



Fall 9-1-1990

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Recommended Citation

Jean Braucher, *Contract Versus Contractarianism: The Regulatory Role Of Contract Law*, 47 Wash. & Lee L. Rev. 697 (1990).

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WASHINGTON AND LEE LAW REVIEW

Volume 47

Summer 1990

Number 4

CONTRACT VERSUS CONTRACTARIANISM: THE REGULATORY ROLE OF CONTRACT LAW

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Legal theorists in recent years have deployed "contract" as a central concept to explain more and more topics. These theorists seek to replace "regulation" with "freedom of contract," or, where actual contracts are not feasible, they seek to use the supposed results of hypothetical contracts. The legal approach of these theorists, which I shall call "contractarianism," has moved beyond the long-standing concern of political theorists with the basic structure of society¹ to address such concrete legal questions² as the appropriate rules to govern corporate actors³ and bankruptcy reorganizations.⁴ In the

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1. See, e.g., J. RAWLS, *A THEORY OF JUSTICE* (1971); Gray, *Contractarian Method, Private Property, and the Market Economy* in *NOMOS XXXI: MARKETS AND JUSTICE* 13 (J. W. Chapman & J. R. Pennock, ed., 1989); Rawls, *The Basic Structure As Subject*, in *VALUES AND MORALS* 47 (A.I. Goldman & J. Kim, eds. 1978).

2. See Brilmayer, *Consent, Contract and Territory*, 74 *Minn. L. Rev.* 1, 3 (1989) (critiquing consent theory of jurisdiction and noting that sovereign jurisdiction poses questions of political theory in a concrete context).

3. See Butler & Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-contractarians*, 65 *WASH. L. REV.* 1 (1990); *Contractual Freedom in Corporate Law*, 89 *COLUM. L. REV.* 1395-1774 (1989) (symposium); Thompson, *The Law's Limits on Contracts in a Corporation*, 15 *J. of Corp. L.* 377 (1990) (critiquing contractarianism in corporate law).

4. See Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 *YALE L. J.* 857, 860 (1982) (viewing bankruptcy as system designed to simulate agreement creditors would have made absent transaction costs).

context of this onward sweep of contractarianism⁵ into particular legal fields, it is useful to re-examine the nature of the *legal* institution of contract. "Contract" refers in this article to legally enforceable agreements and associated legal obligations.⁶ An examination of the difference between a contractarian view of the nature of contract and the actual nature of contract is a powerful method to reveal weaknesses of contractarian approaches to legal fields.

How do contractarians—particularly legal theorists who promote contract theories of particular legal topics—conceive of contract? Their views of the nature of contract are often implicit, rather than discussed, so the answer to the question is not easy to formulate. Another difficulty is presented by the fact that contractarian theorists to some extent use the idea of contract metaphorically.⁷ Nonetheless, it seems fair to conclude that contractarian theorists contemplate binding obligations when they speak of

5. Concerning the sweeping extension of contractarianism, see Coleman, *Comment: Rights, Markets, and Community*, 11 HARV. J. L. & PUB. POL'Y 649, 649 (1988):

As communitarians characterize liberalism, all important socio-political, economic and legal institutions are contractual, or market based; and justice itself can be treated as the outcome of a rational contract among idealized, individually rational autonomous agents.

Id.

6. This usage, which is not meant as a formal definition, is consistent with the Restatement (Second) of Contracts (1979) in that it requires legal recognition for an obligation to be contractual. However, because I adopt a relational view of contracts (as will be discussed), I do not accept the Restatement's dependence on "promise" for a definition of contract. The Restatement defines 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." RESTATEMENT (SECOND) OF CONTRACTS § 1 (1979). "Promise" is defined from an objective (external) perspective as a "manifestation of intention" that justifies "a promisee in understanding that a commitment has been made." *Id.* at § 2(1).

The phrase "associated legal obligations" in the text is intended to refer to the idea that much of contract law does not depend on agreement in any meaningful sense. The phrase takes in obligations derived from common law, statutes and administrative regulations. All of these forms of law are regulatory.

7. See Bratton, *The 'Nexus of Contracts' Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 410 (1989) (describing various ways to understand the idea that a firm is a "nexus of contracts," including that this idea is a metaphor).

For a more literal version of the contractual theory of the corporation, see Butler, *The Contractual Theory of the Corporation*, 11 GEO. MASON U. L. REV. 99, 100 (1989):

The contractual theory of the corporation is in stark contrast to the legal concept of the corporation as an entity created by the state. The entity theory of the corporation supports state intervention—in the form of either direct regulation or the facilitation of shareholder litigation—in the corporation on the ground that the state created the corporation by granting it a charter. The contractual theory views the corporation as founded in private contract, where the role of the state is limited to enforcing contracts. In this regard, a state charter merely recognizes the existence of a "nexus of contracts" called a corporation. . . . Moreover, freedom of contract requires that parties to the nexus of contracts must be allowed to structure their relations as they desire.

Id.

This passage relies on a false distinction between regulation and contract. Enforceable contract is created by the state, and contract enforcement entails regulation.

contracts. At the same time, however, contractarians neglect the implications of the fact that contracts are not self-enforcing. Contractarians view non-contractual legal approaches as "regulatory;" in contrast, they see contract as a device by which parties control their relations and achieve their desires by consent.⁸ Their approach thus misconceives contract because all law, including contract, is regulatory.

Actual contract does not reflect contractarianism's single-minded pursuit of individualism. Enforceable contract is a societal institution that sets the limits within which parties may exercise some degree of control over their legal liability. Contract law also defines parties' obligations to a large extent. Mediating between private ordering and social concerns, contract is a socio-economic institution that requires an array of normative choices. Contract thus is not contractarian. Contractarianism's central metaphor is weak to describe its aims, for the reason that its fantasy of radical individualism is impossible as the basis of actual contract law. The questions addressed by contract law concern *what* social norms to use in the enforcement of contracts, not whether social norms will be used at all.

Use of the concept of consent seems to be inevitable in explanations and justifications of the law of contract.⁹ Consent itself, however, is a conclusion based on a complex set of normative judgments; consent is not a simple description of fact.¹⁰ In the event of a dispute between contracting

8. For a description of contract law that focuses on full party control, see Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 297-98 (1986) [hereinafter *Consent Theory*]. After calling contract the law that governs "the valid transfer of entitlements," Barnett explains:

The rules governing alienation of property rights by transfer perform the same function as rules governing their acquisition and those specifying their proper content: facilitating freedom of human action and interaction. Freedom of action and interaction would be seriously impeded, and possibly destroyed, if legitimate rights holders who have not acted in a tortious manner could be deprived of their rights by force of law without their consent. Moreover, the moral requirement of consent mandates that others take the interests of the rights holder into account when seeking to obtain the rights she possesses.

Id. (footnotes omitted). The flaws of this approach are addressed in Part IA, *infra*.

9. See A.W.B SIMPSON, *A HISTORY OF THE COMMON LAW OF CONTRACT* 5-6 (1975) (defining contract in terms of consent and noting the difficulty of defining contract in way that does not assume elements of doctrine specific to time and place). Simpson adopts for the purposes of inquiry a "loose working definition of contract law as the law governing the legal effect of those consensual transactions which have been regarded as giving rise to a relationship of obligation." *Id.* at 6. Simpson's definition uses the terminology of consent, but it recognizes that obligation is broader than that to which there has been consent.

10. Philosophical writers often talk about consent as if we all know what it is and the only interesting question is its significance. These writers seem to speak of consent almost as though it were a "fact." See generally CONSENT: CONCEPT, CAPACITY, CONDITIONS AND CONSTRAINTS (Papers from Sixth Annual Conference of American Section of the International Association for the Philosophy of Law and Social Philosophy) (L.T. Sargent, ed.) (1979). They may elaborate that consent is a "voluntary agreement," or "an assumption of obligation" that is "voluntary." *Id.* at 1, 159. But that sort of definition still leaves us with all the questions addressed by contract law, including: what constitutes an agreement or an assumption of obligation? what obligation has been agreed to or assumed? and when is an agreement or assumption sufficiently voluntary?

parties, some external power must first decide whether the parties have consented in a valid manner and, if so, determine the scope of the consent. Legal decisionmakers, serving collective societal norms, construct consent. This process is unavoidably a means of regulation,¹¹ one which fosters one view or another of beneficial contractual relations. Consent will not work as a rationale to enforce contracts without also bringing in social control of the parties' affairs in the event of dispute.

Social control is inevitable in a system of contract enforcement. The concept of consent is a means to recognize and impose social duties, and in addition, consent as a rationale—however defined—has limits.¹² Because social norms are within as well as without individuals, however, parties to contracts do not experience social definition of obligation as wholly imposed.¹³

11. Legal enforcement of contracts is regulation of private affairs; it involves use of state power. See Cohen, *The Basis of Contract*, in *LAW AND THE SOCIAL ORDER* 78-79, 103-04 (1933) (reprinted from 46 *HARV. L. REV.* 533 (1933)). Cohen explains that a contract: cannot be said to be ever generally devoid of all public interest. If it be of no interest, why enforce it? For note that in enforcing contracts, the government does not merely allow two individuals to do what they found pleasant in their eyes. Enforcement, in fact, puts the machinery of the law in the service of one party against the other. When that is worthwhile and how that should be done are important questions of public policy.

Id. at 78-79. Enforcement is regulatory even when the state, through the institution of contract, attempts to facilitate ordering by the parties. See Fuller, *Consideration and Form*, 41 *COLUM. L. REV.* 799, 810 (1941) (discussing "private agreement" as "regulation").

12. See Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 *YALE L. J.* 997, 1014 (1985) (describing contemporary view of contract law). Dalton states:

We understand that contract law is concerned at the periphery with the imposition of social duties But we conceive the central arena to be an unproblematic enforcement of obligations voluntarily undertaken.

Id. See also Linzer, *Uncontracts: Context, Contorts and the Relational Approach*, 1988 *ANN. SURVEY OF AM. L.* 139, 141 [hereinafter *Uncontracts*]. Linzer observes:

Although the bulk of academic writers recognize that there are many legitimate occasions for the non-consensual imposition of contractual duties, the mainstream [of academic writers] continues to believe strongly in the centrality of consent, though with commonsense modifications.

Uncontracts at 141; Beermann, Book Review, 67 *B.U.L. REV.* 553, 555 (1987) (reviewing H. COLLINS, *THE LAW OF CONTRACT* (1986)). According to Beermann:

The theoretical problem has been to break out of the conceptualization of contract law as a core of facilitation of voluntary agreements with a periphery of regulation. This project requires an explanation of the normative judgments that inform the concept of voluntariness and an understanding of the values that determine when and how contracts are enforced.

Id.

13. What seems to be needed to understand consent to contract is something like Amitai Etzioni's "I&We paradigm":

The term highlights the assumption that individuals act within a social context, that this context is not reducible to individual acts, and, most significantly, that the social context is not necessarily or wholly imposed. Instead, the social context is, to a significant extent, perceived as a legitimate and integral part of one's existence, a

There are three essential dimensions to the regulatory role of contract law. First, law and legal decisionmakers make interrelated determinations concerning the validity of consent and the limits of consent as a rationale for enforcement. Sometimes the law mandates or prohibits terms because of validity problems, because the social limits of consent as a rationale have been reached, or for both of these reasons in combination. Second, as part of the process of interpreting whether a contract was formed and, if so, the scope of contractual obligation, legal decisionmakers mold obligations along socially desired lines. Interpretation cannot be neutral, but must be done from some point of view. Third, the law must supply a great deal of the content of contractual obligation. No matter how detailed parties are in their planning, they will never plan for every contingency. (Nor is it necessarily desirable that the law encourage them to try to do so). Supplied terms reflect social views of the proper goals of contractual relations.

The mixed ideals served by contract law include government facilitation of private ordering considered socially useful, protection of parties, and reciprocity and a balance of power in exchange relations.¹⁴ Those who propose to look at more and more legal problems in terms of contract would probably be disappointed with the results of employing actual contract law. In the course of determining validity of consent and of interpreting and supplying terms, contract law would reinvent the same sorts of regulatory constraints these theorists seek to escape.

For example, assuming no statutory or administrative limitation, a contractual term permitting a corporate officer to take corporate opportunities for his own benefit¹⁵ would raise such questions of contract law as: Did (enough?) shareholders and other affected parties (e.g., creditors, employees) validly consent? Do the consequences of the term tend to point out problems concerning the validity of consent to it? For example, did the appropriate decisionmakers have sufficient information? In addition, what does the term mean as applied? Suppose the corporate officer appropriated all the good opportunities and left the bad ones for the corporation. In the context of the particular relationship in question, did the term permit such action by the corporate officer? If not, what background rule should be used in the absence of a governing term supplied by the parties?

We, a whole of which the individuals are constituent elements.

A. ETZIONI, *THE MORAL DIMENSION—TOWARD A NEW ECONOMICS* 5 (1988). The "I&We paradigm" seeks a balance between the individual and the community, and the annihilation of neither. *Id.* at 8.

14. See, e.g., M. SANDEL, *LIBERALISM AND THE LIMITS OF JUSTICE* 105-09 (1982); Macneil, *Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law*, 72 *Nw. L. Rev.* 854, 862, 895 (1978) [hereinafter *Adjustment*].

I remain a skeptic about the need for and the wisdom of a unified field theory of contract, particularly a one-dimensional one; a good gray compromise statement of competing concerns will probably do. See Hillman, *Essay—The Crisis in Modern Contract Theory*, 67 *TEXAS L. REV.* 103 (1988) (reviewing current theoretical debates and presenting a "flexible, pragmatic model").

15. This example is suggested by Butler & Ribstein, *supra* note 3, at 65.

This article highlights the essential external normative (that is, regulatory) role of contract law in an effort to serve two goals. One is to defend a traditional view of contract law, as serving multiple, sometimes competing objectives, against recent assaults of a highly theoretical and individualistic nature. The other goal is to detail the ways contractarian approaches to other legal fields misapprehend and thus misappropriate contract. Contractarian approaches fail to recognize the complex regulatory character of contract law. Part I of the article discusses three theories of contract, the views of consent adopted under each theory, and how each theory addresses or fails to address the three essential regulatory dimensions of contract law. Part II elaborates on these three normative dimensions—determining validity of consent and the limits of consent as a rationale, interpreting contractual obligation and supplying terms. Each of the three subsections of Part II discusses one of these normative dimensions, explaining why it is inescapable and in addition explicating the particular normative choices reflected in current American law.

I. THREE THEORIES OF CONTRACT AND THEIR VIEWS OF CONSENT

Each of three contemporary theories of contract has a different view of the nature of consent. Literal libertarian¹⁶ theory views consent as an express articulation of intentions at the outset, making elaborate provisions for contingencies. The Chicago-style (Posnerian) law and economics theory of contract conceives of consent as express in part, but also takes the position that consent frequently must and should be fictional, based on an assumption about what most people want (specifically, that most people want wealth maximization). Both the literal libertarian and the Posnerian theories of contract view consent as an event, something that occurs at the outset of relations and defines obligations thereafter. In contrast, a relational view of contract leads to a conception of consent as a process dependent on particular norms of the relation as well as on norms of the broader social context. Contractual relations, according to this third contemporary theory, are embedded in and defined by social context. These three theories have very different implications for questions of validity of consent and for interpreting and supplying terms.

16. I prefer the term "libertarian," rather than "liberal," for modern writers such as Robert Nozick and Randy Barnett who reject any element of communitarianism in their political theory. See R. NOZICK, *ANARCHY, STATE, AND UTOPIA* (1974); Barnett, *Consent Theory*, *supra* note 8. The term "liberal" in contemporary scholarly usage suggests a richer understanding of human nature (as including "dispositions to reasonableness and fairness"). Fallon, *What is Republicanism and Is It Worth Reviving?*, 102 *HARV. L. REV.* 1695, 1706 (1989).

Etzioni uses the term "Whigs" to describe Nozick, Friedrich Von Hayek, and Milton Friedman, emphasizing the historical origins of their views and tweaking them as anachronistic. A. ETZIONI, *supra* note 13, at 6-8.

A. *Libertarian Consent Theory of Contract*

If not for Randy Barnett, I might be accused of creating a straw man in the form of the libertarian literal consent theorist. Here is Barnett's own summary of his consent theory of contract:

A consent theory of contract requires that an enforceable contract satisfy at least two conditions. First, the subject of a contract must be a morally cognizable right possessed by the transferor that is interpersonally transferable, or "alienable." Second, the possessor of the alienable right must manifest his intention to be legally bound to transfer the right—that is, he must consent.¹⁷

This theory conceives of consent as express, conscious and individually controlled.¹⁸ In addition, a contract is a "transfer,"¹⁹ not a relation. A discrete exchange is Barnett's paradigm of contract. Barnett believes his version of consent serves freedom and individual autonomy by giving each party who consents control in dealings with other parties.²⁰

Barnett plays down two of the three inevitable external normative dimensions of contract law, and he initially missed the third. He thus ignores the complexity and the limits of consent.

First, Barnett gives scant attention to questions concerning validity of consent and believes that validity can be summed up in an easy on/off determination of "voluntariness."²¹ He also removes from the domain of contract law questions about whether entitlements affect the validity of consent.²² The legitimacy of entitlements is treated as a separate question, a matter of property law, which in his view determines how persons can acquire resources. He believes contract, in contrast, specifies how these entitlements defined by property law can be transferred. Barnett's analytical structure cuts off inquiry into whether entitlements bear on the legitimacy

17. Barnett, *Squaring Undisclosed Agency Law with Contract Theory*, 75 CALIF. L. REV. 1969, 1978-79 (1987) [hereinafter *Agency Law*].

18. It is not a "will" theory, however, because it adopts an "objective" test of consent. See Barnett, *Consent Theory*, *supra* note 8, at 272-74, 301, 303. Barnett accepts objectivism quite willingly, but he does so because he believes this gives individuals more, not less, control of their contracts; it protects individuals' "boundaries." *Id.* at 301. Barnett says that "an inquiry into subjective intent would undermine the security of transactions by greatly reducing the reliability of contractual commitments." *Id.* at 273. The objective test undermines "security of contract" in another way, however, by directing a legal decisionmaker to judge parties' words and conduct by external standards, not necessarily their own. This point is developed in Part IIB, *infra*. Any system of legal enforcement of contracts will bring in social control because an enforcement system charges legal decisionmakers to interfere to resolve disputes. Barnett assumes that it is possible, and not particularly burdensome, for parties to communicate to each other and at the same time to potential reviewing courts in "ordinary" ways.

19. Barnett, *Consent Theory*, *supra* note 8, at 292, 297, 303, 304.

20. *Id.* at 291, 297, 299 n.121.

21. See *id.* at 318-19. Barnett discusses validity in four paragraphs, as an afterthought before his conclusion.

22. *Id.* at 270, 291-300.

of consent to contract. Following Robert Nozick, Barnett rejects a patterned view of distributive justice, treating a historical basis for entitlements as the only appropriate approach, on the grounds that patterned theories "require constant interferences with individual preferences."²³ This is circular reasoning—the individual preferences Barnett is concerned about protecting depend upon the particular set of entitlements, so protection of preferences cannot justify these entitlements. Furthermore, patterned distributive justice need not depend on contract rules. Taxes and transfer payments are a more effective primary means of maintaining a desired distributive pattern of entitlements.²⁴ In addition, having adopted a historical approach to entitlements, Barnett immediately backpedals from the principle of rectification it entails.²⁵

Second, Barnett views interpretation to determine the fact and scope of consent as a simple matter. He takes the position that consent is a "clear, common sense test of enforceability."²⁶ Barnett adopts contract law's standard "objective" test of questions of formation and interpretation, but does not address the difficulties of applying it. At one point, Barnett treats application as uncomplicated: "If the word 'yes' ordinarily means *yes*, then a subjective and unrevealed belief that 'yes' means *no* is generally immaterial"²⁷ Barnett's statement invites comparison with the proposition that, "No means no," which has not been treated as self-evident in the law of rape. In rape law, consent historically has been socially constructed from a male point of view, although there have been recent changes in the law suggesting the development of a new perspective.²⁸ Consent to contract is no less socially constructed, no matter what perspective is chosen as appropriate.²⁹ At another point, Barnett recognizes that "[t]he hard work facing

23. *Id.* at 286, 296. Nozick describes two conceptions of justice, a process-oriented, historical one, as opposed to a time-slice, "patterned" conception, which looks at current distribution. R. Nozick, *supra* note 16, at 153-64. Nozick favors the process conception.

24. This point is discussed further in Part IIA1, *infra* at notes 65-69.

25. Barnett sets the lifetimes of original wrongdoers and original owners as the statute of limitations for redress of wrongful takings of resources. See Barnett, *Consent Theory*, *supra* note 8, at 296 n.113. Nozick gives the principle of rectification broad play but adds: "to introduce socialism as the punishment for our sins would be to go too far." R. Nozick, *supra* note 16, at 230-31.

26. Barnett, *Consent Theory*, *supra* note 8, at 271.

27. *Id.* at 303.

28. See Henderson, *Review Essay: What Makes Rape a Crime?*, 3 BERK. WOMEN'S L.J. 193 (1987-88); Note, *Shifting the Communication Burden: A Meaningful Consent Standard in Rape*, 6 HARV. WOMEN'S L.J. 143 (1983).

29. Peter Linzer, in contrast to Barnett, shows full awareness of the problem of what constitutes consent and of the concept's expandability. At one point Linzer treats consent as "conscious assent to terms at the moment a contract is formed." Linzer, *Uncontracts*, *supra* note 12, at 139. Linzer also notes the possibility, however, that "we [could] stretch 'assent' and 'consent' to mean nothing more than membership in a society." Linzer, *Is Consent the Essence of Contract?—Replying to Four Critics*, 1988 ANN. SURV. OF AM. L. 213, 218 [hereinafter *Consent*]; see *Uncontracts*, *supra* note 12, at 142. The latter statement implicitly recognizes that consent is socially constructed when the concept of consent is stretched, but I

any legal system" includes determining "what acts constitute 'consent,'" but Barnett neglects to take on the job.³⁰ What Barnett fails to recognize is that legal interpretation inevitably involves social control of contract parties.

A large flaw in Barnett's consent theory is its focus on formation, while ignoring the very real and practical problem that the law must supply terms where the parties are silent.³¹ Barnett has conceded that most "real-world" contractual disputes do not involve issues of alienability of rights or of whether the parties manifested consent to transfer rights.³² More often, the content of obligation is at issue.³³ Barnett has made another even more significant concession about his theory—that use of fictitious consent is necessary to complete it and to supply terms:

Developing a consent theory's approach to construing contractual intent when parties are silent on an issue would require a lengthy and separate treatment. Such an effort would involve, among other topics . . . the presumption that the parties intended what most similarly situated parties would have intended *ex ante*, thus putting the onus on a minority of parties to express dissent.³⁴

Express consent was alluring to Barnett as a central concept because of a false promise of full individual control. His quest was driven by radical individualism and a libertarian view of human nature. Barnett believes that it is possible to separate an individual's decisions from context, which includes the influence of groups and the society of which the individual is

argue that "objective" assent to terms at formation is also a social construction, just a different one. See Part IIB, *infra*. Referring to consent in the sense of conscious assent at the outset, Linzer is rightly "unbowed in [his] skepticism about the centrality of consent in many transactions that we deal with in contract law," although he adds, "This is not to say that consent is irrelevant." Linzer, *Consent, supra*, at 213, 213 n.1.

30. See Barnett, *Consent Theory, supra* note 8, at 307.

31. Farnsworth wrote:

The urge to have a 'theory' of contract law has tended to increase the distance between contracts scholarship and practice. In particular, it has led to an excessive emphasis by scholars on why promises are enforced.

Farnsworth, *A Fable and A Quiz on Contracts*, 37 J. LEGAL EDUC. 206, 208 (1987). Farnsworth follows that statement with a quote from Barnett, *Consent Theory, supra* note 8, showing Barnett's focus on the grounds for enforcement: "Contract theory at present . . . does not provide a satisfactory answer to [the] question . . . which interpersonal commitments the law ought to enforce." *Id.*

See Craswell, *Contract Law, Defaults Rules and the Philosophy of Promising*, 88 MICH. L. REV. 489, 529 (1989) (observing that much of the current philosophical debate about the binding force of promises is simply irrelevant to contract law's choice of background rules).

32. Even on the question of manifestation of consent to some sort of obligation, full party control is not possible because the objective test calls for external evaluation of the parties' words and actions by a legal decisionmaker, a process which inevitably imports social control. Part IIB discusses this point more fully.

33. See Barnett, *Agency Law, supra* note 17, at 1979.

34. *Id.* at 1986-87, n.71.

a member.³⁵ But individuals internalize social norms and experience them to a significant extent as their own values.³⁶ On the other hand, individuals experience all of their decisions and actions as constrained by social context to some degree. There is no such thing as absolute autonomy, so we need not worry about losing it (about dreaded "crossings" of our "boundaries"³⁷). Individuality itself is a social construction fostered by many institutions, including contract.³⁸

B. Posnerian Contract Theory

In contrast to Barnett's initial attempt to explain contract in terms of express consent and conscious individual control, Richard Posner describes as consensual every legal principle or decision that serves a goal of wealth maximization.³⁹ His theory thus considers tort law as well as contract law

35. Barnett's consent theory derives from a conception of a primal scene of solitary existence:

From the moment individuals live in close enough proximity to one another to compete for the use of scarce natural resources, some way of allocating those resources must be found.

Barnett, *Consent Theory*, *supra* note 8, at 294. The trouble with this story is that individuals never have lived apart from a social group. The individual only exists within groups and a social context (even during occasional separations such as Robinson Crusoe's), and the individual's choices can only be understood in this context.

36. See A. ETZIONI, *supra* note 13, at 5, 45-48.

37. R. NOZICK, *supra* note 16, at 58. Nozick adds: "Voluntary consent opens the border for crossings." *Id.* Barnett also thinks of rights as defining boundaries. See Barnett, *Consent Theory*, *supra* note 8, at 301, 303.

38. Barnett's focus on individual freedom is in keeping with a long practice of ignoring the implications of the fact that most contracts involve an organization on one or both sides. See Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704, 733 n.63 (1931) (referring to our "vicious heritage of regularly viewing 'parties' to a deal as single individuals.") It is beyond the scope of this article to tackle the "daunting task" of developing a jurisprudence of organizations and then applying it to contract. See Stewart, Book Review, *Organizational Jurisprudence*, 101 HARV. L. REV. 371, 375 (1986) (reviewing M. DAN-COHEN, RIGHTS, PERSONS, AND ORGANIZATIONS: A LEGAL THEORY FOR BUREAUCRATIC SOCIETY (1986), which makes the points that organizations do not have "autonomy rights," except derivatively, but do have "utilitarian rights"). I have addressed some implications of organizational consent to contract in Part IIC, *infra*.

39. Posner considers consensual the results of hypothetical markets, constructed by theorists who "guess people's market preferences" in situations, such as accidents, where stopping to bargain is not possible. See Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 129-30 (1979) [hereinafter *Utilitarianism*]; Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, in LAW, ECONOMICS, AND PHILOSOPHY 81, 85-91 (Kuperberg & Beitz, ed. 1983) (*reprinted from* 8 HOFSTRA L. REV. 487 (1980)) [hereinafter *Ethical Basis*]. Posner uses the Kaldor-Hicks definition of efficiency, that a move is efficient if it increases total value (measured by willingness—including ability—to pay), even though some individuals have less value after the move. *Id.* at 82-85. Posner's argument that wealth maximization is based on implied general consent depends on the debatable assumption that if parties could stop and bargain they would seek *only* to maximize wealth and would not sacrifice this goal sometimes in favor of others. This assumption is designed to make efficiency the only appropriate social policy goal.

consensual to the extent tort or contract law serves the goal of wealth maximization. Posner's particular law and economics version of consent is admittedly fictitious in the sense of being based on putative general desires, not necessarily those of the parties.⁴⁰ Stretching the concept of consent in this way is reminiscent of attempts to stretch promise to explain all of contract. For example, one could substitute "consenting" and "consents" for "promising" and "promises" in this passage from an essay by Patrick Atiyah (and thus produce a good critique of Posner's view of consent):

Is it meaningful or useful to claim that a person who boards a bus is promising [consenting] to pay his fare? If so, would it not be just as meaningful to say that when he descends from the bus and crosses the road he promises [consents] to cross with all due care for the safety of other road users?⁴¹

Neither promise nor consent fully explains contractual obligation—or civil obligation generally. It does not improve the explanatory power of these concepts to attempt to hide their limits with a fiction.

Like all fictions, Posner's version of consent masks a social policy choice. Under Posner's theory, a social policy choice is presented as an assumption about human nature (the assumption being that wealth-maximization—and nothing else—is what most people would choose if they could stop and bargain over every social interaction). This account denies human desires for fairness, decency, trust, cooperation and the like. That people seem to act upon such desires—unless all of human nature is reductively *defined* as self-interested—has been verified empirically.⁴² Posner's use of the language of consent is an attempt to appeal to libertarians. This ploy seems to have worked. For example, Barnett has moved to a recognition that consent must at least in part be based on presumptions about general desires.⁴³

It is no surprise that Barnett adopted an event model of consent, given his wish to have contractual obligation individually controlled from the

40. See Posner, *Ethical Basis*, *supra* note 39, at 88-89.

41. Atiyah, *Contracts, Promises and the Law of Obligations* in *ESSAYS ON CONTRACT* 19 (P. Atiyah ed. 1986). (Cohen, *supra* note 3, at 85, used a similar hypothetical.) Atiyah argues that contract obligation is better explained by conduct, benefit, and reliance than by "promise." Atiyah, *supra*, at 19.

All civil obligation, including contract and tort law, could be explained in terms of consent, or all in terms of "duty," if these concepts are stretched, but in the process the concepts lose their power to distinguish. "Consent" and "duty" are both social constructions. See Linzer, *Uncontracts*, *supra* note 12, at 142; see also Feinman, *The Jurisprudence of Classification*, 41 *STAN. L. REV.* 661, 700-04 (1989) (discussing overlapping paradigms of contract and tort).

42. For a compilation of empirical studies supporting the proposition that people act upon these sorts of desires, see A. ETZIONI, *supra* note 13, at 51-66. Two examples of this sort of behavior are: people on out-of-town trips leave tips at restaurants they do not expect ever to revisit, and people return apparently lost wallets to strangers, with cash untouched. *Id.* at 51-52.

43. See Barnett, *Agency Law*, *supra* note 17, at 1986-87 n.71.

outset to protect parties from each other. Slightly less self-evident is the reason for Posner's adoption of an event model of consent, occurring at the outset of a transaction.⁴⁴ If consent is fictitious, it is particularly easy to see that it need not be conceived of as an event. Posner's use of the event model is not mysterious, however; it serves his constrained views of human nature and proper public policy. It is also consistent with the standard neoclassical economic view of contracts as exchanges rather than relations.

Posner believes validity doctrines should be narrowly construed to preserve liberty of contract,⁴⁵ ignoring that this assertion begs the question what conditions are necessary for liberty. On entitlements, he argues that the wealth maximization principle "ordains the creation of a system of exclusive rights," but on the question of how to assign rights, he can do no better than to propose using intuitions about "who is likely to value them the most."⁴⁶ Posner's assumption that generally people want only wealth maximization in their interactions results in a unitary approach to both interpretation and questions of supplying terms. The approach calls for legal decisionmakers to interpret or supply terms to maximize wealth.

In addition to the objection that wealth maximization is not and should not be the sole goal of contract law, Posner's approach is problematic because of the difficulties involved in defining and measuring costs. What costs count can be controversial. The Coasean idea of "joint costs," or costs caused by conflicting activities, raises issues concerning the definition of costs.⁴⁷ In addition, it is not a simple matter to anticipate or to measure all of the effects of legal rules over the short and long run. A legal rule that seems to be inefficient in the short run may help to mold values, resulting in long-term changes in the efficiency equation.⁴⁸ Undercutting norms of trust and cooperation may increase transaction costs over the long

44. For example, he says, "The notion of consent used here is what economists call *ex ante* compensation." Posner, *Ethical Basis*, *supra* note 39, at 86. "*Ex ante*" literally means "from before," and refers to expectations at the outset.

45. See Posner, *Utilitarianism*, *supra* note 39, at 134, 138.

46. *Id.* at 125. For critiques of the circularity of wealth maximization as a way to assign entitlements, see Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U.L. REV. 349, 378-79 (1988) [hereinafter *Defining Unfairness*]; Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 524-26 (1980).

If we are going to use intuitions to assign entitlements, a powerful intuition is that redistribution will increase social welfare because the poor will value entitlements more than the already glutted rich. Posner's system rejects this approach by definition; value is defined in terms of willingness to pay under the existing distribution of resources. *Utilitarianism*, *supra* note 39, at 119.

47. See Braucher, *Toward A Broader Perspective on the Role of Economics in Legal Policy Analysis: A Retrospective and an Agenda from Albert O. Hirschman*, 13 LAW & SOC. INQUIRY 741, 770 (1988); D'Amato, *Can Any Legal Theory Constrain Any Judicial Decision?*, 43 U. MIAMI L. REV. 513, 514-519, 530-536 (1989).

48. See Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference Shaping Policy*, 1990 DUKE L. J. 1.

term⁴⁹ and may immediately impose "costs" in the form of moral and aesthetic distress.⁵⁰

C. Relational Contract Theory

A relational approach to contract is highly attuned to context and norms as the basis of obligation. Ian Macneil, the primary relational theorist,⁵¹ developed the relational paradigm of contracts in response to the inadequacies of a paradigm of contracts as discrete transactions. Macneil recognized that the two paradigms of contract can coexist, although even the most discrete transactions are to some extent relational, in that they are embedded in social context.⁵² Macneil's argument is that we have been "brainwashed" into conceiving of contracts as discrete transactions, thus misunderstanding relational contract, which is actually the paradigm.⁵³

Drawing upon Macneil's work relational approach, one can conceptualize consent either as a discrete event or as a continuing process.⁵⁴ The event model of consent, which coincides with an exchange paradigm of contract, freezes the content of obligation at the outset. In its more literal-minded version, the event model of consent envisions that parties articulate their intentions in detail at the outset and make elaborate provisions for

49. Even Posner states that "conventional pieties" such as keeping promises and telling the truth reduce transaction costs. *Utilitarianism*, *supra* note 39, at 123. Posner appears to believe, however, that markets sustain the necessary level of these pieties. Albert Hirschman has made a more sweeping point that nonmarket institutions and values are a necessary part of the background for successful markets, and that markets would undermine themselves if not checked by nonmarket values. See A. HIRSCHMAN, *RIVAL VIEWS OF MARKET SOCIETY AND OTHER RECENT ESSAYS* 115, 139 (1986).

50. The lesson of Coase is that we cannot say which of two conflicting activities imposes a cost on the other. If moral or aesthetic enjoyment of the absence of an activity or way of thinking counts as an activity, then nearly any activity or way of thinking can be seen as producing joint costs. See Schlag, *An Appreciative Comment on Coase's The Problem of Social Cost: A View from the Left*, 1986 *Wis. L. Rev.* 919, 954.

51. See, e.g., I. MACNEIL, *THE NEW SOCIAL CONTRACT* (1980); Macneil, *Adjustment*, *supra* note 14; Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 *Wis. L. Rev.* 483 [hereinafter *Relational Contract*].

52. See Macneil, *Adjustment*, *supra* note 14, at 856-59. In contrast to Barnett's primal scene of solitary existence, see note 35, *supra*, Macneil wrote:

In the beginning was society. And ever since has been society. This surely must be the most forgotten fact in the modern study of contracts, whether in law or in economics. This lapse of memory we deliberately impose on ourselves in both disciplines by our heroin-like addiction to discrete transactions.

I. MACNEIL, *supra* note 51, at 1.

53. Macneil, *Relational Contract*, *supra* note 51, at 485-93.

54. Consent is ideally conceived of as a continuing process in the law and social practice of informed consent to medical treatment. See Dresser, *Ulysses and the Psychiatrists: A Legal and Policy Analysis of the Voluntary Commitment Contract*, 16 *HARV. C.R.-C.L. L. Rev.* 777, 830 (1982). In medical treatment, however, the usual understanding is that the patient is not bound to future stages of treatment; the relationship and the treatment evolve, and the patient can revoke consent at any time. *Id.* In contrast, conventionally the law treats consent to contract as irrevocable by unilateral action, unless the power to revoke is reserved specifically.

contingencies. If parties later change aspects of their bargain, an eventuality conceived of as unusual, the event model expects that a new formal articulation will occur.

The literal version of the event model of consent works best if the contract is very simple: For example, buyer agrees to pay \$400 for a 10-year-old clunker described not as a car but as a "heap of junk," and seller agrees to deliver it tomorrow.⁵⁵ But it turns out the literal, event model of consent does not work very well even here. Many details and effects of contingencies have not been spelled out. For example, assume the parties never mentioned hubcaps or brakes. Is there any liability, and, if so, how much, when the heap of junk is delivered without hubcaps and without brakes? Suddenly the hypothetical is much too sparse; we need to know all we can find out about the parties and their dealings, for example: Did the parties have dealings before? Did the buyer inspect? What was his purpose in buying? Did the seller know of this purpose? Were the parties both consumers or both merchants, or one of each? What questions did each party ask the other? What was disclosed? The full context is relevant to the dispute that has arisen. In addition, the significance of each element of context depends on social norms.

If the contract is more complicated and calls for performance over a period of time (*e.g.*, a working capital loan agreement, with periodic extensions of credit), the event model becomes yet more unrealistic. Not only do the parties inevitably fail to address many matters at the outset, but the context that fills in their agreement extends over a period of time. Norms may evolve in the particular relation.

The process model of consent coincides with a relational paradigm of contract. In this approach, either the contractual relation is loosely defined, and it evolves (*e.g.*, employment), or, if the relation is more structured (*e.g.*, long-term supply contract for materials used in manufacturing), the parties are likely to realize at the outset that they cannot anticipate many contingencies, and they may create a framework for future decision-making. Alternatively, they may start with a detailed contract document, but then cooperate and adjust their relations without having provided a framework for doing so in advance.

A flexible view of contract formation and contract interpretation, incorporating the ideas of consent as a continuing process and contract as relation, opens up the possibility of finding the content of obligations in the norms of cooperation and fairness reflected in a contractual relationship and its social context. This relational, process version of consent can go beyond wealth maximization and serve values Posner wishes to eliminate from the public policy of the common law. It is based on the emerging socio-economic challenge to the neo-classical economic paradigm of human

55. See Macneil, *Adjustment*, *supra* note 14, at 857. Macneil uses a more extreme example of discreteness, a cash purchase of gasoline on a turnpike by someone rarely traveling the road.

nature. This new paradigm assumes a tension and balance between the individual and the community as well as a moral dimension to utility (that is, that people are motivated by pleasure *and* by morality).⁵⁶ Thus, at a minimum, conceiving of consent as a process and contract as relation means the content of obligation depends on social context and is tied less to definition at the outset; beyond that, as will be seen, this relational conception of contracts provides a theoretical foundation for the argument that the law of contract *should* serve other values in addition to wealth maximization.

The implications of relational theory for questions of validity of consent (and for questions about the effect of entitlements on validity) are dramatic; the theory calls for issues of mutuality and power to be addressed throughout the relation.⁵⁷ Macneil wrote:

When we turn to relational contract law, any distinction between a *status quo* before exchange and the situation following projection of exchange into the future tends to become virtually meaningless. Relations involve a flow of exchanges, or many flows at the same time, occurring in complex patterns not lending themselves to division into discrete periods. It follows that relational contract law must, if it is to concern itself at all with mutuality and power, deal with those issues, before, during and after exchanges.⁵⁸

In a relational approach to contract, interpretation and supplying terms both require investigation of the norms of the relationship and of the social context. Some difficulty is caused by the fact that the effort to observe relational norms occurs after the relation has broken down and the process of consent has come to a halt. Even relying on the state of the relationship before the breakdown, a relational approach to interpretation and supplying terms cannot depend entirely upon consent, except in a fictitious sense of consent. The creation of the relation is likely to have been conscious and even express, and the creation of its norms over time also may have been conscious and express to some extent. But an outsider must declare what the operative norms are in the event of a dispute. The relational approach, however, recognizes that individual control can only be relative, not absolute, so that external definition of obligation is seen as pervasive. The policy choice to look at relational norms when interpreting contracts or supplying terms relies upon a view that private ordering can occur only in a context. It recognizes the interplay of contractual relations with community standards.

56. See A. ETZIONI, *supra* note 13, at 21 (stating that there are "at least two irreducible sources of valuation or 'utility': pleasure and morality"). See also *id.* at 8-13.

57. See I. MACNEIL, *supra* note 51, at 86.

58. *Id.* Macneil hastened to add the caveat that where discreteness and presentation (dealing with the future in the present) are valued in a contractual relation, then use of discrete legal principles is appropriate. *Id.*

Can consent as a process work in practice? This approach may be difficult for some to accept because abandoning the event model of consent means giving up the illusion of party control, achieved by full definition of obligation at the outset. Even so, accepting the concept of consent as a process forces greater candor; denial and evasion will not make the regulatory content of contract law go away. Contract law is regulatory even when it clings to the event model of consent, for example in traditional formation doctrine,⁵⁹ and to the exchange paradigm of contracts.

Relational theory, like any contract theory, must go beyond a rationale of express, conscious consent. This theory calls for legal decisionmakers to attempt to discover and apply norms from the parties' pre-breakdown relationship as well as from the broader social context in order to answer questions about validity of consent, interpretation and supplying terms.

II. THE NORMATIVE DIMENSIONS OF CONTRACT LAW

Enforcement of contractual obligation requires external normative definition—that is, regulation. This regulation has three dimensions. First, determining the validity of consent requires elaborate normative judgments. A related question is the appropriate limits of consent as a rationale for contract enforcement, particularly for enforcement of very harsh terms. The second normative dimension of contract law stems from the necessity that contracts be interpreted; courts must interpret to determine the creation and the content of obligation, and interpretation unavoidably involves normative choices about when obligation should arise and what its content should be. Finally, parties are inevitably silent on many matters, and interpretation thus shades over into supplying terms, a process that constrains and in some cases replaces party control. The three subsections that follow, addressing these issues of validity, interpretation, and supplying terms, explain why external normative definition is essential in each of these dimensions. Additionally, these subsections explore what are the particular normative choices reflected in current American contract law. The regulatory role of contract law is played out in the three normative dimensions.

A. *Validity of Consent and the Limits of Consent*

1. Differentials in Wealth, Power, Knowledge, and Judgment

“Consent” occurs in the context of a prior distribution of entitlements and abilities. Interrelated elements of wealth, power, knowledge, and judg-

59. In its most rigid, stylized form, the law of formation has elaborate normative content; this body of doctrine attempts to protect parties from each other *and* from themselves and expects parties to look out for each other as well as for themselves. *See, e.g., Fuller, supra* note 11 (discussing functions of legal formalities in general and consideration in particular). For example, the cautionary function recognizes that formalities protect parties from inconsiderate commitment. Barnett ignores the cautionary function in his defense of enforcement of informal promises without consideration. *See Barnett, Consent Theory, supra* note 8, at 310-17.

ment of the parties constitute the conditions in which they make choices or undertake relationships. Choices, relations, entitlements, and abilities cannot be separated. A focus on "consent" in the context of the conditions of the status quo suggests that these conditions are a legitimate basis for choice, which is not necessarily so. Giving consent involves a relative judgment; one consents to a change, not to the prior position or the resulting one.

Contract law must make judgments about validity of consent. The parties cannot determine for themselves what constitutes valid consent. If that were so, a man with a gun to his head and his assailant could decide that physical duress does not affect validity of consent. Validity depends on external normative choices. In an imperfect world, where the distribution of entitlements is unjust and where traits and abilities vary dramatically, consent is at best a relative justification for contract enforcement, not an absolute one. Contract law must draw lines concerning when the circumstances make consent "valid."⁶⁰ Arguably, it is redundant to speak of "valid consent;" invalid consent is not consent. Yet there are many common expressions about consent that refer to conditions necessary to validity: voluntary consent, informed consent, consenting adults. These expressions recognize that the significance of acts and words of apparent consent may be undercut by circumstances as well as by characteristics of the one consenting.

Legal categories that deal with the problem of validity of apparent consent include duress and undue influence, misrepresentation (or fraud), mistake, incapacity, and unconscionability.⁶¹ Unconscionability can be understood as a residual invalidity category that picks up cases of quasi-duress and quasi-fraud⁶² and of limited capacity as well as combinations of various borderline validity problems. These legal categories refer to problems of power (duress),⁶³ knowledge (fraud and mistake), and judgment (incapacity)⁶⁴ and to elements and combinations of these three problems (undue influence, unconscionability). Translating the invalidity categories in this way emphasizes their malleability and expandability. How much power, knowledge,

60. Sandel has observed:

Rawls emphasizes that, notwithstanding their voluntary dimension, our actual obligations are never born of consent alone but inevitably presuppose an antecedent background morality

M. SANDEL, *supra* note 14, at 110. Sandel makes the point that the mere fact of agreement is not the test of its fairness. *Id.* at 109.

61. Eisenberg says these doctrines deal with "quality" of consent. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 742 (1982). Although this terminology makes sense logically, consent is generally taken to be an on/off matter in contract law, which is a reason to use the word "validity."

62. See Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487-88 (1967) [hereinafter, *Unconscionability*].

63. See Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253 (1947).

64. See Meiklejohn, *Contractual and Donative Capacity*, 39 CASE W. RES. L. REV. 307 (1988-89).

and judgment are necessary to make consent valid? Each of the categories calls for normative refinement in application.⁶⁵

Contract doctrine has not explicitly addressed wealth imbalances as a separate validity category, although wealth is often a factor in the validity doctrines or in particular contract rules. Contract law's failure to embrace redistribution as a core goal can be justified on the grounds that contract cannot do this job well. Contract law rules are often a crude, temporary, and puny means of redistribution.⁶⁶ For example, a contract rule that redistributes wealth from landlords to tenants is crude because it does not help the homeless or affect wealthy non-landlords, while it does affect relatively poor as well as rich landlords. Furthermore, this sort of rule is temporary in that increased costs of a rule frequently can be passed along (to the tenants), or investments can be shifted to avoid the costs of the rule. Finally, given the extremes of wealth and poverty in our society, contract rules are a small, slow way to achieve redistribution. Taxes and transfer payments are a better way to maintain a pattern of distributive justice.⁶⁷

Using taxes and transfer payments as the central method of redistribution answers one critique of a patterned conception of justice, that it requires constant interference in people's transactions.⁶⁸ A transition problem remains for those who believe in the importance of equity in the pattern of distribution: It is hard to tolerate, at a minimum, extreme contractual advantage-taking by those rich in entitlements in their dealings with the relatively poor, so long as we fail to redistribute sufficiently through taxes and transfer payments. This is a reason for contract law to take wealth disparities into account.

What is at stake in the validity doctrines of contract law is defining the conditions necessary to freedom. Attempting to do so raises deep value conflicts. At one extreme, libertarians want very minimal conditions because they fear that freedom will be limited in the name of fostering it. Libertarians conceive of freedom in negative terms, rather than in terms of creating even minimum positive conditions to allow self-actualization.⁶⁹ At the other extreme, freedom could be defined in terms of substantively fair distribution, because of fear that unequal distribution of wealth and other advantages

65. See, e.g., A. FARNSWORTH, *CONTRACTS* 262 (1982) (describing law of duress and stating: "Judges have been caught up in making moral judgments of the most delicate sort . . .").

66. See Braucher, *Defining Unfairness*, *supra* note 46, at 383-84 (discussing ineffectiveness of contract law as means of redistribution).

67. See *supra* note 23 (concerning Nozick's description of "patterned" distributive justice, versus historical basis for justice in distribution).

68. See Kronman, *Contract Law and Distributive Justice*, 89 *YALE L.J.* 472, 475 (1980).

69. Nozick defines voluntariness in terms of absence of coercion, with coercion defined in terms of negative rights (not to be harmed). See R. NOZICK, *supra* note 16, at 262; see also Nozick, *Coercion*, in *PHILOSOPHY, SCIENCE AND METHOD: ESSAYS IN HONOR OF ERNEST NAGEL* 440 (S. Morgenbess ed. 1969).

at the outset of any supposedly free process makes the process merely a way for the advantaged to increase their advantages.⁷⁰ While one extreme tends to mean freedom for the rich, powerful, informed, and shrewd at the expense of the poor, weak, ignorant, and naive, the other threatens the idea of some role for individual choice. These extremes coincide with Nozick's two categories of justice—a historical basis (and process orientation), as opposed to a time-slice, "patterned" conception.⁷¹

Invalidity doctrines in contract law, a compromise of these distributive and process conceptions of justice, have historically been more responsive to the libertarian end of the spectrum of opinion, sharply limiting the situations in which apparent consent could successfully be challenged. Initially, for example, duress only invalidated "apparent" consent in cases of physical assault, physical imprisonment or threats of serious bodily harm.⁷² Gradually, the doctrine of duress expanded to cover economic pressure,⁷³ and the law was forced to acknowledge and struggle with the inevitable relativity of the idea of duress.⁷⁴

The invalidity categories have expanded, but a great constraint on expansion of legally recognized conditions for free contractual choice remains. This is the bifurcation of the question of consent into apparent consent and validity. Rather than looking at the total context in which consent has supposedly been given (which would be a more relational approach), the law of contract has asked, first, are there words or acts of consent ("objectively" judged)? If so, then the one who apparently consented must prove that he or she did not validly do so. Where there are words or acts of consent, this bifurcated analysis tips the balance in favor of validation of questionable consent.⁷⁵ One could ask, in what sense was there an "appearance" of consent where the promisee extracted consent to a contract with a threat of physical harm? Surely there was no appearance

70. See Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 582 (1982).

71. See R. NOZICK, *supra* note 16, at 152-64. See also M. SANDEL, *supra* note 14, at 106-09.

72. See Dawson, *supra* note 63, at 254.

73. See *id.* at 255.

74. See RESTATEMENT (SECOND) OF CONTRACTS §§ 175, 176 (1979) (stating law of duress in terms of whether threat was "improper" and whether threat left promisor with "reasonable" alternative).

75. See *Lewis v. Lewis*, 387 So. 2d 1206 (La. Ct. App. 1980) (upholding post-separation community property settlement against wife's duress challenge and reversing trial court's nullification of settlement). The wife testified that her husband had threatened that she would be "taken care of" if she did not sign the property settlement. *Id.* at 1207. She also claimed she had been beaten in the past, and the appellate court conceded, "A meager amount of evidence indicated some physical cruelty was involved" in the separation on the grounds of cruel treatment. *Id.* at 1210. The couple's son was living with the husband. *Id.* at 1207. There were two other witnesses to threats, but the judge discounted them as follows: "[T]he same two witnesses admitted either that the threats were not made in connection with the community property settlement or that the threats were made during a normal husband-wife argument in the presence of other persons." *Id.* at 1210.

of valid consent to the promisee who made the threat. The same can be said of a promisee who drafts a harsh term into paragraph 25 of the tiny print in a form contract used in a consumer transaction; in what sense is the drafter-promisee misled by an appearance of consent to that term on the part of the consumer? Yet in both cases, the "apparent" promisor has to raise and prove lack of valid consent.

The concern in the bifurcated approach seems not to be with reasonable reliance by the promisee, but rather with cooked-up validity challenges threatening security of transactions. The bifurcated analysis and allocation of burden of proof to the promisor in validity challenges also seem designed to restrict the juristic dispensing power to let people out of bad bargains. The policy choice has been to favor security of transactions over concern for validity of consent. Often, this approach is unfair. (One might even argue that limited validity analysis is inefficient to the extent that contract enforcement in a context of invalid consent exceeds prevention of manufactured validity challenges; this argument, however, only demonstrates the circularity of efficiency analysis on distribution questions—in this case, questions about how much information, judgment and power are necessary for valid choice.) Validity analysis has used a narrow focus on an event of consent, with minimal, constrained attention to social context, sometimes viewed as a suspect basis for questioning obligation.

A recurrent debate in the law of validity of contractual consent is whether to examine the process by which consent is achieved, the substance of the resulting contract, or both.⁷⁶ The difficulty of defining improper process led to greater attention to substantive fairness, but the difficulty of defining fair substance led back to a focus on procedural fairness. Neither focus works, procedurally or substantively, to avoid the difficult normative choices involved in determining validity of consent. Procedurally, the problem is that it is as difficult to define fair procedure as to define fair results. Substantively, an exclusive focus on "fair" process leads to an apology for oppressive results flowing from prior imbalances in traits and wealth. Requiring every promisee to prove "fair" substance, however, would threaten the very idea of individual choice and increase unpredictability about the enforceability of contracts. Difficult value choices about the conditions necessary for valid consent are inescapable. Looking at both procedure and substance to develop a compromise approach to making these choices seems to be the best the law can do.

2. Consent to Oppression

A question related to validity is: what are the limits of consent as a

76. See, e.g., Dawson, *supra* note 63, at 282-88 (arguing that unfairness of resulting exchange was factor usually overlooked in analysis of law of duress); Leff, *Unconscionability*, *supra* note 62 (discussing substantive and procedural unconscionability); Eisenberg, *supra* note 61, at 754 (pointing out that it is difficult and unproductive to classify cases as involving procedural as opposed to substantive unconscionability, and calling for specification of norms based on transaction types).

justification for oppressive results? The law prohibits some terms and makes others unenforceable (and makes some mandatory), in part because of the impossibility of designing procedures adequate to make consent valid; to avoid impositions by one party on another, the law withholds enforcement, prohibits some terms, and requires others. Oppressiveness as a reason to require, to prohibit or not to enforce a contract term is in part based on invalidity of consent and in part goes beyond a rationale of lack of consent.

The law prohibits or makes unenforceable certain harsh terms and contracts because of doubt that they can be validly entered into; the suspicion is that only knowledge, power and judgment problems (often combined with lack of wealth) could produce them. The harshness of the terms is evidence of validity problems. In addition, widespread regret over certain sorts of contracts casts doubt on the validity of consent.⁷⁷

In most, and arguably all, cases where indecency of a term or contract might be used as a ground for denying enforcement, the conditions surrounding apparent consent are dubious, so that the validity and oppressiveness rationales can be understood as complementary. Take the example of *In the Matter of Baby M*.⁷⁸ Although rejected in the trial court and not addressed by the Supreme Court, there were plausible fraud⁷⁹ and

77. Certain contracts are made unenforceable because of the high likelihood of regret. See Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1281, 1321-22 (1980) (risk of regret sometimes makes nonenforcement optimal). Contracts increase welfare only if expectations concerning gains are not biased systematically. When many people who enter into a given sort of contract end up regretting making the contract, then that sort of contract is not welfare-enhancing. Under economic assumptions that people choose what they want, the presence of widespread regret casts doubt on the conditions in which the choices were made. For other explanations of significant regret, see West, *Economic Man and Literary Woman: One Contrast*, 39 MERCER L. REV. 867 (1988) (arguing that economic assumptions about human nature are wrong, in that people do not always know what is best for them and are not always motivated to seek what they cognitively know is best for them); Hirschman, *Against Parsimony*, in A. HIRSCHMAN, *supra* note 49, at 142-59 (stating that economic assumptions about human nature are oversimplified and that economics has neglected reflective value changes, possibility of noninstrumental action, and effects of morality, civic spirit and trust).

78. 109 N.J. 396, 537 A.2d 1227 (1988).

79. The contract provided: "The sole purpose of this Agreement is to enable WILLIAM STERN and his infertile wife to have a child which is biologically related to WILLIAM STERN." 109 N.J. at 470, 537 A.2d at 1265. Mary Beth Whitehead was not told that Elizabeth Stern did not try to become pregnant for fear of exacerbating multiple sclerosis. 217 N.J. Super. 313, 379, 525 A.2d 1128, 1161 (1987). The trial court construed "infertile" not to mean literal inability to conceive, 217 N.J. Super. at 380, 525 A.2d at 1161, and determined that the omission of information concerning Dr. Stern's multiple sclerosis was not material. 217 N.J. Super. at 384, 525 A.2d at 1162, 1163. In addition, Mrs. Whitehead underwent a psychological evaluation and was told that she "passed." 109 N.J. at 437, 537 A.2d at 1247. An agency recommended her as a surrogate even though the evaluator said it would be important to explore with her in more depth whether she would be able to relinquish the child and noted Mrs. Whitehead had a tendency to deny her feelings. 217 N.J. Super. at 343, 382, 525 A.2d at 1142, 1162. This basis for fraud was rejected when asserted against the Sterns on the grounds that the infertility center that conducted the evaluation was not proved to be the

unconscionability⁸⁰ arguments against enforcing the contract. Furthermore, as to surrogacy contracts generally, there is evidence of judgment-related problems in a disproportionate number of women who seek to act as surrogate mothers; for example, many of them consciously or unconsciously use surrogacy as a way to attempt to deal with unresolved feelings associated with prior losses of fetuses in abortions and prior losses of children through relinquishment for adoption.⁸¹ In addition, there seems to be a high risk of misunderstanding between the parties about the nature of the "deal"; the mother usually thinks, and is encouraged by those who promote surrogacy to think, of herself not merely as providing a paid service, but as giving a great gift, which merits abiding respect and gratitude, while the father and his wife often come to want her eliminated from their and the baby's consciousness, and they consider payment of money to settle their debt.⁸²

Sterns' agent. 217 N.J. Super. at 383, 525 A.2d at 1163. The Supreme Court did not address the fraud issue, holding the contract unenforceable as against public policy. 109 N.J. at 411, 537 A.2d at 1234.

80. Substantively, the argument was that \$10,000 was too low a price in view of the efforts and risks on the part of the surrogate. 217 N.J. Super. at 377, 525 A.2d at 1160. Procedurally, there were the information problems that also formed the basis of the fraud argument. See *supra* note 79. Additionally, the Whiteheads had no lawyer when they entered into the contract with the Sterns. 217 N.J. Super. at 378, 525 A.2d at 1160. The lawyer who reviewed a similar contract document with them in connection with Mrs. Whitehead's work with another couple (not the Sterns) was under contract with the infertility center to act as counsel for surrogate candidates, a fact the Whiteheads used to suggest that the lawyer was not fully dedicated to their interests. 109 N.J. Super. at 436, 537 A.2d at 1247.

81. See Parker, *Motivation of Surrogate Mothers: Initial Findings*, 140 AM. J. PSYCH. 117, 118 (1983). In a sample of 125 women who applied to be surrogates, 44 had either had an abortion or had relinquished a child for adoption. Parker wrote:

Some women believed these previous losses would help them to control and minimize any depressive feelings they might have in response to relinquishing the baby. A few consciously felt that they were participating in order to deal with unresolved feelings associated with their prior losses.

Id. at 118. Here are two chilling anecdotes from Parker's study:

The only applicant who had been adopted had been 'forced' at age 14 to relinquish her baby, and she wanted to repeat the experience of relinquishment and master it. One applicant who had had an abortion said that instead of 'killing a baby' she wanted to give the gift of a live baby to a loving couple who wanted to have and raise a child.

Id. In an unusual departure from a *a priori* argument, Richard Posner has called for empirical research concerning regret in surrogacy contracts. See Posner, *The Ethics and Economics of Enforcing Contracts of Surrogate Motherhood*, 5 J. OF CONTEMP. HEALTH L & POL'Y 21, 28-29 (1989). Empirical research will not resolve the question, of course. How many women attempting to work through guilt over earlier abortions and adoptions do we need to offset the joy of would-be parents of the surrogates' children?

82. There is ample evidence of this sort of phenomenology in various accounts of surrogacy. See P. CHESLER, SACRED BOND—THE LEGACY OF BABY M (1988); KEANE & BREO, THE SURROGATE MOTHER (1981); M.B. WHITEHEAD & P. SCHWARTZ-NOBEL, A MOTHER'S STORY: THE TRUTH ABOUT THE BABY M CASE (1989).

There are other reasons to oppose enforceability of surrogacy contracts, such as the arguments that they commodify women's reproductive capacity and children themselves. See *infra* text accompanying notes 97-102. There are objectional third-party effects, such as the

The mother is cheated when she does not get the esteem she was encouraged to expect.

Oppressiveness as a reason not to enforce a contract also goes beyond a rationale of lack of valid consent. Denying enforcement of oppressive terms is based on respect for an underlying value that consent is thought to serve—freedom. Whether contracts are conceived of as exchanges or as relations, the point is to restrict future freedom to some extent,⁸³ so it only makes sense to talk of “freedom of contract” as referring to the freedom to get the advantages of restricting one’s future freedom. Where someone else will pay for a restriction on future freedom, it can be considered an “an opportunity.”⁸⁴ Yet there is a stock qualification—that we refuse to take this reasoning to the extreme of allowing a person to sell herself into slavery.

There are very few modern instances of people selling themselves into slavery, so the widespread use of this hypothetical, in addition to its pedigree,⁸⁵ seems due to where it leads. The next question, almost inevitably, is: what is sufficiently “like” slavery also to be impermissible in the name of consent and freedom?⁸⁶ One can attempt to account for limits on consent as a justification for enforceability by creating the category of “inalienable rights”⁸⁷ or, more precisely, “market inalienability.”⁸⁸ But the language of inalienable rights⁸⁹ tends to suggest that consent is a sufficient rationale for enforceability except in the most dire, extreme sorts of cases. This is argument by label.⁹⁰

impact on the previous children of a surrogate mother of having their mother give up their half-sibling for adoption in exchange for a sum of money.

83. See Mensch, Book Review, *Freedom of Contract as Ideology*, 33 STAN. L. REV. 753, 759 (1981) (stating that “[a]ll contracts are in restraint of trade”).

84. The New Jersey Supreme Court in its opinion in *In the Matter of Baby M*, 109 N.J. at 442, 537 A.2d at 1250, conceded that some women see surrogacy as “an opportunity.”

85. J. MILL, *On Liberty*, in J. MILL & T. CARLYLE 311-12 (Harvard Classics ed. 1909). For other uses of the self-enslavement example, see, e.g., Cohen, *supra* note 11, at 105; Posner, *Utilitarianism*, *supra* note 39, at 134; Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 764 (1983).

86. Nozick, perhaps anticipating this move, says even slavery contracts and suicide contracts should be permissible. See R. NOZICK, *supra* note 16, at 58. Posner also takes the extreme position of defending slavery contracts. Posner, *Utilitarianism*, *supra* note 39, at 134. But see D. Herzog, *Happy Slaves: A Critique of Consent Theory* 179-81 (1989) (stating that it is an embarrassment to consent theorists that consent theory could validate slavery); G. ORWELL, 1984 7 (New American Library ed. 1949) (describing party slogan, “Freedom is Slavery,” on the facade of the Ministry of Truth).

Barnett concedes the illegitimacy of slavery contracts and the legitimacy of extension of this idea by analogy, referring to “agreements amounting to slavery arrangements.” Barnett, *Consent Theory*, *supra* note 8, at 293; see also *id.* at 290.

87. *Id.* at 270, 291-94 (stating that contract theory must be situated in entitlements theory, and that one can only contract away alienable, as opposed to inalienable, rights).

88. See Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1854 (1987).

89. See Tushnet, *An Essay on Rights*, 62 TEX. L. REV. 1353 (1984) (discussing instability and social contingency of rights).

90. A more ordinary label is to call some terms indecent—too harsh to be enforceable.

Many sorts of deals or terms are currently unenforceable, or prohibited by law. Denial of enforcement is a mild legal response to contracts considered socially undesirable; it means the law refuses to foster a market in that sort of deal. Where promises restrict freedom in questionable ways, refusal by the state to enforce them means that consent of the promisor must be continuing (consent in the past is not enough). Keeping up good relations then becomes the only way to get mutual advantages, since external enforcement is unavailable.

Law can also respond more severely by making certain contracts or terms a violation of a civil regulatory scheme, such as the Federal Trade Commission's power over unfair practices⁹¹ or even a crime, such as the criminal prohibition of price-fixing agreements under the Sherman Act. A special case is the rule that contracts for personal services are not specifically enforceable; the objection is not to the contract itself, but to enforcement that makes a person a temporary slave.⁹²

There are numerous examples of the law's response to contracts or contract terms considered socially undesirable in themselves. A contract term waiving the statutory right to discharge in bankruptcy is not enforce-

When the law prohibits or makes unenforceable certain terms or contracts, a rationale of indecency is needed to supplement a market failure/cost-benefit analysis rationale, which is based at least in part on lack of valid consent. For example, most consumers do not understand complex contingent terms in credit contracts such as cross-collateralization or blanket security interests and do not shop over them, so that consumers do not choose these terms; creditors do, without market policing. Disclosure will not work because it is not possible to get consumers to read and understand explanations of all sorts of complex contingent terms. The best way to achieve efficiency is to prohibit the terms most consumers would not choose given a full understanding of the terms. This rationale involves a recognition of failure of consent in actual markets (consent is invalid because of a knowledge problem), and construction of hypothetical consent through imagining choices under ideal market conditions (cost-benefit analysis). See Braucher, *Defining Unfairness*, *supra* note 46, at 351-54, 417-29.

Left unexplained by the market failure/cost-benefit rationale is the restriction of choice to the minority of consumers who would choose harsh terms, even if they understood them, in order to get a benefit such as credit that is otherwise unavailable. Here an "indecency" rationale can supplement the efficiency rationale. The only way to achieve most people's choices under full information is by restricting a minority's choices, and in addition—the indecency rationale goes—the minority is better off without credit that depends on giving the creditor the right to take away all of their household goods on default.

I have never meant to suggest that the threat to take away all household goods does not have leverage value to creditors in collection efforts or that actually taking away worthless household goods from one debtor may be useful to creditors as a way to "encourage" other debtors to pay "voluntarily." But the same arguments can be made for knee-breaking as a remedy. Threats have value, but that fact does not end normative inquiry into their legitimacy. See Scott, *Rethinking the Regulation of Coercive Creditor Remedies*, 89 COLUM. L. REV. 730, 777-78, n.158 (1989); compare Braucher, *Defining Unfairness*, *supra* note 46, at 428.

91. See, e.g., Credit Practices Rule, 16 C.F.R. § 444.2 (1989) (prohibiting use of certain terms in consumer credit contracts).

92. See RESTATEMENT (SECOND) OF CONTRACTS § 367 comment a (1979) (referring to undesirability of imposing "what may seem like involuntary servitude").

able.⁹³ Wage assignments⁹⁴ and blanket household goods security interests⁹⁵ in consumer credit are not merely unenforceable, they are prohibited, with the lender subject to civil sanction for putting these terms in a contract. It is a crime to engage in loansharking, offering credit at very high interest rates with implicit agreed remedies such as knee-breaking, or to offer sexual services for money. Is it helpful, when drawing lines such as these, to think in terms of "inalienable rights"? This sort of "rights talk" seems designed to stop thought rather than to help get a feel for the limits the law should put on prior consent as a rationale for current enforcement.⁹⁶

In her examination of market inalienability, Margaret Jane Radin does not present it as an easy on/off classification; rather, she explores commodification as a "continuum."⁹⁷ Radin justifies a pluralistic position that recognizes a role for markets and for market-inalienability on the basis of a positive conception of freedom, in which inalienabilities are freedom-enhancing and not experienced as impositions of unwanted restraints on the desire to transact in markets.⁹⁸ She sees market inalienability as a means to foster a better view of personhood, one which recognizes context as integral to individuality.⁹⁹ This sort of thinking can be the basis for gradual extension, reflecting societal norms, of realms where consent to contract is an insufficient basis for enforcement, in order to foster freedom. From this perspective, denial of enforcement of surrogacy contracts is an easy case. The picture of the state forcibly removing a child from its mother, who is now desperate to maintain the relationship and who feels the contract was a terrible mistake, is the sort of melodrama of human suffering captured in grand opera.¹⁰⁰

93. 11 U.S.C. § 727(a)(10) (1988) (providing that effective waiver of discharge can be executed only after filing in bankruptcy, and that waiver requires court approval).

94. A wage assignment term gave a creditor power, without prior judgment or prior notice and hearing and in some states without even default in payment, to notify the debtor's employer and have the employer pay all or a percentage of the debtor's wages to the creditor. See Credit Practices Rule, Statement of Basis and Purpose and Regulatory Analysis, 49 Fed. Reg. 7740, 7755 (1984). This type of term is now prohibited by the FTC's Credit Practices Rule. See Credit Practices Rule, *supra* note 91.

95. These security interests gave the creditor the right to repossess household goods and personal effects (even though not purchased with the credit given) upon default, through either self-help repossession (if possible without breach of the peace) or summary proceedings. See Credit Practices Rule, Statement of Basis and Purpose and Regulatory Analysis, *supra* note 94, at 7761. Nonpurchase-money, nonpossessory security interests in household goods are now prohibited by the Credit Practices Rule. See Credit Practices Rule, *supra* note 91.

96. See Tushnet, *supra* note 89.

97. See Radin, *supra* note 88, at 1918.

98. *Id.* at 1899, 1903-04. See also Cohen, *supra* note 11, at 76-79 (discussing contract law's tendency to emphasize negative conception of freedom).

99. See *id.* at 1903-05.

100. But see Shultz, *Reproductive Technologies and Intent-Based Parenthood: An Opportunity for Gender Neutrality*, 1990 Wis. L. Rev. 297, 365-66 (defending specific enforcement of surrogacy contracts from a liberal perspective, despite harshness of enforcement). Shultz argues that if surrogacy contracts are not enforced, the father suffers an analogous loss. The

For a more arguable case, consider again the example of blanket household goods security interests, which are not only made unenforceable, but are prohibited by the Federal Trade Commission's Credit Practices Rule, subjecting a creditor who puts such a term in a consumer contract to civil sanction.¹⁰¹ If you think prohibiting these household goods security interests is a good idea, it is probably not because we have inalienable rights to our clothes, curtains, furniture, stereo equipment and assorted household clap-trap. Rather, the appointments of a person's home have something to do with identity, and giving a creditor the right to take everything away, or to threaten to do so, gives terrible leverage, putting the debtor at the creditor's mercy. There is some irony in the fact that this example involves a degree of noncommodification in the name of personal identity based on commodities.¹⁰² Losing your household possessions is not the same as losing your child. But here again, the scene at the time of enforcement is potentially melodramatic: To maintain the credibility of a creditor's threats, the creditor's repo man hauls away largely unsalable used household goods, while humiliated and anguished family members look blank or weep.

In sum, validity of consent and oppressiveness of the resulting deal are related reasons to deny enforcement. Drawing validity lines involves determining how much wealth, power, knowledge and judgment are necessary for an obligation arising from a contractual relation to be enforced against a now unwilling party. Drawing validity lines thus involves defining the conditions for freedom. In drawing these lines, it is helpful to look at both the procedure by which the obligation supposedly came into being and its substance. Rules denying enforcement of particular harsh terms and contracts are based in part on doubts about validity of consent. The rationale for these rules also goes beyond lack of consent, in order to serve the underlying value of freedom. The rules refuse enforcement where a contract places too great a restraint on freedom and puts a person too drastically in another's control.

B. Interpretation

1. External Definition of Obligation and the 'Objective' Element in Interpretation

The second normative dimension of contract arises from the fact that interpretation is necessary to answer the questions whether a party has

goal of nonenforcement, however, is to discourage surrogacy contracts and to make clear that no one should build expectations around state action to remove a child from one parent based on a contract.

101. Credit Practices Rule, *supra* note 91. See also note 95, *supra*.

102. Radin calls regulation of the conditions of alienation "incomplete commodification." Radin, *supra* note 88, at 1919. In the example in the text, a person may sell household goods outright. Under the Credit Practices Rules, however, she may not give a security interest in household goods unless the goods are purchased with the credit given for the security interest, so household goods are incompletely commodified. See Credit Practices Rule, *supra* note 91.

Radin also distinguishes between personal things, such as homes, with which people justifiably identify themselves, and improper object-relations, involving "property for power." Radin, *supra* note 88, at 1908.

consented and, if so, to what. These questions arise when the parties in a legal dispute offer different versions of the meaning, in context, of their words and actions; legal decisionmakers then must resolve issues of meaning by taking sides. Parties can attempt to control interpretation by explaining themselves clearly in their relationship, but words and actions do not have fixed meanings apart from external definition. Interpretation at the time of contract enforcement thus inevitably involves some loss of party control.

In the law of contract, there are elaborate separate bodies of doctrine concerning formation as opposed to interpretation of content of obligation, but both sorts of questions involve interpretation.¹⁰³ Perhaps the major reason for the special attention given to formation is that consent to formation is all that is necessary under current contract doctrine for the law to supply much of the content of obligation, a point that will be elaborated under the third heading concerning the normative role of contract law, supplying terms. Consent to all elements of obligation is not possible. Rather than contract and status being categories that are in opposition, all contracts have elements of status. Sixty years ago, Williston noted that to a greater or lesser extent, "once having entered the relationship the rights and duties of the parties are fixed by rules and laws independent of the parties."¹⁰⁴ This is a reason to examine formation questions with special care, but formation is logically subsumed within interpretation.

Contract law uses a mixed subjective and objective approach to determine both whether formation has occurred and what is the content of obligation.¹⁰⁵ If a legal decisionmaker finds an intention of the parties in common, this governs. In this subjective part of interpretation, judges and juries look for actual common intent. However, actual intent of a party can only be proved indirectly. "Ordinary" or "reasonable" meaning is relevant to, although not dispositive of, the question of shared subjective meaning. Shared idiosyncratic meaning governs if it can be proved by external signs.¹⁰⁶ Because a judge or jury is charged to determine whether parties had a common intention in the event of a dispute that cannot be resolved otherwise, parties have an incentive to communicate so as to be understood by these third parties. This incentive is heightened by the fact that the law dictates use of an "objective" standard of ordinariness or

103. RESTATEMENT (SECOND) OF CONTRACTS § 200 comment a (1979) (stating that questions of interpretation arise in determining existence of contract as well as in determining rights and duties under contract).

104. Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 379 (1921). Williston was more of a relativist concerning freedom of contract than is often supposed: "Observation of results has proved that unlimited freedom of contract, like unlimited freedom in other directions, does not necessarily lead to public or individual welfare and that the only ultimate test of proper limitations is that provided by experience." *Id.* at 374. This is modernist thinking. See Schlag, *Missing Pieces: A Cognitive Approach to Law*, 67 TEX. L. REV. 1195, 1213-17 (1989) (discussing modernism and comparing modernism to prerationalism, rationalism and postmodernism).

105. I A. CORBIN, CONTRACTS § 106 (1963).

106. See *Ricketts v. Pennsylvania R. Co.*, 153 F.2d 757, 761 (2d Cir. 1946) (Frank, J., concurring) (arguing that objective theory went "too far" in treating consideration of actual intent as irrelevant).

reasonableness in case of doubt about shared intention.¹⁰⁷ Those who, without special effort, communicate in ways that judges and juries understand are advantaged.

The objective test comes into play when a court is not convinced that the parties had an intention in common; the court must then either find no contract or that one party is bound to the other's "reasonable" understanding.¹⁰⁸ The usual policy justification for the objective element in interpretation is to protect reasonable reliance on apparent meaning.¹⁰⁹ A possibility in the background of disputes over reasonable meaning is that there really was no misunderstanding because one party is now lying about his or her understanding. When this is so, if a court correctly determines the actual meaning in common by looking for the reasonable meaning, then subjective intent is served. Thus, the reasonableness test in part guards against manufactured subjective differences in intention.

Where both parties really do have different understandings, yet only one is deemed reasonable, one party is bound without subjective intent. This aspect of the objective approach requires potential promisors to be concerned about how their actions and communications appear to potential promisees and heightens their concern with what meaning a court will consider "reasonable."

How is a court to know what external signs mean objectively, whether one party had a reasonable understanding and the other did not? An examination of all the circumstances, including the general cultural context, is appropriate, but it will not mechanically produce a "right" answer. Parties do not control what will be viewed as reasonable. The law and the social practice of making contracts can never be perfectly synchronized, especially given our heterogeneous culture.

Take the "easy" case of mutual assent through offer and acceptance, labeled as such, of a business deal, obviously a bargain. We have learned from contract doctrine to think that the parties have gone beyond tentativeness by labeling a set of communications as an offer and acceptance, and that they are serious because a real deal is serious business. But is this really true? If one party does not think making a bargain entails liability for expectancy loss, why is this contrary to objective appearances? Whose point of view is the objective one? Stewart Macaulay's empirical work¹¹⁰

107. An example of parties who do not necessarily communicate in ways judges or juries understand is cohabiting couples, who may not enter into "bargains" or "contracts" to express a sense of reciprocal obligation. See Dalton, *supra* note 12, at 1095-1113.

108. See A. CORBIN, *supra* note 105, at § 106; RESTATEMENT (SECOND) OF CONTRACTS § 20 (1979).

109. This is also the basis of the theory of liability for reliance on a promise. RESTATEMENT (SECOND) OF CONTRACTS § 90 (1979).

110. See Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 20 AM. SOC. REV. 55 (1963).

Corbin, a good legal realist, realized that rules concerning contract damages are not a product of the parties' assent, but rather are creations of courts. See 5 A. CORBIN § 1010

revealed that the point of view actually adopted by the law as "objective" may be a legal creation. His study indicated that actual business norms may be inconsistent with the core principle of contract law that agreement to a bargain creates liability for expectancy loss. Macaulay found that business persons did not think that, absent reliance, "cancelling the order" (not to their way of thinking a "breach of contract") should entail liability.¹¹¹

The objective test for formation has never seriously sought an empirical basis. Even if it did do so, no choice of one perspective could be neutral; such a choice must involve taking sides. The choice of the most common understanding of a given set of actions and communications, that is, of "ordinary meaning,"¹¹² is not neutral; those with idiosyncratic meanings are the losers.¹¹³

One might argue that, even if initially the law is out of step with ordinary meaning, the ordinary meaning of legally significant communications tends to move toward what the law says it is because sophisticated actors will communicate knowing of the meaning the law ascribes.¹¹⁴ One problem is that the law's version of objective meaning is more available to some than to others.¹¹⁵ Another is that transaction costs *are* positive, so it does matter what the legal rule is.¹¹⁶ Legal rules often cause only glacial movement in the social practice of contracting. Even sophisticated parties will be constrained and burdened by what the law regards as objective meaning. The law could attempt to minimize these costs in general by seeking an empirical basis for its choice of objective meaning,¹¹⁷ but it cannot eliminate them or avoid burdening some parties more than others.

One way of understanding the objective element is as a means to reduce losses caused by misunderstanding. Attention to "ordinary" meaning in

(stating that rule that foreseeable consequential damages are recoverable is based not on an expression of assent, but rather on judicial policy choice); *but see* *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903) (opinion of Holmes, J.) (using fiction of "tacit agreement" concerning liability for consequential damages).

111. *See* Macaulay, *supra* note 110, at 61.

Legal liability for expectancy can be understood, however, as protection of difficult-to-prove reliance, in the form of not acting. Fuller, *supra* note 11, at 812.

112. *See* Barnett, *Consent Theory*, *supra* note 8, at 303 (referring to "ordinary meaning" as basis of consent).

113. Dalton speaks of "coercion" in forcing people to communicate in so-called reasonable ways in order to assure legal recognition under a reviewing court's chosen objective approach. *See* Dalton, *supra* note 12, at 1044 n.161.

114. Barnett approves of the objective approach because it provides a means of communication that is "available to the parties." *See* Barnett, *Consent Theory*, *supra* note 8, at 315; *see also supra* note 18; Fuller, *supra* note 11, at 801 (discussing channeling function of formality as way, ideally, for parties to signal to courts and to each other their intention to be bound).

115. *See* Barnett, *Contract Remedies and Inalienable Rights*, 4 *SOC. PHIL. & POL'Y* 179, 200 (1986) (conceding that assumptions of the unsophisticated about law do not necessarily match background rules of law).

116. *See* Coase, *The Problem of Social Cost*, 3 *J. OF LAW AND ECON.* 1 (1960).

117. Administrative agencies would be better equipped to do this than courts.

contract interpretation is, however, a blunt instrument for achieving this end. A direct attempt to reduce losses due to misunderstanding would require identification of the party who can avoid misunderstanding most cheaply. An approach based on this efficiency goal would put the burden of clear communication on the sophisticated, on those who control the formation and drafting process and who engage in repeated transactions of the same type and thus learn of common misunderstandings.¹¹⁸ In cases of doubt, this approach tends to recognize as reasonable the ordinary meanings of consumers, employees, franchisees, and small businesses over those of merchants, employers, franchisors and big businesses. A sophisticated, repeat player in the same sort of deal is in the best position to learn of common misconceptions and to prevent them most cheaply.¹¹⁹ This approach has the advantage of being both efficient and fair.

2. Meaning of Text in Context

Whether a question of interpretation involves formation or content of obligation, the reasonableness of one party's meaning depends on context. Selection of what is significant in the context gives the court a regulatory role. The "easiest" type of case raising an issue of consent to the content of obligation is a dispute in which the parties agree on controlling language, for instance in a written document. The case is then "merely" one of interpreting text in context as of the time of formation.

The implications of judicial review according to a reasonableness standard are more sweeping for content-of-obligation cases than for formation cases. As to both formation and content, parties have incentives to worry about how a reviewing court will interpret their words and actions. The safe thing to do is to communicate in "reasonable" ways. But it is much harder for parties to communicate successfully to each other and, at the same time, to potential reviewing courts as to every express term of a

118. The Restatement (Second) can be read as consistent with this economic approach. It binds Party A to Party B's meaning if Party A has reason to know of Party B's meaning and Party B has no reason to know of Party A's meaning. See *RESTATEMENT (SECOND) OF CONTRACTS* § 20(2)(b) (1979).

119. Sometimes mandatory rules, and not just disclosure, may be necessary to achieve efficiency for the greatest number because disclosure is not always effective to overcome common expectations of the unsophisticated. We have learned to be rightly skeptical of disclosure as a means to achieve efficiency. See Leff, *Contract as Thing*, 19 *AM. U. L. REV.* 131, 157 (1970) (noting that a certain number of consumers will sign a contract document even if contract has "THIS IS A SWINDLE" embossed on it in electric pink). When it comes to content of obligation, as opposed to whether there has been formation at all, nondisclaimable terms, or prohibited terms, may be the only way to achieve efficiency for the greatest number. See *infra* note 132. Putting the burden of communication on sophisticated parties may be an inadequate way to achieve efficiency because it encourages drafters of contract language to "recur to the attack." Llewellyn, *Book Review*, 52 *HARV. L. REV.* 700, 703 (1939). The same problem may exist in the area of formation. If so, it would be necessary in some sorts of transactions to have legal rules, rules that cannot be changed by disclosure, addressing when obligation arises.

contract, as opposed to communicating only on the question whether they have formed a contract at all. As a result, courts (or, if you prefer, parties) are more likely to get content issues wrong than questions about formation. Generally, the less attention parties give to a matter, the greater the risk of misinterpretation. The burden of communicating "reasonably" concerning a number of matters means consent in the sense of party control from the outset is particularly elusive when it comes to content of obligation. So much for the "easy" cases, requiring interpretation of text in context.

3. Beyond Text: Interpreting Context

Harder than disputes that call for interpreting text are interpretation disputes in which the parties disagree about the primary source of content of the obligation. Consider this sort of example: One party claims that the language of a written document controls, in the sense that it should be the focus of interpretation, although of course conceding that its meaning derives from context at the time of formation. The other party, however, may claim that the written language does not control (and may never have done so), but rather the obligation is defined by the parties' relations as a whole, in particular by later words and actions.¹²⁰ (This form of argument

120. See Feinman, *A Case Study in Critical Contract Law*, in ANNUAL SURVEY OF AMERICAN LAW 273, 277-78 (1988) (giving similar analysis).

Another variation is that the second party claims the writing was not intended to cover the dispute that has arisen, and the parties never formed any intention on the eventuality in question in later dealings, so that the obligation must be defined by supplied terms. This sort of case involves a threshold question of interpretation. If the parties had no intention, then the court faces an issue of whether to supply a term and, if so, what term. For an example of this sort of case, see *Morin Bldg. Prod. Co. v. Baystone Constr. Inc.*, 717 F.2d 413 (7th Cir. 1983). *Morin* involved a construction contract dispute between a general contractor and a subcontractor after the owner rejected aluminum siding put up by the sub on an automobile plant addition. There was much evidence that the owner acted unreasonably. *Morin*, 717 F.2d at 414. The general contractor relied on contract language, including language allowing the owner to reject based on "artistic effect." *Id.* The court held that this language, contained in form documents, did not control when considered in context; the court relied upon a background rule of law that a condition of satisfaction in a contract involving commercial quality is subject to a reasonable person standard. Judge Posner, writing for the court, relied on a rationale of fictional consent, that the rule supplied was "what the parties would have expressly provided with respect to a contingency that they did not foresee, if they had foreseen it." *Id.* at 415. *Cf.* RESTATEMENT (SECOND) OF CONTRACTS § 204 comment d (1979) (rejecting rationale for supplied terms that "the search is for the term the parties would have agreed to if the question had been brought to their attention," and favoring rationale that court should supply term that "comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process"). Judge Posner's analysis in *Morin* is consistent with his explanation of his wealth maximization theory of law as consensual in a fictitious sense of consent based on guesses about the choices of most people in hypothetical markets. See note 39, *supra*.

Farnsworth would classify the *Morin* case as one in which the form contract language is an "overstatement" of expectation, used without the parties actually having an expectation concerning the matter in question. See Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860, 875 n.86 (1968) [hereinafter *Omission*]. If parties had no intention in

avoids the strictures of the parol evidence rule. The parol evidence rule, actually a complex body of rules, allows prior extrinsic evidence to show meaning of a writing and also allows evidence of later agreements.¹²¹) In this type of dispute, the parties do not agree on a focus of the interpretive exercise. Context must be investigated to determine the appropriate focus, if any.

A court that seeks to adhere to an event model of consent can resort to the categories of modification and waiver to analyze a case where one party argues that later actions and words, rather than an initial contract document, define the content of obligation. A court can also resort to hierarchies for determining content, such as that express terms are given greater weight than course of performance.¹²² Alternatively, using a relational approach, a court could examine the whole relation to determine what priority to give various communications.¹²³ Under the relational approach, a court must examine context to determine what in the context is most important. The court's role is not merely to interpret a text or even a text in context, but to interpret context. Interpreting a legal text is regulation, and interpreting context can make the regulatory role broader.

Unhinging meaning from text gives the interpreter a greater charter to find in the context evidence that the parties intended to pursue goals such as self-definition and participation, and not only wealth maximization.¹²⁴ If

common, Farnsworth favors using principles of fairness and justice rather than the "facade" of doing for individuals what they would have done if they had anticipated the situation. Farnsworth, *supra*, at 877-79. Farnsworth's analysis was adopted in § 204 of the RESTATEMENT (SECOND). See RESTATEMENT (SECOND) OF CONTRACTS § 204 (1979). This analysis rejects fictional consent in favor of candor in acknowledging that a policy choice is necessary.

121. See RESTATEMENT (SECOND) OF CONTRACTS §§ 213, 214(c) (1979).

122. See *id.* at § 203(b).

Macneil has described a whole set of traditional hierarchies in interpretation:

Formal communications such as writings control informal communications; linguistic communications control nonlinguistic communications; communicated circumstances control noncommunicated circumstances; and finally utilization of noncommunicated circumstances is always suspect.

Macneil, *Adjustment*, *supra* note 14, at 893.

123. Macneil, *Adjustment*, *supra* note 14, at 894.

124. William Whitford has pointed out that Ian Macneil has two messages; the most commonly known one is that contracts are relational, and the other is that parties in relational contracts frequently temper wealth maximization goals with other objectives such as self-definition and participation in decision-making. See Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545, 549-55. As an example of a goal of self-definition, Whitford gives a franchisee's interest in preserving the relationship with a franchisor, because losing the franchise means the end of the franchisee's career. *Id.* at 550. As one example of participation, Whitford refers to labor-management collective bargaining agreements and the central tenet of modern labor law that employees should have input into formulating employment conditions. For another example, Whitford points to collective bargaining between consumer organizations and manufacturers or sellers in Germany, in which consumer representatives have input into what is fair. *Id.* at 552-54. See A. ETZIONI, *supra* note 13, at 74-75 (stating that "many people work best, and feel less exploited, in contextual relations, in which they work in part out of moral commitment and are treated as human beings, and not merely as commodities.").

one looks at context, one can find in most contractual relations elements of trust and cooperation. A court can see these as the significant part of context (where "appropriate") and treat as less significant, or as superceded, efforts to create a fallback position of distrust expressed in an elaborate writing.

Is this use of context illegitimate judicial meddling in the parties' affairs, upsetting the "consent" reflected in the writing? Or is it more faithful to the parties' intentions and aspirations, to "true" consent? Suppose one adds here that the contract in question is between two business organizations and that the writing was drafted primarily by one party's law department, with pages of boilerplate. The business people in both organizations paid scant or no attention to the boilerplate. They spent their time defining and adjusting performance expectations in a cooperative spirit.¹²⁵ In this sort of situation, free-form examination of context may be a more appropriate form of interpretation, one that is truer to the spirit of the enterprise and thus to "consent," than a narrow focus on the writing. To the extent that interpretation of context is successful in determining true consent and in backing up norms of cooperation, it is also more efficient (less costly) than an approach that relies on attempting to force parties into expensive negotiation and drafting to articulate terms, freezing them at the outset. Sometimes terms can be worked out better over the course of the relation. Cooperation and trust may be cheaper as well as more satisfying ways of conducting a business relationship than suspicious attempts at mutual control.

The important thing to see is that there is no neutral position on what the parties meant; the reviewing court has a choice. What did the parties mean when they executed a writing and then proceeded to cooperate and adjust their relations for a period of time until relations broke down? A court can choose to emphasize the writing when the breakdown occurs. The court can justify this choice as being based on the parties' intentions—why did they execute the writing unless they wanted it to govern in the event of disagreement? Or the court can choose to conclude that the writing is an overstatement of the parties' intentions,¹²⁶ and if it ever did reflect their agreement, it came not to reflect their true, evolved understanding. "Consent" no more clearly dictates one of these choices than the other; the question is how to define and thus construct consent.

In summary, interpretation makes parties be concerned about the appearances created by their communications and actions. Interpretation thus protects reliance and also can be the vehicle for putting the burden of communication on those in the best position to prevent misunderstanding. Meeting this burden of communication as to many terms is harder than

125. See Macaulay, *supra* note 110, at 56 (describing "contractual," as opposed to "noncontractual" relations, as characterized by planning for contingencies and paying attention to legal sanctions).

126. See Farnsworth, *Omission*, *supra* note 120, at 875 n.86.

meeting the burden of communication as to only the question of formation of a contractual relation. In addition, to the extent a relational view of contract is adopted and consent is viewed as a process, context becomes not merely the backdrop for interpretation, but the source of obligation to be interpreted. Interpretation of context can be a basis for finding that the parties consented to goals of cooperation, trust, and reasonableness not necessarily expressed in contract documents.

C. Supplying Terms

1. Consent and Efficiency as Rationales

Background law and the courts in particular cases supply many sorts of terms and conditions without a basis in the parties' expressions or necessarily implicit in their relations in the sense of being understood by both. (What is implicit in any relation is open to debate.) These supplied terms and conditions are provided by many categories of contract doctrine. They include judicial definition of performance obligations not specified by the parties (*e.g.*, "reasonable" price, "reasonable" time of delivery),¹²⁷ stock background terms supplied by law, disclaimable or not, (*e.g.*, implied warranty of merchantability),¹²⁸ general legal standards that modify express terms and may also supply terms (*e.g.*, the obligation of good faith and fair dealing),¹²⁹ excuse doctrines that release parties from obligation based on unknown conditions (mistake) or unforeseen contingencies (impossibility, frustration, impracticability), constructive conditions (*e.g.*, fixing order of performance), and remedies supplied by law. The common label "gap filling

127. See RESTATEMENT (SECOND) OF CONTRACTS § 204 comment d (1979); U.C.C. § 2-305(1); U.C.C. § 2-309(1).

128. See U.C.C. § 2-314. Some states have made implied warranties nondisclaimable in consumer transactions. See Braucher, *An Informal Resolution Model of Consumer Product Warranty Law*, 1985 WIS. L. REV. 1405, 1411 n.25.

129. The nature of the obligation of good faith has been debated by Robert Summers and Steven Burton. See Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968); Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980); Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982) [hereinafter *Good Faith II*]; Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1984). Although Burton has argued for a more constrained scope to the obligation of good faith than has Summers, Burton concedes that the good faith obligation may be used to supply terms where the parties' expectations cannot be ascertained. *Id.* Burton argues that the obligation of good faith should not, however, be used to override express terms. *Id.* Even so, a court that wishes to avoid a direct assault on "freedom of contract" can engage first in interpretation that finds a term in a writing to be either an overstatement of expectation, see Farnsworth, *supra* note 120, at 875 n.86, or an earlier expectation that has been superseded by implicit modification over the course of the relationship, and then, having cleared away the express term by interpretation, the court can go on to supply a term. See, *e.g.*, *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1985).

terms” is a misnomer because the “gaps” the law has to fill generally are wider than the zones filled in by the parties.¹³⁰

Sometimes both parties consciously choose to have terms supplied by a court or by background law. When parties fail to include essential terms, in some cases they both do so consciously, knowing that a court will fill them in if there is a dispute. When the law permits parties to contract out of background terms and conditions (referred to collectively hereafter merely as “terms”) by supplying their own express terms, the background terms can be seen as consensual, at least in part.¹³¹ Parties who are sophisticated can contract out, and thus may be consciously adopting the background terms by not contracting out. Even as to the sophisticated, however, consent to optional background terms is in part fictional. These parties may not think of all possible contingencies, and it will be too costly to define all aspects of the relationship and thus contract out of all background terms that are undesirable. To see all nonmandatory background terms as consensual is to ascribe too much calculation to parties, even sophisticated ones, and to underestimate transaction costs. The unsophisticated are usually unaware of supplied terms, so that the idea that they are consenting to them is much more likely to be a fiction.¹³²

130. See, e.g., Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989). Although their analysis has strengths, see *infra* text at and following note 135, the adoption of penalty default rules advocated by Ayres and Gertner might cause fearful drafters to produce endlessly detailed contract documents.

131. Mandatory background terms and prohibited terms are discussed in Part IIA and note 119, *supra*, and note 132, *infra*.

132. See Barnett, *Contract Remedies and Inalienable Rights*, *supra* note 115, at 200 (discussing example where silence of unsophisticated parties does not indicate assent to background rules of law).

Disclaimable background terms often do not work well in transactions between a sophisticated and an unsophisticated party. The sophisticated party, who is usually responsible for drafting the contract document, will decide whether to disclaim or change the background term, and rarely will the unsophisticated party understand the choice that has been made. For example, where permitted by law, implied warranties of merchantability and liability for consequential damages are almost always disclaimed in consumer contract documents. See Eddy, *Effects of the Magnuson-Moss Act Upon Consumer Product Warranties*, 55 N.C.L. REV. 835, 836-48 (1977). Consumers are unlikely to understand or even to be aware of such disclaimers. This has led to mandatory background terms, such as a mandatory implied warranty of merchantability in consumer sales, an approach that has limited usefulness because of the unlikelihood that the consumer will litigate. These shadowy terms are based on a litigation model of consumer dispute resolution and do not provide a good basis for direct complaints to sellers, the actual forum of most consumer dispute resolution. See Braucher, *An Informal Resolution Model*, *supra* note 128. By contrast, prohibition of certain terms used against consumers, such as wage assignments and blanket household goods security interests, is both efficient and likely to have practical effect. If these terms are not in contracts, creditors cannot use them. See Braucher, *Defining Unfairness*, *supra* note 46. Prohibition of terms is efficient where most consumers would not want them if they understood them and the costs of getting them explained are prohibitive. The unusual consumers who would choose these terms are denied the cost reductions and deals that allowing the terms might allow; but this is done in the interest of giving most consumers what they want at lowest cost. See *supra* note 90.

Optional background terms can be explained as serving efficiency by eliminating transaction costs. Richard Posner describes his normative theory of law based on wealth maximization as consensual, in a fictitious sense of consent.¹³³ In this approach, terms are constructed from hypothetical ideal markets and are consensual in a fictitious sense in that they are designed to match most people's (assumed) choices under ideal market conditions. Thus, efficient background terms are those that the parties would have supplied if they had planned concerning the matter in question (under ideal market conditions, including perfect information).¹³⁴ Under the neoclassical economic assumption of wealth maximization as the goal of trades, efficient terms are those that minimize costs (*e.g.*, the terms assign risks to those who can most cheaply avoid them or minimize their effects and assign responsibilities to those who can most cheaply perform them). A problem with supplying wealth-maximizing terms when the parties are silent—without worrying about how gains are distributed—is that this may lead to strategic behavior by the sophisticated at the expense of the unsophisticated.¹³⁵ One party may not raise an issue, anticipating either that the second party would not accept the first party's desired term on the point or would charge dearly to do so, but later the first party may succeed with a wealth-maximization argument to get its way in the event of a dispute. While treating all optional background terms as literally consensual ascribes too much calculation to many parties, a blanket efficiency approach to supplying terms ascribes too little strategic calculation to others.

2. Beyond Consent and Efficiency: The Role of Community Standards

In addition to serving efficiency, supplied terms (and prohibited terms) can serve a goal of setting minimum standards of decency and fairness in the content of transactions (or other goals such as facilitating self-definition and participation by parties in the governance of their affairs). Even if background provisions of law are variable by agreement, agreement to variations may not be a practical possibility or worth it to the party burdened by the background provisions. The background provisions thus may be "sticky." Furthermore, in situations in which it is not possible to create conditions for valid consent, mandatory, nonvariable supplied terms may be the only way to achieve both efficiency and decency.¹³⁶

If neoclassical economic assumptions are modified to reflect the view that most people would seek other goals in addition to wealth maximization, then all supplied terms can be understood as consensual if they reflect the mix of goals that most people (in our society) would try to write into

133. See Posner, *Ethical Basis*, *supra* note 39, at 88-89.

134. For an instance of Judge Posner using fictitious consent to supply a term, see *Morin Bldg. Prod. Co., Inc. v. Baystone Constr. Co.*, 717 F.2d 413 (7th Cir. 1983).

135. See Ayres & Gertner, *supra* note 130, at 93-94.

136. See Part IIA2 and notes 119 and 132, *supra*, and Braucher, *Defining Unfairness*, *supra* note 46, at 384-86, 394.

contracts if this were feasible. This explanation expands consent to mean something like "membership in a society," as Peter Linzer has put it.¹³⁷ This rationale for supplied terms as based on consent is like Posner's explanation of wealth maximization as based on consent, with "just" one difference—it makes a different assumption about what most people want. This expanded notion of consent assumes that people want wealth, but that they also have other values than minimizing costs. Under this richer assumption about human nature, the minimum decency, self-definition and participation parts of the rationale for supplied terms are just as consensual as the wealth-maximization part. Both efficiency and other goals such as minimum decency involve fictitious consent, in the sense of being based on general desires, not necessarily those of the particular parties.

I make the argument that mixed efficiency and decency goals can be explained in terms of fictitious consent—that is, as based on general desires of most people—for rhetorical purposes. My preference is to follow the dictum of the legal realist Karl Llewellyn: "Covert tools are never reliable tools."¹³⁸ Therefore, the language of consent should not be used to describe the practice of supplying terms based upon general assumptions about human nature (which may be in part aspirational, if decency is counted as a general human desire). To supply terms, a legal decisionmaker must make policy choices, not merely follow the directives of the parties. The law should make policy choices explicitly and not mask the choices as "consent."

Neither interpretation nor supplying terms, which are overlapping and complementary exercises, can be explained fully in terms of consent. Take for example this type of case: One party claims that a written document should control, in the sense of being treated as the focus of interpretation. The other party claims that neither party reasonably considered the language of the written document controlling on the issue in question, because the parties in fact had no intention on the contingency that has arisen, and that a legally supplied term is necessary. There is a threshold question of interpretation concerning whether the parties had an expectation expressed in the document or implicit in the context.¹³⁹ If the court concludes that there was no expectation, but that it is appropriate to supply a term, what the court supplies is not based on consent except in a fictitious sense.¹⁴⁰ The parties cannot control in advance what they do not even contemplate.

As previously discussed, interpretation itself goes beyond consent in the sense of firm and full party control from the outset, because an external decisionmaker must make a reading of the parties' words and actions. The lack of party control is particularly clear where the decisionmaker finds meaning in the relations as a whole. It is only a small step from interpreting

137. Linzer, *Consent*, *supra* note 29, at 218.

138. Llewellyn, *supra* note 119, at 703.

139. *See, e.g., supra* notes 120 & 129 (discussing *Morin*); *see also* Farnsworth, *Omission*, *supra* note 120 (discussing the interrelation of interpreting and supplying omitted terms).

140. *See supra* note 120 (discussing *Morin*).

context without a textual focus to supplying terms; the two rationales may work together. For example, in the lender liability case *K.M.C. Co. Inc. v. Irving Trust Co.*,¹⁴¹ the court relied both on the "history of the relationship"¹⁴² over several years and on an obligation of good faith in performance, supplied by law; the court said the lender had a duty to exercise its discretion reasonably.¹⁴³ In the absence of business reasons to the contrary, the court said that the lender was obligated to give notice of a refusal to advance funds under the working capital loan agreement between the parties, despite contract language reserving to the lender the prerogative whether to make further advances and making all loan amounts repayable on demand.¹⁴⁴

141. 757 F.2d 752 (6th Cir. 1985). In this case, Borrower, a wholesale and retail grocery business, entered into a secured transaction providing for Lender to supply working capital under a line of credit, secured by inventory and accounts. Borrower was pre-approved for \$3 million in credit in 1979 when the financing agreement was first entered into; a year later, the line of credit was increased to \$3.5 million, at a lower interest rate. On March 1, 1982, Lender refused, without prior notice, to advance \$800,000 requested by Borrower, an amount that would have increased the loan balance to just under the \$3.5 million credit limit. Lender would have been fully secured for the full loan balance, including the \$800,000. The refusal to make the advance left Borrower without funds to cover outstanding checks; the checks bounced, causing the company to collapse. *Id.* at 754, 762. Because Borrower's receipts all went into a blocked account to which Lender had sole access, the refusal to advance funds left Borrower without essential operating capital. *Id.* at 759. Three days later, on March 4, Lender agreed to advance \$700,000.

At trial to a jury before a magistrate, Lender failed to explain why its loan officer refused to make the advance on March 1. There was evidence that a personality conflict between its loan officer and Borrower's president played a role and that the refusal of the advance was unreasonable. *Id.* at 761-62. The jury found Lender liable for breach of contract and fixed damages at \$7.5 million, an amount based on an optimistic assessment of the Borrower's value. *Id.* at 755, 766. The U.S. Court of Appeals for the Sixth Circuit affirmed the judgment for the Borrower. *Id.* at 766.

142. *Id.* at 762.

143. *Id.* at 759-61. At issue on appeal were a magistrate's instructions to the jury as follows: that there is implied in every contract an obligation of good faith; that this obligation may have imposed on Lender a duty to give notice to Borrower before refusing the advance requested; and that such notice would be required if necessary to the proper "execution" (presumably meaning performance) of the contract, unless Lender's decision to refuse to advance funds without prior notice was made in good faith and in the reasonable exercise of its discretion. *Id.* at 759.

The court upheld the instruction, finding that Lender's discretion whether to advance funds was limited by an obligation of good faith performance, as would be its power to demand repayment (which it equated with an acceleration clause). *Id.* at 760. In dicta (the issue was first raised on appeal, improperly), the court said that Lender's discretion must not only be exercised honestly, but also reasonably, so that the test was what a "reasonable loan officer" would have done. *Id.* at 760-61. The court said there was "ample evidence in the record from which the jury could have concluded that March 1 simply was not that unusual a day in the history of the relationship" between Lender and Borrower. *Id.* at 762.

144. Lender's argument relied on a close reading of contract documents. The court supplied a term modifying Lender's discretion, finding it subject to a requirement of reasonableness. The implied good faith and fair dealing obligation not only modified discretion, to require reasonableness, it also supplied a requirement of notice. *Id.* at 759. The requirement of notice before refusing further advances was not based on any specific provision for notice in contract documents; it was a term supplied by the court as part of the obligation of good faith and fair dealing in performance.

Just as there is no radical division between interpretation and supplying terms, there is no radical division between consent and "imposed" social obligation. Consent is socially defined, and social obligation is experienced by individuals at least in part as legitimate and as part of their identities. This is true even of individuals in their organizational roles. Consider, for example, the testimony of two bankers, including an executive vice president of the defendant, Irving Trust, in the *K.M.C. Co.* case. They testified that bankers owe their clients a duty of good faith, a duty that requires notice of a refusal of an advance where the lender is well secured, as it was in that case.¹⁴⁵ This testimony is an example of how consent, even in a narrow sense of conscious agreement, and social obligation are overlapping and complementary concepts.

One finds the interaction between these concepts at work in the Restatement (Second) of Contracts, reflecting traditional views. Consider, for examples, sections 205 (duty of good faith and fair dealing)¹⁴⁶ and 204 (supplying an omitted essential term).¹⁴⁷ A comment explaining the obligation of good faith and fair dealing includes the following language:

Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness.¹⁴⁸

The two basic purposes of the duty of good faith and fair dealing reflected in this language, honoring expectations (both subjective and objective)¹⁴⁹ and honoring community standards, are, quite properly, presented as intertwined and mutually supportive, rather than contradictory. It can be added

145. *Id.* at 761-62. The Irving Trust banker, following his employer's theory of the case, tied the obligation to give notice to a subjective belief that the bank was adequately secured.
Id.

See Comments on Professor Linzer's Paper, 1988 ANN. SURV. OF AM. L. 199, 209, in which Jonathon Eddy, describing his practice experience in lender liability matters, said:

If you get bank counsel and bankers talking among themselves kind of behind closed doors, in cases where banks get tagged for lender liability, it seems to me often you get the reaction[:] "Oh, yeah, they really deserved to get nailed in that case. I mean, the loan officer's action was outrageous."

Id.

146. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) (providing that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement") (emphasis supplied).

147. *See* RESTATEMENT (SECOND) OF CONTRACTS § 204 (1979) (providing that "[w]hen the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court").

148. RESTATEMENT (SECOND) OF CONTRACTS § 205 comment a (1979).

149. This seems a fair reading of "agreed common purpose" and "justified expectations of the other party."

that an obligation of good faith and fair dealing in performance is also consistent with efficiency because it obviates the need for elaborate expressions of intentions not to weasel or be a jerk.¹⁵⁰ These intentions are, or ought to be, taken for granted. The is/ought distinction is neither clear nor very important; the obligation of good faith and fair dealing is experienced as coming simultaneously from within the party and from the community without.

Section 204 on supplying terms also reflects a view of consent and community standards as complementary. The parties must have at least consented to formation; their bargain must be "sufficiently defined to be a contract." The Restatement takes this as a sufficient consensual basis for supplying a reasonable term. A comment explicitly rejects the fiction that "the search is for the term the parties would have agreed to if the question had been brought to their attention."¹⁵¹ Rather, it treats as *relevant* to the question what is a reasonable term "the probability that a particular term would have been used if the question had been raised."¹⁵² It thus insists on a rejection of a rationale of fictional consent that excludes community standards of fairness (i.e., it rejects a rationale based on wealth maximization only):

[W]here there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process.¹⁵³

In addition to reflecting a preference for candor, this comment seems to express a fear that a rationale of fictional consent will assume wealth maximization as the only goal of bargainers and exclude fairness, a fear which is understandable given the current ascendance of the neoclassical economic paradigm of human nature. In addition to the appeal of candor, it is prudent not to speak of consent when referring to general desires of people in our society for both wealth and decency until the neoclassical paradigm has been safely (and decently) buried and a new, richer paradigm has replaced it.¹⁵⁴

150. See Posner, *Utilitarianism*, *supra* note 39, at 123 (arguing adherence to conventional virtues reduces policing costs). See also *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752, 761-62 (6th Cir. 1985) (noting evidence that refusal of advance was unreasonable and that personality conflict between loan officer and borrower's president contributed to loan officer's decision).

151. RESTATEMENT (SECOND) OF CONTRACTS § 204 comment d (1979); Posner prefers to use language of fictional consent. See, e.g., *Morin Bldg. Prod. Co. v. Baystone Constr. Co.*, 717 F.2d 413, 415 (7th Cir. 1983). See also Posner, *Ethical Basis*, *supra* note 39, at 85-91.

152. RESTATEMENT (SECOND) OF CONTRACTS § 204 comment d (1979).

153. *Id.*

154. See A. ETZIONI, *supra* note 13, at xii (stating that in making his critiques of neoclassical economic paradigm he "encountered strong reactions of the kind previously faced only when he dealt with issues such as the United States involvement in the war in Vietnam, multilateral nuclear disarmament, and the future of the family").

The Restatement (Second) of Contracts is fundamentally a-theoretical.¹⁵⁵ For example, "contract" is defined in a circular fashion in terms of legal enforceability.¹⁵⁶ The Restatement does not attempt to give a theoretical conception of when enforceability is appropriate. Despite the lack of a clear theory, one observation can be made: the Restatement excludes some theories. In particular, it excludes any theory premised on a radical division between individuals and the social community.¹⁵⁷ It gives a role to expressed, conscious consent (but defined as requiring attention to others' reasonable understandings¹⁵⁸ and as based on meaning in context¹⁵⁹) and to efficiency analysis.¹⁶⁰ But the call for "community standards of fairness" in supplying terms and for "community standards of decency, fairness, or reasonableness" in application of the good faith and fair dealing obligation are clear instances of the Restatement's rejection of the necessity of consent in a narrow sense of (highly elusive) party control. The Restatement's call also goes beyond efficiency. These examples from the Restatement show that the Restatement is consistent with a more complex theory of contract that includes a moral dimension to obligation derived from a sense of community.

It should be noted that traditional notions of fair terms may be, more frequently than not, the same as efficient terms. In a commercial world of relational contracts, trust and cooperation are essential. A legal approach that recognizes and promotes these norms reduces the parties' negotiating

155. Speidel, *Restatement Second: Omitted Terms and Contract Method*, 67 CORNELL L. REV. 785, 804 (1982) (lamenting that Restatement (Second), in its analysis of supplying omitted essential terms in § 204, "launches the court into commercial context without a paddle"). While Speidel understands the political necessity of compromise in a restatement, he nonetheless rues its "failure to articulate a complete theory of contract." *Id.* at 808. He refers then to theoretical literature focusing on "economic efficiency, relational theory, moral obligation, altruism or distributive justice." *Id.* A restatement that addressed all these theories and attempted to settle the exact role of each in the law of contract would be lucky to draw more than one supporter (its drafter).

156. See RESTATEMENT (SECOND) OF CONTRACTS § 1 (1979).

157. For example, it excludes Randy Barnett's consent theory and Richard Posner's wealth maximization theory.

158. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS §§ 201(2)(b) (concerning whose meaning prevails) and 20(2)(b) (concerning effect of misunderstanding) (1979).

159. See, e.g., *id.* at §§ 202 (words and other conduct are interpreted in light of all circumstances) and 214(c) (evidence of agreements and negotiations prior to or contemporaneous with the adoption of writing are admissible to show meaning of writing, whether or not integrated).

160. This is explicit in the Introductory Note and its Reporter's Note in Chapter 16 on Remedies, Restatement (Second) of Contracts (1979). Economic analysis is treated as helpful but as having problems: "The analysis of breach of contract in purely economic terms assumes an ability to measure value with a certainty that is not often possible in the judicial process. The analysis also ignores the 'transaction costs' inherent in the bargaining process and in the resolution of disputes, a defect that is especially significant where the amount in controversy is small."

Economic analysis is appropriately *part* of policy analysis; for example, in the matter of supplying essential omitted terms, efficiency can be made part of "policy" in the comment language quoted in the text at note 153, *supra*.

and policing costs. Legal rules may also mold values so as to reduce costs in the long run. Because norms of trust and cooperation are basic to workable contractual relations, the law should not lightly undercut them on the basis of arguments about short-term gains.

The communitarian streak in modern contract law is modest but pervasive. Contract law sets minimum standards, not high ones,¹⁶¹ limiting advantage-taking and requiring other-directedness. Contract is often thought of as the last liberal bastion,¹⁶² but even here individual autonomy is only a relative value and one among others. Contractarians should take note. They are living in a fantasy world if they believe that abandoning noncontractual regulation in favor of contract law would provide release from social constraints. Contract law is also regulatory.

Conclusion

By insisting on a communitarian dimension to contract law, I do not mean to suggest that "community" is a magic solution to the specification and application of norms in the law of contract. Community, like consent, is in the eye of the beholder; reifying the notion of community would not be helpful.¹⁶³ The increasing talk of community both in legal scholarship and in the popular media may be in inverse relation to people's actual sense of connection and reciprocal obligation to each other.¹⁶⁴ In part, we talk about community out of longing rather than because we really have one. The question remains: what sort of community do "we" (whoever we are) want? This brings us back to the task of articulating norms, which is the only way to interpret and supply much of the content of contractual obligation.

The work of building and stating norms may not be easy, but before we can get back to this traditional job of the law, we need to clear away the suggestion that we can evade the task by simple resort to "freedom of

161. See, Summers, *Good Faith II*, *supra* note 129, at 811, 834 (stating that obligation of good faith and fair dealing is a minimum standard, not a high ideal).

162. See Buchanan, *Assessing the Communitarian Critique of Liberalism*, 99 *ETHICS* 852, 853, 857 (1989) (distinguishing familial obligations and obligations to one's community or country from those "chosen or explicitly undertaken through contracting or promising" and treating contracts between economic agents as opposite of community). To a large extent, however, contractual obligation is socially defined rather than "explicitly undertaken." Contracts have communal elements.

163. See Burton, *Law as Practical Reason*, 62 *S. CAL. L. REV.* 747, 754 (1989) (discussing problem that "reasonable standards of fair dealing in the trade" may not exist and thus cannot be used to define obligation).

164. From more venerable expressions such as "the civil rights community" or "the diplomatic community," there has been a degenerate trend in the identification of "communities" in the media. Thus, we see references to the likes of "the lending community" or "the investment banking community." The nadir in this trend was reached on August 23, 1989, when Robert MacNeil referred on the MacNeil-Lehrer News Hour to "the drug-trafficking community," a Hobbesian sort of "community" indeed. *MacNeil-Lehrer News Hour* (television broadcast, Aug. 23, 1989).

contract.” The legal institution of contract itself requires elaborate normative definition in three dimensions. First, there are interrelated questions about validity of consent and the social limits of consent as a rationale for using state force against a now unwilling contract party. To answer these questions, we need a positive conception of liberty, one which identifies its minimum conditions, rather than seeing liberty as merely “freedom from” particular constraints. We also need a positive conception of limits to enforcement of contracts, with the limits seen as a means to foster freedom rather than to restrict it. Second, interpretation of contracts can only be done from some point of view, which means that it inevitably carries normative baggage. Self-consciousness about this baggage can help us make better choices about which parties should bear the burden of communication. Third, law must supply much of the content of contractual obligation. Particularly when long-term effects are considered, the “fair” terms produced by traditional views drawn from community standards promote rather than undercut market institutions. In the legal activities of interpreting and supplying contract terms, we should be wary of approaches that sacrifice norms of trust, cooperation and participation for supposed short-term gains. Legal approaches that can be reconciled with both efficiency and fairness have the best chance of sustaining productive contractual relationships in the long run.

