

# Before Death Do Us Part: On Premature Contract Breakup\*

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## Abstract

In an incomplete contracts framework with repeat trade, I show that granting a conditional right to terminate the contract yields breakup rents in ex-post renegotiations that substitute for insufficient bargaining power and help to restore the buyer's ex-ante efficient reliance investment, thus providing a contractual solution to the holdup problem. It extends the set of efficient simple contracts and yields multiple equilibria for nonpolar surplus sharing rules given investment nonverifiability. More information available for third parties through verifiability, however, restricts parties' efficient contract choice and implies lower equilibrium quality and extended exit options. Moreover, with restricted renegotiation the conditionality of the buyer's exit option (existing legal default) introduces memory through seller's moral hazard and renders the otherwise time-separable contract nondivisible. The unique first-best equilibrium contract then stipulates a no-termination rule and the highest feasible quality level. Legal implications in the context of U.S. contract law are discussed.

**JEL classification:** D23, D86, K12, L23

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