THE MORALITY OF JINGLE MAIL: MORAL MYTHS ABOUT STRATEGIC DEFAULT

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The recent housing bubble and its subsequent burst have led to a wave of defaults on home mortgages. Many, no doubt most, of the defaults are due to an inability to pay. But an increasing number of homeowners are engaging in "strategic default"—that is, they are deciding not to pay their mortgages even though they could afford to pay. In the mortgage industry, the term "jingle mail" suggests an image of a borrower who mails the keys to the bank and walks away from the house and the mortgage; although, in reality, many homeowners simply stop making payments without relinquishing possession of their houses until forced out.[1] In fact, some evidence suggests that the "rich" are defaulting on home mortgages at a much higher rate than is the general population.[2] By some estimates, at least a million people strategically defaulted in 2009.[3] Since then, the strategic default rates have gotten worse, rising from twenty-two percent of foreclosures in March 2009 to thirty-one percent in March 2010.[4] In some areas, there are so many homes in default that a clever borrower may manage to enjoy many months of rent-free living.[5] Foreclosure takes time under ordinary circumstances, and with so many borrowers defaulting at once and so many houses on the market, it now often takes many months of nonpayment

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1. *See, e.g.*, David Streitfeld, *Owners Stop Paying Mortgages, and Stop Fretting*, N.Y. TIMES, June 1, 2010, at A1.

2. *See* David Streitfeld, *Biggest Defaulters on Mortgages Are the Rich*, N.Y. TIMES, July 9, 2010, at A1.

3. *60 Minutes: Strategic Default: Walking Away from Mortgages* (CBS television broadcast May 9, 2010), http://www.cbsnews.com/stories/2010/05/06/60minutes/main6466484.shtml.

4. Diana Olick, *BofA: Mortgage Walkaways Have Huge Incentive*, CNBC (June 2, 2010, 1:15 PM), http://www.cnbc.com/id/37471499.

5. *See* Streitfeld, *supra* note 1 ("The average borrower in foreclosure has been delinquent for 438 days before actually being evicted . . . .").

before homeowners are forced out. I personally know someone who has been living in a home and who has actually been earning money by renting space in the house without making a payment for over a year now (and counting), despite a healthy law-firm salary.[6]

The decision to default even when one can afford to make the payments may make financial sense if the homeowner bought or refinanced at the height of the market and now owes much more than the house is currently worth. In a couple of states, home loans are by statute "nonrecourse," which is to say that the lender may foreclose on the house in the event of default, but is not entitled to a deficiency judgment for the difference between the value of the house and the amount the borrower owes. In those states, a borrower who is willing to suffer damaged credit, and perhaps a damaged social reputation as well, has little else to fear from banks. Even in "recourse" states (the vast majority of states), the practical ability to collect on deficiencies may be limited. To be sure, a damaged credit history is costly, but those who are extremely "underwater," i.e., who owe much more than their homes are worth, may save so much by defaulting that it is well worth any damage to their credit histories. Of course, they must give up their houses, but for many, the costs to rent or buy a similar house are currently much lower than the payment on their underwater mortgages. Even especially persistent banks can often be thwarted in their efforts to collect on debts by bankruptcy proceedings, which generally allow individuals to retain assets protected in bankruptcy (e.g., retirement plans) and protects future earnings, while also allowing these same individuals to walk away from their debts.[7]

Currently, there are so many underwater home mortgages that a cottage industry is developing to assist homeowners who are engaging in strategic default. For example, the website youwalkaway.com boasts of "empowering homeowners through intelligent strategic default."[8] The company's "platinum" membership costs $99.95 a month, plus a $395 enrollment fee, and includes such niceties as a strategic default "kit," do-not-call letters, personal consultation with a CPA, phone and online chat support,

6. Needless to say, this person shall remain nameless, but I must admit that, ironically, this person is a former contracts student of mine.

7. There is a means test for Chapter 7 liquidations now, which is designed to force high-income earners to use the less-forgiving Chapter 13, pursuant to which they will (roughly speaking) have to apply their disposable income to their debts for three to five years. 11 U.S.C. § 707(b) (2006). But the means test is not very stringent. For example, anyone earning less than the median household income in his or her state—by definition roughly half of Americans—automatically passes the test. And many people making salaries above the median will still be able to use Chapter 7, depending on their expenses.

8. YOU WALK AWAY, http://www.youwalkaway.com (last visited Mar. 12, 2011).

and more.[9] Moreover, it seems as though every week there is a new story in a major news outlet about strategic default. The term "strategic default" was virtually unheard of in the mainstream news media before the summer of 2009, but by the summer of 2010, dozens of articles on the subject were appearing monthly.[10]

Some of these stories focus on hand-wringing by the banking industry over what will happen to the housing market if more homeowners strategically default, while other news coverage has adopted a predictable tone of moral condemnation against those who engage in strategic default.[11] More and more authors and commentators are discussing why more people are not engaging in strategic default, some of whom go so far as to encourage homeowners to take that step.[12] Much of this advice comes from Internet bloggers, newspaper columnists, and other fringe "experts."[13] Some of this advice has come from more academic circles, most famously Arizona law professor Brent White, who in a recent series of articles has afforded strategic default a certain moral credibility.[14] Professor White's arguments have gained a level of national attention unusual for legal scholarship, having been discussed in national media outlets such as *Time Magazine, The New York Times,* and the television show *60 Minutes*.[15]

9. *Join Us*, YOU WALK AWAY, http://www.youwalkaway.com/join (last visited Mar. 12, 2011).

10. *See, e.g.*, James B. Stewart, *'Strategic Defaults'? I Agree with Fannie*, WALL ST. J., June 30, 2010, at C4; Bob Tedeschi, *Seeking To Close Off an Exit*, N.Y. TIMES, July 25, 2010, at RE5.

11. *See* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 WAKE FOREST L. REV. 971, 998 (2010) ("The clear message to American homeowners from nearly all fronts is that one has a moral responsibility to pay one's mortgage.").

12. *See, e.g.*, Yongheng Deng & John M. Quigley, *Woodhead Behavior and the Pricing of Residential Mortgages* 1–4 (Berkeley Program on Hous. & Urban Pol., Working Paper No. W00-004, 2004), *available at* http://urbanpolicy.berkeley.edu/pdf/DQ_Woodhead_Web.pdf; Peter Ubel, *Human Nature and the Financial Crisis*, FORBES, Feb. 22, 2009, http://www.forbes.com/2009/02/20/behavioral-economics-mortgage-opinions-contributors_financial_crisis.html.

13. *See, e.g.*, Nicole Gelinas, *The Rise of the Mortgage 'Walkers,'* WALL ST. J., Feb. 8, 2008, at A17; Roger Lowenstein, *Walk Away from Your Mortgage!*, N.Y. TIMES, Jan. 10, 2010, (Magazine), at MM15.

14. *See* White, *supra* note 11, at 972–73; Brent T. White, *The Morality of Strategic Default* (Ariz. Legal Studies, Discussion Paper No. 10-15 2010), *available at* http://ssrn.com/abstract=1597835 [White, *The Morality of Strategic Default*]; Brent T. White, *Take this House and Shove It: The Emotional Drivers of Strategic Default* (Ariz. Legal Studies, Discussion Paper No. 10-17, 2010), *available at* http://ssrn.com/abstract=1603605 [hereinafter White, *Take this House and Shove It*]. Professor White has a recently published book apparently aimed at a popular audience that seeks to advise people about mortgage defaults generally: BRENT WHITE, UNDERWATER HOME: WHAT SHOULD YOU DO IF YOU OWE MORE ON YOUR HOME THAN IT'S WORTH? (2010).

15. *See, e.g.*, Lowenstein, *supra* note 13, at 16; *60 Minutes: Strategic*

Professor White and others tend to overstate greatly the degree to which it makes financial sense for underwater homeowners to default on their loans.[16] For example, there is a great deal of confusion about just how many states are nonrecourse states. A quick Internet search for nonrecourse loans will reveal numerous websites and news sources that list ten or more states as nonrecourse (including youwalkaway.com). One *Bloomberg* article claims that "about a third" of the states "prohibit collection efforts on primary residences after foreclosure."[17] But in fact most of the states that are often listed as nonrecourse actually do allow deficiency judgments so long as the lender is willing to foreclose through the court system.[18] Before there were so many foreclosures, lenders who had a choice often proceeded without judicial process even if it meant forgoing a deficiency claim. But now that housing values are so low and strategic default is more common, it may make more sense for lenders to preserve their deficiency claims by going through the more costly judicial process. Before 2009, only four states were true nonrecourse states (Arizona,[19] California,[20] North Dakota,[21] and Oregon[22]), and one of those states (California) only gave nonrecourse status to purchase-money loans (thus

Default: Walking Away from Mortgages, *supra* note 3; Brad Tuttle, *Is Walking Away from Your Mortgage the Smartest Thing You Can Do?*, TIME MONEY BLOG (Nov. 30, 2009, 10:08 AM), http://money.blogs.time.com/2009/11/30/is-walking-away-from-your-mortgage-the-smartest-thing-you-can-do; *cf.* Ken Harney, *Anger, Not Money, Drives Most 'Intentional Defaulters*,*'* CHI. DAILY HERALD, May 21, 2010, at 2; Shahien Nasiripour, *Don't Look Back: Major Players Continue To 'Walk Away' from Poor Mortgages*, HUFFINGTON POST (Jan. 25, 2010 3:56 PM), http://www.huffingtonpost.com/2010/01/25/dont-look-back-major-play_n_435965.html; Claire Shipman & Mary Pflum, *Is It Wrong To Walk Away from a Mortgage Deep Underwater?*, ABC NEWS (Feb. 11, 2010), http://abcnews.go.com/GMA/mortgage-defaults-borrowers-walk-away-underwater-home/story?id=9802435; Liz Pulliam Weston, *Are You Foolish To Pay Your Mortgage?*, MSN MONEY (Dec. 9, 2009), http://articles.moneycentral.msn.com/Banking/HomeFinancing/weston-should-you-walk-away-from-your-home.aspx.

16. *See, e.g.*, White, *supra* note 11, at 979–86 (discussing the financial logic of engaging in strategic default).

17. Kathleen M. Howley, *Lenders Pursue Mortgage Payoffs Long After Homeowners Default*, BLOOMBERG (Jan. 28, 2010), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aIf_vUQZFt.s.

18. Several states do not allow deficiency judgments for power-of-sale foreclosures, but will allow deficiency judgments if the lender goes through the judicial process. *See, e.g.*, ALASKA STAT. § 34.20.100 (2008); IOWA CODE ANN. § 655A.8. (West 1995 & Supp. I 2010); MINN. STAT. ANN. § 582.30 (West 2010); MONT. CODE ANN. §§ 71-1-232, -317 (West 2009); WASH. REV. CODE § 61.24.100 (2010).

19. ARIZ. REV. STAT. ANN. § 33-814A (2007 & Supp. I 2010). However, note that, in Arizona, only properties of 2.5 acres or less are nonrecourse. *Id*. § 33-814G.

20. CAL. CIV. PROC. CODE § 580b (Deering 2010).

21. N.D. CENT. CODE § 32-19-03 (2010).

22. OR. REV. STAT. § 86.770(2) (2009).

recourse would be allowed for home equity loans, and arguably refinanced mortgages).[23] The vast majority of home mortgages in America are recourse loans.[24] Moreover, the defaulting landscape is constantly changing as banks—including Fannie Mae and Freddie Mac—become more aggressive in pursuing deficiency judgments; Fannie Mae has even announced that it will not lend to strategic defaulters for a period of seven years.[25]

Still, in some cases, White and others may be correct that it makes *financial* sense for those who are very much underwater to default strategically. The arguments offered so far for why it is *morally* permissible to do so, however, are seriously flawed. Unfortunately, there has been virtually no response to these moral myths from academic quarters. Some of the arguments do have a strong intuitive appeal at first, making it all the more important that we subject them to close scrutiny. If it truly is in a borrower's best financial interests to default strategically, any argument for the moral permissibility of such a move will be especially tempting to that borrower. A clear-eyed public discussion of these arguments is very much in order.

Much is at stake here. There are currently enough underwater home mortgages that, if strategic default became socially acceptable, it could have a snowball effect on the already depressed housing market. Approximately twenty-four percent of all residential mortgages were underwater at the beginning of 2010.[26] Some states have been hit particularly hard, such as Nevada (seventy percent), Arizona (fifty-one percent), and Florida (forty-eight percent).[27] A new wave of defaults would further depress home values, causing even more homeowners to go even further underwater, and thus perhaps leading to even more defaults. Such an occurrence would clearly be bad for the holders of the mortgages. Nor can we simply shrug off such a possibility as only a misfortune for banks, since, for all practical purposes, it is the American public who is guaranteeing the vast majority of home mortgages, through the troubled Fannie Mae and Freddie Mac[28]—not to mention the negative impact that a

23. Since then, two more states—Nevada and North Carolina—have taken away the opportunity for recourse on purchase-money home mortgages, but only for loans made only prospectively. *See* NEV. REV. STAT. § 40.455 (2006 & Supp. I 2009); N.C. GEN. STAT. § 45-21.38A(d)(2) (2009).

24. Many states do limit the amount of recourse to the difference between the loan amount and the market value of the home in an attempt to protect borrowers from noncommercially reasonable sales of foreclosed property.

25. Eileen Connelly, *Fannie Mae Tries To Stop 'Jingle Mail*,' MSNBC.COM (June 23, 2010), http://www.msnbc.msn.com/id/37879718.

26. Media Alert, First American CoreLogic, Underwater Mortgages on the Rise According to First American CoreLogic Q4 2009 Negative Equity Data (Feb. 23, 2010), http://www.loanperformance.com/infocenter/library/Q4_2009_Negative_Equity_Final.pdf.

27. *Id.*

28. According to the Federal Housing Finance Agency, Fannie Mae and

further worsening of the housing market would likely have on the overall economy.

Additionally, the underlying issue is not just about home mortgages, but rather is central to contract law as a whole. The relationship between contractual duties and moral duties has long been of central importance in debates about the philosophy of contract law. Such debates have taken place primarily in academic settings. We who teach contract law often manage to induce first-year law students to wrestle with such controversies in the classroom, but such abstractions are generally forgotten by the time students sit for the bar exam and are seldom discussed by policy makers. Until now, that is. Since the beginning of the housing crisis, at least two states have passed laws cutting back on the recourse available to lenders in home mortgage settings.[29] Although I will argue that strategic default is immoral even in nonrecourse states, a trend toward disallowing recourse (if there is such a trend) would probably signal a shift in the way people think about contractual duties. If that is true, it is not at all clear why home mortgages are different from the promises people make in other contractual settings. A movement toward disallowing recourse would invite people to think that it is always morally permissible to break promises as long as there is no legal remedy for the promisee. Although it is impossible to say for sure what long-term effect such a change in attitude would have, it is easy to imagine it greatly impacting both our interpersonal relationships and our commercial dealings with one another.

Accordingly, I will examine the arguments for why strategic default is morally permissible and show why these arguments fail. Inevitably, I will often refer critically to Professor White's work, but in fairness, that is only because he has done the best job of clearly stating the arguments in favor of strategic default. My aim is not to offer my own account of why strategic default is immoral. Rather, my goal is merely to evaluate the arguments that have been offered in support of the permissibility of strategic default and to correct some of the more glaring errors. In the end, I am left thinking what most Americans seem to think as well: those who borrow hundreds of thousands of dollars and promise to pay that money back should do so if they are reasonably able.[30] But I will not argue for that

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Freddie Mac owned approximately 30.5 million mortgages as of the first quarter of 2010. FED. HOUS. FIN. AGENCY, FORECLOSURE PREVENTION & REFINANCE REPORT: FIRST QUARTER 2010, http://www.fhfa.gov/webfiles/15860/1Q10FPR.pdf; *see also* Binyamin Appelbaum, *Costs Surging for Freddie Mac and Fannie Mae*, N.Y. TIMES, June 20, 2010, at A1 (discussing the financial impact of foreclosures on Freddie Mac and Fannie Mae); *Freddie Mac Seeks More Aid After a Big Loss*, N.Y. TIMES, Aug. 10, 2010, at B7 (reporting on Freddie Mac's increasing number of foreclosed properties and its need for more federal assistance).

29. *See supra* note 23 and accompanying text.

30. Luigi Guiso, Paola Sapienza & Luigi Zingales, *Moral and Social*

conclusion directly here.

Because the arguments in favor of strategic default are numerous, and because they are often presented in a way that easily confuses different issues, I will approach them by dividing them into groups. Part I examines arguments that focus on the borrower. It is important to emphasize early and often that I am not concerned in this Article with borrowers who cannot afford to repay their mortgages, as I will explain. Part II focuses on arguments that center on lenders and claims that borrowers are not obligated to keep their promises due to some fact about their lenders or, perhaps, about lenders in general. Part III centers on arguments that the borrower need not repay, either because contracts are not promises or because the content of a borrower's promise does not include a duty to repay so long as one gives up the house. In this Part, I will distinguish between recourse and nonrecourse states. I will first show that true nonrecourse states are much rarer than is commonly supposed. I will then argue that, while the arguments for the morality of strategic default are more plausible in such settings, they fail nonetheless. Finally, this Article concludes by briefly noting a few important miscellaneous points. Although each deserves a more detailed discussion, such work is beyond the scope of this Article.

I. BORROWER-CENTERED ARGUMENTS

It is difficult not to feel sorry for homeowners who bought at the height of the housing market, especially in bubble-prone areas. Today, some of these homeowners find themselves owing twice as much as their homes are worth or more, even in some cases when they placed significant down payments on the houses. Unless there is a dramatic turnaround in housing values, such borrowers face years of making payments before they will see any accumulation of equity.

It is imperative at the outset to emphasize that the term "strategic default" does not include those homeowners who default on their homes because they cannot afford to make payments, no matter how at fault they may have been in creating their predicaments in the first place. The principle that *ought* implies *can* is as well accepted as any in moral philosophy. Put simply, people are not morally required to do that which they are unable to do.[31]

Constraints to Strategic Default on Mortgages 19 (Nat'l Bureau of Econ. Research, Working Paper No. 15145, 2009), *available at* http://www.nber.org/papers/w15145 (stating that eighty-one percent of survey respondents "think it is morally wrong to default on a mortgage when you can afford to pay it").

31. Actually, nothing is really *that* simple in philosophy—especially moral philosophy. We can easily put pressure on this principle by imagining conflicting moral obligations like those faced by Antigone. *See* SOPHOCLES,

They may still be legally responsible for their debts, at least until their debts are discharged in bankruptcy. However, our concern here is with moral permissibility.

We are concerned with borrowers who have the ability to repay but who find it in their financial interests not to do so simply because they owe much more on their homes than they are worth. Industry experts disagree as to how exactly "strategic default" should be defined,[32] but it is not important for my purposes which definition one uses. Let us use the term loosely and apply it to those homeowners who are far enough underwater so that, according to the laws of their state, default is a good financial decision, even though they could, with reasonable comfort, afford to continue making payments on their houses for the foreseeable future. To make the case even simpler, let us further assume that the homeowners cannot only make the payments comfortably, but can also do so just as comfortably as they could before the fall of housing values.

Further, let us only consider the cases in which it is truly in the best financial interests of homeowners to default strategically. One might well wonder if Professor White and others overestimate how many such cases there are. As mentioned previously, most of the states that are often called nonrecourse actually allow for deficiency judgments if the lender is willing to pursue a judicial foreclosure.[33] While it has been more common in those states to foreclose by a nonjudicial "power of sale" and forgo the deficiency judgment, those practices may change if enough people begin to engage in strategic default.[34] And while bankruptcy is an option for most borrowers, recent reforms do include a "means test" that would force many higher income borrowers into Chapter 13, in which they would be forced to apply all of their disposable income to their debts for three to five years.[35] Still, many borrowers will find it in their best financial interests, all things considered, to default on their mortgages even if they can afford to make the payments. It is those

ANTIGONE (Reginald Gibbons & Charles Segal trans., Oxford Univ. Press 2003) (c. 442 B.C.E.); *see also* MARTHA C. NUSSBAUM, THE FRAGILITY OF GOODNESS: LUCK AND ETHICS IN GREEK TRAGEDY AND PHILOSOPHY 51–82 (2001). The philosophy of promising allows such tensions: for example, if I promise to leave my entire estate to my first son, and then make a separate, identical promise to my second son. But here we are only concerned with borrowers who have the ability to pay, yet simply find that it is not in their best financial interest to do so.

32. *See* White, *Take this House and Shove It*, *supra* note 14, at 7.

33. *See supra* note 18.

34. *See, e.g.*, Jody Shenn, *Banks Seeking To Sell $10 Billion of Bad Mortgages*, BLOOMBERG (May 24, 2010), http://www.bloomberg.com/news/2010-05-24/banks-seek-10-billion-of-bids-in-increased-effort-to-sell-sour-mortgages.html ("Lenders have sought bids on about $10 billion of troubled mortgages in recent months, more than in all of 2008 and 2009 . . . .").

35. 11 U.S.C. § 1322(d) (2006).

borrowers with whom we are concerned here.

By defining strategic default in this way, we have taken most of the arguments that focus on the borrower off the table. Since we are assuming that most of the relevant facts about the borrower are the same after the decline in housing values as before, we would expect her moral obligations to be the same. Of course, one important fact about the borrower has changed: it is now in her financial best interest to default. But this fact alone is generally not sufficient for moral permissibility. (We will consider additional factors that may make a moral difference soon enough.) It may be in my financial best interest to steal money from my employer if I am certain I can get away with it, but obviously that fact alone does not make it morally permissible to do so.

One might object here that, while the morality of strategic default may be an open question, it is not on a par with stealing. Since I will occasionally refer to such parallels, this intuition is worth addressing at the outset. First, the point is not to say that strategic default is like stealing. Rather, my aim is to point to a structural parallel between the two defenses. The moral reasoning is similar in structure. Second, depending on the circumstances, strategic default may well be worse than stealing. Refusing to pay back hundreds of thousands of dollars when one could easily do so certainly is more harmful to the lender than stealing a box of pens, or the small amount of cash that might be in my wallet at any given moment.

There is, however, one borrower-centered argument worth addressing. Professor White points out that borrowers have other moral obligations that may be in tension with their obligations to pay their banks.[36] Many borrowers have children, for example, and the difference between their bloated house payment and the lower cost of renting could be used to save for their children's college education. Even those who do not have children could save for retirement, an investment Professor White characterizes as a moral duty we owe to those who would otherwise have to take care of us in our dotage. Thus, sometimes strategic default may not be merely morally permissible, but actually "the most moral thing to do."[37]

While this argument has a certain intuitive appeal, it depends on an ambiguity about what it means to be able to afford mortgage payments. If there is truly a duty to save for a child's college education, and fulfillment of this obligation is stymied by mortgage payments, then arguably one cannot afford to make the mortgage payments. In this case, however, that person is not the person about whom we are arguing. We have stipulated that *our* borrower can afford to make the payments and indeed can afford to do so just as much after the fall in the value of the house as before. Therefore,

36. *See* White, *The Morality of Strategic Default*, *supra* note 14, at 6–8.
37. *Id.* at 6.

that borrower could not afford to save for college before, suggesting either that he has overreached in his borrowing or, perhaps, that he had little choice (imagine a state like California, where even the most modest homes are incredibly expensive). One might try to argue that the former borrower owes more of a duty than the latter, but I am willing to concede for the sake of argument that neither has a duty. The borrower in whom I am interested is someone who can afford to make the payments, presumably while also meeting all other moral obligations.

To be sure, even someone who can afford to save for retirement and college and make the payments on his mortgage could still find a good use for the money he might save by defaulting. Perhaps his children could go to an even better college, or he could save for a more comfortable retirement (or, in Professor White's way of thinking, relieve others of even more of the burden of caring for him in his old age). He might even choose to give that money to famine relief, where it could literally save lives overseas. But this argument proves too much, as it could apply to any decision in which it is in a person's best financial interest to make. Again, imagine that I can steal from my employer and be certain that the theft will go undetected. The fact that I could use that money for my sons' educations or to save society the burden of taking care of me in my old age, or even that I could use that money for famine relief, does not morally justify stealing it.

In fairness to Professor White, his argument does not merely focus on competing moral obligations, but weighs those obligations against the (he thinks) weakness of the moral duty to pay the mortgage in its own right—arguments we will get to soon enough. But it is important that we diligently resist the temptation to slip back to the morally more persuasive borrower who is in true financial hardship. For example, in this case White can't help himself: "many . . . homeowners now find themselves pouring all or most of their disposable income into a home that is no longer an investment, but rather a threat to their families' financial security."[38] One certainly feels for anyone whose financial security is truly threatened, but the more interesting moral question at issue here is that of strategic default, i.e., the cases in which the borrower can afford to pay the mortgage but finds that it is not in her best financial interest to do so.

I should also be clear that, although my own aim is to discuss strategic default as I have narrowly defined it, much of the discussion about the mortgage crisis is not so narrowly focused. Many authors are keen to draw attention to the plight of borrowers who cannot afford to repay their mortgages, and I do not doubt that those borrowers far outnumber the strategic defaulters. Other

38. *Id.* at 7.

authors draw attention to various forms of misfeasance by banks or mortgage brokers of the sort that might morally excuse borrowers from repaying their loans, and I do not wish to detract from those arguments. No doubt part of Professor White's project is to show that the moral picture is more complicated than it might appear to some, and that point is well taken. My goal here is only to help clarify a small part of the moral picture. Borrowers without special mitigating circumstances such as fraud who can comfortably afford to repay their loans have neither a legal nor a moral right to breach.

II. LENDER-CENTERED ARGUMENTS

A slightly more compelling set of arguments focuses on the role of lenders, seeking to blame the lender for the borrower's plight. We can divide these arguments into roughly three categories: first, there are arguments that lenders were responsible for the particular loan at issue; second some arguments are that lenders were responsible for the housing crisis in general; and third, and perhaps most interesting, there are arguments that there is a "normative asymmetry" between borrowers and lenders.

One argument for the permissibility of strategic default focuses on the fact that in a typical transaction, the lender rather than the borrower "arrange[s] the appraisal."[39] We must be careful here. First of all, let us set aside cases in which a fraud has been committed, especially if the lender had reason to suspect the fraud. One hears of cases in which a loan generator was so eager to close the transaction that she used a favored appraiser who was known to appraise houses implausibly high. While undoubtedly some such cases did occur, that mere fact alone is not enough to relieve all borrowers of their duty to pay.

Second, it is important to keep in mind that, although borrowers seldom arrange for the appraisals themselves, the appraisal is as likely to be arranged by a real-estate broker as it is by the lender, or perhaps by a mortgage broker who is not lending the money itself.[40] In fact, when the lender insists on an appraisal, it is for the protection of the lender, not for the protection of the borrower. It is odd at best for a borrower to blame the lender for obtaining an unreliable appraisal when the appraisal was not intended for borrower's benefit in the first place. Appraisals are not

39. White, *supra* note 11, at 1007.

40. Approximately seventy-five percent of residential mortgage appraisals are arranged by brokers. Karen Freifeld & Sharon L. Lynch, *Fannie Proposes Ban on Lenders' In-House Appraisers*, BLOOMBERG (Feb. 27, 2008), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a8mRh6OENZnc.

expensive,[41] especially compared to the amounts being loaned, and it is easy enough for the borrower to hire someone who represents only the borrower's interests. The fact that borrowers seldom do so does not relieve them of their moral obligation to pay back their loans. It is also true that lenders are "more financially sophisticated"[42] than borrowers, but it does not take a great deal of financial acumen to decide whether to spend a few hundred dollars on an independent appraisal.

A related set of arguments is that lenders acted in a financially irresponsible manner with respect to many of the loans in question: by relaxing the loan-to-value ("LTV") requirements, banks irresponsibly failed to ensure that many of the home loans were sufficiently collateralized.[43] There are actually two arguments here. One is that, in a particular case, the lender loaned too much money in comparison to the house's value. The second is that, because of these general practices, lenders created an overall bubble in the housing market. Let us consider these arguments in turn.

First of all, note that the first argument, if it applies at all, only applies in those cases in which the bank under-collateralized the loan. Suppose, for example, that in the particular case in question, a bank would only loan up to eighty percent of the value of the house. Suppose further that a borrower paid $100,000 down and borrowed $400,000 for a total purchase price of $500,000. If that house dropped in value to $250,000 in a short time, the homeowner would be far underwater. In this case in particular, however, the bank could not be blamed for being irresponsible in its LTV ratio, and therefore the argument is not available to this borrower. As we shall see over and over again, it is all too easy for an underwater homeowner to say, "banks did this," or "banks did that," without regard to her own particular situation.

In fact, recall that when speaking of strategic default we are only speaking of those borrowers who have the ability to pay for the loan, then we are necessarily talking about a set of "by the book" financial decisions that does not appear nearly as irresponsible as we might have thought at first glance. The most financially irresponsible decisions were those made by the lenders (and borrowers!) in transactions in which the borrower had little or no income and made no down payment. It also seems unlikely that many of those loans will fit into the category of strategic default. Instead, the borrowers with whom we are concerned here turned out to be good bets, at least on paper. Of course, borrowers who engaged

41. Appraisals averaged $362 nationwide in 2009, according to a recent Bankrate survey. Holden Lewis, *Texas Tops 2009 Closing Costs Exclusive*, BANKRATE.COM (Sept. 1, 2009), http://www.bankrate.com/finance/mortgages/texas-tops-2009-closing-cost-exclusive.aspx.

42. White, *supra* note 11, at 1008.

43. *Id.* at 1007–08.

in strategic default were bad bets because of that fact. But in such a case, the irresponsibility of the decision turns not on the inability to pay, but on the unwillingness to pay. We might blame banks for laying themselves open to opportunistic behavior in this way much as a person would blame herself if she left her wallet in a place it could be easily stolen, but that sort of irresponsibility does not relieve the borrower of the duty to pay any more than it excuses the thief.

Secondly, the eventual holder of the mortgage is seldom in practice the original lender. Of course, many people who invested in the mortgage-backed securities market undoubtedly acted irresponsibly by purchasing high-risk mortgages. But for the most part, the borrowers who are considering strategic default are those who can still afford to pay their mortgages despite the economic downturn, and therefore were likely not high-risk mortgages. However irresponsibly the banks may have acted, for the most part they did not act irresponsibly by loaning to *these* borrowers. Besides, it is ultimately the American public who, as guarantors of Fannie Mae and Freddie Mac, will be left holding the bag on a great many, if not most, of these loans. The fact that Fannie Mae and Freddie Mac were themselves irresponsible is unfortunate, but it does not make it excusable for borrowers who can afford to repay their loans to leave the public to absorb the loss.

Much more importantly, it is not at all clear why a lender's financially irresponsibility in trusting a borrower is thought to relieve the borrower's duty to pay in the first place. To be sure, once we label the lender "irresponsible," then it is easier to think the lender deserves whatever outcome it gets. And perhaps it does. That consideration, however, does not speak to the moral duty of the borrower.

Finally, we have not yet mentioned the most obvious objection: that the borrowers acted just as irresponsibly as did the lenders. It seems obvious in retrospect that both many lenders and many borrowers greatly overvalued the future value of homes. Many people came to believe that home values would always go up, and that homeownership would always be a good investment. To be sure, most lending institutions are more financially sophisticated than are most borrowers, but in this case there is plenty of blame to go around. For whatever it is worth, the most irresponsible lending institutions continue to pay dearly for their mistakes from the cost of nonstrategic defaults alone.[44] Borrowers made a bet on the value

44. *See* THE MORTGAGE LENDER IMPLODE-O-METER, http://ml-implode.com (last visited Mar. 12, 2011) (stating that, as of January 31, 2011, "387 major U.S. lending operations have 'imploded'"). Furthermore, as of the end of the second quarter of 2010, 9.11 percent of all mortgages remained in "serious default," or at least ninety days past due. David Streitfeld, *Number of Home Foreclosures Drops, but Risk of Delinquency Deepens*, N.Y. TIMES, Aug. 27, 2010,

of their homes. The mere fact that banks are more sophisticated financial players does not justify borrowers walking away from their bets.

A better, related argument involves moving away from the narrow facts of a given loan to banking practices in general and arguing that irresponsible banking practices writ large led to homes being overvalued. The point here is not that a bank necessarily acted irresponsibly in making the particular loan in question, but rather that the general practices of lending institutions during the housing boom—e.g., relaxing LTV ratio requirements, credit standards, and proof-of-income standards—led to an overvalued housing market. A consumer who bought at the height of the market and then later learned of these practices after seeing her house greatly decline in value might well feel anger and frustration toward the banks.

There are two problems with this argument as a defense for strategic default. One is that it too quickly associates the irresponsible practices of "banks" with those of the particular institution to which the borrower made his promise and from which he received hundreds of thousands of dollars. It is all too easy to cast stones at any large, faceless company and even easier when referring to an entire industry of such companies. Banks in particular are easy to pick on these days because so many of them were "bailed out" by the government,[45] though it is far from obvious how to tie the bailout of big Wall Street banks to an individual homeowners' decisions to default. Banks are owned by real people, people who suffer losses when homeowners default on their mortgages. Moreover, the people left holding the bag on most mortgages are seldom in control of the banks that generated the loans to begin with. Many of the mortgages are eventually bought by large institutional investors that are managing the pensions or other investment accounts of everyday people just like the borrowers. Again, it is the taxpayer who may stand to lose the most of all, especially considering the enormous number of mortgages backed by Fannie Mae and Freddie Mac.[46]

Second, it seems ironic at best for buyers to complain that lenders were responsible for the inflated housing market. No doubt, lending practices have a huge impact on prices, and it would be naïve to think otherwise. It also seems odd to argue that lending institutions are more responsible than buyers, who along with sellers, are most directly involved in setting prices. Of course any

at B3, *available at* http://www.nytimes.com/2010/08/27/business/27default.html.

45. *See Treasury's Bank Bailout List*, CNNMONEY.COM, http://money.cnn.com/news/specials/storysupplement/bankbailout (last visited Mar. 12, 2010) (listing the banks that have been bailed out by the Treasury Department).

46. *See* FED. HOUS. FIN. AGENCY, *supra* note 28, at 2.

given buyer might claim innocence, and blame other buyers for driving up prices, but if it is fair to generalize about banks, then it is fair to generalize about buyers. As I said before, there is plenty of blame to go around, and banks are already paying for their sins with nonstrategic defaults. It seems only right for buyers, who themselves played a role in driving up prices, to keep their promises, at least if they are able to do so without great hardship.

One might also argue that homeowners had no choice but to pay inflated home prices, and because of this lack of choice cannot be blamed for their actions. But the fact is that most buyers could have easily chosen to rent rather than buy. Part of Professor White's argument for the irresponsibility of banks' lending practices is that they loaned even when price-to-rent ratios were off the charts:

> [H]istorical home prices have hewed nationally to a price-to-annual-rent ratio of roughly fifteen-to-one. At the peak of the market, however, price-to-rent ratios reached fifty-one-to-one in the most inflated markets, and the national average reached twenty-three-to-one.[47]

Although Professor White offers these statistics as evidence of the irresponsibility of banks, the statistics just as clearly evidences the financial irresponsibility of buyers. If these numbers are correct, they suggest that most buyers who find themselves the most underwater now could have met their housing requirements much less expensively by renting instead of buying in the first place. And while the average consumer would not be aware of these precise ratios, it should be easy enough to compare the costs of renting to the costs of ownership in individual cases.

The final set of lender-centered arguments for the moral permissibility of strategic default focuses on the alleged "normative asymmetry," to use Professor White's phrase, between banks and borrowers. The idea is that borrowers should be allowed, even encouraged, to act the same way banks do—as cold, hard, rational actors who act only in their own self-interest without regard for emotion or morality. The fact that most borrowers do not think this way, but instead see themselves as morally obligated to keep their promises even when it is not in their best financial interests to do so,[48] is presented by Professor White as a mystery that can only be explained by the efforts of "social control agents" acting on behalf of the banks and the government to encourage consumers not to act in their own best interests.[49]

Once again, this is an argument that generalizes about what "banks" supposedly do, without regard for what the particular lending institution in question has done, or for what the current

47. White, *supra* note 11, at 1007 (footnotes omitted).
48. *See id.* at 986–96.
49. *See id.* at 996–1007.

holder of the note has done (again, in most cases, the borrower's neighbors and fellow taxpayers). In the worst versions of these arguments, the actions of two particular firms who engaged in high-profile (supposedly) strategic defaults themselves are mentioned again and again.[50] It is unclear without examining the contracts at issue whether default was strategic or not, or whether it even could be strategic.[51] (Did the contracts in those cases give the borrowers the right to walk away? If not, why did their creditors not pursue deficiency judgments?) But even if these were cases of strategic default, it is hard to see how the fact that Morgan Stanley engaged in strategic default justifies my engaging in strategic default on my loan when Morgan Stanley did not loan me money and does not own the right to my payment.

On the other hand, I might think that, although Morgan Stanley's actions have nothing to do with me, they are indicative of the way all banks act. Indeed, Professor White even argues that if the bank is a corporation, "the directors and executives of the corporation have a legal duty to shareholders to maximize profits and minimize losses."[52] If this is meant as an empirical generalization about how corporations actually act, the claim is reckless at best. It is just too easy to assume the worst of corporations, especially if one is looking for a way to rationalize one's own self-interested decision. On the other hand, if Professor White means to suggest—as it seems he does—that bank directors have a *legal duty* to engage in strategic default when it would maximize profits to do so, then he should know better, as that is demonstrably false. The business judgment rule gives directors great latitude in running a corporation.[53] In particular, it allows them to choose a course of action they consider to be the morally right thing to do even when that course of action would not maximize profits.[54] No state in the union requires directors of corporations to choose profits over morality.

Ironically, for all of Professor White's talk of normative asymmetry, or a "moral double standard," it is he who argues for a double standard in this case. In a typical sale of a home, the buyer borrows money from the bank to pay over to the seller, promising to pay that money back. The seller promises to hand over the house in

50. Both Morgan Stanley and Tishman Speyer Properties recently defaulted on significant real estate loans. Since neither company was in bankruptcy, they were accused by some in the press of engaging in strategic default. Lowenstein, *supra* note 13, at 15; White, *The Morality of Strategic Default*, *supra* note 14, at 10; Mark Miller, *The Ethics of Strategic Default*, REUTERS (Aug. 20, 2009, 5:08 PM), http://blogs.reuters.com/deep-pocket/2010/08/20/the-ethics-of-strategic-default.

51. *See infra* Part III.

52. White, *supra* note 11, at 1009.

53. ROBERT CHARLES CLARK, CORPORATE LAW § 3.4 (1986).

54. *Id.* § 3.5, at 136–38.

exchange for the money. And the bank promises to transfer money to the seller on the buyer's behalf in exchange for the buyer's promise to pay the money back. When all goes as planned, the property is transferred to the buyer at the time of closing or soon after, and the bank hands over the money to the seller. At that point, *the bank has fully performed* its obligations to the buyer, as has the seller. Later, when the buyer finds that it is not in her best interest to perform, it seems odd at best to justify strategic default on the grounds that she is getting the bad end of a double standard. For all the talk of banks being cold-hearted, profit-seeking, rational actors, in every potential case of strategic default (not involving fraud) we can at least say that the bank kept its promise. It handed over hundreds of thousands of dollars or more on behalf of the buyer at the buyer's request. When we look at the transaction as an exchange of promises, it is jarring for the would-be promise breaker to complain of a double standard or normative asymmetry.

Even stranger is Professor White's repeated emphasis on the reluctance of lending institutions to modify loans for underwater homeowners after the fact as an example of normative asymmetry.[55] While it might be admirable for banks to modify loans for struggling homeowners, doing so certainly goes well beyond what their promises obligate them to do.[56] Again, the bank in these cases has fully performed its promise, while the homeowner threatens to breach his own promise. If there is a normative asymmetry here, it is in claiming that a bank has to do not only what it promised, but much more, while a homeowner who could very well keep his promise but finds it in his interests not to do so does not have to keep his. (A bank *may* have a moral obligation to modify loans for those who cannot afford to pay the entire amount, but those loans are not our concern here.)

What Professor White means by a normative asymmetry, then, is not an asymmetry in this transaction, but rather in the broader standards of conduct. In particular, the suggestion is that if the shoe were on the other foot, the bank would engage in strategic default, and that fact justifies the borrower in defaulting in the actual circumstances. But our moral duties do not typically depend on what the other party would do in a different situation. For example, most of us would agree that the fact that you would steal from me if given the opportunity would not make it morally permissible for me to steal from you if given the opportunity.

55. *See*, White, *supra* note 11, at 1010–11.

56. Moral philosophers refer to such actions as supererogatory: they are those actions that an actor is not morally required to perform but is to be praised for performing should she decide to do so. Similarly, suberogatory actions are those that are morally permissible, though we may nonetheless think less of the actor who performs them. *See generally* Heidi M. Hurd, *Duties Beyond the Call of Duty*, 6 ANN. REV. L. & ETHICS 1 (1998) (Ger.).

Similarly, the fact that Mugsy is the sort of guy who starts fights without provocation does not make it morally permissible for me to attack Mugsy without provocation (assuming I am not acting to deter him). To be sure, if Mugsy is a bad person, the rest of us may not feel as sorry for him if he is the victim of wrongdoing as we would for a more virtuous person. We may even say he got what he deserved. But that lack of sympathy does not translate to moral permission for me to mistreat him in the same way he mistreats others.

One might claim here that I misunderstand the force of the argument. Perhaps the point is not that banks are acting immorally, but rather that they are acting *amorally*. In other words, perhaps the fact that they are not responsive to moral reasoning suggests that they are playing by a different set of rules, and that therefore we are permitted to play by those same rules. To them it is just business, and in the world of business there is a different set of rules as to what is acceptable and what is not. At bottom, this version of the argument rests on the idea that banks are not engaged in the moral practice of promising, but rather in the entirely different practice of entering into contracts. I will take up this argument in the next Part, in which I examine arguments that focus on the nature of the promise/contract as opposed to the lender's behavior or character.

III. AGREEMENT-CENTERED ARGUMENTS

So far we have examined arguments that focus on some fact either about the borrower or about the lender that would justify borrowers in engaging in strategic default. I have argued that none of those grounds for strategic default are morally satisfying. However, there is a more sophisticated set of arguments that focus not on the parties to the agreement, but rather on the agreement itself. Although my aim in this Article is to address the moral arguments alone, here the moral and legal arguments are intertwined. I see two broad kinds of arguments that focus on the agreement: that contracts are not promises and therefore do not create moral obligations; and that in any event the content of the agreement anticipates and allows for strategic default, so that one who defaults is in effect not even breaking the agreement.

First of all, one might argue that mortgage contracts do not constitute promises at all. Promises, one might argue, are a matter of interpersonal moral obligations, whereas contracts are a matter of legal obligations. While many legal obligations are no doubt based on moral obligations (e.g., prohibitions on murder, rape, and other heinous crimes), contract law is simply a device by which the government greases the wheels of commerce. Perhaps when it comes to contracts, it's not personal, just business.

Whether contractual obligations are in some sense based on our moral obligations to keep promises is a complicated question about which much has been written. For example, Professor Charles Fried famously argued that moral obligations to keep promises are the backbone of contract law.[57] By contrast, Professor Michael Pratt has argued that undertaking a promissory moral obligation is neither necessary nor sufficient for contractual duties.[58] Courts for the most part seem to agree more with Pratt than Fried. For example, contract law has a strict-liability standard,[59] and courts often point out that the existence of a moral duty to keep a promise is not sufficient to support a breach-of-contract claim.[60] In fact, I have argued at great length that contract law is not primarily concerned with enforcing the moral duties associated with promising.[61] Instead, contract law is the government's solution to the practical problem that people who lack sufficient reason to trust one another face when they seek to make mutually beneficial exchanges.[62] And in a much-discussed recent paper, Professor Seana Shiffrin, who would prefer that contract law be more responsive to the moral norms of promising, catalogues the "divergence of contract and promise."[63]

None of these debates, however, speak to whether individuals have a moral duty to keep the promises they make in contractual settings. The above-mentioned debates are primarily attempts to explain and/or justify contract law, i.e., the legal response to the breaching of contracts. A state may well decide not to enforce moral obligations, or to enforce contractual obligations for instrumental rather than moral reasons, but that does not mean that the individuals who make those promises do not have moral obligations. Indeed, often when courts decline to enforce contracts they nonetheless emphasize that they are doing so notwithstanding the moral duty to keep one's promise. Legal academics often debate the purpose or justification of legal regulation, including the extent to which a set of laws does or should enforce morality, but those are debates over what kinds of government intervention in private affairs are justified and generally are not debates about what is morally required independently of one's legal obligations.

57. *See* CHARLES FRIED, CONTRACT AS PROMISE 14–17 (1981).

58. *See* Michael G. Pratt, *Contract: Not Promise*, 35 FLA. ST. U. L. REV. 801, 809–10 (2008).

59. *See* E. ALLAN FARNSWORTH, CONTRACTS § 2.8 (4th ed. 2004).

60. *See, e.g.*, Pierce v. Clarion Ledger, 452 F. Supp. 2d 661, 664 n.3 (S.D. Miss. 2006); Mills v. Wyman, 20 Mass. (3 Pick.) 207, 211–12 (1825); Stone v. Lynch, 325 S.E.2d 230, 233, 312 N.C. 739, 743 (1985) (citing Carolina Helicopter Corp. v. Cutter Realty Co., 139 S.E.2d 362, 263 N.C. 139 (1964)).

61. *See* Curtis Bridgeman, *Reconciling Strict Liability with Corrective Justice in Contract Law*, 75 FORDHAM L. REV. 3013, 3015–20 (2007).

62. *See generally* Curtis Bridgeman, *Contracts as Plans*, 2009 U. ILL. L. REV. 341.

63. *See* Seanna Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 709, 719–27 (2007).

Thus, although contract law is (arguably) largely indifferent to moral obligations, it does not follow that contracts do not give rise to moral obligations for the parties that enter into them. On the contrary, contracts routinely use the language of promising. When one signs a document saying, "I promise to pay . . ." in exchange for hundreds of thousands of dollars, it seems obvious that one incurs at least a prima facie moral obligation to pay as promised, whether the law is interested in enforcing the promise because of the moral duty or for some other reason. Professor White suggests that contracts are not "sacred" promises[64] and does not explain what would make a promise sacred, and why such a badge is necessary for a moral obligation.

A second agreement-centered argument is that regardless of whether contracts contain morally significant promises or not, they are not promises to perform. Instead, mortgage contracts include an implied "put" option.[65] That is, the homeowner is said to have a contractual "right" to walk away so long as she is willing to suffer the consequences of doing so.[66] The implied right to walk away is apparently thought to be on especially firm ground in nonrecourse states, where the law allows lenders no remedy other than foreclosing on the real property.[67] As we have seen, though, true nonrecourse states are much rarer than is commonly supposed. All but a very few states (between one and four, depending on how one counts) allow deficiency judgments even for residential mortgages, though some states will require holders of the mortgage to use judicial process to bring deficiency claims.[68] Thus we shall first consider recourse loans, and then consider the nonrecourse context later.

The put-option argument is tricky, so we must proceed with caution. Let us first consider its simplest—and most specious—form. At one point Professor White draws an analogy between cell-phone contracts and mortgage contracts.[69] Since further discussion will build from this starting point, it is worth quoting Professor White at length:

> Think of it this way: when you got your cell phone, you likely signed a contract with your carrier in which you "promised" to pay a set month [sic] payment for two years. Let's say, though, that two months after you sign your contract, the price of cell phone service drops by half—

64. White, *The Morality of Strategic Default*, *supra* note 14, at 4.

65. *See* White, *supra* note 11, at 1006, 1011–12.

66. *Id.* at 1006.

67. *Id.* at 985.

68. *See supra* notes 18–22. The precise number will depend on whether one includes only purchase-money mortgages and whether one includes new legislation enacted in the last year or two, none of which applies retroactively.

69. White, *The Morality of Strategic Default*, *supra* note 14, at 4.

> meaning that the same cell phone service you pay $100 a month for could be had for half of that with another carrier. You decide that you would be financially better off paying the early termination fee of $300, rather [than] $100 a month for another 22 months for the same service that you can now get for $50.
>
> Would it be immoral for you to break your contractual "promise" to pay $100 for two years, and elect instead to pay the early termination fee? Of course not. The option to breach your "promise" to pay is part of the contract, as is the consequence of breach—a $300 early termination fee. There is absolutely nothing immoral about exercising your option to breach, and you'd be financially wise to do so.
>
> Though a mortgage contract is more substantial, and involves a home, it is simply a contract, just like a cell phone contract. Like a cell phone contract, a mortgage contract explicitly sets out the consequences of breach.
>
> In other words, the lender has contemplated in advance that the mortgagor might be unable or unwilling to continue making payments on his mortgage at some point and has decided in advance what fair compensation to the lender would be. The lender then wrote that compensation into the contract. Specifically, the lender probably included clauses in the contract providing that the lender may foreclose on the property, keep any payments that have been made, and may opt to pursue a deficiency judgment against the mortgagor, if state law so allows.[70]

The problem with this argument is obvious: it fails to distinguish between a contract that lays out the consequences of one party's failure to perform its duty and a contract that gives one party a right to cancel. Contracting parties often find it worthwhile to negotiate the consequences of default in the contract itself, but such terms should not be confused with termination clauses. Although it is true that mortgage contracts are "simply" contracts, to the extent that cell phone contracts include termination clauses that give the consumer a right to cancel by paying a fee, mortgage contracts are not "just like cell phone contracts." Of course, it is *possible* for a borrower and lender to negotiate such a put option (which may explain some of the high-profile and supposedly strategic corporate defaults), but the vast majority of mortgage contracts do not include such clauses. The question of whether it is immoral to "break" or "breach" your cell phone contract does not even arise in the example so long as you pay the termination fee in accordance with the agreement: terminating is not breaching, but

70. *Id.*

rather exercising a bargained-for right.

It may seem at first that I am relying on a rather thin distinction. After all, economists may be interested only in the consequences of a course of action and may not concern themselves with whether the parties label the course of action as an option, or by contrast as a breach of a duty. Economists are generally just concerned with the way individuals respond, or should rationally respond, to incentives. Such concerns go to the heart of what is in a party's financial best interests, but here we have defined strategic default so that it is in a party's financial best interests. While economists tend to shy away from the moral issues, those are my only concerns here (and at least in the relevant passage it is Professor White's point). There is a significant moral difference between agreeing in a contract that a course of action is forbidden and agreeing that it is available for a price. In short, words matter.

That Professor White fails to appreciate this point can best be illustrated by reading what he says immediately after the previously quoted passage:

> By writing this penalty into the [mortgage] contract, and then signing the contract, the lender *has agreed* to accept the property, and (in most states) the option to pursue a deficiency judgment, in lieu of payment.[71]

The problem, of course, is that the lender has agreed to no such thing. Put simply, that is not what these contracts say.

It is true that mortgage contracts are typically drafted by lenders, not borrowers, and that lenders are much more legally and financially sophisticated than borrowers. It is probably also true that borrowers rarely read all, or perhaps even very much, of the mortgage contracts they sign, though here I am only speculating. One need not argue that a party read or understood a contract in order to argue that she agreed to its terms.[72] More importantly, one does not need to read the fine print of a long mortgage contract to understand that borrowers are promising to pay the mortgage, not simply promising to pay unless they are willing to suffer the consequences of default. Indeed, I suspect that most Americans understand this point quite well without reading their mortgage contracts, and as evidence I offer the same statistics that Professor White finds so surprising, i.e., that "only 17% of homeowners indicated that they would default if [their] equity shortfall reached 50%."[73] Professor White's explanation for the "'underexercise' of the default option" is that homeowners are the victim of "social control

71. *Id.* at 5 (emphasis added).

72. *See* Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 319 (1986).

73. White, *supra* note 11, at 991.

agents" acting on behalf of the banks and the government.[74] The more likely explanation is that borrowers understand themselves to have promised to perform, and that they understand those promises carry moral weight.

Professor White's argument calls to mind an old debate in contracts theory that all contracts contain an implied option either to perform or to breach and pay damages. Versions of this argument go back at least to Oliver Wendell Holmes, Jr.,[75] and have more recently been popularized by law-and-economics scholars, most notably Judge Richard Posner.[76] The idea, roughly put, is that contractual duties only go as far as the remedies for breach. As Holmes put it, "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else."[77] The view is sometimes known as the "disjunctive thesis" or the "option theory of contract," since it sees contracts as giving one an option either to perform or to pay damages. The best argument for the thesis is that since contract law refuses to punish for breach—in particular, since it refuses to award punitive damages—then it must not consider breach to be an instance of wrongdoing so long as compensatory damages are paid.

Typically two kinds of responses are given to the disjunctive thesis. One set of responses relies on details of contract doctrine. For example, the commentary to Article II of the U.C.C. declares, "[T]he essential purpose of a contract between commercial men is actual performance."[78] Although the U.C.C. applies only to goods, the *Restatement (Second) of Contracts* has adopted both this rule[79] and its rationale.[80] In addition, the *Restatement (Second)* begins by defining a contract as "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty,"[81] while the next section defines a promise as "a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."[82]

Commitment to performance manifests itself in more subtle details of contract doctrine as well. For example, the fact that modifications require consideration shows that contractual duties are not disjunctive. If they were truly disjunctive, then a promise to

74. *Id.* at 987, 1001.
75. *See* Oliver W. Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).
76. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 131 (5th ed. 1998) (discussing efficient breach).
77. Holmes, *supra* note 75, at 462.
78. U.C.C. § 2-609 cmt. 1 (2003).
79. *See* RESTATEMENT (SECOND) OF CONTRACTS § 251 (1981).
80. *Id.* § 251 cmt. a.
81. *Id.* § 1.
82. *Id.* § 2.

perform rather than breach and pay damages should be sufficient consideration for a modification. Instead, common law courts refuse to see such promises as consideration, citing the legal-duty rule. Since a party to a contract has a legal duty to perform, a duty that cannot be discharged by merely paying damages, the promise to perform rather than breach does not provide anything new to the promisee and therefore cannot count as consideration.[83] And even under the U.C.C., which does not require consideration for contract modifications, a threat to breach can still be considered wrongful and grounds for a defense of duress.[84] Moreover, as Pollock once pointed out to Holmes in the course of debating this same issue, the fact that a plaintiff need not plead a failure to pay damages in addition to a breach suggests that breach alone is a legal wrong.[85] So does the fact that there is a tort for the wrongful inducement of breach by a third party. If contracting parties had a right to breach and pay damages it would not be an actionable wrong in tort for third parties to induce them to breach.[86]

Fine points of doctrine aside, the more straightforward reason the disjunctive thesis fails is that it ignores the distinction between the content of a duty and what we decide to do about a failure to perform a duty. By extension, one might as well argue that one has an "option" or "right" to steal or commit murder so long as one is willing to go to prison. The question of which behavior is permissible or forbidden is a different question from that of how we respond to such wrongdoing. Even though a court will do no more than make a breaching party pay expectation damages in the case of breach, that fact no more entails that there is no legal duty to perform than the fact that some states will not impose a death penalty even for murder means that individuals have a right to commit murder so long as they go to jail for the rest of their lives.

One might object that contract law, as a form of private law, is inherently different from criminal law. Criminal law by its nature is concerned with proscribing certain kinds of unwanted behavior, and with punishing violations of those proscriptions. And similar examples hold true for tort law as well. Although tort law does punish in extreme cases, it normally does no more than provide compensation for wrongdoing. Yet that fact does not give potential

83. *See, e.g.*, Levine v. Blumenthal, 186 A. 457, 458 (N.J. 1936) (holding the attempted modification of a lease unenforceable without "a new and independent consideration").

84. U.C.C. § 2-209 cmt. 2; *see, e.g.*, Austin Instrument, Inc. v. Loral Corp., 272 N.E.2d 533, 535 (N.Y. 1971).

85. *See* Letter from Sir Frederick Pollock to Oliver Wendell Holmes (Sept. 17, 1897), *in* 1 HOLMES-POLLOCK LETTERS 79–80 (Mark DeWolfe Howe ed., 1961). Thanks to Nate Oman for pointing out this exchange to me. *See also* Nathan B. Oman, *Why There Is No Duty To Pay Damages: Powers, Duties, and Private Law*, 39 FLA. ST. U. L. REV. (forthcoming 2011) (on file with author).

86. *Id.*

tortfeasors the right to act negligently so long as they do not act recklessly or intentionally (risking punitive damages) and so long as they are willing to compensate.

But even if one believes in the disjunctive thesis in the context of contract law, notice that Professor White's version stretches the thesis to absurdity. The Holmesian disjunctive thesis posits that a promisor has a duty either to perform *or to pay expectation damages.* Professor White's version apparently gives parties the right to choose between performance and simply forfeiting the house without paying any additional damages (otherwise one would lose the financial benefits of strategic default). Of course, the mortgage contract does not give such a right. On the contrary, not only do the terms of the contract require performance, but as Professor White notes in the above passage, the clauses in mortgage contracts that discuss the remedies upon breach invariably include the right to pursue deficiency judgments to the extent allowed by state law.[87]

The argument is perhaps on firmer ground in the few states that are truly nonrecourse. At least in those states one could argue that the promise must be understood in light of the legal backdrop against which the contracting took place. If we presume that all parties to a mortgage contract in a nonrecourse state know, or ought to know, that there is no opportunity for a deficiency judgment in that state, then perhaps the best understanding of their agreement is that the borrower has a right to walk away if he is willing to give up the house. This intuition is potentially bolstered by the fact that lenders will presumably place a premium on borrowing in such states; borrowers will presumably have to pay a higher interest rate in such states because of the different legal rules, and they are therefore, in effect, paying for the right to walk away.

It would be a mistake to draw such conclusions from a statutory limitation on remedies, however. For example, some states have statutory limitations on the amount of compensatory damages that tort victims may collect, either in total or for certain kinds of injuries. No one in his right mind thinks that these limitations create a right to injure so long as he pays up to the maximum statutory damages. Similarly, statutes that prohibit lenders from recovering a deficiency judgment do not give borrowers the legal right to default strategically. Even more obviously, the existence of bankruptcy laws that provide for the possibility of a fresh start does not mean that ab initio the borrower has no legal duty to keep his promise, even if the existence of bankruptcy laws increases his cost of borrowing. If it did, then to the extent that debts arising from tort law can be discharged in bankruptcy (as most can),[88] we could

87. *See supra* note 71 and accompanying text.

88. For an example of an exception, see 11 U.S.C. § 523(a)(6) (2006) (stating that debt resulting from willful or malicious injury cannot be discharged in bankruptcy).

equally well say that, for example, we have a duty *either* to drive carefully *or* to drive negligently and either pay damages or discharge the damages in bankruptcy.

The underlying problem with this entire family of arguments is that they lose sight of the fact that legal duties do not determine the extent of moral duties. The debate at issue here, after all, involves the extent to which it is *morally* permissible to default strategically. We have been considering arguments that it is morally permissible to do so because the most that one promised is that one would surrender the house if the payments are not made. But of course in mortgage contracts one promises much more, at least if the words of the contract mean anything at all. It takes a rhetorical gymnast—a sport, it must be admitted, at which lawyers excel—to argue that the plain words of promise in a mortgage contract really just mean at most a promise to do what the existing legal system will require one to do. Even if one could successfully argue that legal duties are exhausted by legal remedies, it is another thing altogether to argue that *moral* duties are exhausted by legal remedies. It is quite common for us to incur moral obligations for which all concerned know there are no legal remedies.

For example, gratuitous promises are not (usually) actionable at law, yet they do generally give rise to moral duties. And if they do not, it is certainly not because the true content of the promise is really to "perform or not." Suppose I promise to feed your cat while you are out of town, not in exchange for any consideration but merely as a gift. Suppose further that I break my promise. When you complain, I tell you that I have done nothing morally wrong, because I had *really* only promised to feed your cat unless I decided not to, since you would have no legal remedy if I failed to keep my promise. Or suppose I tell you that I have really promised either to feed your cat or to compensate you for your loss should my failure to feed him cause him to starve, since your best hope for a legal remedy would be compensatory damages under a claim for promissory estoppel—a debt I might well discharge if the bankruptcy rules allow. You would rightly think me either insincere or insane, even though we both knew at the time I made my promise that you would have little or no legal remedy if I broke my promise.[89]

The situation may well be different, however, when we consider

89. In the philosophy of promising, there is an active debate about whether we have a duty to keep gratuitous promises in the absence of some sort of reliance. Of those who think we have no such duty, however, I know of no one who argues that we have no duty simply because there is no background legal remedy for such promises. Anyone bothered by the morality of gratuitous promises should remember that the larger point here is simply that the content of legal duties does not exhaust the content of moral duties. There are plenty of other examples to demonstrate this point, e.g., the duty to care for one's parents, the duty to perform small favors for close friends upon request, or the duty not to cheat on one's romantic partner.

promises among nonhuman legal entities, especially limited-liability entities like corporations or LLCs. Suppose that Smith wishes to build an apartment building and borrows money from Bank for that purpose. If Smith borrows that money in her personal capacity without negotiating an explicit put option or nonrecourse clause, then she has a duty to repay the mortgage even if it is in her financial interests not to do so. On the other hand, if she chooses to organize an LLC whose whole purpose is to own the property (what is often called a "special purpose vehicle," or "SPV"), and then borrow the money through that LLC with no personal guarantee, then she herself has no moral duty to pay the mortgage out of her personal assets even if the LLC defaults. The lender who knowingly agrees to lend to an LLC assumes the risk that upon default it will have no recourse beyond the assets of the LLC—and for LLCs that are created solely for the purpose of owning a particular property, such a transaction would be economically identical to a simple nonrecourse loan.

It is tempting to say that the lender has no complaint when the LLC defaults because the lender knowingly assumed the risks in such a case and presumably priced the loan accordingly. But an advocate of strategic default could well point out that the same is true in consumer nonrecourse loans. What is different in the case of the LLC, however, is that in that case it is the LLC making the promise, and the LLC is by definition a legal entity distinct from Smith, the organizer of the LLC. Smith may walk away from the property and lose only whatever money she has invested in it without being on the hook, morally speaking, for the deficiency, for the simple reason that she herself never promised to pay (assuming it was clear to all concerned when she was acting in her personal capacity and when, if ever, she is acting as a representative of the LLC). If the Bank wanted Smith to be on the hook, either morally or legally, for the debt, it should have secured a promise from Smith herself rather than just from the LLC.

At this point we might well wonder in what sense legal entities like LLCs have moral duties like promissory duties at all. After all, LLCs are not persons in the moral sense, even if they are in many legal senses, and thus it is not clear what it means for them to have moral obligations apart from the obligations of the individuals who act as their agents. But we need not settle such questions here, since for all practical purposes strategic default is not an option for non-human legal entities. Such entities are always liable for deficiencies unless they bargain for a nonrecourse loan at the outset. Even in bankruptcy, nonhuman entities are not entitled to a "fresh start" from Chapter 7; after a Chapter 7 liquidation, debts stay with non-human legal entities forever. They do have a limited ability to discharge debts in Chapter 11, but only in circumstances justified on public-policy grounds, and even then creditors are assured of at least as much payment as they would have received in a liquidation.

Of course, an LLC put together as an SPV just to own one property will likely have no other assets to satisfy a deficiency judgment, but that does not make the default "strategic" in our sense. Either the LLC has the assets to pay the mortgage, in which case the lender will be able to reach those assets eventually, or it does not.

To summarize, agreement-centered arguments make one or both of the following mistakes: they either completely ignore the stated language of mortgage contracts—which are certainly worded in a way that suggests a sincere, morally binding promise—or they insist on interpreting those words as really only meaning that one morally undertakes to do only what the law will require one to do, and no more. But it is not generally true that moral obligations are determined by legal obligations, nor is that a reasonable interpretation of what these promises mean.

CONCLUSION

In conclusion, I would like to add three miscellaneous points. Each point deserves much attention in its own right, but in each case a fuller discussion is beyond the scope of this Article.

First, not only do home buyers generally have a duty to keep their promises, third parties also have a duty to refrain from wrongfully inducing them to breach. The law has long recognized a tort of interference with contractual relations.[90] In order for the cause of action to lie, a plaintiff must demonstrate not only that the defendant induced the breach, but that she did so improperly.[91] What counts as an improper reason for inducing breach is far from clear, though what is clear is that malice is not required.[92] Attorneys who advise their clients to engage in strategic default are likely privileged in doing so.[93] Likewise, those like Professor White who are merely engaging in a public discussion about law and policy are unlikely to be liable, either, especially considering the right to free speech.[94] But organizations like youwalkaway.com, which are profiting by encouraging strategic default, could well be exposing themselves to liability. "It is also improper interference . . . to pursue any competitive scheme that would enhance the defendant's opportunities at the expense of actual existing contract rights in the plaintiff, in the absence of some justification other than the competition for future business."[95] But a further discussion of this possibility is beyond the scope of this Article.

Secondly, there has been much blame placed on the credit-

90. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 129, at 978–82 (5th ed. 1984).
91. *Id.* at 979.
92. *Id.* at 982–89.
93. *See id.* at 985.
94. *See id.* at 988–89.
95. *Id.* at 987 (footnotes omitted).

reporting agencies after the bursting of the housing bubble. The complaint is that lending institutions tended to rely on credit scores too much, considering that credit scores are based more on one's habits of paying on time than on one's ability to pay—say, on one's personal balance sheet. Thus, someone who had always made payments would have a high credit score, but that credit score would not reflect income or assets, and thus by itself would not be a good measure of a borrower's ability to pay back any particular loan. Professor White goes even further and castigates the credit-reporting system as a "means of social control" used by banks and the government to induce consumers not to act in their own best financial interests.[96] He notes with obvious disappointment that most American homeowners see their good credit scores as "statement[s] of their good moral character,"[97] and that a bad credit score is "meant to reflect not only one's poor creditworthiness, but also one's poor moral character."[98]

To be sure, when people get poor credit scores due to forces beyond their control—e.g., crushing medical expenses or the loss of a job—it is indeed unfortunate that their credit scores incorrectly suggest poor moral character. But Professor White's very argument also shows how, at least to some degree, credit scores can and sometimes do say something important about one's moral character. A debtor with an excellent income and balance sheet may look like a good credit risk, but if that person has a history of strategically defaulting whenever it is in his interest to do so, then that fact *does* reflect poorly on his moral character, and this past default history should be something that lenders care about.

Finally, I want to distance myself from one particular line of argument that has been offered for why it is immoral to default strategically. Some have argued that borrowers have a duty to continue to pay for their homes because of the effects that breach would have on the country as a whole, and in particular on their neighbors, especially in neighborhoods that have been hit particularly hard by the mortgage crisis.[99] Borrowers probably should take such effects into account when deciding what the best thing to do is, but here I agree with Professor White that "we don't generally expect individuals to make personal economic decisions for the good of [others]."[100]

More importantly, such arguments miss something important about the nature of promissory morality. Although some have

96. White, *supra* note 11, at 1006.
97. *Id.* at 1005.
98. *Id.*
99. *See* Luigi Zingales, *The Menace of Strategic Default*, CITY J., Spring 2010, at 47, *available at* http://www.city-journal.org/2010/20_2_strategic-mortgage-default.html.
100. White, *The Morality of Strategic Default*, *supra* note 14, at 8.

argued that we have a duty to keep promises because of the effect that our breaches would have on others (perhaps by undermining the effectiveness of the practice of promising as a whole),[101] these arguments fail to take into account the fact that promissory duties are relational. When *A* makes a promise to *B*, *A* incurs a duty to *B* that is different from the duties that *A* has with respect to everyone else. If *A* breaches his promise to *B*, then *B* has a right to complain to *A* in a way that no one else does. If the only reason we have a moral duty to keep our promises is that breaching decreases social utility as a whole, then everyone would have just as much of a right to complain about *A*'s breach as *B* has. But clearly the promisee has moral standing to complain about a breach above and beyond that which she would have as one of many members of society who rely on the practice of promising. Similarly, the neighbors of a strategic defaulter may well be right to complain that the defaulter is failing to live up to some sort of communal obligation, but that failure pales in comparison to the claim the promisee has to the hundreds of thousands of dollars the homeowner borrowed.

What is especially curious about home mortgages, and especially the current housing crisis, is that many people stand in the shoes of the promisee. The borrower promises to repay a financial institution, which itself is owned by a large group of disparate investors. Moreover, it is understood all along that the right to payment may be sold—indeed, is very likely to be sold, and perhaps many times over—to other investors. The eventual beneficial holder of a mortgage is very unlikely to have been seated at the table, or even represented, when the promise was made. Nevertheless, the holders of such mortgages still stand in a special relationship to the promisor by virtue of having paid for the right to the promisor's payment. As it happens, in today's world the line between the average member of the public and someone who stands in a promissory relationship to the borrower has been blurred like never before. Mortgages are freely traded now, and the buyers of the rights to payment are very often institutional investors that represent ordinary people, either through mutual funds or retirement accounts. Indeed, because the government, as expected, stepped in to back up Fannie Mae and Freddie Mac (a position the government was not technically required to take but that everyone had always assumed it would), U.S. taxpayers arguably now stand in the shoes of the promisee for the vast majority of home mortgages.

So I agree in principle with Professor White that, in general, we are not morally required to sacrifice our own best interests for the common good—or at least we are not required to do so as a matter of

101. *See, e.g.*, Neil MacCormick, *Voluntary Obligations and Normative Powers*, 46 PROCS. ARISTOTELIAN SOC'Y SUPPLEMENTARY VOLUME 59, 73 (1972) (U.K.).

promissory morality. That is to say, usually we do not owe a promissory duty to the general public or even to our neighbors to keep our promises. Nevertheless, given the way mortgages work today, promisors do come to owe promissory duties to a wide array of beneficial holders of mortgages. And in a time of crisis like the current one, these duties are owed to the general public as well, at least within the United States, since the general public stands to foot the bill for a great deal of the losses. In short, we all have a right to be upset about strategic default. Those who engage in strategic default not only threaten the stability of the banking system and slow down the economic recovery; they also fail to live up to their obligations to each of us, leaving us to pay for the money they borrowed, and for no better reason than because they find it in their best interests to do so.

One final point: It is unpopular to take the same side as banks these days, many of whom acted recklessly at best or downright criminally at worst. Some banks have recently compounded the problem by engaging in fraudulent foreclosure practices. We should be compassionate to those who were taken advantage of by banks, as well as those who simply suffered great misfortune in the economic downturn. But it is counterproductive to that aim to argue that everyone has a legal and/or moral right to refuse to pay back money they have borrowed whenever they can get away with doing so. Anyone who wants to call attention to the plight of those in great financial need or those who suffered real injustice at the hands of the mortgage industry should begin by reaffirming the moral duty of those who can easily repay the money they rightfully owe to do so, if only to distinguish them from those who have legitimate moral and/or legal excuses or defenses.