cited judicial opinion offers little information on *why* Wegematic failed to deliver: Was it lack of effort or did the company's engineers lack the necessary technical skills? The opinion adheres to a strict liability standard and does not probe such questions. Instead, the opinion emphasizes that Wegematic submitted a detailed proposal to develop within a tight schedule "a truly revolutionary system utilizing all of the latest technical advances," but soon thereafter claimed that delivering on such promises was

16. *See generally* Assaf Jacob & Roy Shapira, *An Information-Production Theory of Liability Rules*, 89 U. CHI. L. REV. 1113 (2022) (arguing that the informational benefit of fault-based liability is "a public good, so fostering private incentives to produce it can be socially desirable").

17. *Id.* at 1142.

18. W. Bentley MacLeod, *Reputations, Relationships, and Contract Enforcement*, 45 J. ECON. LITERATURE 595, 596 (2007) (noting that reputation in contracts is based on the extent to which one tends to breach her agreements).

19. United States v. Wegematic Corp., 360 F.2d 674, 674 (2d Cir. 1966).

20. *Id.* at 674–75.

21. *Id.* at 675, 677.

impracticable.[22] In other words, the litigation did not focus on Wegematic's faulty behavior in the performance stage, but rather on its "fault" in setting an unrealistic benchmark in the contracting stage. What outside observers learn from litigation is that Wegematic promised the world and did not come close to delivering on it.

For buyers in a market for new technological systems, learning that a certain seller is prone to overpromise major technological breakthroughs is key. We term such pieces of information "reputation relevant," to denote how they can easily sway market actors' willingness to do business with said seller. Indeed, the *Wegematic* case led to significant reputational fallouts: Shortly thereafter the defendant—which up to the case had been a rising star in the computing industry—effectively discontinued its operation.[23]

The exact details of how strict contract liability produces information vary from case to case. Some litigation reveals information about the defendant's capacity to calculate realistically, thereby implicating her due diligence skills. Other cases reveal that the defendant opportunistically reneged on her promises, thereby implicating her integrity. But the upshot remains the same: Contract litigation under strict liability often produces information on the defendant's propensity to keep promises. To the extent that such information becomes publicly available, it facilitates a more robust market (reputational) discipline.

Now contrast this basic contract law scenario with a scenario of medical malpractice. Say that during a complex surgery, the patient suffers a severe injury, and sues in court. For outside observers, knowing that the surgery caused harm is not that helpful for deciding whether they want to be treated in the future by the surgeon in question. After all, it is the nature of complex procedures that bad things may inevitably happen, perhaps due to background risks or inherent risks. The important piece of information for potential patients (or employers of surgeons) is not whether harm occurred but rather whether other surgeons could have avoided the harm. Medical malpractice litigation under a negligence rule tends to provide answers to this question, by focusing on whether the surgeon adhered to "customary care" or performed below it.[24] Medical malpractice litigation under strict liability would not. In other words, whereas the sales-of-goods litigation focuses on the defendant's "faulty" behavior in setting up standards for how she should behave, the professional-malpractice litigation focuses on the defendant's faulty behavior in living up to existing standards.

The first of our Article's three contributions is therefore to clarify an efficiency-based justification for the different starting points of tort liability

22. *Id.* at 675.

23. *See* Ken Shirriff, *The Vacuum Tube's Forgotten Rival*, IEEE SPECTRUM (Mar. 27, 2022), https://spectrum.ieee.org/the-vacuum-tubes-forgotten-rival [https://perma.cc/7AGD-CAT4].

24. Gideon Parchomovsky & Alex Stein, *Torts and Innovation*, 107 MICH. L. REV. 285, 291 (2008).

(negligence) and contract liability (strict liability).[25] A negligence regime comes with higher administrative costs relative to strict liability,[26] but also with the promise of more granular information on how the parties behaved.[27] In torts, the informational benefits of negligence over strict liability are pronounced and often justify its higher administrative costs. In contracts, by contrast, strict liability often comes with distinct informational benefits of its own, producing information on parties' tendency to overpromise. Accordingly, there exist common contractual contexts where a strict liability regime produces *more* reputation-relevant information than a negligence regime, as well as other common contractual contexts where the informational benefits of negligence are too marginal to justify its higher administrative costs.[28]

Still, in many other instances, learning that the promisor breached her promise in the past is not necessarily indicative of the likelihood that she will breach her promise in the future. For example, unusual contingencies may arise after the parties made legally binding promises. In such circumstances, knowing *what* happened—namely, that dire circumstances interfered and the defendant failed to deliver—is not very helpful for outside observers. Instead, outside observers will need to learn *why* and *how* things happened: Was the promisor prepared and flexible enough to deal with the unexpected, or did she opportunistically manipulate the events to invoke excuses? In other words, the relevant information in such contexts is not about the outcome (did the defendant deliver?), but rather about the process (did the defendant exercise due care? What was her level of investment in quality controls?). To provide such granular information, contract litigation must introduce negligence-based investigations.

This is where the Article's second contribution comes in, fleshing out the ways in which various contract law doctrines employ fault in ways that resemble a negligence regime.[29] Doctrines of interpretation, excuses, and remedies often produce granular details on things such as the technological know-how or preparedness of the parties, thereby affecting the parties' reputation. Looking at these doctrines from a reputational perspective allows us to revisit time-honored puzzles, such as the "inverted hierarchy" of contract interpretation, the intractability of excuse doctrines, judicial hostility toward liquidated damages clauses, and the courts' tendency to interpret best efforts clauses objectively. In other words, while the Article's first contribution is in explaining contract law's baseline of fault-free liability, the Article's second contribution is in highlighting the functionality of veering away from this baseline under certain conditions and creating "islands of fault."

25. *See infra* Part II.

26. Posner, *Fault in Contract Law*, *supra* note 8, at 1435–36.

27. Jacob & Shapira, *supra* note 16, at 1116.

28. *See infra* Section II.B.

29. *See infra* Part III.

The Article's final contribution is in outlining two sets of concrete policy implications that stem from recognizing the information-production function of contract law.[30] The first set of applications concerns the case for openness and against secrecy in contract litigation. Contract litigation produces quality information on past contractual disputes. To the extent that such information becomes publicly available, it can facilitate effective reputational discipline. This simple observation carries important lessons both for regulators, such as when to allow mandatory arbitration provisions, and for judges, such as when to grant protective orders or rights of action for nominal damages. The same observation also carries lessons for academics, such as how to assess the desirability of legal intervention versus "leaving things to the market." Many contract scholars have observed that contractual parties rely heavily on reputational mechanisms and gone on to presume that private ordering works just fine without law. This Article spotlights how private ordering is often made possible only *through* contract law. Contract litigation subsidizes the production, certification, and diffusion of information, thereby facilitating the proper functioning of reputational enforcement. Acknowledging that law and reputation complement each other necessitates rethinking one's priors regarding the design of default rules.

A second set of policy implications concerns the case against personalized law. Recently, notable contract scholars started calling to customize contract law, by utilizing big data and predictive analytics.[31] The idea is that today's technology allows us to easily boost the efficiency of contract law by tailoring different rules to different parties, and by deciding whether the defendant breached or what remedy to award to the plaintiff based on the parties' unique skills and preferences.[32] Our reputational framework exposes a major flaw in this line of argument: Personalizing contract law would take away the information-production, "benchmarking" benefits that the law in its current, impersonal form provides. Personalization may therefore end up hurting the efficiency of our contract system.

All these contributions stem from one overarching point, namely, that the choice of liability rules affects not just the parties to the dispute but also outside observers. Standard economic analysis evaluates liability rules based on how they affect the contractual parties (or, in torts, how they affect

30. *See infra* Part IV.

31. *See, e.g.*, Ariel Porat & Lior Jacob Strahilevitz, *Personalizing Default Rules and Disclosure with Big Data*, 112 MICH. L. REV. 1417, 1418 (2014); Omri Ben-Shahar & Ariel Porat, *Personalizing Mandatory Rules in Contract Law*, 86 U. CHI. L. REV. 255, 256 (2019) [hereinafter Ben-Shahar & Porat, *Personalizing Mandatory Rules in Contract Law*]; OMRI BEN-SHAHAR & ARIEL PORAT, PERSONALIZED LAW: DIFFERENT RULES FOR DIFFERENT PEOPLE 19 (2021) [hereinafter BEN-SHAHAR & PORAT, PERSONALIZED LAW].

32. *See* Ben-Shahar & Porat, *Personalizing Mandatory Rules in Contract Law*, *supra* note 31, at 256 ("Instead of one-size-fits-all protective mandates, the law would tailor the protection to the personal attributes of each protected party. . . . We argue that, if done properly, personalization could increase the benefits and reduce the unintended costs of mandatory law.").

potential injurers and victims). This Article, by contrast, focuses on how the choice of liability rules affects outside observers' willingness to do business with the parties to the dispute. In that sense, the Article also resolves some of the ambiguity in how courts and scholars refer to "fault" in contract law.[33] For many, "fault" in contract law means a notion of morality, in the sense of measuring contractual behavior against what is right or blameworthy ("not living up to one's promises is wrong!").[34] This Article highlights the many areas in which contract law emphasizes a different, "due-care" notion of fault that measures contractual behavior against the acceptable standard in the industry. In the instances in which contract law veers from its strict liability baseline and employs fault, it does so not so much to make the parties feel guilty (facilitating moral sanctions), but rather to allow third parties to more easily compare between potential contractual partners (facilitating reputational sanctions).

The Article proceeds in four parts. Part I sets the background by providing a primer on why reputation matters greatly in contracts, and how contract litigation shapes reputation. Part II applies this general reputation-through-litigation framework to explain the divide between torts and contracts. Part III uses the framework to analyze areas in contract law that employ fault-based elements. Part IV derives implications for personalized law and access to courts. An extended Conclusion clarifies our contributions by juxtaposing them with the extant literature and acknowledges the limitations of our account.

I. BACKGROUND: CONTRACT LAW AND REPUTATION

Reputation matters in contracts. Parties choose with whom to enter contracts based on the reputation of potential partners, and keep their contractual commitments out of a desire to maintain their own reputation. But wanting to maintain a good reputation does not automatically translate to behaving optimally. This is because reputation is "noisy," in the sense that it does not accurately reflect one's actual behavior.[35] When left to their own devices, market actors find it hard to collect and verify information on how potential contractual partners behaved in the past, let alone accurately infer this based on scattered bits of information on how these partners will likely behave in the future. Such informational problems can dampen the disciplinary power of reputation, as parties anticipate that reneging on their promises may not necessarily translate to losing reputation. Luckily, the market for reputation is not completely left to its own devices. The legal system often helps the market discipline itself by producing quality information on how contractual partners

33. *See, e.g.*, Richard A. Epstein, *The Many Faces of Fault in Contract Law: Or How to Do Economics Right, Without Really Trying*, 107 MICH. L. REV. 1461, 1462 (2009).

34. *Id.*

35. Christopher McKenna & Rowena Olegario, *Corporate Reputation and Regulation in Historical Perspective*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION 260, 272 (Michael L. Barnett & Timothy G. Pollock eds., 2012).

behaved in given circumstances. This Part fleshes out these reputation-through-litigation dynamics and how they affect contractual behavior.

Section I.A provides a general primer on the role that reputation concerns play in contracts. To enhance their future business opportunities, market actors try to develop a reputation for being honest, diligent, flexible, and prepared. But outside observers often have a hard time differentiating between who is truly honest, diligent, flexible, and prepared and who is just cheap talking. This is where Section I.B comes in, highlighting how contract litigation effectively subsidizes the market for reputation. If reputation matters, and litigation matters for reputation, the next question to explore is what matters for litigation: What dictates the quality and quantity of information that will be produced during litigation? Section I.B explains that much of the answer depends on the liability rule in place and the extent to which it relies on fault. Introducing fault-based elements changes the types of documents that are exposed during discovery, the kind of assessment the judges provide, and the type of disputes that are being aired in public to begin with.

A. *Reputation Matters*

1. Why Reputation Matters

"In many instances, an agreement between two commercial parties will be self-enforcing because both parties want to earn and preserve a good reputation so as to enhance . . . future business prospects."[36]

Contract scholars have long recognized the key role that reputational concerns play in the effectiveness of the contract system.[37] Promisors' incentives to deliver and promisees' incentives to cooperate are not just a function of the threat of legal liability, but also (indeed, very much so) a function of nonlegal forces.[38] Granted, not all contractual exchanges rely heavily on reputational concerns. But in contracts based on promises for deferred exchanges, reputation inevitably plays a key role. The time lag between when the promise is made and when it is delivered introduces "uncertainties and risks."[39] As a result, the parties need to be able to trust each other's integrity and competence.[40]

For a contractual relationship to work, I must be able to trust you to deliver on your promise even after you have already gotten what you wanted from the exchange. I must trust you to anticipate and prepare for uncertainties

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36. Scott, *supra* note 5, at 1392.

37. *See, e.g.*, Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 557 (2003); Eisenberg, *supra* note 6, at 1430.

38. *See, e.g.*, COOTER & ULEN, *supra* note 3, at 299 (describing the various nonlegal measures companies take in response to breach).

39. *Id.* at 283.

40. *Cf.* CHARLES FRIED, CONTRACT AS PROMISE 11 (1981) ("A promise invokes trust in my future actions, not merely in my present sincerity.").

down the road. In general, since our contract is bound to be incomplete (we will not allocate all risks in advance), I must trust you to preserve my reasonable expectations. If I do not trust you to do that, I am less likely to enter a contract with you, and, once in a contract, I am less likely to abide by it.[41] Importantly, these reputational concerns extend beyond the dyadic relationship between me and you.[42] If I underperform for you, I may lose my reputation among other buyers and suffer diminished business opportunities.[43]

One would think that such expected reputational fallouts would incentivize contractual parties to abide by their promises and perform adequately. In general, a market actor who wishes to find contractual partners and enjoy beneficial exchanges must develop a reputation for not overpromising, for not behaving opportunistically, for identifying and preparing for hidden hazards, and for responding in a timely and proper manner to known dangers.

But it would be a mistake to assume that reputational concerns necessarily weed out contractual misbehavior.[44] After all, the real world is fraught with information problems.[45] If I behave badly toward you in our bilateral contract, other market actors will not necessarily observe it. Sure, you may complain to others about me and how I cheated you, but your ability to widely disseminate damning information and the ability of others to verify your claims is very limited.[46] Outside observers may therefore overreact to some allegations and underreact to others. As a result, there may be a gap between how I behave and what my reputation is, thereby dampening the disciplinary power of reputation.

To better understand the role that reputation plays in contracts, we need to stop assuming that reputation works perfectly and start exploring the

41. *See* Emily Kadens, *The Dark Side of Reputation*, 40 CARDOZO L. REV. 1995, 1999 (2019) [hereinafter Kadens, *The Dark Side of Reputation*] ("[A]nyone who wishes to remain in business will strive to maintain a good reputation.").

42. Schwartz & Scott, *supra* note 37, at 557 ("Reputation . . . will induce performance when a single contract partner's boycott would not.").

43. For the classic economic models, see generally Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981), which describes a "moral hazard" model; and David M. Kreps & Robert Wilson, *Reputation and Imperfect Information*, 27 J. ECON. THEORY 253 (1982), which describes an "adverse selection" model.

44. Eisenberg, *supra* note 6, at 1430 ("[R]eputational effects are not alone sufficient, because reliable information concerning a promisor's history of breach is often hard to come by and often disregarded even when known.").

45. *See* Schwartz & Scott, *supra* note 37, at 557.

46. *See* Paul R. Milgrom, Douglass C. North & Barry R. Weingast, *The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs*, 2 ECON. & POL. 1, 9–10 (1990). One may argue that market actors' ability to disseminate information is much better nowadays, in the era of social media and free-information flows. Yet, as everyone who has partaken in social media discussions can attest, the problem these days is that we have access to too much information with too little veracity (the "fake news" moniker comes to mind). Sure, an aggrieved party may publish accusations in social media; but in most cases, these accusations will not reach a broad audience and may not be perceived as credible.

conditions that make it more (or less) likely to work.[47] When are third parties likely to acquire information on how parties to a bilateral contract behaved? When are third parties' reputational judgments based on this information likely to be accurate? These are the questions we turn to now.

2. How Reputation Matters

Let us recast *Wegematic* as our running example. With a company such as Wegematic, "reputation" can be defined as the set of beliefs that stakeholders (customers, investors, workers, and so on) hold regarding its quality.[48] Stakeholders do not have the ability to directly observe how skilled the company's engineers are, or how ethical its corporate culture is. As a result, the company's stakeholders often rely on the company's past observable actions as cues to evaluate how the company is likely to behave in the future. Sometimes the company's stakeholders hear bad news about the company—for example, that the company supplied goods of inferior quality, or that it underreported sales in consignment. In these cases, stakeholders may downgrade their beliefs about the company's quality, and decrease their willingness to do business with it going forward. The aggregate of lost future business opportunities constitutes the "reputational sanction" for misbehaving.

The important question for our purposes is what dictates the size of the reputational sanctions: How many business opportunities will be lost, exactly? A burgeoning reputation literature identifies five conditions that are necessary for meaningful reputational sanctions to occur, namely, revelation, diffusion, certification, attribution, and motivation.

For a computer company to suffer diminished business opportunities, information about how it overpromised and underdelivered in the past must surface and become public (the "revelation" stage).[49] Information that was revealed must be widely diffused so that it reaches a critical mass of market actors, in order for it to matter (the "diffusion" stage).[50] If, for example, the computer company has hundreds of potential buyers as its target audience, yet only two or three of these buyers hear about the company's past transgressions, the company will not be fazed by the threat of reputational

47. *See* MacLeod, *supra* note 18, at 596 (noting that while the idea that reputation enhances contractual exchanges is well accepted, "[e]xactly how this is achieved in practice is much more complex and less well understood"); McKenna & Olegario, *supra* note 35, at 271–73.

48. *See* Cynthia E. Devers, Todd Dewett, Yuri Mishina & Carrie A. Belsito, *A General Theory of Organizational Stigma*, 20 ORG. SCI. 154, 156 (2009). "Quality" is used here as an umbrella term, encompassing the company's abilities and intentions. Because we are dealing with commercial exchanges and using *Wegematic* as our running example, we focus in this Part on corporate reputation. However, our basic arguments in this Article apply to individual reputation as well, as the many real-world examples we use in Parts II and III below indicate.

49. *Cf.* Emily Kadens, *Cheating Pays*, 119 COLUM. L. REV. 527, 534–37 (2019) [hereinafter Kadens, *Cheating Pays*] (discussing the "discoverability of cheating").

50. Julian F. Kölbel, Timo Busch & Leonhardt M. Jancso, *How Media Coverage of Corporate Social Irresponsibility Increases Financial Risk*, 38 STRATEGIC MGMT. J. 2266, 2280 (2017).

sanctions. Information that was revealed and widely diffused has to be perceived as credible by the company's stakeholders (the "certification" stage).[51] After all, potential buyers are not going to stop doing business with a certain seller based on any piece of information spread by a fly-by-night rumor propagator. For buyers to update their beliefs and stop purchasing from the company, they must trust the source of damning information.[52]

Information that has been diffused and certified still must be attributed to deep-seated flaws that are likely to reoccur in the future, in order for the company's stakeholders to update their beliefs and act on information (the "attribution" stage). This point requires further elaboration, as it is crucial to our theory and has thus far largely escaped the legal literature.[53] When stakeholders hear bad news about a company, they usually ask themselves "how is it relevant to me?" That is, stakeholders try to infer whether the problem that led to the company's past failings is likely to resurface in the future in their own interactions with the company. Some pieces of bad news are deemed more relevant and indicative than others.[54] When stakeholders attribute the bad news to a one-off mistake, its indicativeness of future behavior is low. In such cases, the reputational sanction is likely to be small. By contrast, when stakeholders attribute the bad news to a deep-seated flaw, its indicativeness of future behavior is high. As a result, the reputational sanction is likely to be large.

Finally, stakeholders must be willing to act on information that has been revealed, diffused, certified, and attributed (the "motivation" stage).[55] Stakeholders may perfectly understand that something is wrong with the company, yet not switch to a competitor, perhaps because that company is a monopoly. If the market consists of only one company selling computers and demand for computers is inelastic, stakeholders cannot really "punish" the misbehaving computer company by taking their business elsewhere.[56] To illustrate, a recent empirical study examined how news about misbehavior by retail outlets affected consumer willingness to patronize the outlets going forward. The study found that the reputational sanction depends strongly on

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51. Stefano DellaVigna & Matthew Gentzkow, *Persuasion: Empirical Evidence*, 2 ANN. REV. ECON. 643, 657–58 (2010).

52. Roy Shapira, *Reputation Through Litigation: How the Legal System Shapes Behavior by Producing Information*, 91 WASH. L. REV. 1193, 1224–25 (2016) (detailing such "source credibility" effects).

53. ROY SHAPIRA, LAW AND REPUTATION: HOW THE LEGAL SYSTEM SHAPES BEHAVIOR BY PRODUCING INFORMATION 3–9 (2020) (compiling references).

54. Thomas Noe, *A Survey of the Economic Theory of Reputation: Its Logic and Limits*, *in* THE OXFORD HANDBOOK OF CORPORATE REPUTATION, *supra* note 35, at 114, 117.

55. Michael L. Barnett, *Why Stakeholders Ignore Firm Misconduct: A Cognitive View*, 40 J. MGMT. 676, 676–77 (2014).

56. On the link between market concentration and reputation, see generally Johannes Hörner, *Reputation and Competition*, 92 AM. ECON. REV. 644 (2002).

the level of competition in the market.[57] Outlets facing less competition experience smaller drops in consumer visits following bad news.[58]

An immediate takeaway from this bird's-eye view of the five stages of reputational sanctioning is that the process of translating bad news into reputational assessments is hardly automatic. Not all bad news is created equal. Some news about how a company behaved in each contractual exchange leads to stakeholders taking their business elsewhere, while other bad news is ignored. There is a lot of "noise" in reputational assessments. They rest not just on objective facts about what happened, but also on subjective interpretations of how things happened. The facts are often open to multiple interpretations, and market actors may get the interpretation wrong. They may interpret an isolated mistake as a deep-seated flaw or not. For example, outside observers may not be aware of events that were beyond the control of the parties and rendered performance impossible. Further, the process of reputational disciplining is not a one-sided affair. Companies accused of misbehaving fight back by trying to discard the veracity of the allegations or turning the heat back on the accusers, thereby increasing the level of difficulty in making accurate reputational assessments.[59]

As a result, market actors may continue doing business with rotten companies, or stop doing business with perfectly fine companies that simply suffered an unlucky break. Luckily, the noisy process of market discipline often gets a helping hand in the form of credible information coming from litigation.

B. *Litigation Matters for Reputation*

Information coming from the courtroom can leak out and affect the court of public opinion. This is especially true in the context of commercial exchanges. To illustrate, consider the common practice of searching one's potential counterparties' "legal" record before deciding whether to enter a contract with them.[60] For more systematic evidence, consider an empirical study about how litigation between venture capital firms ("VCs") and the entrepreneurs they finance affects the VCs' reputations.[61] The study revealed that when litigation flushes out damning information about how a certain VC treated a certain startup company, other startups avoid that VC and contract with its competitors instead.[62]

57. Felix von Meyerinck, Vesa Pursiainen & Markus Schmid, *Competition and the Reputational Costs of Litigation* 3 (Univ. of St. Gallen Sch. of Fin. Rsch. Paper, Working Paper No. 2020/07, 2022), https://ssrn.com/abstract=3744414 [https://perma.cc/R5BL-E64J].

58. *Id.* at 18–20.

59. Kadens, *Cheating Pays*, *supra* note 49, at 540.

60. G. Richard Shell, *Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action*, 44 VAND. L. REV. 221, 271 n.223 (1991).

61. Vladimir Atanasov, Vladimir Ivanov & Kate Litvak, *Does Reputation Limit Opportunistic Behavior in the VC Industry? Evidence from Litigation Against VCs*, 67 J. FIN. 2215, 2215–16 (2012).

62. *Id.* at 2244.

Litigation creates such reputational effects through each of the abovementioned conduits for reputational sanctions.[63] First and foremost, litigation helps by uncovering new pieces of information on the behavior of the parties to the dispute (the revelation stage). The legal system vests fact-finding powers in private litigants to probe and demand relevant information from their rivals. In the process of trying to win the legal case, litigants produce as a byproduct quality information on how their counterparties behaved—information to which market players would not otherwise be privy.[64] A recent example comes from the litigation concerning Elon Musk's bid to acquire Twitter. While the case never made it to trial, the earlier stages of the process produced information about issues such as the number of daily active Twitter users who are real humans and not bots or fake accounts.[65] This information, in turn, led Twitter's investors and regulators to reevaluate how they perceived the company.[66]

Second, litigation helps not only by revealing new information, but also by processing existing information (the attribution stage). Judicial opinions are good at highlighting patterns of misbehavior, organizing large chunks of information, and making it all less complex for outside observers.[67] Without anticipating our discussion in Parts II and III too much, judicial opinions could make it easier for market players to assess whether the interfering events were beyond the promisor's control, how intentional the breach was, and so on.

Third, litigation affects reputation by shaping the frequency and tenor of media coverage (the diffusion stage). When it comes to corporate reputation, meaningful diffusion usually happens via mass media coverage and, in some cases, via social networks.[68] Litigation provides journalists with what communication scientists call "information subsidies," by reducing the

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63. For a summary in a different context, namely, shareholder litigation, see Roy Shapira, *Mandatory Arbitration and the Market for Reputation*, 99 B.U. L. REV. 873, 887–88 (2019).

64. A separate question, to which we return in the Conclusion, is the extent to which such information becomes publicly available (by not being sealed or made confidential). *See infra* Conclusion; *see also* Diego A. Zambrano, *Discovery as Regulation*, 119 MICH. L. REV. 71, 124–25 (2020) (discussing reputational impacts of discovery disclosures).

65. For media coverage drawing attention to what these pieces of information say about Twitter going forward, see, for example, Dave Michaels, *Elon Musk's Belated Disclosure of Twitter Stake Triggers Regulators' Probes*, WALL ST. J. (May 11, 2022, 5:18 PM), https://www.wsj.com/articles/elon-musks-belated-disclosure-of-twitter-stake-triggers-regulators-probes-11652303894 (on file with the *Iowa Law Review*); Greg Roumeliotis & Sheila Dang, *Musk Says $44 Billion Twitter Deal on Hold over Fake Account Data*, REUTERS (May 16, 2022, 4:27 AM), https://www.reuters.com/technology/musk-says-44-billion-twitter-deal-hold-2022-05-13 [https://perma.cc/JJ7J-LM7L].

66. *See, e.g.*, Michaels, *supra* note 65 (on regulators' response); Russell Brandom, *Twitter Shares Plummet as Musk Raises New Doubts About Acquisition*, VERGE (May 13, 2022, 8:55 AM), https://www.theverge.com/2022/5/13/23070422/musk-twitter-buyout-acquisition-analysts-stock-drop [https://perma.cc/B7TL-TB9Y] (on investors' response).

67. SHAPIRA, *supra* note 53, at 35–74 (providing evidence based on interviews with journalists).

68. David L. Deephouse, *Media Reputation as a Strategic Resource: An Integration of Mass Communication and Resource-Based Theories*, 26 J. MGMT. 1091, 1096 (2000).

costs of covering the story.[69] Court documents provide journalists with information that is well documented and detailed, and may contain good quotes from internal company communications. Importantly, information from court documents is invaluable for investigative reporters because it is practically *libel-proof*; as long as the media reports accurately from court documents, it is shielded from defamation liability.[70]

Finally and relatedly, information from litigation is often considered by market players to be credible (the certification stage). A well-developed psychology literature tells us that not all sources of information are created equal: Stakeholders are more likely to update their beliefs and act on information when they perceive the source as credible.[71] Judicial opinions are normally considered disinterested and fair. Depositions and testimonies are given under oath. Documents are produced under the threat of perjury. Indeed, in a separate project, one of us interviewed thirty journalists on how they use information from the courtroom, and the journalists noted that "[t]he mere phrase 'according to court documents' is a rhetorical device [that] increase[s] [a] story's credibility."[72] That is, a journalist may have all the information she needs from another source, but she would still find it valuable to search for corroboration in court documents to increase the chances that her story reverberates.[73]

To affect reputation through all these conduits, litigation need not culminate in a judicial verdict after a full trial. Even disputes that are decided by a jury or those that settle relatively early may generate documentation during pleading, discovery, or trial. The Musk-Twitter litigation is a case in point.[74] Other examples abound.[75]

The next step in understanding reputation-through-litigation dynamics is to switch from "in general" claims (i.e., "in general, litigation has the potential to affect reputation") to claims about the cross-sectional variation, which examine the conditions under which the reputational effect of litigation is large or small, positive or negative. A key determinant of litigation's reputational impact is the underlying liability rule and the extent to which it is fault-based.

69. Roy Shapira, *Law as Source: How the Legal System Facilitates Investigative Journalism*, 37 YALE L. & POL'Y REV. 153, 166, 180–89 (2018) (providing evidence from interviews with reporters, reporters' tip sheets, journalism school syllabi, and communication science literature).

70. *Id.* at 173.

71. *E.g.*, DellaVigna & Gentzkow, *supra* note 51, at 655–56.

72. Shapira, *supra* note 69, at 175.

73. *Id.*

74. *See supra* note 65 and accompanying text.

75. *See, e.g.*, David Enrich, *How Abbott Kept Sick Babies from Becoming a Scandal*, N.Y. TIMES (Sept. 8, 2022), https://www.nytimes.com/2022/09/06/business/abbott-baby-formula-lawsuits-jones-day.html (on file with the *Iowa Law Review*) (relying on information from settled lawsuits to hold sellers accountable).

When the underlying liability rule is negligence (such as in torts), litigation revolves around questions such as what defendants knew, when they knew it, whether they could have prevented the problem, and how their conduct compares to that of their peers (the industry benchmark). Under strict liability, by contrast, litigation revolves around simpler questions, such as what damage occurred and whether the defendant's actions caused it. The fault-related set of questions usually provides more granular information on the behavior of the parties.[76]

Armed with a better understanding of how litigation affects reputation, we can now go back to the two-pronged puzzle we started this Article with. Part II uses the reputational perspective to explain why contract liability is much less fault-dependent than tort liability. Part III then explores why contract law nevertheless employs fault in doctrines of interpretation, excuses, and remedies.

II. WHAT EXPLAINS THE DIFFERENCE BETWEEN CONTRACT LIABILITY AND TORT LIABILITY?

The Restatement (Second) clarifies that "[c]ontract liability is strict liability."[77] The reason for nonperformance need not matter when determining breach, and the reason for breach need not matter when determining damages.[78] In tort law, by contrast, negligence rules. What explains this fundamental difference between the two branches of private law? Section II.A presents the existing attempts to answer this question and highlights their shortcomings. Section II.B offers an alternative explanation, namely, information production.

A. *EXISTING EXPLANATIONS*

Understanding how the concept of fault plays out differently in contracts and in torts is essential to the understanding of the development of modern private law.[79] Yet there exist surprisingly few detailed attempts to answer this fundamental question.[80] Existing accounts can be grouped into three categories: (1) those who think that as a positive matter, there is no divide and so there is no reason to provide a normative justification for it; (2) those

76. Jacob & Shapira, *supra* note 16, at 1126–34 (juxtaposing informativeness of strict liability and negligence in tort litigation).

77. RESTATEMENT (SECOND) OF CONTS. ch. 11, intro. note (AM. L. INST. 1981).

78. For the classic formulation by Justice Holmes, see *Globe Refin. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903). Under Holmes's "option theory" of contracts, making a legally binding promise is akin to purchasing an option to perform or pay damages. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

79. *See, e.g.*, Kreitner, *supra* note 4, at 1533 ("The formative period in the history of contract and tort [law] . . . may be characterized by the cleavage of contract and tort [law] around the concept of fault. . . .").

80. *Id.*

who think that there is a divide and that there is a clear normative justification for it, based on principles of consent; and (3) those who think that there is a great divide but that there is no good normative justification for it.

First, several prominent contracts scholars challenge the premise that contract liability is strict. They claim that many contract law doctrines contain "doctrinal vehicles by which the parties can introduce fault assessments."[81] Fault is not missing from contract liability but is rather already baked into how we define "contract" or "performance," or so the argument goes.[82] For example, when determining whether a contract was formed, the common mistake doctrine invites courts to assess the parties' fault.[83] When determining whether a contract was breached, the unconscionability doctrine introduces fault elements, and courts also frequently assess the reasonableness of the promisor's efforts.[84] And when venturing outside the realm of liability for nonperformance, fault shows up even more clearly, through doctrines of formation or remedies.[85] For example, when determining what measures of damages to award—reliance, restitution, or expectations—courts often consider how willful the breach was.[86]

But even if we accept this account at face value, it does not help us solve the puzzle of why contract law employs fault so differently than tort law does. The proponents of this account acknowledge as much: When they describe the role of fault in contract liability, they highlight how the burden is on the defendant to show *lack of* fault on her part.[87] If the defendant manages to show that she took due care and exerted efforts, she may escape liability. This is fundamentally different from tort law, where the burden is on the plaintiff to show fault (i.e., lack of due care) on the part of the defendant.

Second, many contract scholars accept the divide as a positive matter and embrace it as a normative matter: For them, contract liability is and ought to be strict, because of the principles of consent and sanctity of contract.[88] In contracts, the parties themselves set the standard of behavior against which they will be measured. Only a strict liability rule will therefore respect the

81. George M. Cohen, *The Fault that Lies Within Our Contract Law*, 107 MICH. L. REV. 1445, 1458 (2009).

82. Barry Nicholas, *Fault and Breach of Contract*, *in* GOOD FAITH AND FAULT IN CONTRACT LAW 337, 345 (Jack Beatson & Daniel Friedmann eds., 1995); Epstein, *supra* note 33, at 1462.

83. BIX, *supra* note 10, at 46–47 (describing cases where the courts grant one party recission even when the mistake was not mutual, based on the fault of the other party); WILLIAM REYNELL ANSON, ANSON'S LAW OF CONTRACT 282 (Jack Beatson, Andrew Burrows & John Cartwright eds., 29th ed. 2010) (same).

84. Posner, *Fault in Contract Law*, *supra* note 8, at 1431.

85. Cohen, *supra* note 6, at 1312.

86. *Id.*; Patricia H. Marschall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733, 741–54 (1982).

87. EISENBERG, *supra* note 5, at 175; Cohen, *supra* note 81, at 1460; Eisenberg, *supra* note 6, at 1429.

88. BIX, *supra* note 10, at 143–44 (compiling references).

parties' consent.[89] In torts, by contrast, the standard of behavior is imposed on nonconsenting parties from the outside, by the state.[90] Other justifications for strict contract liability emphasize how it supposedly increases predictability and promotes commercial exchanges.[91]

Here as well, even if we accept this account at face value (despite many detractors[92]), it does not help us solve the puzzle of how contract law employs fault. Such accounts can help us understand the different starting points, namely, why contract law is less fault-based relative to tort law. But they do not help us understand the many instances in which contract law nevertheless employs fault.[93]

Finally, several law-and-economics scholars acknowledge the difference in how contracts and torts employ fault yet argue that it cannot be justified on efficiency grounds.[94] For these scholars, liability rules should optimally incentivize precaution regardless of whether their subjects are tortfeasors or promisors. The two branches of private law should therefore adopt a more mixed approach to liability: Tort law should rely more on strict liability and contract law should introduce more negligence elements.[95]

Law-and-economics scholars argue that, if anything, strict liability is *less* justified in contracts than it is in torts.[96] One such argument relies on the ability to regulate activity levels. A distinct advantage of strict liability over negligence in torts is that it better regulates injurers' activity levels.[97] But in contracts, reducing the activity levels is not necessarily a good thing, or so the argument goes.[98] Torts regulate activities that impose externalities on others.

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89. *Id.*; Cohen, *supra* note 81, at 1447.

90. *See, e.g.*, Roscoe Pound, *The Role of the Will in Law*, 68 HARV. L. REV. 1, 15–18 (1954) (distinguishing between contracts and torts as systems that deal with agreement and aggression, respectively).

91. *Id.*

92. For example, justifying strict liability as a reflection of mutual consent is dubious given how in practice it is often extremely hard to assess mutual intent. Cohen, *supra* note 81, at 1450.

93. One could argue that fault in contract law is consistent with the consent and sanctity of contract principles because the parties themselves can introduce elements of fault into assessing breach. But such an argument again does not solve the puzzle but only kicks it up one level: It does not explain when and why parties agree to introduce fault elements and when and why they do not.

94. To be sure, there exist many law-and-economics accounts in favor of strict contract liability, such as on the ground of creating better incentives (promisors are the best cost avoiders) or reducing litigation costs (courts need not probe promisors' behavior). RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 178–82 (7th ed. 2007). But such accounts usually justify strict tort liability as well. Our point here is to look at how law and economics justify the existing divide between tort liability and contract liability.

95. Levmore, *supra* note 13, at 1142–43 (summarizing the conventional wisdom).

96. Posner, *Fault in Contract Law*, *supra* note 8, at 1435.

97. Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 24 (1980).

98. Posner, *Fault in Contract Law*, *supra* note 8, at 1435.

Contracts regulate activities that supposedly create win-win situations. Reducing the former type of activity is socially desirable; reducing the latter is not.[99]

Another law-and-economics argument relies on the desirability of burden shifting.[100] Conventional theory suggests that the main criterion for determining where the burden should lie is who has better access to information.[101] Applying this logic makes contract and tort liability rules seem backwards: In contracts the defendant usually must prove that she took ample precaution to avoid breach, whereas in torts the plaintiff usually must show lack of care on the part of the defendant. It is hard to imagine why tort victims would know more about the precaution that their injurers took, relative to what victims of breach know about the precaution that their contractual partner took.[102] If anything, the opposite seems more plausible.

Having failed to come up with an efficiency justification, these law-and-economics scholars attribute the divide to a historical accident in how U.S. private law developed and point to how in civil law countries contract liability is fault-based.[103] But this assertion is factually inaccurate. As civil law scholars have pointed out, civil law country systems contain many similarities to the U.S. system in this regard, including the abovementioned "burden-shifting" feature.[104] If many legal systems share this feature, it is hard to imagine that the feature has no functionality. As the next Section shows, there actually exists an efficiency justification for the divide between torts and contracts, and it is based on information production.

B. An Information-Production Explanation

1. When Strict Contract Liability Is More Informative than Negligence

Contract litigation and tort litigation produce different types of information. In tort litigation, the plaintiff needs to show that the defendant acted wrongfully: either causing harms intentionally or causing harm by failing to exercise due care.[105] As a result, tort litigation typically produces information on why and

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99. *Id.*

100. *Id.* at 1443–44.

101. *See, e.g.*, ARIEL PORAT & ALEX STEIN, TORT LIABILITY UNDER UNCERTAINTY 67–68 (2001) (noting that parties' differential access to information dictates burden shifting); Hyun Song Shin, *Adversarial and Inquisitorial Procedures in Arbitration*, 29 RAND J. ECON. 378, 381–91 (1998) (providing a formal model).

102. Posner, *Fault in Contract Law*, *supra* note 8, at 1444; *see also* Chris William Sanchirico, *A Primary-Activity Approach to Proof Burdens*, 37 J. LEGAL STUD. 273, 276–78 (2008) (criticizing the conventional wisdom and providing an alternative justification).

103. *See supra* note 14 and accompanying text.

104. *See, e.g.*, Grundmann, *supra* note 9, at 1586 ("The traditional view among contract scholars is that civil law systems opt for fault liability in contract law while common law systems opt for strict liability. Yet this impression is the result of too much abstraction on both sides. Upon closer inspection, the common denominator between civil and common law systems is that all systems opt for a nuanced combination of the two.").

105. EISENBERG, *supra* note 5, at 174.

how things happened. A tort plaintiff usually tries to extract information on issues such as what the defendant knew, when she knew it, could she have prevented the problem in real time, and how her behavior fares relative to common practice in her industry.

In contract litigation, by contrast, the plaintiff simply needs to show that a contract was formed, and the defendant's performance was deficient.[106] As a result, contract litigation typically does not extract much information on *why* and *how* parties do not perform their contracts. Instead, the plaintiff usually marshals evidence on *what* happened: the mismatch between what the defendant promised and what she delivered.[107]

On the surface it may therefore seem that tort litigation produces more quantity and better quality of information than contract litigation. But we are interested here in something else, namely, the extent to which information from litigation shapes reputations (and thereby deters misbehavior). Some types of information are more reputation relevant than others. The relevant question for our purposes is whether there is match between the types of information being produced in each legal field, and the types of information that are useful to outside observers in the relevant market. The answer to that question naturally depends on the context. Potential buyers in the market for new computers look for different types of information relative to potential patients in the market for a LASIK procedure.

Once we phrase the question like this, it becomes clear that the seemingly thin version of information production in contract litigation is very much reputation-relevant. Outside observers searching for potential contractual partners are interested in the partner's tendency to overpromise and underdeliver. Contract litigation under strict liability extracts exactly this type of information. Under strict liability, litigation revolves around figuring out what the gap was between what the defendant promised at the contracting stage and what she delivered. Strict liability thus flushes out instances where the promisor was reckless, overoptimistic, dishonest, or all of the above when she set the standard for how she was supposed to behave going forward.[108]

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106. *Id.*

107. In many instances, the defendant would then try to rebut the claim or reduce damages by marshalling evidence that her nonperformance was not her fault. We return to this important information-production point in Part III below. For now, we are strictly interested in the different starting points of what plaintiffs must prove in contracts versus in torts. In other words, we are interested in the "Burden of Production" branch of the "Burden of Proof" tree: the sequential process by which each party presents evidence. *See* Eric L. Talley, *Law, Economics, and the Burden(s) of Proof*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF TORTS 305, 308 (Jennifer Arlen ed., 2013) (unpacking the different doctrines under the umbrella term of "Burden of Proof").

108. For a case indicating that the seller in question is overly optimistic about her ability to deliver major breakthroughs, see generally *United States v. Wegematic Corp.*, 360 F.2d 674 (2d Cir. 1966). For a case indicating that the contractor has low creditworthiness and cannot secure necessary financing, see generally *Dills v. Town of Enfield*, 557 A.2d 517 (Conn. 1989).

In other words, strict liability in contract disputes may not probe the defendant's fault in the performance stage (did she exert enough efforts?), but it does probe the defendant's "faulty" behavior in the contracting stage (was she prudent and responsible enough when making promises?). In tort cases, by contrast, the parties do not commit in advance to behaving in a certain manner (put differently, they do not set a standard against which their behavior can be measured). Adjudicating tort cases according to strict liability would therefore produce little of informational value.

In fact, under certain (common) conditions, strict contract liability leads to more information production than a negligence rule. To illustrate, suppose that I contracted a construction company on January 1, 2022, to complete a building for me by January 1, 2024. Now say that during 2022–2023 the contractor exerted reasonable efforts, yet ultimately failed to meet the deadline. Under a negligence rule, I would not bring a lawsuit to begin with, figuring that my chances would be slim. Under a strict liability regime, by contrast, I would be more likely to sue in court, and therefore more likely to produce as a byproduct information about that contractor's tendency to overpromise and underdeliver. Switching from strict to fault-based liability in that scenario would result in losing valuable information.[109]

Such information-production effects of strict contract liability are especially valuable when it comes to corporate contracts. As Cathy Hwang recently documented, corporate contracts reflect the fact that "businesses are not monoliths."[110] Each division within a company has its own incentives and goals. The final contracts that companies enter reflect the internal tug-and-pull among these different divisions.[111] Outside observers considering whether to enter contracts with company X will therefore be interested in information about company X's internal negotiation and checks and balances. Litigation under strict contract liability, with its emphasis on the parties' behavior at the contracting stage, implicates exactly such questions. For example, litigation may teach outside observers that company X's sales team is writing checks that

109. To be sure, there are bound to be "trial selection effects" that may muddy the dynamics described here. *See* George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 26–27 (1984). If defendants realize that litigation under strict liability would expose their tendency to overpromise, they will be more willing to offer greater amounts to settle the dispute before damning information about them comes out. *See id.* As a result, fewer disputes will be aired in public under a strict contract liability regime (precisely because this regime is so reputation-shaping), or so a potential rebuttal to our argument goes. *See id.* Our counter-rebuttal is twofold. First, the fact that defendants anticipate a higher reputational sanction for overpromising—and will accordingly avoid being embroiled in disputes to begin with—is a good thing. It is a step toward an effective contracts system, whereby parties are incentivized to make prudent and responsible promises ex ante, and to settle quickly and compensate those who were harmed ex post. Still, there may indeed be circumstances where what is good for the parties (settling quickly out of court) is not good for society. We explore this second point at length below in Section IV.A.

110. Cathy Hwang, *Collaborative Intent*, 108 VA. L. REV. 657, 663 (2022).

111. *Id.*

its R&D department cannot cash. Or that the legal team is too weak to resist the tendency of upper management to overpromise, and therefore neglects to include qualifiers and exemptions. Such information would then affect whether and how outside observers deal with company X going forward, such as by taking its predictions with a bigger grain of salt and requiring more verifications.

Let us pause for two quick clarifications. First, we do not claim that all contract litigation under strict liability is reputation relevant. In general, the informativeness of litigation depends on the level of detail that it extracts about the promise and the subsequent performance. *Wegematic* was a good example for our purposes because the opinion details at length the seller's overoptimistic (to say the least) promises regarding the seller's ability to achieve major technological breakthroughs.[112] Another example comes from *Stees v. Leonard,* which dealt with the typical scenario of a contractor promising to erect a building within a certain timeline.[113] The contractor repeatedly failed to deliver, and the building collapsed.[114] In court, the contractor argued that the failure was not due to lack of skill or effort on his part, but rather because the soil upon which the building was constructed was unstable.[115] The court nevertheless held the contractor liable, making no reference to claims regarding skill and efforts. Instead, the opinion elaborates on how "improvident" the contractor was in making unqualified promises without doing due diligence.[116] For market participants, knowing that a certain contractor lacks foresight and preparedness is a very valuable piece of information when deciding whether to do business with said contractor going forward. Still, there exist many other court opinions that do not go into detail about the overoptimism or due diligence or technical skills of the promisor. These opinions are less likely to shape reputations.

A second clarification concerns the type of inferences that outside observers make based on information from litigation. Outside observers may infer from litigation that nonperformance is attributed to the promisor's low "capacity," or to her low "integrity."[117] This distinction matters less for our purposes. What matters more is whether outside observers attribute the problems that came out during a specific dispute to deep-seated issues that

112. *See generally Wegematic Corp.*, 360 F.2d 674; *see also supra* text accompanying notes 19–22 (discussing *Wegematic*).

113. Stees v. Leonard, 20 Minn. 494, 507 (1874).

114. *Id.* at 508.

115. *Id.*

116. *Id.* at 503.

117. On the capacity versus integrity distinction, see Oren Bar-Gill & Omri Ben-Shahar, *An Information Theory of Willful Breach*, 107 MICH. L. REV. 1479, 1491 (2009). The discussion here implicates the (murky) distinction between the two models of reputation in economics: "adverse selection" models (types/dispositions) and "moral hazard" models (actions/choices). *See supra* note 43.

are likely to resurface in the future. To illustrate, outside observers may infer from litigation that the seller behaved honestly and did not voluntarily breach her promise (high integrity), but that she was nevertheless overoptimistic and prone to bite off more than she could chew (low capacity). In that case, even though litigation cleared suspicions about the promisor's integrity, outside observers will still think twice before contracting with her. Alternatively, outside observers may infer from litigation that the seller has all the necessary technological skills (high capacity), but that she is prone to opportunistically look for better options and renege on her commitments (low integrity). In that case, too, buyers may think twice before contracting with the seller.

For our purposes, we can treat all these facets together as speaking to the seller's investment in quality controls: whether she develops excess capacity, hires and trains skilled employees, learns to realistically calculate her capabilities, and so on. If outside observers discern from litigation that the seller fails to invest in such quality controls, they will infer that she is prone to overpromise and underdeliver. And it will matter less whether outside observers think that the seller failed to invest by disposition or by choice.[118]

We can now revisit the fundamental question: What explains the difference between contracts and torts? From an information-production perspective, the difference can be summed up in one word: benchmarking. In torts, strict liability is not informative enough because outside observers do not have a benchmark against which to assess the injurer's quality. Potential patients cannot infer from the fact that a given surgery failed that they should avoid that surgeon going forward. Rather, they need more information to assess the behavior of this specific surgeon against that of other potential surgeons. Did the surgeon take the precautionary measures that are common in such medical procedures? If she did not, you may want to avoid her. If she did, there is no reason to switch to other surgeons. Tort litigation under strict liability does not provide such a benchmark, whereas tort litigation under negligence does.

In contracts, by contrast, outside observers have a clear benchmark against which they can assess the parties' behavior: The parties themselves provided said benchmark when they agreed to deliver a specified good on a given date.[119] Knowing just the basic details of what happened—that the promisor did not deliver—can be very informative, as it tells outside observers something about the promisor's propensity to keep promises. In this way, strict contract liability assesses the "reasonableness" of how parties set benchmarks for themselves and others (put differently: how they design a contract). Contract litigation under strict liability provides such valuable information,

118. Bar-Gill & Ben-Shahar, *supra* note 117, at 1491.

119. We focused here on how litigation provides a benchmark for nonparties to help them make better reputation judgments. But one could also couch the dynamics in a slightly different way, such that contract litigation under strict liability is a referendum on the parties' ability to set proper benchmarks for themselves (at the contracting stage).

even without probing the level of care that contractual parties took when performing the contract. In fact, precisely because contract liability does not probe fault in performing contracts, it incentivizes parties to come forward (litigate) and produce information on their counterparties' propensity to overpromise. A negligence rule would *dis*incentivize the production of such information because promisees would not bother litigating cases where the promisors misbehaved at the contracting stage (overpromised) yet exerted reasonable efforts at the performance stage (took due care).

Our information-production perspective thus provides an efficiency-based rationale for the different ways in which torts and contracts employ fault.[120] Negligence-based investigations come with increased administrative costs relative to a strict liability regime. At the same time, negligence-based investigations may generate more granular information about market actors. In disputes over sales of goods, the added informational benefit of negligence-based investigations is small at best (sometimes negative), and so there is no justification to incur their higher administrative costs. In disputes over torts between strangers or professional malpractice, the added informational benefits of fault-based investigations are pronounced and often outweigh the higher administrative costs.

* * *

Looking at private law through this information-production lens clarifies the functionality of doctrines that were long considered intractable or puzzling.

Take for example the right of victims of breach to sue for nominal damages.[121] A victim of a breach who did not suffer damages can nevertheless litigate her case all the way to the ruling, in order to have the court declare that breach occurred.[122] In torts, by contrast, an injured party that cannot show damages will not get past the motion to dismiss.[123] Judges and academics

120. As will become clearer, see *infra* Part III (analyzing on-the-ground applications of contract law doctrine), our theory does not depend on judges making fully conscious, meditated decisions to design contract law in ways that maximize information production. Other "design forces" (aside from judges' conscious decision-making) could push private law into information production, such as market forces, selection of disputes to trials, and trial strategy once a dispute reaches trial. For example, if the parties anticipate that a certain type of discovery or certain judicial ruling could affect their reputations, they will change their legal strategies accordingly, to achieve (or avoid) such reputation-through-litigation effect. And as will become clearer, see *infra* Part IV (examining policy implications), sometimes the parties' choices will not reflect the social optimum. For example, sometimes parties will prefer to keep quality information on their past dispute secret, even when such information could benefit the market.

121. Uzuegbunam v. Preczewski, 141 S. Ct. 792, 801–02 (2021).

122. *Id.* at 798.

123. Yehuda Adar & Ronen Perry, *Negligence Without Harm*, 111 GEO. L.J. 187, 188 (2022) ("The harm requirement is one of the most fundamental tenets of negligence law: the tort is incomplete and there can be no legal redress without proof of actual damage."). Our focus here is on negligence; there are, to be sure, other torts that do not require a showing of harm.

alike have long questioned the logic behind this doctrine: Why spend the judicial system's scarce resources on private law litigation that leaves the parties exactly like they entered it?[124] The information-production perspective provides a ready-made answer: Having the court declare what happened in a given contractual dispute can help outside observers decide whether they want to contract with the disputants going forward. Spending the judicial system's resources on such cases can therefore be justified not only for making the aggrieved party feel vindicated in some abstract sense, but also for producing information that generates reputational deterrence.[125]

Indeed, a nineteenth-century common law precedent that the Supreme Court recently relied on—*Marzetti v. Williams*—is a case about reputational fallouts.[126] The plaintiff there sued his bank for bouncing his check even though he had a large cash balance. The court allowed the case to proceed and ruled on the merits, reasoning that it is important to settle such issues even when damages are nominal, in order to protect the plaintiff's reputation for creditworthiness and character.[127]

2. When Strict Contract Liability Is Less Informative than Negligence

Contract law approaches liability in sales-of-goods contracts or debt contracts differently than it does in professional service contracts. While the former adheres to a strict liability standard, the latter relies on fault-based determinations. Courts often find that a fault standard is an implied term in contracts with experts such as lawyers or physicians.[128] The reasoning is that lawyers or physicians cannot guarantee results, and so we should assess their contractual behavior based on the process and the effort they exerted (due care).[129] When they do not rely on the "implied term" technique, courts note that a breach of a professional services contract raises a concurrent tort of negligence, and opt to adjudicate the dispute under said tort regime.[130] Whichever doctrinal hook they use, courts clearly gravitate to fault-based determinations in such contracts.

Treating these types of contracts differently makes perfect sense from our information-production, "benchmarking" perspective. Legal and medical services are what economists call a "credence good," meaning that those who

124. *See, e.g.*, Chronister Oil v. Unocal Refin. & Mktg., 34 F.3d 462, 466 (7th Cir. 1994).

125. *See* Sadie Blanchard, *Nominal Damages as Vindication*, 30 GEO. MASON L. REV. 227, 250–66 (2022).

126. *See* Marzetti v. Williams (1830) 109 Eng. Rep. 842, 845 (KB). The Supreme Court cited *Marzetti* in *Uzuegbunam v. Preczewski*, 141 S. Ct. 792, 798, 799 (2021). *See also id.* at 806 (Roberts, C.J., dissenting) (same).

127. *Marzetti*, 109 Eng. Rep. at 844–45.

128. Cohen, *supra* note 81, at 1450.

129. *Id.* at 1450–51.

130. Patricia M. Danzon, *Liability for Medical Malpractice*, *in* HANDBOOK OF HEALTH ECONOMICS 1339, 1343–45 (Anthony J. Culyer & Joseph P. Newhouse eds., 2000).

purchase it cannot readily assess the quality of what they paid for.[131] For outside observers, it is even more difficult to judge the capacity and integrity of experts based on their past observable behavior. What is observable from the outside is the final outcome: Did the lawyer win the case? Was the surgery successful? But outcomes are not very informative in these contracts. A litigator may have done a fantastic job, yet the judge decided against her for various other reasons that have nothing to do with the quality of lawyering. To make an informed judgment about whether to hire that lawyer, outside observers need a benchmark against which to measure the lawyer's past behavior. This is where professional malpractice litigation comes in.

Professional malpractice litigation extracts information about the level of effort and care that the professional undertook, to which market players were otherwise not privy. Further, courts usually assess expert behavior by judging it against the benchmark of "common practice," that is, how others in the industry behave.[132] As a result, outside observers may infer from a finding of liability that the performance of the physician or lawyer in question falls below industry standards. In these contracts, fault-based liability is therefore much more informative than strict liability would have been.

There is a broader point at issue here, regarding the difference between contractual commitments to produce results and contractual commitments to exert efforts. For outside observers, observing the results of past contracts is much easier than observing the level of effort exerted in past contracts. Accordingly, it makes sense for the legal system to adjudicate results-based commitments under strict liability (telling outside observers what happened), and efforts-based commitments under a negligence rule (telling outside observers not just what happened but also why and how things happened).[133]

Relatedly, the information-production perspective explains why the approach to liability in the precontractual stage is fault-based and not strict.[134] In the precontractual stage, the parties have not yet agreed on a benchmark against which their behavior can be measured. Accordingly, telling observers *what* happened—telling them that the defendant did not want to enter a contract with the plaintiff—is not very informative. What outside observers need to know in such circumstances is how and why the negotiations broke down. If the reason that the parties could not reach an agreement is because actor X behaved opportunistically and wasted actor Y's time, outside observers

131. Gillian K. Hadfield & Deborah L. Rhode, *How to Regulate Legal Services to Promote Access, Innovation, and the Quality of Lawyering*, 67 HASTINGS L.J. 1191, 1196 (2016).

132. Parchomovsky & Stein, *supra* note 24, at 290–91.

133. *See* E. Allan Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1, 9 (1984).

134. Kimberly D. Krawiec & Kathryn Zeiler, *Common-Law Disclosure Duties and the Sin of Omission: Testing the Meta-Theories*, 91 VA. L. REV. 1795, 1865 (2005) (providing empirical evidence); IAN AYRES & GREGORY KLASS, INSINCERE PROMISES 139 (2005).

will want to learn about it so that they can avoid entering negotiations with actor X going forward.

Litigation over precontractual disputes indeed produces such granular information. It heavily emphasizes intentionality. When the plaintiff claims that the defendant misled her regarding his intention to contract, she needs to marshal evidence suggesting that the defendant did so intentionally or at least negligently.[135] Similarly, when the plaintiff claims that the defendant withheld key pieces of information from her, the court will focus on whether the alleged failure to disclose reflects intention to deceive or at least careless disregard.[136] Innocent failures to disclose are usually not actionable.[137] The courts' focus on intentionality helps outside observers decide whether the defendant's past behavior is indicative of her future behavior.[138]

The above examples also illustrate the boundaries of our efficiency-based rationale for strict contract liability. Strict liability is not optimal across the full spectrum of contracts, just as no other single rule can be.[139] To generalize, strict liability provides useful information in sales of goods or debt contracts, where the dimensions of performance are usually detailed and easy to understand, and outside observers can presume that the promisor took upon herself the risk of changing circumstances.[140] Strict liability is less informative in other contexts, such as contracts for professional services. In these other contexts, the information-production perspective calls for introducing fault-based investigations. The next Part delves more deeply into the various instances in which contract law does just that.

135. AYRES & KLASS, *supra* note 134, at 139.

136. *See, e.g.*, Raritan River Steel Co. v. Cherry, Bekaert & Holland, 367 S.E.2d 609, 612 (N.C. 1988) ("The tort of negligent misrepresentation occurs when a party justifiably relies to his detriment on information prepared without reasonable care by one who owed the relying party a duty of care."); First Interstate Bank of Gallup v. Foutz, 764 P.2d 1307, 1315 (N.M. 1988). When intention to deceive is apparent, the courts often employ the common law tort of fraudulent disclosure. *See, e.g.*, Affiliated Cap. Servs. Corp. v. W. Atl. City Assocs., 760 F. Supp. 1067, 1073 (W.D.N.Y. 1991); Stephenson v. Capano Dev., Inc., 462 A.2d 1069, 1074 (Del. 1983).

137. *See, e.g.*, Shore Builders, Inc. v. Dogwood, Inc., 616 F. Supp. 1004, 1012 (D. Del. 1985). *But see* Frona M. Powell, *Relief for Innocent Misrepresentation: A Retreat from the Traditional Doctrine of Caveat Emptor*, 19 REAL EST. L.J. 130, 130 (1990) (noting a trend "toward placing the burden on the vendors to verify their facts before making representations"). Courts do impose liability for innocent failures to disclose in situations where one side owes special heightened duties to the other, as in a fiduciary relationship. *See, e.g.*, Keller v. A.O. Smith Harvestore Prods., Inc., 819 P.2d 69, 72–73 (Colo. 1991).

138. Intentionality and controllability are considered key determinants of the "attribution" stage in reputational sanctioning. *See infra* Section III.A.

139. Epstein, *supra* note 33, at 1462 (noting that "enforceable agreements [are a] highly heterogeneous" category).

140. *Cf.* Cohen, *supra* note 81, at 1460 (describing how debt contracts and contracts for the sale of goods allocate risks).

III. POCKETS OF FAULT IN CONTRACT LAW

While strict liability can produce reputation-relevant information in some types of contractual disputes, it is not likely to be informative in all circumstances, and so there will be reason to introduce fault-based investigations. This Part analyzes various doctrines in contract law to show how they are effectively structured in a manner that leads to valuable information-production. Section III.A focuses on rules of interpretation, providing explanations for two time-honored puzzles, namely, why courts regularly interpret "best efforts" clauses objectively, and why they "invert the hierarchy" of gap filling. Section III.B resolves some of the perceived ambiguity of excuse doctrines. Section III.C highlights the information-production effects of remedies doctrines: from supracompensatory damages, to liquidated damages, to nominal damages. In the process, we explore how contract litigation affects not just the reputation of defendants (promisors) but also that of plaintiffs (promisees).

A. INTERPRETATION

Contractual parties sometimes decide to incorporate clauses that set a fault-based standard for assessing liability. This is the case with "best efforts" and "good faith" clauses, which frame the parties' contractual obligations as efforts-based rather than results-based. When disputes arise in such contracts, courts are often called on to assess the quality of efforts ex post.[141] Courts can assess efforts in two ways, namely, subjectively and objectively. The subjective method examines whether the promisor tried *her* best.[142] The objective method compares the promisor's behavior to that of an "average, prudent, comparable" contractual party in similar circumstances.[143]

It is seemingly more intuitive to interpret parties' agreement to exert "best efforts" subjectively. If the promisor gave it all she could, a layman would probably say that she did not breach her efforts-based commitment. Yet, in practice, courts regularly rely on objective assessments: Promisors whose subjective best efforts fell below objective industry standards can be found liable.[144] This practice has drawn much criticism from contract law scholars, who note that it is both unjust and inefficient to assess the efforts of one market actor relative to the ability of others.[145] Why, they ask, should courts judge

141. *See id.* at 1450.

142. McDonald's Corp. v. Hinksman, No. 92-cv-3187, 1999 WL 441468, at *12 (E.D.N.Y. May 28, 1999).

143. *Id.*; Herrmann Holdings Ltd. v. Lucent Techs. Inc., 302 F.3d 552, 559 (5th Cir. 2002) (quoting CKB & Assocs. v. Moore McCormack Petrol., Inc., 809 S.W.2d 577, 581–82 (Tex. App. 1991)).

144. *See, e.g.*, Kevin M. Ehringer Enters. v. McData Servs. Corp., 646 F.3d 321, 326–27 (5th Cir. 2011); Farnsworth, *supra* note 133, at 9–10.

145. *See, e.g.*, Omri Ben-Shahar & Ariel Porat, *Personalizing Negligence Law*, 91 N.Y.U. L. REV. 627, 637–41 (2016).

someone who has limited cognitive, physical, or technical capacity according to standards that are not realistic for her to achieve even at her best?[146]

By approaching this question from an information-production perspective, we can offer a straightforward answer: Assessing efforts objectively enhances the accuracy of reputation markets by providing outside observers with a benchmark. When the contractual commitment is to follow a certain process (efforts) rather than deliver a certain outcome, it becomes harder for outside observers to assess whether past disputes are indicative of the disputants' future behavior. Litigation helps third parties by providing a benchmark against which to measure the parties' efforts. If the courts rely solely on a subjective benchmark (whereby the promisor's efforts in a particular case are measured against her best efforts), litigation will produce information about the promisor's integrity, but not about her competence.[147] By contrast, when the courts introduce objective aspects, litigation will produce information on both integrity and competence, which will in turn allow third parties to more holistically assess the promisor's reputation. Put differently, a subjective interpretation tells outside observers whether the promisor is a good person in general, whereas an objective interpretation tells outside observers whether the promisor is a good contractual partner relative to others. The latter is more reputation-relevant than the former.

Another interpretation technique that introduces fault-based investigations is gap filling. Contracts contain gaps, in that the parties usually do not explicitly allocate all risks.[148] When disputes arise about remote risks, courts need to decide how to fill those gaps. The specific method that courts choose affects the quantity and quality of information that is being produced. Some gap-filling methods are more reputation-relevant than others. For example, filling gaps based on the prevalent industry standard is especially helpful for outside observers, as it directly benchmarks the contractual behavior of the parties against the behavior of similar buyers and sellers.

Looking at gap-filling practices from an information-production perspective helps us clarify the "inverted hierarchy" puzzle of contract interpretation and supplementation. In traditional accounts, contract interpretation is conceptualized as a multistage, hierarchal process that starts with the subjective and moves on down to the objective.[149] That is, courts supposedly start by examining the subjective intent of the parties in question, and only if subjective intent cannot clarify the meaning of the contract do

146. *Id.*

147. If the promisee knows that best efforts are being measured subjectively, she will not bother to extract information on how that promisor fares relative to others in the market (and may not litigate to begin with).

148. COOTER & ULEN, *supra* note 3, at 349.

149. Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1712 (1997).

courts move to consider objective elements such as trade usage.[150] In practice, however, this purported interpretive hierarchy is regularly inverted, with courts relying on trade usage instead of attempting to ascertain subjective intent.[151] It is hard to reconcile this reality of an inverted hierarchy with basic notions of freedom of contract, which militate toward prioritizing subjective gap filling.[152]

It is easy to reconcile the inverted hierarchy with an information-production perspective. When courts emphasize objective elements such as trade usage, litigation produces information on whether the specific parties in question performed at, above, or below the industry benchmark. Such information in turn provides outside observers with a clear benchmark against which to assess the disputants' competence and integrity and decide whether to do business with them going forward.

B. Excuses

After the parties make legally binding promises, dire circumstances may arise and put into question the parties' ability and desire to perform. Sometimes the parties include "force majeure" clauses in their contracts, addressing what happens if such unexpected circumstances arise. Other times the parties do not address these situations ex ante, and the courts employ a set of somewhat overlapping doctrines to decide ex post whether to excuse nonperformance: from impossibility to impracticability to frustration of purpose.[153]

Contract scholars have long decried excuse doctrines as "the most intractable problems in contract law."[154] But our information-production perspective helps resolve the perceived ambiguity in these doctrines and

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150. *Id.* at 1712–13.

151. *Id.* at 1713–14, 1719.

152. *Id.* at 1768–69.

153. *See, e.g.*, RESTATEMENT (SECOND) OF CONTS. § 261 (AM. L. INST. 1981). The doctrine of impossibility deals with situations where a contingency arises that makes the contractual promise physically impossible to perform. *Id.* § 261 cmt. a. Impracticability deals with situations where performance may be physically possible, but the changing circumstances render it much more burdensome than initially anticipated. *Id.* § 261 cmt. d. Frustration of purpose operates similarly to impracticability, with an emphasis on situations where the changed circumstances render performance by one party worthless to the other. *Id.* § 265 cmt. a. There also exist doctrines that deal with dire circumstances that preceded the promise, such as "duress" and "necessity," but they are not our focus here. We focus only on performance excuses, where the parties concede that they made a legally binding promise.

154. Melvin A. Eisenberg, *Impossibility, Impracticability, and Frustration*, 1 J. LEGAL ANALYSIS 207, 208 (2009); *see also* Yehonatan Givati, Yotam Kaplan & Yair Listokin, *Excuse 2.0*, CORNELL L. REV. (forthcoming) (manuscript at 3, 9 n.37), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4466317# [https://perma.cc/Y7WV-TBPX] (compiling quotes from contract law luminaries).

clarify their functionality.[155] The existing literature finds excuse doctrines intractable because it focuses on the circumstances: how dire and unexpected these circumstances were. Accordingly, existing scholarship has a hard time explaining why we regularly observe courts refusing to grant excuses in very dire circumstances while granting excuses in less-dire circumstances.[156] It is better to view excuse doctrines as focusing on the parties' behavior, examining how they prepared for and reacted to given circumstances. When the parties invested in redundancy and backup plans ex ante and tried to "fight back" and perform in the face of adversity ex post, the courts tend to grant excuses. By contrast, when the parties were ill prepared ex ante and were quick on the trigger to invoke excuses ex post, the courts tend to refuse excuses.[157]

From an information-production perspective, emphasizing the parties' preparedness and flexibility instead of the circumstances makes perfect sense. After all, outside observers are less interested in learning about unexpected circumstances in a given case. Experienced market players realize that bad luck happens, and that they can expect different unexpected circumstances to arise in their own dealings. As outside observers, they are instead interested in learning whether a potential contractual partner invests in affecting her own luck, by having a ready-to-execute backup plan.

To illustrate, let us start with disputes where the contract included a "force majeure" clause. Such disputes usually reach the courtroom because the promisee believes that the promisor invoked excuses opportunistically, or because the promisor believes that the promisee refused excuses rigidly.

In some of these cases, litigation vindicates the promisor's reputation against the accusation of opportunism. Consider, for example, *Ergon-West Virginia, Inc. v. Dynegy Marketing & Trade*.[158] Dynegy was under contract to supply natural gas to Ergon.[159] Then, hurricanes Katrina and Rita happened, wreaking havoc on the gas industry's infrastructure.[160] Dynegy invoked the force majeure clause to excuse performance.[161] Ergon sued in court, claiming that Dynegy did not meet the clause's stipulation that parties must "remed[y] with all reasonable dispatch" contingencies that arise.[162] In other words, Ergon was claiming that Dynegy failed to exert reasonable efforts to

155. For a nonmutually exclusive attempt at an organizing framework for excuse doctrines, see generally Givati et al., *supra* note 154, which discusses how indeterminacy makes excuse doctrines suitable for dealing with macroeconomic shocks.

156. The classic example is the Suez Canal case, where the fact that war broke out was deemed insufficient to grant excuses. Transatlantic Fin. Corp. v. United States, 363 F.2d 312, 319–20 (D.C. Cir. 1966).

157. Hein v. Fox, 254 P.2d 1076, 1078 (Mont. 1953); Chemetron Corp. v. McLouth Steel Corp., 381 F. Supp. 245, 249–50 (N.D. Ill. 1974).

158. Ergon-West Va., Inc. v. Dynegy Mktg. & Trade, 706 F.3d 419, 419 (5th Cir. 2013).

159. *Id.* at 422.

160. *Id.*

161. *Id.*

162. *Id.*

accommodate the needs of its contractual partner. The court excused Dynegy because its own upstream suppliers declared force majeure in their contracts with Dynegy.[163] The court cited expert testimony showing that in the natural gas industry, it is common practice for sellers to "pass on" invoking force majeure when their own suppliers do the same to them.[164] From our perspective, the upshot of the court's opinion is that Dynegy's reputation will likely suffer no harm. Natural gas buyers have no reason to switch from Dynegy to its competitors, because the court just told them that Dynegy behaved in line with industry norms. There also exist many examples of the converse, namely, litigation suggesting that the promisor opportunistically invoked excuses.[165]

In other cases, litigation produces damning information on a promisee that rigidly refuses to excuse the promisor. COVID provided many such examples.[166] In *UMNV 205–207 Newbury, LLC v. Caffé Nero Americas Inc.*,[167] a café located in Boston's high-end Newbury Street asked to be excused from paying rent during the first wave of lockdowns. The landlord refused, pointing to a contract provision stipulating that tenants must pay the rent in all circumstances and without defenses.[168] The court excused the café, criticizing the landlord for rigidly sticking to the contract language when it was clear that the purpose of the contract was frustrated by the lockdown.[169] Local Boston media outlets covered the case extensively and highlighted the court's criticism of the landlord. The media described the decision as "a warning to landlords that they should consider working with struggling tenants during the pandemic, instead of aggressively filing lawsuits against

163. *Id.* at 425.

164. *Id.* at 423, 425.

165. *See, e.g.*, Lorraine Mirabella, *California Court Rejects Under Armour Effort to Dismiss UCLA Lawsuit Against Baltimore Brand*, BALT. SUN (Aug. 26, 2021, 5:48 PM), https://www.baltimoresun.com/business/bs-bz-judge-rejects-under-armour-request-dismiss-ucla-lawsuit-20210826-hsk3tfvjyvcshpfjtphja7cx6y-story.html [https://perma.cc/5UDJ-KUBS] (covering a dispute between Under Armour and UCLA, where the former backed out of a sponsorship agreement citing COVID as force majeure); Minute Order at 1–5, Regents of the Univ. of Cal. v. Under Armour, Inc., No. 20smcv01205 (Cal. Super. Ct. Aug. 26, 2021), 2021 Cal. Super. LEXIS 100673, at *1–9 (rejecting Under Armour's motion to dismiss UCLA's lawsuit); Brian Planalp, *Plaintiffs Land Key Victory in Suit Against Kings Island Owner over 2020 Season Passes*, FOX19 (Apr. 21, 2022, 8:50 PM), https://www.fox19.com/2022/04/22/plaintiffs-land-key-victory-suit-against-kings-island-owner-over-2020-season-passes [https://perma.cc/EK8V-GY8S] (covering a dispute between an amusement park and season passholders, where the former refused to refund the latter despite park closures during the pandemic); Walker v. Cedar Fair, L.P., No. 21-cv-2176, 2022 WL 1186701, at *1–4 (N.D. Ohio Apr. 21, 2022) (rejecting the amusement park's claim and criticizing its behavior).

166. *See generally* Givati et al., *supra* note 154 (providing many examples of COVID-related excuses).

167. UMNV 205–207 Newbury, LLC v. Caffé Nero Ams. Inc., No. 2084cv01493, 2021 WL 956069, at *2 (Mass. Super. Ct. Feb. 8, 2021).

168. *Id.*

169. *Id.* at *5–6.

them."[170] The media further emphasized that the coffeeshop chain (Nero) did not have such problems with the many other landlords it was working with, and that the landlord (Urban Meritage), a prominent repeat player owning many storefronts in the area, had a long history of lease disputes.[171] Consequently, other Boston store owners are likely to think twice before entering a contract or agreeing to certain provisions when contracting with Urban Meritage.

Next, consider cases where the contract does not contain a force majeure clause. In these cases, the courts' decision to excuse performance comes down to questions such as whether the contingency makes performance impossible or just challenging, whether the contingency destroys a basic assumption in the contract or just touches an auxiliary aspect, and whether frustration was self-induced.[172] Naturally, the courts have wide discretion in how they answer such questions. A deep dive into case law reveals that courts exercise their discretion by emphasizing two factors, namely, foreseeability and controllability.[173]

To illustrate, consider the classic case of *Krell v. Henry*, about a contract to rent an apartment to view the coronation procession of King Edward VII.[174] When the King fell ill and the procession was canceled, the court excused performance. The *Krell* opinion illustrates both foreseeability and controllability: Neither party could have foreseen the contingency of the procession being canceled, and neither party could have done anything to prevent the King from falling ill in order to change the decision to cancel the procession.[175] By contrast, in cases where the promisor manipulated the circumstances to render performance impractical, the courts refused to grant excuses.[176]

The emphasis on foreseeability and controllability maps nicely to reputational theory. Recall that reputation hinges on attribution: The size of

170. Christopher R. Vaccaro, *Opinion: Superior Court Throws a Brushback Pitch at Landlords*, BOS. BUS. J. (Mar. 18, 2021), https://www.bizjournals.com/boston/news/2021/03/18/chris-vaccaro-opinion-superior-court-throws-a-bru.html (on file with the *Iowa Law Review*).

171. Tim Logan & Janelle Nanos, *Judge Rules Restaurant Can't Be Forced to Pay Rent for the Months It Was Ordered Closed During Pandemic*, BOS. GLOBE (Feb. 12, 2021, 12:54 AM), https://www.bostonglobe.com/2021/02/11/business/judge-rules-restaurant-cant-be-forced-pay-rent-months-it-was-ordered-closed-during-pandemic [https://perma.cc/MAB5-8Q7D].

172. *See generally* RESTATEMENT (SECOND) OF CONTS., ch. 11 (AM. L. INST. 1981) (outlining circumstances where "justice requires a departure from the general rule that the obligor bear the risk that the contract may become more burdensome or less desirable").

173. *See generally* Givati et al., *supra* note 154 (highlighting cases that invoke the excuse doctrine during economic crises).

174. Krell v. Henry, [1903] KB 740, 740–41 (Eng.).

175. *Id.* at 750–53.

176. RESTATEMENT (SECOND) OF CONTS. §§ 261–263 (AM. L. INST. 1981) (noting that courts tend to grant excuses when the events are clearly beyond the control of the promisor, such as when the promisor died or when an intervening event destroyed the good); ANDREW BURROWS, A RESTATEMENT OF THE ENGLISH LAW OF CONTRACT 26 (2016) (noting that in common law, contracts are not considered frustrated if frustration is self-induced).

the sanction is a function of the extent to which outside observers attribute past problems to deep-seated issues that are likely to resurface in the future.[177] Pertinently here, the attribution literature identifies controllability and foreseeability as two key determinants of attribution.[178] The more outside observers perceive a reported misbehavior as foreseeable and controllable, the more they will update downward their evaluation of the party in question, resulting in a bigger reputational sanction.[179] And so when a court excuses the promisor, outside observers can infer that whatever went wrong in this past dispute is not indicative of how that promisor will behave in future contracts (no reputational sanction).[180] For concreteness, let us illustrate with several real-world cases.

Some excuse cases implicate the promisor's lack of preparedness and low "capacity." For example, *Chemetron Corp. v. McLouth Steel Corp.* revolved around an agreement to sell large amounts of liquid oxygen monthly.[181] The defendant failed to deliver the promised amounts and argued that a series of explosions in its compressor rendered performance impossible.[182] The court rejected the impossibility claim, attributing the failure to deliver to maintenance problems and to the fact that the defendant previously put several of its production machines out of use, thereby eliminating much-needed redundancy.[183] Similarly, in *Jennie-O Foods, Inc. v. United States,* a supplier of processed turkeys argued that turkey diseases reached epidemic proportions, rendering performance impossible.[184] The court rejected the claim, attributing the production time problems to the supplier's own problematic facilities, supply management issues, and poor allocation decisions.[185]

Other cases produce information on the promisor's lack of flexibility and willingness to fight through circumstances. *Hein v. Fox*, for example, revolved around an agreement to drill a well. The defendant wanted to be released from the contract, given that a layer of solid rock made it impracticable to drill in the agreed-upon spot.[186] The court rejected the claim, reasoning that the plaintiff did not try to overcome the hardship, for example, by securing better drilling equipment.[187]

177. *See supra* Section I.A.2.

178. *See* A. Rebecca Reuber & Eileen Fischer, *Organizations Behaving Badly: When Are Discreditable Actions Likely to Damage Organizational Reputation?*, 93 J. BUS. ETHICS 39, 42–43 (2010).

179. SHAPIRA, *supra* note 53, at 47–57.

180. *Ex ante*, promisees will not bother to litigate claims of breach when it is clear that the promisor "breached" only due to unforeseeable events beyond her control.

181. Chemetron Corp. v. McLouth Steel Corp., 381 F. Supp. 245, 249 (N.D. Ill. 1974).

182. *Id.* at 256.

183. *Id.* at 256.

184. Jennie-O Foods, Inc. v. United States, 580 F.2d 400, 403 (Ct. Cl. 1978).

185. *Id.* at 411–12.

186. Hein v. Fox, 254 P.2d 1076, 1078 (Mont. 1953).

187. *Id.* at 1079.

These cases illustrate how the courts apply excuse doctrines in ways that incentivize information production. The doctrine incentivizes promisees to challenge excuses by proving foreseeability and controllability on the part of promisors. It also incentivizes promisors to marshal information on the abnormal rigidness of promisees. Both types of information help outside observers decide whether they want to do business with the disputants going forward.

This information-production reading of excuses does a better job than the prevalent "moralistic" account. According to the moralistic account, excuse doctrines function to identify contingencies that make it not immoral to breach one's promises.[188] But such an account cannot explain why courts regularly refuse to grant excuses "if a performance remains practicable and is merely beyond a *particular party's* capacity to render it."[189] It strains logic and our sense of fairness to suggest that if someone does her absolute best and falls short, she behaved immorally. It makes more sense to view such a doctrine as serving a function of warning the market against actors who cannot be trusted to deal with the unexpected, whether by disposition or by choice.

C. Remedies

Even when liability for breach is strict, remedies doctrines may introduce incentives for each party to extract granular information on how the other party behaved and provide opportunities for judges to voice their opinions on the parties' conduct. This Section examines the three examples of supracompensatory damages, liquidated damages, and nominal damages. The Section then highlights the related topic of how information from litigation affects the plaintiff's (promisee's) reputation.

Supracompensatory Damages. Doctrines such as willful breach give plaintiffs an opportunity to receive higher damages, if plaintiffs can marshal evidence on *how* the defendants breached. On paper, intent to breach is irrelevant in contract law.[190] In reality, however, courts often award different types of damages based on the level of the willfulness of the breach, such as awarding expectation damages or disgorgement when the breach is willful, and awarding "only" reliance damages when the breach is inadvertent.[191] Courts may also choose higher measures of expectation damages when they consider the breach to be willful.[192] Anticipating that proving willfulness will be their

188. *See, e.g.*, Hanoch Dagan & Ohad Somech, *When Contract's Basic Assumptions Fail*, 34 CANADIAN J.L. & JURIS. 297, 301 (2021).

189. Luber v. Luber, 614 A.2d 771, 774 (Pa. Super. Ct. 1992) (emphasis added); 9795 Perry Highway Mgmt., LLC v. Bernard, 273 A.3d 1098, 1104 (Pa. Super. Ct. 2022) (quoting *Luber*, 614 A.2d at 774).

190. RESTATEMENT (SECOND) OF CONTS. ch. 16, intro. note (AM. L. INST. 1981) (declaring that "'[w]illful' breaches have not been distinguished from other breaches").

191. Bar-Gill & Ben-Shahar, *supra* note 117, at 1498–99 (compiling references); Posner, *Fault in Contract Law*, *supra* note 8, at 1442 (compiling references).

192. Bar-Gill & Ben-Shahar, *supra* note 117, at 1495 (compiling real-world examples).

gateway to higher awards, plaintiffs are incentivized to extract information on what defendants knew, when they knew it, and why they did not stop the breach when they could have. Such information, in turn, could make outside observers reassess their willingness to do business with the defendant.

To illustrate, consider the case of grocery wholesaler Fleming. When supermarkets sued Fleming for overcharging (for toying with the "percentage over costs" formula) and won, the New York Times highlighted to its readers the fact that a large part of the award was punitive, and told them that it signals just how fraudulent the wholesaler's behavior was.[193] Similar dynamics were in play when a small independent record label won its case against hip-hop icon label Def Jam. The Times coverage highlighted how the large "penalty damages" ($132 million) signify just how bad Def Jam's business practices were.[194]

Oren Bar-Gill and Omri Ben-Shahar provided an account of willful breach that is a close cousin to ours.[195] They, too, emphasize the information-production aspect, rather than the mental state: Discovering that the breach was willful tells us something about the promisor's underlying tendencies to behave opportunistically.[196] The difference between their account and ours is that theirs is backward looking while ours is forward looking. For them, awarding higher damages for willful breaches serves to punish the promisor and compensate the promisee for all the previous times that the promisor behaved badly toward the same aggrieved party but was not detected.[197] For us, the increased damages serve a reputational function: They incentivize the promisee to marshal information about the bad behavior of the promisor, which in turn serves to warn third parties against doing business with the promisor going forward.

Liquidated Damages. Contractual parties sometimes stipulate in advance a sum of money to be paid once a breach has occurred. The courts' approach to such liquidated damages clauses has long puzzled contract law scholars. One part of the puzzle is that courts seem to scrutinize liquidated damages clauses more closely than they do for any other type of contractual provision.[198] For law-and-economics scholars, this hostility toward liquidated damages

193. Bloomberg Bus. News, *Company News; Shares of Fleming Fall 10% on Decision in Fraud Case*, N.Y. TIMES (Mar. 19, 1996), https://www.nytimes.com/1996/03/19/business/company-news-shares-of-fleming-fall-10-on-decision-in-fraud-case.html (on file with the *Iowa Law Review*).

194. Lynette Holloway, *The Media Business; Record Label and Its Chief Told to Pay $132 Million*, N.Y. TIMES (May 7, 2003), https://www.nytimes.com/2003/05/07/business/the-media-business-record-label-and-its-chief-told-to-pay-132-million.html (on file with the *Iowa Law Review*).

195. *See generally* Bar-Gill & Ben-Shahar, *supra* note 117 (explaining a law-and-economics account of willful breach).

196. *See id.* at 1485.

197. *Id.* at 1483, 1492.

198. COOTER & ULEN, *supra* note 3, at 321; Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 554 (1977).

cannot be justified on efficiency grounds, since these clauses save litigation costs and reduce uncertainty.[199]

Our information-production perspective clarifies a hitherto ignored efficiency basis for scrutinizing liquidated damages clauses. The key, as Saul Levmore observed, is to understand that liquidated damages create a regime akin to "super-strict liability."[200] By agreeing to liquidated damages, the parties essentially agree to avoid any probing after the fact into how they behaved. Specifically, liquidated damages remove the need to inquire into whether the promisee was at fault for not mitigating the harms caused by the breach.[201] Accordingly, it is true that liquidated damages reduce the administrative costs of litigation, but at the same time they reduce litigation's informational benefits.[202]

Another part of the puzzle concerns when and why courts nevertheless uphold liquidated damages clauses. Conventional wisdom suggests that the main criterion that dictates whether to interfere is the size of the gap between the actual losses and the stipulated damages.[203] Yet in practice courts regularly intervene even when the gap is small, and refrain from intervening even when the gap is large.[204] This has led scholars to decry liquidated damages doctrine as highly intractable.[205] Our information-production perspective can help clarify the internal logic in how courts apply it. It seems that instead of focusing on the reasonableness of the stipulated damages, the courts rather focus on the reasonableness of the promisor's behavior. And by focusing on promisors' fault, the courts generate reputation-relevant information.

199. Ariel Porat, *Economics of Remedies*, *in* THE OXFORD HANDBOOK OF LAW AND ECONOMICS: PRIVATE AND COMMERCIAL LAW 308, 325–26 (Francesco Parisi ed., 2017); *see* Richard A. Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 290 (1979).

200. Saul Levmore, *Stipulated Damages, Super-Strict Liability, and Mitigation in Contract Law*, 107 MICH. L. REV. 1365, 1367 (2009).

201. *Id.* at 1371.

202. Whether the savings outweigh the loss is an empirical, context-specific question that we cannot answer in full here.

203. Goetz & Scott, *supra* note 198, at 554 ("For an executory agreement fixing damages in case of breach to be enforceable, it must constitute a reasonable forecast of the provable injury resulting from the breach; otherwise, the clause will be unenforceable as a penalty . . . .").

204. *See, e.g.*, David H. Vernon, *Expectancy Damages for Breach of Contract: A Primer and Critique*, 1976 WASH. U. L.Q. 179, 235–37.

205. On the perceived intractability of the doctrine, see, for example, *Evans v. Moseley*, 114 P. 374, 375 (Kan. 1911) ("There is no branch of the law on which a unanimity of decision is more difficult to find, or on which more illogical and inconsistent holdings may be found."); and *Callanan Road Improvement Co. v. Colonial Sand & Stone Co.*, 72 N.Y.S.2d 194, 196 (Sup. Ct. 1947) ("Many more complex and intrinsically less tractable subjects have been reduced to order; this one, from the struggles of the English judges with it before the Revolution to the present time, remains oddly elusive.").

To illustrate, contrast the two classic cases of *Hackenheimer v. Kurtzmann*[206] and *Norwalk Door Closer Co. v. Eagle Lock & Screw Co.*[207] Louis Kurtzmann sold his shares in C. Kurtzmann & Co., a company that manufactures and sells pianos, to the other shareholders.[208] As part of the agreement, Louis committed to not use the name Kurtzmann in manufacturing or selling pianos for a period of ten years, under a liquidated damages clause of fifty thousand dollars.[209]

He subsequently broke this promise by attempting to sell pianos under his own name.[210] When the other shareholders sued, the court enforced the liquidated damages clause, even though the actual losses that the company suffered were negligible.[211] Louis managed to sell only a small number of pianos, whereas the company sold thousands of them over the same period.[212]

In *Norwalk Door Closer Co.*, defendant Eagle agreed to manufacture goods exclusively for Norwalk over a period of seven years.[213] The parties further agreed to liquidated damages, whereby Norwalk can treat any early termination by Eagle as a breach and collect $100,000.[214] Four years after signing the contract, Eagle terminated the agreement but transferred all its assets to a newly formed corporation under new ownership, which took upon itself Eagle's obligation toward Norwalk.[215] Indeed, the new corporation, Eagle Lock Company, picked up from where the "old" Eagle left off, and produced exclusively for Norwalk.[216] Norwalk nevertheless sought to exercise the $100,000 liquidated damages against Eagle, but the court refused to enforce the clause.[217]

The conventional wisdom, which focuses on the gap between actual and stipulated damages, cannot explain the difference between *Norwalk* and *Kurtzmann*. In both cases the gap between stipulated damages and actual (virtually nonexistent) harm was large, and so we should have expected both courts to strike down the clause, or so the conventional argument goes. Yet, when viewed from an information-production lens, the distinction between

206. *See generally* Hackenheimer v. Kurtzmann, 138 N.E. 735 (N.Y. 1923) (enforcing a liquidated damages clause after defendants breached a contract to refrain from selling pianos under the "Kurtzmann" name).

207. *See generally* Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 220 A.2d 263 (Conn. 1966) (refusing to enforce a liquidated damages clause against a defendant who terminated the original agreement and sought to transfer its obligations to its newly formed corporation).

208. *Kurtzmann*, 138 N.E. at 736.

209. *Id.* at 737.

210. *Id.*

211. *Id.* at 738–39.

212. *See id.* at 737; *Kurtzmann Pianos: A Golden Era Piano Maker*, CHUPP'S PIANOS, https://www.chuppspianos.com/kurtzmann-pianos [https://perma.cc/46MK-D3TB].

213. *Norwalk Door Closer Co.*, 220 A.2d at 265.

214. *Id.* at 266.

215. *Id.*

216. *Id.* at 267.

217. *Id.* at 268.

the cases becomes clear. Louis Kurtzmann acted in a manner that clearly violated core marketplace norms, attempting to undercut his contractual partners. Such behavior could be indicative of low integrity and learning about it could be valuable to other market participants. The court's choice to not interfere with the liquidated damage clause in *Kurtzmann* serves the purpose of broadcasting such relevant information. And it incentivizes future parties to litigate liquidated damages claims even when actual harm is low, as long as they can generate information on the low integrity of their counterparties. Eagle, by contrast, did not behave in ways that indicate low integrity or some other deep-seated flaw. Striking down the liquidated damages clause in *Norwalk* therefore makes sense, as it discourages future promisees from attempting to enforce these clauses when there is nothing wrong with the promisor's behavior.

Nominal Damages. From a reputational perspective, one cannot assume that remedy-stage doctrines will have the same reputational impact as liability-stage doctrines. The reason is that the reputational effect depends on dissemination of information from litigation, and the media is usually more likely to disseminate information about who won the case and why, rather than what type of legal remedy was awarded and why. One type of cases where the opposite holds true—in the sense that the media headlines are more likely to spotlight the size and type of award—is nominal damages. If a plaintiff seeks millions in damages, and the court grants her just one dollar, that becomes the story—a man-bites-dog story.

To illustrate, consider *Skender v. Eden Isle Corp.*[218] A law firm represented an employee in an overtime-pay dispute with his employer. The employee won four thousand dollars, and later sought more than thirty thousand dollars in attorney fees.[219] The court granted the law firm a measly dollar, scolding it for inflating their hours and hourly rates (implying low integrity), and for its quality of litigating the underlying dispute (implying low competence).[220] The judicial opinion was picked up by the media, which emphasized the measly award and the sharp criticisms of the law firm's low integrity and competence.[221] Similar examples abound.[222]

218. *See generally* Skender v. Eden Isle Corp., No. 20-cv-00054, 2021 WL 2964991 (E.D. Ark. July 14, 2021) (considering a motion for attorneys' fees and costs on a Fair Labor Standards Act collective action).

219. *Id.* at *8.

220. *Id.* at *7 ("Although Plaintiff was, technically, the prevailing party, his 'success' was paltry, at best.").

221. Maya Earls, *Judge Slams Hourly Rates, Awards $1 Attorneys' Fee in Wage Suit*, BL (July 15, 2021, 2:40 PM), https://news.bloomberglaw.com/daily-labor-report/judge-slams-hourly-rates-awards-1-attorneys-fee-in-wage-suit (on file with the *Iowa Law Review*).

222. *See, e.g.*, Terrie Morgan-Besecker, *Jury Awards Scranton Businessman Bob Bolus $1 in Lawsuit Against Bank*, TIMES-TRIB. (July 16, 2022), https://www.thetimes-tribune.com/news/jury-awards-scranton-businessman-bob-bolus-1-in-lawsuit-against-bank/article_c88d2588-bocd-5

Note the difference between awarding nominal damages to plaintiffs who sought hefty damages, and allowing a right of action to plaintiffs who demand nominal damages to begin with. In the former, litigation produces damning information about the plaintiff. In the latter, litigation produces damning information about the defendant and vindicates the plaintiff's reputation. This segues to a broader point about plaintiffs' reputation, to which we now turn.

Promisee's Reputation. Thus far, we have focused mostly on how litigation produces information about the promisor. But sometimes litigation produces information about the promisee too. And that information could be reputation-relevant, in the sense that it could sway third parties' assessments of whether they want to do business with the promisee going forward. To understand how litigation affects *plaintiffs'* reputation, let us break down these dynamics to demand side and supply side.

Demand for information about plaintiffs is limited to disputes where the plaintiff promisee is a repeat player in the relevant market (and so outside observers are interested in learning about her quality and not just about the defendant promisor). Disputes in business-to-consumer contracts are therefore less relevant in that regard. Amusement parkgoers are not interested in learning about how an individual season passholder behaved, but rather in how the company operating the facility behaved. Generally, buyers in a certain market are less likely to do business with a fellow buyer, and more likely to do business with a given seller in that market. Demand for information about plaintiffs is much more plausible in business-to-business contracts. Take for example a contractual dispute between a performing artist and a company operating a performing-events venue. Information coming from such litigation between the two may be of interest to a different company X, which is in the market for organizing an event for an employees' retreat. Pertinently, company X will be interested not just in how the venue-operating company behaved, but also in how the performing artist behaved, given that both parties to the dispute are potential contractual partners for company X.[223]

The supply of information about promisees is a function of how courts apply specific contract doctrines. An example that we have already encountered is excuses in relational contracts. Long-term contractual partners often "view themselves as conducting their everyday interactions according to a set of flexible understandings that requires them to make many adjustments, and ignore minor deviations," while "preserv[ing] their . . . right to insist on strict

e63-b1f8-9bedd4c3c64d.html (on file with the *Iowa Law Review*) (criticizing the winning plaintiff's lack of credibility).

223. In reality, the group of third-party observers is not homogeneous: Some outside observers will be interested in information about the promisor, while other outside observers will be interested in information about the promisee. To illustrate, think of a scenario where a supermarket chain gets into a dispute with one of its distributors. Other distributors in the market will be interested in information about how the supermarket chain behaved, whereas other supermarkets in the market will be interested in information about how the distributor behaved.

performance of their contract when they think their contracting partner is behaving badly."[224] Many recent COVID cases provided information about that balance, telling outside observers whether the fact that someone insisted on her right and did not ignore deviations should be held against her or not.[225]

Another example is the mitigation doctrine, which limits the victim's recovery when she failed to exert reasonable efforts to minimize her own losses.[226] Mitigation effectively introduces "comparative fault" elements into contract litigation, thereby producing granular information on how the plaintiff behaved relative to others in the market. To illustrate, consider the tenant-landlord dispute in *NorKei Ventures v. Butler-Gordon*.[227] The landlord there showed that the tenant breached by vacating the premises too early.[228] But the mitigation doctrine incentivized the defendant tenant to show that the plaintiff landlord unreasonably rejected potential replacements. Such information is relevant for other potential tenants who may avoid that landlord or demand explicit contractual protections going forward.

Yet another example comes from specific performance doctrine. To illustrate, consider *Market Street Associates Ltd. Partnership v. Frey*.[229] The case revolved around a leaseback agreement whereby retailer J.C. Penney sought financing by selling some of its properties to General Electric Pension Trust, while retaining the right to use them.[230] The agreement stipulated that if J.C. Penney were to approach the Trust seeking financing for occasional improvements to the properties, and the Trust refused, J.C. Penney would be entitled to buy said property back at the selling price plus a yearly fixed interest of six percent.[231] Over the years, the market value of real estate shot up so that it became profitable for J.C. Penney to buy the properties back at the stipulated interest rate.[232] J.C. Penney then asked the Trust to finance improvements, yet did not mention the buyback option.[233] When the Trust refused, J.C. Penney filed a lawsuit requesting specific performance, namely,

224. Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1781 (2001) [hereinafter Bernstein, *Private Commercial Law in the Cotton Industry*] (describing the cotton industry).

225. Recall the Caffé Nero case. *See supra* notes 166–70 and accompanying text.

226. Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 967 (1983) ("T[he] duty to mitigate is a universally accepted principle of contract law requiring that each party exert reasonable efforts to minimize losses whenever intervening events impede contractual objectives.").

227. NorKei Ventures, LLC v. Butler-Gordon, Inc., No. 07c-04-623, 2008 WL 4152775, at *1 (Del. Super. Ct. Aug. 28, 2008).

228. *Id.*

229. Mkt. St. Assocs. Ltd. P'ship v. Frey, 941 F.2d 588, 588 (7th Cir. 1991).

230. *Id.* at 591.

231. *Id.*

232. *Id.*

233. *Id.*

that the court order the Trust to sell the property back.[234] The trial court eventually entered summary judgment in favor of the Trust.[235] The court reasoned that J.C. Penney engaged in "sharp dealing" by deliberately using ambiguous language and neglecting to mention the buyback option, in an attempt to lure the Trust into not considering that option.[236] While J.C. Penney's actions were facially in accordance with the agreement, the court exercised its discretion to refuse specific performance. In the process, the court produced damning information about the integrity and ethicality of J.C. Penney's contractual behavior.

IV. IMPLICATIONS

Contract law litigation produces a positive externality in the form of information about the tendency of certain market actors to overpromise and underdeliver.[237] From that simple observation, two categories of potential policy implications emerge: One concerns the case for open dispute resolution, and the other concerns the case against personalized law. Section IV.A makes the case for openness and against mandatory arbitration, protective orders, and secret settlements. The Section also uses the information-production perspective to revisit conventional wisdoms about private ordering. Section IV.B spotlights the major flaw in recent calls to personalize private law. Proponents of personalization claim that customization would yield efficiency gains. But they neglect the efficiency losses from taking away the reputation-shaping, "benchmarking" effects of contract law in its current impersonal form.

A. *THE CASE FOR OPEN DISPUTE RESOLUTION*

When parties litigate a contractual dispute between them, the information that comes out in litigation is a positive *externality*, helping third parties who did not pay for litigation. This means the disputants do not fully internalize the benefits of dispute resolution. When left to their own devices, the parties to a given dispute would therefore underproduce information.[238]

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234. *Id.* at 592.

235. *Id.*

236. *Id.* at 594.

237. To the extent that the existing literature discusses positive externalities associated with litigation, it emphasizes either "legal" externalities (namely, how litigation produces legal precedents and dynamic legal guidance), or "educational" externalities (namely, how litigation produces information that instructs future parties on how to exercise care). For the former, see Elizabeth Chamblee Burch, *Securities Class Actions as Pragmatic* Ex Post *Regulation*, 43 GA. L. REV. 63, 117–18 (2008). For the latter, see Joshua C. Teitelbaum, *Computational Complexity and Tort Deterrence*, 51 J. LEGAL STUD. 249, 250, 260 (2022). We highlight here a different, "reputational" positive externality, namely, warning outside observers of less competent or opportunistic market actors.

238. On the divergence between private motives to use the legal system and the public interest, see generally Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575, 584–85 (1997). For an application to

Promisors that breached their promises are often willing to pay more for a confidentiality provision to spare themselves the risk of adverse publicity. Promisees (plaintiffs) anticipate promisors' (defendants) willingness to pay for secrecy and use it as a bargaining chip to extract higher settlement awards. In other words, plaintiffs may not care whether relevant information leaks out and "warn" third parties against contracting with the defendants. Recognizing this misalignment between private incentives and public interest carries important lessons for judges, regulators, and academics.

1. Lessons for Judges: Protective Orders and Nominal Damages

Against Protective Orders. A long-standing debate in the legal literature concerns how publicly available legal records should be.[239] The debate spans multiple applications: settlement versus trial, openness of proceedings, and so on.[240] Our information-production theory of contract law informs this debate by putting a thumb on the scale against secrecy. If open dispute resolution produces a public good in the form of quality information on potential contractual partners, protective orders and secret settlements in contractual disputes are a public bad.[241]

Judges should therefore exercise their discretion and not automatically grant parties' requests to grant protective orders or enforce secret settlements. To be sure, judges too are incentivized to go along with parties' requests for confidentiality. After all, judges are measured by how they manage their caseload, and not by the amorphous (unmeasurable?) concept of how they contribute to reputational discipline. We hope that the framework developed here will urge judges to overcome pressures to clear the docket and get them to consider also the positive effects that open dispute resolution can have on contractual behavior ex ante.

For Nominal Damages. Our framework also puts a thumb on the scale for granting rights of action even when promisors seek only nominal damages. The well-trodden debate over a right of action for nominal damages has resurfaced following the recent Supreme Court case of *Uzuegbunam v. Preczewski*.[242] The contours of the debate are clear: Everyone agrees that there is a right of action for nominal damages for prospective relief to prevent future or continuing injuries. The question is whether there is also a right of

nonlegal sanctions, see generally Robert Cooter & Ariel Porat, *Should Courts Deduct Nonlegal Sanctions from Damages?*, 30 J. LEGAL STUD. 401 (2001).

239. For a recent contribution and a summary of existing arguments concerning the confidentiality of litigation records, see generally Dustin B. Benham, *Foundational and Contemporary Court Confidentiality*, 86 MO. L. REV. 211 (2021).

240. Laurie Kratky Doré, *Secrecy by Consent: The Use and Limits of Confidentiality in the Pursuit of Settlement*, 74 NOTRE DAME L. REV. 283, 321–22 (1999) (detailing the various facets of the debate).

241. ALEXANDRA LAHAV, IN PRAISE OF LITIGATION 72–73 (2017).

242. *See generally* Uzuegbunam v. Preczewski, 141 S. Ct. 792 (2021) (analyzing Article III standing requirements in a First Amendment suit requesting injunctive relief and nominal damages).

action for nominal damages for retrospective relief, to redress past injuries (even when plaintiffs do not show harm). The *Uzuegbunam* majority ruled in the affirmative, relying on a couple of long-standing common law precedents. Our reputational framework contributes to the nominal damages debate along the following four dimensions.

First, the reputational framework provides an efficiency-based rationale for allowing nominal damages for retrospective relief. Insisting on a right of action even in cases with no provable damages facilitates reputational discipline in two ways, namely, (1) information and (2) motivation. When left to their own devices, market actors will have a hard time collecting and certifying information on the past behavior of potential contractual partners. Allowing every promisee who feels that she was wronged to sue is akin to subsidizing the production of quality information on past behavior of individual parties.

But reputation markets also suffer from a motivation problem: Victims of a breach often find it costly to spread damning information about their past partners, especially because said partners may fight back and tarnish the victims' reputations.[243] By effectively subsidizing litigation even when damages are nominal,[244] the legal system also reduces the costs of spreading gossip: A victim who knows that she was wronged can count on the court to rebuff any attempt by the promisor to tarnish the victim's reputation. Indeed, historical case studies indicate that what eventually brings cheaters down is persistent "nudniks" who are determined to sue when they feel wronged and refuse to do the "rational" thing of cutting one's losses and walking away.[245] By providing these nudniks with a venue to certify their grievances and covering their costs, the nominal damages doctrine greases the wheels of reputational disciplining.

Second, as Part II above explained, the reputational framework clarifies the distinction between suing for nominal damages in contracts versus suing for nominal damages in torts. While breach-of-contract victims who cannot show harm can still get the court to decide on their case, tort victims who cannot show harm do not advance past the motion to dismiss.[246] This difference matches well with our distinction between what is reputation-relevant in contractual disputes (knowing what happened) and what is reputation-relevant in torts (knowing how things happened). A court declaration that X

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243. Milgrom et al., *supra* note 46, at 10.

244. In such cases, the nominal damages are often just "a hook to allow prevailing plaintiffs to at least recover attorney's fees and costs." *Uzuegbunam*, 141 S. Ct. at 805 (Roberts, C.J., dissenting) (citing WILLIAM B. HALE, HANDBOOK ON THE LAW OF DAMAGES 30–31 (1896); 1 THEODORE SEDGWICK, A TREATISE ON THE MEASURE OF DAMAGES § 96 (9th ed. 1912)).

245. Kadens, *Cheating Pays*, *supra* note 49, at 567. On the importance of a subset of "nudnik" consumers to the operation of the contract system as a whole, see generally Yonathan A. Arbel & Roy Shapira, *Theory of the Nudnik: The Future of Consumer Activism and What We Can Do to Stop It*, 73 VAND. L. REV. 929 (2020).

246. *See supra* notes 121–25 and accompanying text.

breached his promises to Y is reputation-relevant enough, even without getting into more granular details.

Third, and more pinpointedly, the reputational framework spotlights the flaw in the *Uzuegbunam* dissent. Chief Justice Roberts and Justice Kavanaugh proposed to solve the conundrum by allowing the defendant to accept entry of judgment for nominal damages against her (paying the plaintiff one dollar) "and thereby end the litigation without a resolution of the merits."[247] Supposedly, such a proposal would solve the problem of utilizing the courts' scarce resources for an action that has no "real-life" implications. But as we have seen throughout this Article, contract litigation affects the real world not just directly, by imposing legal sanctions, but also indirectly, by facilitating reputational sanctions. Accepting the minority's proposal would allow defendants to keep damning details about their integrity or capacity away from other market actors. If the promisee wishes to invest her own resources in litigation in order to flush out damning information about how the promisor treated her, we should not give the misbehaving promisor absolute power to shut down this positive externality.

Finally, the reputational framework also delineates the limits of the nominal damages doctrine. Common law courts have long limited parties' right to sue for nominal damages to one round: The plaintiff has a right to litigate her breach-of-contract case in the court of first instance, but she does not have a right to appeal.[248] From our vantage point, this nuance in the doctrine makes perfect sense: We want to motivate aggrieved parties to come forward and tell the world about how the promisor misbehaved. But we do not want to subsidize the airing of grievances at all costs. Having the factual details of a specific dispute flushed out once is enough to create the reputational impact; we do not need to spend the scarce resources of courts of appeals on ironing out legal questions.

We have dealt thus far with judicial discretion to keep certain aspects of the dispute from becoming secret (granting protective orders) or open (granting right of action). But the problem of parties contracting out of the legal system often manifests on steroids in the form of mandatory arbitration provisions, where the matter does not make it to courts to begin with. The next Section explores what, if anything, regulators can do about that matter.

2. Lessons for Regulators: Mandatory Arbitration Provisions

Over the past decade and with the help of the Supreme Court,[249] the nation's largest companies have signed most of their customers and employees

247. *Uzuegbunam*, 141 S. Ct. at 802 (Kavanaugh, J., concurring); *id.* at 808 (Roberts, C.J., dissenting).

248. *See, e.g.*, DeCastro v. Wellston City Sch. Dist. Bd. of Educ., 761 N.E.2d 612, 615–16 (Ohio 2002).

249. Epic Sys. Corp. v. Lewis, 138 S. Ct. 1612, 1632 (2018); Am. Express Co. v. Italian Colors Rest., 570 U.S. 228, 233 (2013); AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 352 (2011).

to provisions that effectively contract out of the legal system. These days, if you purchase a product from or work for a large company, chances are that you effectively waived your right to sue in court (mandatory arbitration), waived your right to group with others who were similarly wronged (class action bans), and even waived your right to tell others that you were wronged (gag clauses).[250] We group these take-it-or-leave-it provisions under the umbrella term "mandatory arbitration." As a result of the mandatory arbitration wave, disputes have not only shifted from public courtrooms to closed-door private arbitrations; they have largely dissipated altogether.[251] To illustrate, out of 330 million customers of the largest telecom companies, only an annual average of thirty people took the companies to arbitration.[252]

Proponents of this trend of privatization and dissipation of disputes cite the cost saving that comes with getting rid of extensive discovery and trials.[253] But the analysis here reveals that dissipation of public discovery and trials also reduces the informational benefits of dispute resolution, thereby increasing the costs of market discipline.[254]

Is there a way to get the cost-saving aspects of arbitration without losing the information-extracting benefits of litigation? Say that a regulator is mindful of the informational benefits of public dispute resolution, what can she do to ensure that information keeps flowing from the legal system to the market?

For one, regulators could use our reputational framework to identify areas in which allowing sellers to impose mandatory arbitration on buyers is more (or less) problematic. Not all arbitration of contractual disputes is created equal. In disputes between individuals, the reputational impact of litigation is usually limited, and so mandatory arbitration provisions are less problematic (all else being equal). By contrast, in disputes between large sellers and individual buyers, the reputational impact of litigation could be sizeable because information on the large, repeat-playing seller could inform the decisions of many other market actors who are bound to interact with said

250. *See* Judith Resnik, Stephanie Garlock & Annie J. Wang, *Collective Preclusion and Inaccessible Arbitration: Data, Non-Disclosure, and Public Knowledge*, 24 LEWIS & CLARK L. REV. 611, 627 (2020) (discussing "the rarity of use by individuals of single-file arbitration . . . between 2009 and 2019"). Unlike mandatory arbitration clauses and class action waivers, gag clauses are, at least on paper, harder to enforce in consumer contracts, following the Consumer Review Fairness Act of 2016.

251. Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2934–36 (2015) (describing the "vanishing" of disputes).

252. Michael Corkery & Jessica Silver-Greenberg, *'Scared to Death' by Arbitration: Companies Drowning in Their Own System*, N.Y. TIMES (Apr. 6, 2020), https://www.nytimes.com/2020/04/06/business/arbitration-overload.html (on file with the *Iowa Law Review*).

253. Zambrano, *supra* note 64, at 73 n.2 (compiling references).

254. *See also* Shmuel I. Becher & Uri Benoliel, *Dark Contracts*, 64 B.C. L. REV. 55, 73–74 (2023) (highlighting the limitations on consumers, courts, legislatures, scholars, and media stemming from a lack of transparency in dispute resolution). The main premises of our analysis here apply also to the related phenomenon of giant corporations handling numerous disputes inhouse (before they reach arbitration), with internal dispute processes. For a comprehensive account, see generally Rory Van Loo, *The Corporation as Courthouse*, 33 YALE J. ON REGUL. 547 (2016).

seller. Mandatory arbitration provisions are therefore more problematic in form contracts than they are in individual contracts, and not only because of the lack of specific assent.

While it may be unrealistic to expect regulators to outright ban mandatory arbitration,[255] there are straightforward steps that regulators and legislatures can take to mitigate the adverse impact of such provisions on reputation markets.[256] At the minimum, policymakers should ensure the existence of accessible databases of disputes with "explained awards." That is, regulators should require that arbitrators include a short summary of who did what to whom, and why the action is considered against the relevant market norms. When such databases exist, the drop in information production from litigation to arbitration could be minimal, as far as contractual disputes are concerned. In sale of goods or debt contracts, for example, the fact that outside observers can know what happened is often enough for them to update their reputational judgments about the disputants. In other words, the arbitration process may be less information-extracting and public-facing than litigation is; but as long as it creates a repository of information that allows outside observers to tell when and to what extent a given seller overpromised and underdelivered, it would still affect sellers' reputations ex post and deter seller misbehavior ex ante.

To be sure, in other contexts and with more complex contracts, arbitration could never come close to replicating the information-production benefits of litigation. To illustrate, consider the Wells Fargo phony-accounts scandal. The banking giant scammed its customers into opening multiple fake accounts.[257] An investigative report by the L.A. Times uncovered these shady practices and set a public backlash in motion.[258] More pertinent for our purposes is how the L.A. Times was able to come out with the story: The reporter relied on court documents from wage-and-hours lawsuits filed by disgruntled Wells Fargo employees.[259] The court documents provided ready-made, libel-proof testimonies of former employees that detailed the lawless culture in the company in question. These court documents are what facilitated the reputational sanction. Nowadays, the same employment contracts usually contain mandatory arbitration provisions. As a result, such disputes are no longer aired in court. And the next time a journalist attempts to show how

255. Recall that these provisions enjoy the unwavering support of the Supreme Court. *See supra* note 249.

256. *See* Ramona L. Lampley, *"Underdog" Arbitration: A Plan for Transparency*, 90 WASH. L. REV. 1727, 1762–78 (2015).

257. Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 280–81 (2020).

258. E. Scott Reckard, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013, 12:00 PM), https://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html [https://perma.cc/FQ8H-BQUG].

259. Roy Shapira, *The Challenge of Holding Big Business Accountable*, 44 CARDOZO L. REV. 203, 256 (2022).

financial companies sucker punched their customers and pressured their employees, such inside information is more likely to remain out of her reach. Funneling all employment disputes into individual arbitration, even if arbitrators publicize their ruling, is likely to sap the market of granular information about large employers' behavior.

3. Lessons for Academics: Private Ordering and Default Rules

Recognizing the way that litigation affects reputation should make academics revisit their priors regarding private ordering systems. A common trope in contracts scholarship is that decentralized, informal enforcement systems are superior to (cumbersome) formal legal enforcement.[260] To support their optimism about the optimality of private ordering systems, contracts scholars often refer to case studies of close-knit or historical merchant communities, where the market supposedly governs itself via reputational discipline and with little help from the public legal system.[261] Yet a deep dive into these case studies reveals that there, too, effective market discipline occurred only with the help of quality information coming from public dispute resolution.

For concreteness, consider two influential studies of private ordering, one focusing on contractual behavior by cotton merchants in twentieth-century America and the other focusing on traders in seventeenth-century England.[262] In both settings, contractual disputes were apparently adjudicated in a system that was very public-facing and information-extracting in nature. For English merchants in the seventeenth century, the main venue for adjudicating claims of cheating was the Star Chambers.[263] The Star Chambers sat in public sessions, and its trials were the best show in town, often drawing "scores of spectators" who lined up outside the courtroom.[264] The process of trials in the Star Chambers regularly extracted quality information. To illustrate, in a span of three cases the court heard depositions from 116 individuals, shedding light on the common norms in the business community

260. *See, e.g.*, Scott, *supra* note 5, at 1382–83 (describing the common wisdom).

261. *See, e.g.*, Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 224, at 1781–82 (describing merchant communities in the cotton industry); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 152 (1992) [hereinafter Bernstein, *Opting Out of the Legal System*] (describing merchant communities in the diamond industry); Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders*, 49 J. ECON. HIST. 857, 867–68 (1989) (describing the Maghribi traders in the eleventh century).

262. *See generally* Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 224 (highlighting private ordering systems between cotton merchants); Kadens, *Cheating Pays*, *supra* note 49 (highlighting seventeenth-century cases recorded in England's Court of Star Chamber); Kadens, *The Dark Side of Reputation*, *supra* note 41 (same).

263. Kadens, *The Dark Side of Reputation*, *supra* note 41, at 2003.

264. *Id.* at 2008 & n.73.

and who disregards these norms.[265] The outcomes of trials in the Star Chambers were public-facing to a fault: When the court found that a promisor behaved fraudulently, it ordered said promisor "to stand in the pillory at Westminster (where the court sat) and at Cheapside (the main commercial thoroughfare) with a paper hung around his neck detailing his fraud."[266]

In the cotton industry, most disputes were adjudicated by an industry tribunal comprised of the disputants' peers. These tribunals wrote opinions that regularly "contain[ed] preachy statements about what is and is not acceptable business behavior . . . ."[267] The opinions often went to great lengths to criticize parties whose business practices fell below accepted standards (even when—especially when—that party prevailed in the legal dispute on a technicality).[268] Pertinently, the industry's associations made every effort to circulate the tribunals' opinions to all industry members "and educate members about their content."[269] The associations also kept a repository of tribunal opinions available for later inspection by members.[270] The tribunals' opinions thus affected norms (what is considered the industry standard) and reputations (who performs below the industry standard) in the community.[271]

Viewed from this angle, it matters less whether the *adjudicators* are public officials (as in sixteenth-century England) or private experts (as in twentieth-century America). What matters more is whether the *process* is public or private. In both cases, it was the publicness of so-called private dispute resolution mechanisms that facilitated much of the supposed private ordering in these settings.

There is a broader point at issue here. Law-and-social-norms scholars who recognize the limits of reputational discipline usually conclude that reputational concerns matter only "in small trading communities."[272] In such close-knit communities, everybody knows each other, everything that happens within one contractual relationship "soon becomes [public] knowledge, and boycotts of bad actors are easy to enforce."[273] In large atomistic markets,

265. Kadens, *Cheating Pays*, *supra* note 49, at 552.

266. Kadens, *The Dark Side of Reputation*, *supra* note 41, at 2018.

267. Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 224, at 1773.

268. *Id.* at 1769. To see how this bears a striking similarity to the practices of the nation's main venue for adjudicating business disputes, namely, Delaware's Court of Chancery, see generally Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997); and Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1 (2015).

269. Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 224, at 1768, 1790 n.237.

270. *Id.* at 1730 n.28.

271. While the names of the disputants were usually redacted, the redaction was done to keep information away from outside observers, such as railroads or insurance companies, so that they would not stop doing business with an industry member whose behavior or creditworthiness were implicated in the opinion. *Id.* at 1730 n.29. The industry members regularly knew the identities of the disputants through internal gossip networks. *Id.* at 1766 n.172, 1768 n.181, 1730 n.29.

272. Schwartz & Scott, *supra* note 37, at 557.

273. *Id.*

reputational concerns would not have much of an impact, or so the argument goes.[274] This conventional wisdom fails to account for how public dispute resolution can produce and certify information in ways that facilitate robust reputational discipline even in large, modern markets.[275] In other words, while existing accounts focus on closeness as facilitating market discipline, we focus on courts as facilitating market discipline even in the absence of closeness.

An even broader lesson for academics is to be wary of drawing conclusions about the optimality of rules based on observing actual contractual arrangements. The fact that parties do not contract around default rules does not mean that said default rules can be presumed efficient from a societal perspective.[276] Similarly, the fact that parties opt to join regimes of strict liability does not mean that strict liability is socially optimal.[277] What is good for the parties to a specific contract is not necessarily good for contractual parties as a group. Parties to a given dispute may opt into certain legal regimes and not opt out of certain default rules because they want to block damning information about them from becoming public ex post after a dispute arises. But from an overall societal perspective, it may be better to air dirty laundry outside, for all other market participants to see. Ex post, airing the laundry will help market actors avoid parties who have low integrity or low capacity. Ex ante, anticipating that their shenanigans may be exposed later will incentivize the parties to set realistic expectations and perform accordingly.

B. The Case Against Personalized Law

Private law as currently construed is decidedly impersonal, relying on concepts such as "reasonable person" and "average competence" to assess liability. But more and more contract law scholars suggest that this state of affairs is highly regrettable and easily changeable.[278] The impersonal nature of private law is regrettable because we should not judge someone who has limited cognitive, physical, or technical capacity by standards that she could never live up to.[279] And it is easily changeable because today's technological advancements in big data and predictive analytics allow the legal system to

274. *Id.*

275. In that sense, our account is closest to Milgrom, North, and Weingast's description of the role that the law merchant played in facilitating reputational discipline among European traders in early Middle Ages. Milgrom et al., *supra* note 46, at 4–5.

276. *Contra, e.g.*, Posner, *Let Us Never Blame a Contract Breaker*, *supra* note 14, at 1361.

277. *Contra, e.g.*, Scott, *supra* note 5, at 1395.

278. *See generally, e.g.*, BEN-SHAHAR & PORAT, PERSONALIZED LAW, *supra* note 31 (hypothesizing a world in which people are governed by laws individually tailored to them); Ben-Shahar & Porat, *Personalizing Mandatory Rules in Contract Law*, *supra* note 31 (discussing the future possibility of the law creating personalized contract protections for consumers); Porat & Strahilevitz, *supra* note 31 (detailing personalized default rules and how they are applied to individuals' contracts or wills).

279. *See* sources cited *supra* note 278.

assess the skills and preferences of every individual.[280] Tort law could therefore easily switch from a "reasonable person" to a "reasonable you" framework for assessing negligence. And contract law could easily tailor different default rules to different contractual parties, or so the argument goes.[281]

These calls to personalize private law were met with fierce objections, pointing to how personalized law is impractical, or to how it clashes with principles of fairness and the rule of law.[282] The proponents of personalization rebutted by emphasizing the efficiency personalization could bring.[283] We add to this debate by clarifying an efficiency-based case *against* personalization.

Personalizing contract law would reduce the quantity and quality of information being produced in litigation. To illustrate, consider the example of assessing breach in efforts-based contracts. Existing law regularly assesses the contractual behavior of individuals by reference to the average traits of others in their industry, thereby providing outside observers with a clear benchmark against which they can rethink their willingness to do business with the disputants.[284] Under the proposed personalization reform, contract law would only assess liability by reference to the individual defendant's capacity, thereby hurting outside observers' ability to compare between different market actors. Under personalized standards, contract litigation would de facto revolve only around the parties' integrity (did the defendant do *her* best?). It would not deal with the parties' capacity, simply because plaintiffs would not bother bringing cases against inherently incompetent but honest actors.

As another example, consider the choice between different types of remedies. Courts currently grant specific performance only in sales of "unique" goods, such as antiques or works of art.[285] Omri Ben-Shahar and Ariel Porat criticize this rule, arguing that the uniqueness of a good is in the eye of the beholder: "Some people care meticulously about in-kind actual completion of their contractual plans, whereas others are less finicky, slower to make reliance investments, adjust more easily to substitutes, or care mostly

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280. BEN-SHAHAR & PORAT, PERSONALIZED LAW, *supra* note 31, at 44. The idea is that one-size-fits-all requires less information, and customization requires more information. The advent of today's digital age drastically reduces the costs of information and makes it more cheaply available to courts and lawmakers, thereby tilting the tradeoff in favor of customization.

281. *Id.* at 62.

282. *See generally, e.g.*, Timothy Endicott & Karen Yeung, *The Death of Law? Computationally Personalized Norms and the Rule of Law*, 72 U. TORONTO L.J. 373 (2022) (analyzing how the emergence of big data analytics makes replacing general legal rules with personalized ones feasible and the pushback it has received from the legal community).

283. Omri Ben-Shahar, *What Is Personalized Law?*, OXFORD BUS. L. BLOG (June 27, 2022), https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/06/what-personalized-law [https://perma.cc/9WF3-WMBX].

284. *See supra* Part II.

285. U.C.C. §§ 2-713, 2-716 (AM. L. INST. & UNIF. L. COMM'N 1951) (amended 2022). In all other cases the preferred award is damages.

about the bottom-line monetary value."[286] Ben-Shahar and Porat therefore propose to switch the criterion for granting specific performance from the type of good in question to the type of person in question. The problem is that such a switch would neutralize much of the reputational benefits of the remedies stage.[287] For outside observers, the relevant type of information that could emerge from disputes between sellers and buyers of unique goods concerns the *seller*. Specific performance doctrine as currently construed produces information on a given seller's behavior. By contrast, the proposed personalized version of specific performance doctrine would only produce information on the idiosyncratic preferences of a given buyer. Existing law is therefore a better fit with the information-production optimum than personalized law is.

Our reputational perspective thus puts a thumb on the scale against personalization of contract law in general. It also highlights the cross-sectional variation, namely, the types of contractual disputes where personalization would be more (or less) problematic. To illustrate, consider Ben-Shahar and Porat's suggestion that the case for personalization is stronger when it comes to consumer contracts.[288] They argue that uniform consumer protection may be both inefficient and unfair.[289] It is inefficient because consumers vary in their needs and means, and so a uniform protection would inevitably misfire in individual cases.[290] And it is unfair because the average level of protection is usually set to help the weakest consumers, but it is often the most affluent consumers that use it.[291]

But from an information-production perspective, disputes with an individual consumer and a large seller (who sells to many other individuals) are exactly where the reputational impact of litigation is at its peak, and we would not want to lose it by personalizing the law. Ben-Shahar and Porat's argument underplays the role that reputational forces play in consumer protection, and the role that litigation can play in facilitating reputational discipline.[292] If every case were tailored to the individual consumer in question, no case would produce information that is generalizable enough to set a meaningful reputational sanction in motion. Under personalized consumer protections, each dispute revolves around questions about the

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286. BEN-SHAHAR & PORAT, PERSONALIZED LAW, *supra* note 31, at 90.

287. *See supra* Section III.C.

288. BEN-SHAHAR & PORAT, PERSONALIZED LAW, *supra* note 31, at 72–73.

289. *Id.*

290. *Id.*

291. *Id.*; *see also* Meirav Furth-Matzkin, *The Distributive Impacts of Nudnik-based Activism*, 74 VAND. L. REV. EN BANC 469, 483–84 (2021) (discussing the ability for affluent nudnik consumers to receive preferential treatment from sellers).

292. *See generally* Arbel & Shapira, *supra* note 245 (discussing how nudniks hold sellers accountable).

buyer in question (her unique needs and means), which is largely irrelevant to other buyers, who are instead interested in learning about *seller* behavior.

CONCLUSION

Sixty years ago, Stewart Macaulay opened his classic article by asking "[What] good is contract law? [W]ho uses it? [W]hen and how?"[293] Macaulay ushered in a new strand of contracts scholarship, which focused on on-the-ground evidence for how commercial parties behave. Over the years, that literature has deemphasized legal enforcement and emphasized reputational enforcement of contracts. Its organizing idea was that commercial parties rely much more on reputational mechanisms than they do on contract law. This Article offers a different perspective: Instead of viewing legal enforcement and reputational enforcement of contracts as an either/or proposition, we view them as fundamentally complementing each other.[294]

To answer Macaulay's question: Contract law is good for facilitating reputational enforcement of contracts. Contract litigation subsidizes the production, certification, and diffusion of information on past contractual behavior. That information, in turn, allows market actors to reach better decisions on whom they want to contract with and how. This Article therefore helps us understand not just how contract law works but also how reputation works in contracts.

The best way to clarify our original contributions would be to juxtapose them with the extant literature. This Article is closely related to the law-and-social-norms literature, and in particular the branch that emphasizes the importance of nonlegal forces in the enforcement of commercial transactions and relationships. A large part of that literature emphasizes "private ordering without law." We, by contrast, spotlight how in reality effective private ordering is made possible through the law. More specifically, we depart from the extant literature also in the following three ways.

First, while there is a broad consensus that reputational concerns matter in contracts, the question of how reputation works is understudied. We spotlighted here the determinants and sources of noise in reputational sanctions, to counter the common "indefensible optimism about the actual operation of information markets" that the literature suffers from.[295] Second, much of the extant literature treats contractual behavior as either law complying or norm following. We, by contrast, focused on the complementarities

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

294. *Cf.* Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955, 1959 (2001) (arguing against the common tendency to treat behavior as either law-complying or norm-following).

295. SHAPIRA, *supra* note 53, at 2 (compiling references). For notable exceptions, see also Yonathan A. Arbel, *Reputation Failure: The Limits of Market Discipline in Consumer Markets*, 54 WAKE FOREST L. REV. 1239, 1244–45 (2019); and Kishanthi Parella, *Reputational Regulation*, 67 DUKE L.J. 907, 918 (2018).

between legal and nonlegal systems. Instead of a horse race approach (highlighting areas where nonlegal systems are supposedly better than legal systems), we suggested looking at the different systems as providing multiple layers of control or, as it were, a diversified portfolio of contract enforcement. Finally, to the extent that the extant literature deals with interactions between law and reputation, it does so usually within a "private ordering" in "the shadow of the law" framework.[296] The idea there is that parties can rely on reputational enforcement, knowing that if everything else fails they can always sue in court.[297] We look at litigation as more than just a fail-safe to reputation: In our account, litigation serves as a clearinghouse of information on past contractual behavior, which facilitates private ordering to begin with.[298]

This Article is also a close cousin of recent work by Omri Ben-Shahar, David Hoffman, and Cathy Hwang that looks at contract law through its effects on third parties.[299] They spotlight how various default rules, interpretation techniques, and remedies provide opportunities for courts to consider nonparty interests. For example, in a dispute between an insurer and an insured over coverage for auto accidents, courts may consider the interests of auto accident victims.[300] We, by contrast, focus on how the same doctrines help nonparties' interests indirectly: Contract law provides nonparties with information that helps them fend for themselves by avoiding low-quality contractual partners to begin with.

Before closing, we wish to acknowledge the serious limitations of our analysis. We have focused on scenarios where private law litigation generates reputation-relevant information, and market actors use this information to make better decisions about whom to do business with and how. But in reality, there are also many scenarios where these conditions do not hold.

296. Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 996–97 (1979).

297. *See, e.g.*, Kadens, *The Dark Side of Reputation*, *supra* note 41, at 2026 ("The availability of public enforcement permitted traders to rely on questionable reputation information and then sue for damages ex post . . . .").

298. In that aspect, our work is related to more recent contributions to the private ordering literature. *See generally* Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377 (2010) (noting that contracts can be designed in ways that provide information to the parties on each other's behavior, thereby facilitating nonlegal sanctions); Lisa Bernstein & Brad Peterson, *Managerial Contracting: A Preliminary Study*, 14 J. LEGAL ANALYSIS 176 (2022) (documenting a trend within procurement contracts of incorporating highly detailed provisions that govern real-time monitoring and information production). While these works focus mostly on bilateral sanctions (you commit to providing me with information that will allow me to stop dealing with you), we focus on third-party, reputational sanctions. And while these works focus on what real-world contracts look like, we focus on contract law doctrines.

299. Omri Ben-Shahar, David A. Hoffman & Cathy Hwang, *Nonparty Interests in Contract Law*, 171 U. PA. L. REV. 1095, 1116 (2023).

300. *Id.* at 1098, 1105.

First, and most basically, in some scenarios the contract law dispute in question would be of little interest to the outside world. In these situations, even if litigation produces quality information, that information is like a tree falling in the forest when no one is around (did it really make a sound?). Contractual disputes between two individuals, for example, rarely receive attention from media outlets or consumer organizations. In these cases, the reputational impact of litigation is close to zero and we need not take it into account when designing legal institutions. Our theory applies more strongly in the subset of contract law cases that involve repeat players with a public imprint. These could be disputes between an individual consumer and a large manufacturer, a construction company, or a healthcare provider, as well as disputes between two businesses. Even if mainline media organizations do not report on such disputes, there are often other information intermediaries who do—from trade associations' circulations and professionals' gossip networks, to consumer organizations and their searchable databases.[301] Indeed, recent evidence suggests that contract law litigation is increasingly comprised of disputes between corporations—the kind where our theory is more relevant.[302]

Second, in some scenarios the contract law dispute in question would interest third parties, yet litigation would not be able to produce quality information about it. Such is the case when the adjudicator in question lacks the needed expertise to understand who behaved according to or below market expectations.[303] In other words, litigation may produce information that is too inaccurate or irrelevant for market actors to use. We acknowledge that court errors dilute the effectiveness of reputational deterrence. Yet we do not view them as fatal to our account, mainly because our argument is a relative rather than an absolute one. We do not argue that litigation always produces perfectly accurate information. We rather focus on the complementarities, namely, how litigation may produce information that is relatively more nuanced and accurate than what third parties could glean on their own (outside observers usually have just "he said she said" contrasting

301. For examples of trade associations' circulations and gossip networks, see industry-specific case studies, such as the ones depicted in Lisa Bernstein's writings. Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 224, at 1751–54; Bernstein, *Opting Out of the Legal System*, *supra* note 261, at 128–30. For examples of online databases, see, for example, *Court Voids "Unconscionable" Chiropractic Contract*, QUACKWATCH (May 24, 2009), https://quackwatch.org/cases/board/chiro/harte/decision [https://perma.cc/P69G-U9LW] (reporting on shady contractual practices by a known chiropractor, based on court rulings); and Brendan Pierson, *Anthem Blue Cross to Pay Consumers $8.3 Mln over Mid-Year Changes*, THOMSON REUTERS (Oct. 29, 2015) (on file with the *Iowa Law Review*) (reporting on problematic contractual practices by a giant health insurance company, based on court proceedings).

302. Farshad Ghodoosi & Tal Kastner, *Big Data on Contract Interpretation*, U.C. DAVIS L. REV. (forthcoming 2024) (manuscript at 54), https://ssrn.com/abstract=4465559 [https://perma.cc/D2UZ-68UX].

303. *See, e.g.*, ERIC A. POSNER, LAW AND SOCIAL NORMS 152–53 (2000) (noting courts' lack of expertise regarding commercial practices).

versions from the disputing parties with no ability to verify who did what to whom and when). Further, in many cases, the relevant information comes in the form of "objective" documents exchanged in discovery. Lack of expertise on the part of the final arbiter does not neutralize the reputational effects of the process itself (discovery, depositions, trial).

Finally, our theory does not purport to be an exhaustive account of contract law. The practice and evolution of contract law is too rich and varied for any model to cover comprehensively. Our aim here was more modest: to highlight a hitherto understudied function of contract law—namely, enhancing the effectiveness of reputational enforcements. Even within this narrow information-production angle, we left many interesting inquires out due to considerations of scope and brevity. For example, while we alluded a couple of times to relational contracts, future work could delve more deeply into how law and reputation interact differently in different types of contracts.[304]

The information-production aspects of contract law (and private law more generally) make for a vast, practically important, yet understudied, topic. We acknowledge that this Article was not able to cover all the topics' ramifications and nuances. Still, by adopting the information-production lens, this Article was able to shed light on why liability standards developed so differently in contracts than in torts, resolved the perceived ambiguity of contract law doctrines such as excuses and liquidated damages, and sketched several testable hypotheses that future empirical inquiries can probe. Importantly, this Article also generated concrete policy implications, such as for legislators considering proposals to personalize the law or for judges considering the public-interest prong when evaluating parties' requests for confidentiality.

304. In a nutshell: On the one hand, parties to a long-term relational contract can carry all the "punishments" for misbehaving within their own bilateral relationships, and do not need the law to provide information on who behaved how and when. On the other hand, once a long-term relationship has gone off the rails, both parties will look for another long-term partner, at which point having a verified version of what went wrong between them will be very important for potential contractual partners. And because breaches are bound to occur at some point in long-term contracts, the relevant information for outside observers would be not what happened but rather how things happened (the procedures that the parties took to anticipate, avoid, and swiftly mitigate breaches). Accordingly, we expect contract law to be more fault-based in that area and regularly benchmark the behavior of the disputants to the industry standard.