"NO CONTRACTUAL RIGHTS WITHOUT PERFECTION RITES" REINVENTING THE FREEDOM OF CONTRACT WITH FORMALITY

Gastón de los Reyes, Jr.

A DISSERTATION

in

Ethics and Legal Studies

For the Graduate Group in Managerial Science and Applied Economics

Presented to the Faculties of the University of Pennsylvania

in

Partial Fulfillment of the Requirements for the

Degree of Doctor of Philosophy

2014

Supervisor of Dissertation

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Dedication page

Given the enormity of the project for me, I would like to thank several people by name whose special mark is deeply embedded—directly or indirectly—in this work.

For the architecture of the arguments that follow, I have to give special thanks to **Lon Fuller** and **Oliver Williamson**. Williamson identifies the groove of the governance problem that courts exacerbate with the way they enforce contracts. Just as importantly, he provides a systematic and lucid (and Nobel award-winning) account of the way that legal doctrine can impact governance. Lon Fuller also studies law's role in economic governance, and he goes beyond the reaches of the comparative ranking methodology Williamson develops. Not only can we can *rank* legal doctrines in terms of their governance consequences, we can aspire for *principles* towards the natural laws of organizational life that teach us how legal doctrine needs to evolve to reengineer social institutions accordingly. Fuller calls this study eunomics, and my aspiration in this dissertation is to elucidate the eunomics of contract law in governing economic relations.

To **Karl Marx**, who inspired me to see through the normative superstructure of society to the wheels of economic development, with hope to reinvent social relations to free human potential.

To **Alan Strudler**, advisor who identified weaknesses in my evolving position uncompromisingly, providing feedback indefatigably on my way to more defensible claims.

To **Thomas Donaldson**, committee member who showed me the analytical power of linking business ethics and governance with contract theory at the nexus.

To **Richard Shell**, committee member who encouraged and helped me to articulate a doctrinal argument with normative bite and managerial relevance.

To **Eileen de los Reyes**, my mother and educator who inspired me, *inter alia*, by completing her dissertation, *The Moral Empire: United States Relations with Cuba, 1822-1903,* when I was 16.

To **Gastón de los Reyes**, my father and engineer who taught me to tinker with ideas for their inner beauty and also scrappily, iterating continuously between prototype and drawing board.

To **René de los Reyes**, my brother who, being self-taught in the matters below, puts my schooling in perspective when he easily cuts to the heart of my most sophisticated arguments.

To **Inigo** and **Eliam de los Reyes**, my sons who both reinforce my commitment to social justice and show me how naturally overriding care for one's children so easily veers us towards injustice.

To **Alexa**, the light of my life who gave me the will to get this far.

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I would like to recognize my professors at the Boston University School of Law, especially Pnina Lahav, Kenneth Simons, Gerry Leonard and Daniela Caruso, for inspiring me with a love for the law and the dream to become a professor.

I would like to acknowledge the inspiration for the title—and the research overall—that comes from Tae Wan Kim's emphasis on the centrality of the ritual element in business ethics.

In addition and above all, I would like to thank all my teachers—formal and informal—across the span of my life without whom I could not have gotten to see what I got to see by doing this research.

ABSTRACT

"NO CONTRACTUAL RIGHTS WITHOUT PERFECTION RITES"
REINVENTING THE FREEDOM OF CONTRACT WITH FORMALITY

Gastón de los Reyes, Jr.

Alan Strudler

Contracts provide managers and entrepreneurs an instrument of governance through which legally distinct parties can pursue transactions—from supply agreements to joint ventures—that the market has not standardized and priced. The willingness of common law courts to enforce contracts—with nothing more than evidence of an exchange—lubricates the economy with a valuable source of commitment that nourishes enterprise. Unfortunately, the social benefit of contract law is compromised by the opportunism that often results from the formalistic approach courts take to enforcing contracts, which is to construct contract terms to apply *at all events* unless expressly qualified. The party who bargained to receive performance is armed by law to sue even where the deal was disrupted by circumstances the parties did not plan for or price into the bargain. By welcoming opportunistic lawsuits, courts diminish the attractiveness of contracts for economic governance.

Tempering the potential injustice of such lawsuits, courts have developed excuse doctrines that justify discharging the defendant from liability notwithstanding the implications of formalistic construction. To date, all efforts to optimize contract law in respect of disruption have sought to strike the right balance between some and no excuse. This dissertation argues that what requires reinvention is not excuse doctrine but rather contract law's doctrine of construction. Formalistic construction should give way to "perfectionistic" construction, meaning that courts should withhold enforcement unless there is sufficient evidence that parties "perfected" the

allegedly breached obligation by planning for and pricing terms for a disruption like the one that undermined the deal.

With the support of strong yet overlooked precedents, this position is defended through four arguments, each anchored in a commitment to the freedom of contract. First, courts committed to enforcing those and only those contract terms parties selected should demand the formality of perfection. Second, perfectionistic construction better advances party autonomy than formalistic construction, with or without excuse. Third, perfectionistic construction pulls the rug out from formalistic opportunism, enhancing the attractiveness of contracts for economic governance. Fourth, requiring parties to undertake the formality of perfection resonates with the legislative aspirations of contract as an autonomous instrument of governance.

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LIST OF ABBREVIATIONS

BvDC	*Baily v. De Crespigny*
FC	formalistic construction
FCwE	formalistic construction, with or without excuse
PC	perfectionistic construction
PvJ	*Paradine v. Jane*

PREFACE

Freedom and Contract

The idea of freedom has been closely associated with the common law of contracts for centuries. At least since the heyday of classical contract in the 19th century, the slogan in the courts of law has been 'freedom *of* contract.'[1] This ideal grounds the fundamental tenet of classical jurisprudence: the courts' role is to enforce the deal terms that the parties bargained for—*pacta sunt servanda*.[2]—not to make the contract for the parties. Whether the deal was fair, favorable for the community or fraught with risk is irrelevant to this principle of enforcement, even if there are exceptional cases.

Notice, though, that freedom of contract is an ideal that does not tell a court *how* to construct the contract from the deal. I am not referring to the controversial parol evidence rule that tells courts to privilege written deal terms over oral ones. Whether written or oral, the question remains: how far do deal terms reach? Do they bind the parties even in future circumstances that the parties did not plan for or price, where the deal that was expressly defined would make little sense? The answer that has dominated the courts of law for hundreds of years is that they do. I will call this answer to the reach of deal terms *formalistic* construction.

Formalistic construction puts the state police power behind deal terms *as if* they were meant to bind under all extenuating circumstances. Consider the 1647 case that is still cited as precedent for this jurisprudence.[3] Jane agreed to let land for four years from Paradine. After a

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[1] "Freedom of contract here means, of course, power of contract, e.g., the power to bind oneself, by agreement, to further action or consequences to which one otherwise would not have been bound." Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 Nw. U. L. Rev. 854, 873 n. 55 (1978).

[2] This Latin phrase that stands for the proposition that agreements are to be kept.

[3] For example, a law review article on the subject footnotes a reference to formalistic construction by saying that "[t]he de rigueur citation here is *Paradine v. Jane*, 82 Eng. Rep. 897 (KB. 1647)."

year, Jane was pushed off the land by the German Prince Rupert, marauding around England during the civil war. Jane did not pay for the land the three years he had been dispossessed. Paradine sued to recover the lease payments, and the court found that the deal term—make four annual lease payments—applied to Jane despite the circumstances. Jane, in his defense, protested that the deal he entered into did not extend to paying for land he could not occupy.

In ruling in favor of Paradine, the court appealed to freedom of contract: "when the party by his own contract creates a charge upon himself, he is bound to make it good, if he may, notwithstanding accident by inevitable necessity, because he might have provided against it by his contract."[4] Jane, the court indicated, had freedom of contract in this deal: he was perfectly free to supplement the deal terms at the front end. That he chose not to, the court implied, legitimates enforcement of the bargain according to a construction that requires him to pay for land he was unable to occupy.

The legal implications of what has come to be known as the rule of *Paradine v. Jane* ("PvJ") (1647) are straightforward enough. First, non-performing parties (in this case Jane) face a losing case if the deal terms, read *according to this rule*, require performance. The second implication concerns the negotiation phase of a bargain. It behooves each party to insert terms that disengage or adjust its performance obligations where appropriate given the deal. I call this activity *perfecting* obligations, meaning planning for and pricing the potential for disruption into the bargain. The rule of PvJ warns negotiating parties to make sure to try to perfect their performance obligations in respect of the kinds of disruption that could strike them, for otherwise they contract at their peril of such disruption.[5] By perfecting their performance obligation, they

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Clayton P. Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521, 521 n. 4 (1985).

[4] *Id.*

[5] The following is a typical judicial expression of the principle:

can undertake to get paid for assuming the risk of onerous or impossible performance, or avoid the obligation altogether.[6] Otherwise, the rule says, the parties are at each other's mercy in case of unplanned disruption that robs the bargain of sense.

Despite the clarity of the legal message, the justification the PvJ court proffers to apply its rule suffers from a circularity that renders it philosophically baseless, on its own terms. Whether a party "has created a charge upon himself" depends on the reach of contract law. The PvJ court has to assume the reach of its own rule to justify imposing damages upon Jane. According to the rule of PvJ that has held sway for two centuries,[7] the deal term sued upon is

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> Where the contract is to do a thing which is possible in itself, or where it is conditioned on any event which happens, the promisor will be liable for a breach thereof, notwithstanding it was beyond his power to perform it; for it was his own fault to run the risk of undertaking to perform an impossibility, when he might have provided against it by his contract. And therefore, in such cases, the performance is not excused by the occurrence of an inevitable accident, or other contingency, although it was not foreseen by, or within the control of, the party.

Anderson v. May, 50 Minn. 280, 282 (1892) (available at SAMUEL WILLISTON, 2 A SELECTION OF CASES ON THE LAW OF CONTRACTS (1904). Here is another:

> In the opinion of the court, the question is fully examined, many cases are cited, and the rule is stated "that where a party by his own contract creates a duty or charge upon himself he is bound to make it good if he may, notwithstanding any accident by inevitable necessity, *because he might have provided against it by his contract*. *** If, before the building is completed or accepted, it is destroyed by fire or other casualty, the loss falls upon the builder; he must rebuild. The thing may be done, and he has contracted to do it. *** *No matter how harsh and apparently unjust in its operation the rule may occasionally be, it cannot be denied that it has its foundations in good sense and inflexible honesty. He that agrees to do an act should do it, unless absolutely impossible*. He should provide against contingencies in his contract.

Stees v. Leonard, 20 Minn. 494 (1874) (emphasis added).

[6] LON L. FULLER, BASIC CONTRACT LAW 661 (1947).

[7] *See infra* note 310 and text accompanying note 14.

> The traditional yet harsh common law rule, sometimes referred to as *pacta sunt servanda*, held that promises must be kept though the heavens fall. Although a court would not grant specific performance of such a promise (actual performance being impossible), the breaching party would still be liable for damages.8 The theory was that the breaching party should protect its interests by negotiating a suitable provision in the contract that addressed the possibility of severe hardship

14-74 Corbin on Contracts § 74.1 (notes omitted). Arguably, the case was inapt for the purpose to which it was put by 19th century courts.

> Moreover, it is odd to cite Paradine for the proposition that in principle, impossibility does not excuse performance. As Pollock pointed out, the performance remained possible: the tenant could still pay the rent. The court did not even say that impossibility would never excuse the lessee from

justly enforced to the maximal reach available in light of its verbal content *because* the defendant could have added words *ex ante* to restrict that maximal reach. And this is done with no substantive inquiry into the parties' deal—what each side was committing to exchange—and, moreover, the fact that the challenged deal term was unperfected makes no difference. The bootstrapping error of the logic is akin to one famously corrected by Socrates in the early Platonic dialogue with Euthyphro about the meaning of piety. The error will become clearer after briefly reviewing this exchange in the *Euthyphro*.[8]

After dispensing with his interlocutor's very simplistic first attempt to define piety in terms of one instance of its expression, Socrates undercuts Euthyphro's second offering—that piety is that which the gods love—by pointing out that the gods disagree about this, and then proceeds to unsettle the third attempt—that piety is what *all* gods love—with this puzzler: "*Is the*

> performing his obligations. It distinguished obligations expressly undertaken - such a paying rent - from those imposed by law without an express promise - such as to give back the premises without "waste." The latter would be excused by a sufficiently uncontrollable event.

James Gordley, *Impossibility and Changed and Unforeseen Circumstances*, 52 AM. J. COMP. L. 513, 522 (2004).

[8] David Charny frames the problem as an antinomy:

> The antinomy arises from two inconsistent but equally powerful ways of interpreting the normative consequences of human action. In one view, rights are determined by entitlement: application of a predictable rule system determines the normative consequences - the rights and duties - of different modes of conduct. A "promise" creates obligations that are determined according to entirely conventional criteria. The structure of claims and benefits is fully determined by natural laws of causality and socially constructed laws that assign entitlements on the basis of actions and their consequences or outcomes.
>
> On the other view, justice requires that a person receive what he *deserves.*
>
> > [S]omeone may resist application of a rule, without questioning that it is the rule and that the conditions for its applications are met. He may assert that its application would be unjust and, if asked to explain further, is likely to say that the person affected by the rule does not deserve whatever are the consequences, beneficial or harmful, of its application.[56]

Hypothetical Bargains: The Normative Structure of Contract Interpretation, 89 MICH. L. REV. 1815, 1828 (1991) (quoting LLOYD WEINREB, NATURAL LAW AND JUSTICE 194 (1987)).

pious loved by the gods because it is pious, or is it pious because it is loved by the gods?"[9] In the terms of PvJ, this translates loosely to: *Is a just contract enforced by courts because enforcement would be just, or is it a just contract because courts would enforce the contract?* Neither Euthyphro nor the PvJ court see past the second horn of the dilemma on their own. Emboldened by its Euthyphro bootstrap, the PvJ court says nothing about the deservingness of Jane's contractual liability *as a matter of justice and first principles of jurisprudence.*[10] The problem is that the observation about Jane's freedom to contract *ex ante* concerning *limitations* in liability simply cannot reach the question whether the law of contracts *should* extend to facts like Jane's in the first place.[11] *How do* and *how should* principles of enforceability make contracts what they are in the first place? These are the deeper questions I take up in this dissertation.

Over the course of my Socratic attack of the rationale for formalistic construction, I will come down sharply against the rule of PvJ, calling for its reversal as a matter of policy and

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[9] PLATO, *Euthyphro*, in FIVE DIALOGUES 15, 10a (G.M.A. Grube, trans.) (Hackett 1981).

[10] Samuel Williston characterizes the deficiency in reasoning this way:

> Instead of recognizing that the law governing the performance of contracts is based on reasons of policy and justice and that these reasons sometimes involve results which are wholly beyond the range of thought of the parties when they entered into the contract, and which occasionally go counter even to the expressed intention of the parties, the courts have sought by rules of construction to find an intention of the parties which shall conform or can be made fictitiously to conform to the conclusion which the court instinctively feels should be reached.

Freedom of Contract, 6 CORNELL L. Q. 365, 371 (1921).

[11] Lon Fuller addresses a related issue in his well-known paper, *Consideration and Form* (to be discussed at length in Section 2.2 below):

> It has been suggested that in some cases the courts might properly give an interpretation to a written contract inconsistent with the actual understanding of either party. What justification can there be for such a view? We answer, it rests upon the need for promoting the security of transactions. Yet security of transactions presupposes "transactions," in other words, acts of private parties which have a law-making and right-altering function. When we get outside the field of acts having this kind of function as their *raison d'etre*, for example, in the field of tort law, any such uncompromisingly "objective" method of interpreting an act would be incomprehensible.

41 COLUM. L. REV. 799, 809 (1941). In this passage, Fuller is careful to avoid a bootstrap by recognizing that the threshold question is whether a particular human interaction should be imbued with the legislating quality of a transaction, or not.

jurisprudential principles. I will do so, moreover, by appealing to and embracing PvJ's shining beacon: the freedom of contract. PvJ's *formalistic* doctrine of construction necessarily marshals the state police power behind deal terms that, in cases of disruption, could fall well outside the contemplation, planning and pricing the parties' mustered into the definition of their deal. Paradine and Jane did not expressly agree—and it is difficult to believe they *could have* agreed expressly or, for that matter, impliedly—that Jane was obliging himself to pay rent even if dispossessed of the land.[12] Yet formalistic construction compels the conclusion that he did.[13] In this way, formalistic construction *imposes* a contract—Jane to pay rent whether or not possessed of the land—that the parties never consciously brought within the scope of their deal. PvJ, I will argue, makes it a principle of law to enforce contracts parties never priced and paid.

In mounting my challenge against formalistic construction, I am resuscitating a hardly noticed and unsigned commentary from an 1833 issue in the serial, *American Jurist*:

> although courts may shelter themselves under the very correct principle that they are only to expound, not to make contracts, I say that they make contracts by means of this doctrine [of *Paradine v. Jane*]; that what they miscall a strict is in fact an enlarged construction; for to a covenant to deliver goods, or carry a ship to such a place or at such a time, simply so expressed, they add the words *at all events*, which never were or could be within the intention of the parties.[14]

Following this line of reasoning, I will argue that the freedom *of* contract demands freedom *from* state-imposed contract terms that the parties did not bargain for, and that this principle cuts into the legitimate reach of PvJ.

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[12] Please note that I am not engaging with the historical case of PvJ but the formalistic rule of construction the rule represents. The facts of the case, naturally, lend themselves well enough to this purpose, as this is the purpose to which the Queen's Bench put the precedent. *But see* John D. Wladis, *Common Law and Uncommon Events: The Development of the Doctrine of Impossibility of Performance in English Contract Law*, 75 GEO. L.J. 1575, 1588-93 (1987).

[13] *See supra* note 5.

[14] *Execution of a Contract Impossible*, 10 AM. JUR. 250, 251-52 (1833) (emphasis in the original).

According to this alternative view, parties should not be forced to enter into deals that are unbounded as *Paradine v. Jane* would have it, *unless* they choose to do so expressly. When the doctrine of formalistic construction extends the reach of a performance obligation far beyond the factual context that defined the deal, the parties become subject to a contract they really did not make on their own. Becoming subject to state enforcement in respect of an obligation that gets constructed in this way is the *opposite* of freedom of contract—heteronomy rather than autonomy.[15] Stipulating that parties who enter into contracts sign up to become legally obligated to the full extent of contract law would legitimate the Euthyphro bootstrap while providing little condolence to parties whose liberty is rankled by judicial overreach. In my conception of freedom of contract, parties should have the liberty to enter into deals that remain uncharted beyond the definite reach of their performance obligations, if that is how they leave them. A court that cultivates this version of the freedom of contract follows the doctrine that is the *opposite* of formalistic construction. This doctrine leads a court to withhold enforcement when it finds insufficient evidence that the parties planned for and priced performance under the disruption behind the alleged breach.

I call this alternative doctrine of construction *perfectionistic* because it amounts to the reluctance to construct and enforce *unperfected* terms in the face of serious adversity. The difference between the two construction doctrines (formalistic versus perfectionistic) can be reduced to the allocation of the burden of proof in cases of disruption. Under a formalistic approach, the court puts the burden on the defendant to have perfected its performance obligation, else the contract is enforced as verbalized. According to perfectionistic construction, courts instead put this burden on the plaintiff, the party desiring the performance. With perfectionistic

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[15] *See* ISAIAH BERLIN, *Two Concepts of Liberty*, *in* FOUR ESSAYS ON LIBERTY (1969).

courts, therefore, it is up to the party who might want to sue to enforce the contract to make sure to *extend* the performance term to reach circumstances outside the conditions already priced into the bargain, else courts will not enforce in those circumstances. Under this approach, courts honor the parties' freedom *from* contract by enforcing deal terms *only* to the extent evidenced by the bargain.

The prescient author of the 1833 note laments that "this unfortunate doctrine [of formalistic construction] is so interwoven with a number of decisions, ancient and modern, in England and in this country, that I fear it will not be easily eradicated." This interweaving became even knottier only decades later when the courts of common law in England developed new excuse doctrines that sustained the principle of formalistic construction even as they justified withholding enforcement in some cases, starting with the landmark *Taylor v. Caldwell* in 1863.[16] Notably, judges reasoning through the application of excuse doctrines did then—and still do[17]—take pains, as in PvJ, to reinforce the freedom of contract norm in their opinions.

I thus take it as my burden in this dissertation to make the case (i) that, easily or not, this formalistic jurisprudence *can* be eradicated within the framework of the freedom of contract, (ii) that there is a viable alternative—perfectionistic construction, and (iii) that this alternative avoids the defects of formalistic construction, with or without excuse. I will be greatly assisted in discharging my burden by having multiple strong lines of overlooked perfectionistic precedent with which to articulate my case.

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[16] 3 B. & S. 826 (1863).

[17] *See Tracetebel Energy Marketing, Inc., and Tractebel Power, Inc., v. E. I. DuPont de Nemours and Co.*, 2000 WL 35723233 (Tex. Dist.); *Tracetebel Energy Marketing, Inc., and Tractebel Power, Inc. v. E. I. DuPont de Nemours and Co.*, 2003 WL 25759876 (Tex.App.-Hous. (14 Dist.)); and *Tractebel Energy Mktg., Inc. v. E.I. Du Pont De Nemours & Co.*, 118 S.W.3d 60 (opinion supplemented on overruling of reh'g, 118 S.W.3d 929) (Tex. App. 2003).

Building on these foundations, my dissertation unfolds through three lines of argumentation that come together in a fourth. The chapters of the dissertation reflect this argumentative structure. In Chapter 3, I feature the leading argument from my dissertation proposal, already limned here: formalistic construction—with or without excuse doctrine—fails parties' freedom of contract. Freedom *of* contract from the perspective of parties requires freedom *from* state-imposed contracts, and the way courts can honor this imperative is through perfectionistic rather than formalistic construction. This argument is primarily instrumental in form.[18] My claim is that formalistic construction with or without excuse (hereinafter "FCwE") frustrates freedom of contract and liberty in a way perfectionistic construction ("PC") does not, and I am pointing to PC's virtue in this regard as a reason to swap out construction doctrines.

Chapter 2 presents my court-facing, rather than party-facing, jurisprudential argument. Here I argue that freedom of contract, from a doctrinal (i.e., a court's) point of view, calls for perfectionistic construction rather than FCwE. I am concerned with defending a particular proposition of this argument, noted as (ii) above, specifically, that perfectionistic construction really is an alternative doctrine, one that cannot be reduced to a variety of FCwE or vice versa. What I need to show, in other words, is that FCwE cannot emulate perfectionistic construction no matter how subtle the tweaking.[19]

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[18] *See* Liam Murphy, *The Practice of Contract and Promise* at 35 (manuscript, 2014) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2363615).

[19] *See id.*; Oliver E. Williamson, *Comparative economic organization: The analysis of discrete structural alternatives*, 36 ADMIN. SCI. Q. 269 (1991) (arguing that existing legal doctrine renders contract law sub-optimal for economic governance). Arthur L. Corbin demonstrates how close one may potentially come to mimicking a perfectionistic approach formalistically, and yet a chasm remains between the two conceptions. *See* Arthur L. Corbin, *The Effect of War on Contracts. by George J. Webber. London: The Solicitors' Law Stationery Society, 1946. 2d Ed.*, 55 YALE L.J. 848, 851-52 (1946) ("A solving principle may be something like this: A contractor is not discharged by frustration of his purpose unless that purpose was known to the other party and the possibility of its attainment was an essential factor in giving to the consideration furnished by that other party the value that enabled him to induce the advantageous bargain.").

I aim to meet this burden with an account of the inimitable constitutional difference between formalistic and perfectionistic construction. This difference, I will show, is the formality of perfection that courts require of parties as a condition to enforceability in one approach, PC, but not the other, FCwE. This constitutional difference—viz., a higher standard for enforceability in a PC—alters the functioning of contract law doctrine and does so, moreover, in a way that reinforces the freedom of contract tenet that courts are not to make contracts for parties. I will showcase the power of this perspective to undercut a dogma that pervades contract scholarship today: that every contract is necessarily incomplete and that the proper response of courts to this incompleteness is to fill "gaps" with court-imposed terms, like formalistic construction.

With all its contingent particularity, contract law today has a vast influence on voluntary business activity, and I motivate the dissertation in Chapter 1 with a third line of argumentation that is anchored in a distinct sense of freedom in contract: freedom *through* contract. Because a court's mercy under excuse doctrine cannot be guaranteed in advance, FCwE provokes a propensity for *opportunistic* behavior by contracting parties when disruption undercuts the basis of a deal. The modus operandi of formalistic courts is to construe deal terms to their full extent and enforce them accordingly notwithstanding intervening circumstances (that occasionally trigger excuse). This means that, with the formalistic courts we have today, if one's counterparty begs for a deal accommodation to compensate for a drastic disruption, one can very credibly threaten a breach of contract suit to back the refusal to negotiate, like Paradine sued Jane. Contract law can thus be wielded by a party for punishing effect following a disruption that was not bargained for, and the potential for excuse doctrine, as I show, provides the defendant no more than a Swiss cheese shield to fend off the initiation of litigation. The potential for "lawful opportunism" of this sort, as Oliver Williamson terms it, poses a risk factor that entrepreneurs and managers have to and do take into account when evaluating whether to pursue a transactional opportunity through contract or, instead, through other means or not at all. The point is that

FCwE makes contracts a less attractive instrument of governance than they could be did courts not reward opportunism.

Following the jurisprudential arguments for PC in Chapters 2 and 3, I will argue in Chapter 4 that flipping the judicial default switch from a formalistic jurisprudence to a perfectionistic one renders contracts a more attractive way to pursue business opportunities, opening the gates for a surplus of free enterprise that can respond to material needs at a lower cost. Improved contract law, in this picture, becomes a way for society to achieve enhanced freedom from material needs *through* contract.

That a perfectionistic jurisprudence should enhance freedom through contract, I will argue, is not merely a stroke of good fortune. It is a reflection of a deeper principle that brings together the three lines of argumentation in the conclusion, Chapter 5. Shifting the burden of perfecting deal terms from the performing party to the party receiving performance (the potential plaintiff) stands for a principle of formality: the only way to secure enforcement for cases where the alleged breach owes to disruption is for the parties to have undertaken the formality of asking each other *expressly* how the deal should work in case some such disruption were to thwart performance. This formality serves as the predicate for the parties to enter a space where freedom of (state-enforced) contract is achievable. Formality opens the door to the ratification of an enforceable deal term, much the same way that formality—like the requirement that a *majority* in *both* Houses of Congress vote to pass a bill—opens the door to legislative rule under the U.S. Constitution. Formality, I will argue, has a natural congruence with the clear-cut power of self-legislation that makes contracts attractive for business in the first place.

Perfectionistic construction, therefore, stands for a jurisprudence that demands that the parties entertain a series of formalities *before* a court will impose liability in the name of contract. There is a natural reinforcement between perfectionistic construction and the exercise of freedom *of*, *from* and *through* contract. This, of course, comes with the risk that a perfectionistic court will

not enforce a term *as far* as a party might have wished (despite the party's failure to undertake the requisite formalities), and this risk motivates an ongoing commitment, especially from the party that will *receive* performance, to perfect the deal term—before *and* after closing. With perfectionistic courts, this is the only way to open the door to a legislative sphere of contract that enjoys the backing of the state. That is the price of putting the freedom of contract first. At least around cases of serious disruption, therefore, the slogan that emerges in the courts of my vision is this: "No contractual rights without perfection rites."

CHAPTER 1: CONTRACTS IN BARGAINS

In this dissertation, I will make claims about the way courts *should* enforce the bargains that constitute contracts. The starting point, accordingly, is to provide a conceptual framework for making sense of the following fundamental questions: *How can bargains provide an instrument of economic governance? What value do courts provide to parties who govern transactions through bargains? In what ways can contract law function less than optimally as an instrument of economic governance? How can alternative contract doctrines be ranked in respect of their contribution to economic governance? Where would one look to discover principles capable of suggesting alternative contract doctrines that might be superior to the status quo?*

I begin by articulating the foundation contracting provides for the governance of economic relations. Contracting that is based on bargaining, I show, provides a vital principle of governance in our society. Moreover, it is distinctive among its alternatives in requiring evidence of commitment from the parties for the ensuing division of labor to get off the ground. There are a variety of ways to ground the needed commitment, and courts in the common law tradition provide an important one, namely, jurisdiction that parties can access *ex post* to enforce the contract as bargained. Critically, the courts do not require the parties to have put down any collateral besides their good word and reputation to seal the deal. In so doing, contract law has become fundamental to the social division of labor. That does not mean, unfortunately, that the contract law contingently in place is necessarily the best choice for good governance. My dissertation takes up this line of inquiry, and this first chapter goes on to articulate the structure of my argument that as a matter of *eunomics* legal doctrine is out of alignment and that the variable that requires adjustment involves the *formalities* required for courts to enforce contracts.

1.1 *Contracting and Bargaining*

Contracting strings together human enterprise in relationships of exchange. These exchange relationships take all sorts of forms, from the intimacy of spousal relations to the distance of arm's-length, legally enforceable contracts.[20] A society cannot partake of the advantages of a division of labor without relying upon a practice of contracting to structure social exchange. Ian Macneil draws out the point this way:

> A key root of contract is specialization of labor and exchange. Specialization of labor occurs whenever different people in a society perform different tasks. Exchange, as the term is used here, is simply the way such specialists distribute their work products among themselves in a reciprocal manner, thereby permitting continued specialization (Macneil, 1979: 160).

Consequently, "[a]t each stage [of history] there is found . . . a historically created relation of individuals to nature and to one another" (Marx, 1859: 164). Consider, for example, "a society consisting exclusively of full time hunters and full time potato farmers" (Macneil, 1979: 160). "If the people require a balanced diet," it then follows that "either exchange will occur, or despecialization will occur with the hunters growing their own potatoes and the potato farmers doing their own hunting."[21]

The operationalization of the division of labor—social contracting practice—has varied in form over the centuries and across societies (Marx, 1857). The industrial capitalism that sprang from the womb of feudalism, to consider key antecedents of 21st century global capitalism, fundamentally transformed the relationship that the affected societies' populations had, and continue to have, to their work. Rather than a caste-based assignment of station in life, e.g., born

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[20] According to Macneil (1987: 32):

> [I]n some relations, such as the household, reciprocity is often so overlaid with other social phenomena as to be relatively difficult to observe. Indeed, the other social phenomena, such as feelings of love, may lead to the denial by the participants of the very existence of reciprocity. Nonetheless, it is present as long as the relations endure.

[21] Id.

into a peasant family with a defined role to play in a specific lord's fief, increasing numbers of the English population began, in the 17th and 18th centuries, to dislocate from a rural life organized around the land into a town life overridingly ordered by freestanding financial exchange (Hall, Thomas, Gracey & Drewett, 1973: 600). Emphasizing this dynamic, the comparative legal historian Henry James Sumner Maine (1861) organized his seminal treatise around the proposition that society had progressed "from status to contract."[22] Neither the bond of the hourly-wage worker to the corporation, nor that existing between a supplier and buyer firm, stems from tradition. Each in our society gets artificially constructed out of a bargain: a deal to exchange labor value for wages, or goods for remittances.

So it is important to see that contracting and exchange, as Macneil utilizes the concept (and I will too), refer to a trans-historical feature of human society—at least any instantiation that relies upon a division of labor (i.e., all but cases like Robinson Crusoe). What varies from society to society and across time is the *how* of the division. Focusing on roles outside the household, I start by asking: *how* do members of a specific society come to take the specific place they have in the social division of labor? Is it by caste tradition? By lot? By fiat? Or as a byproduct of the freedom (and necessity) to bargain with their time and resources?

According to Karl Llewellyn, principal drafter of the Uniform Commercial Code that still governs the contract law of sales across the United States, the fruit of our freedom from the yolks of tradition (e.g., feudalism) and fiat (e.g., totalitarianism) means that the overriding principle of economic governance in our society is the bargain.

> Bargain is then the social and legal machinery appropriate to arranging affairs in any specialized economy which relies on exchange[23] rather than tradition (the manor) or

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[22] Legal historian A.W.B. Simpson (1987: 324) remarks that this is "the only legal best seller of that, or perhaps any other, century."

[23] Llewellyn is here using "exchange" in a narrower sense than Macneil and I do. For Macneil and me, exchange is inherent in tradition and dictatorship as much as in the free market. Without exchange in the deep sense, societies wither away. But exchange in the sense of social roles chosen freely (and often by

> authority (the army, the U. S. S. R.) for apportionment of productive energy and of product (Llewellyn, 1931: 717).

Notice that even as the overriding principle that "arrang[es] affairs in [our] specialized economy," the bargain continually folds in the other principles of governance within its governance architecture.[24] For example, a corporation—seen as an oasis of hierarchy in the free market of bargains—is born out of a series of bargains, and once born, it becomes a site for fiat within its sphere, even as it is the case that the subjects of that dictatorship (its employees) become such (and remain such) through a bargain—in the free market for labor. By the same token, tradition continues to operate in our society as through universities still governed through feudal notions of lineage (the tenure line) and status (dean, full professor) (Stinchcombe, 1965). In addition, tradition pulls the social strings as through an invisible hand that reproduces caste relations, even though formally social roles are assigned through the free market.[25]

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necessity) does not characterize every society. The extent to which it is a feature of any healthy society is an intriguing question beyond the scope of this work. That what Lon Fuller (1941) calls the principle of private autonomy should have some ambit in any society seems more difficult to doubt, as suggested by these remarks that help make ends meet between Llewellyn's and Macneil's definitions of exchange:

> The principle of private autonomy is not, however, confined to contracts of exchange, and historically it perhaps found its first applications outside the relationship of barter or trade. As modem instances of the exercise of private autonomy outside the field of exchange we may cite gratuitous promises under seal, articles of partnership, and collective labor agreements. In all these cases there may be an element of exchange in the background, just as the whole of society is permeated by a principle of reciprocity. But the fact remains that these transactions do not have as their immediate objective the accomplishment of an exchange of values (p. 809).

[24] *Cf.* Dahl & Lindblom (1953: 171) ("[I]n no complex society, even a totalitarian one, is there any single exclusively prevailing relationship.").

[25] A recent account in the New York Times identifies the phenomenon and suggests how the invisible hand of caste does its handiwork in the United States:

> Economists say a child born in the bottom quintile of the income distribution has just a 5 percent chance of moving up to the top quintile without college. The chance of making it to the top nearly quadruples if the child gets a college degree. But currently, the proportion of children from low-income families who obtain a college degree is low — around 9 percent — compared with 50 percent of children from affluent families.
>
> The reasons for these disparities are clear but the remedies are complicated. Poor kids tend to go to under-resourced high schools and, when they graduate, are often not academically prepared for top colleges. The poor students who try to obtain a degree most often enroll in public two- and four-year colleges near their homes, where attrition rates can be high and graduation rates low.

Indeed, the non-bargain forms of governance that result from bargaining (or survive notwithstanding bargaining) raise the question whether Llewellyn is really right about the primacy of bargaining in our society. Truly, hierarchical organizations like corporations, where fiat is the ultimate principle of governance, have overwhelming reach today. Consequently, organizational theorists have had good reason to doubt the primacy of the bargain in the social division of labor. Herbert Simon utilizes an evocative thought experiment to visualize the doubt.

> Suppose that [a visitor from Mars] approaches the Earth from space, equipped with a telescope that reveals social structures. The firms reveal themselves, say, as solid green areas with faint interior contours marking out divisions and departments. Market transactions show as red lines connecting firms, forming a network in the spaces between them. Within firms (and perhaps even between them) the approaching visitor also sees pale blue lines, the lines of authority connecting bosses with various levels of workers. As our visitor looked more carefully at the scene beneath, it might see one of the green masses divide, as a firm divested itself of one of its divisions. Or it might see one green object gobble up another. At this distance, the departing golden parachutes would probably not be visible.
>
> No matter whether our visitor approached the United States or the Soviet Union, urban China or the European Community, the greater part of the space below it would be within the green areas, for almost all of the inhabitants would be employees, hence inside the firm boundaries. Organizations would be the dominant feature of the landscape. A message sent back home, describing the scene, would speak of "large green areas interconnected by red lines." It would not likely speak of "a network of red lines connecting green spots." (Simon, 1991: 27).[26]

This dissertation focuses on bargaining, not because fiat and other principles of governance are not important, but because bargaining continues in our global capitalist society to provide *the* way parties come together formally in enterprise so long as they are not compelled to do so as a result of hierarchy or tradition. And even the corporation, as already noted, gets *constituted* by a series of bargains. Nevertheless, and for the avoidance of doubt, let it be clear that nothing in my

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> Poor students who are accepted into selective four-year universities often find themselves adrift — overwhelmed by the financial, academic and cultural challenges created by an environment shaped to serve the habits and needs of the wealthy (Tyre, 2014).

Another recent article points to the enormous influence of one's ancestors in determining one's social class, finding that "[t]o a striking extent, your overall life chances can be predicted not just from your parents' status but also from your great-great-great-grandparents" (Clark, 2014).

[26] Thanks to Zuckerman (2013) for this reference.

dissertation will turn on the question whether the bargain has primacy over fiat, or vice versa. Simply put, my concern is bargaining and the complex of advantages and limitations contract law creates for governance through contract.

1.2 *Bargaining and Commitment*

A bargain can be understood as having two related parts. The first is the set of terms that define the deal: *what each side will be giving up and getting*, which is another way of describing the role each side has agreed to take as a party to the deal (including the standard of care demanded). The terms have to reach into the future because the bargain is about getting what the bargain said one would get and doing what the bargain said one was supposed to do *at some point in the future*.[27] This bringing of the future into the present is called "presentiation"[28] by Macneil. No matter how much the parties think them through and work them out, though, deal terms on their own lack the legs to get a deal off the ground. If written down, terms burn with the paper and leave no deal behind.

What turns a set of terms into a living deal is enough commitment from all parties concerned to close.[29] Commitment is a prerequisite for bargain-based contracting in a way that is

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[27] It may seem that a closing, like a real estate sale, concerns only the exchange of title and payment that occurs at the time of closing. This obscures two points. First, the deal terms when drawn up are the foundation for the future event of the closing. Second, even a tidy sale implies the importance of future commitments, like the seller's commitment not to claim ownership of what was supposed to have been sold at closing as well as ongoing backing of important representations and warranties. According to Arthur L. Corbin, an exchange that occurs entirely would be "better described as a barter or an exchange of goods" because it "creates no contractual duty. (Corbin, 1917: 171-72).

[28] Ian Macneil (1974: 589) brought this term of art into the contracts literature (quoting the Oxford English Dictionary) to mean the following:

> TO presentiate: 'to make or render present in place or time; to cause to be perceived or realized as present.' Presentiation is only a manner in which a person perceives the future's effect on the present; but it depends upon events outside the individual psyche, events viewed as determining the future. Presentiation is thus a recognition that the course of the future is bound by present events, and that by those events the future has for many purposes been brought effectively into the present.

[29] According to Barbara Fried (2012: 630):

unique among the alternative principles of governance. Under both tradition and fiat, members of society cannot dodge their commitments, and they ultimately have no say as to what is required of them. Being subject to a hierarchy induces a commitment to follow orders, or else one must exit the hierarchy or risk being pushed out, and growing up in a traditional caste system imbues in one a sense of commitment to fulfill one's given role, or else one risks being outcaste. In contract, in a bargain-based society, there is no a priori "or else" because it is entirely a matter of choosing, given one's choice set, what bargains one enters into. Hence one's place in the social division of labor remains formally open, *until* one commits to specific bargains. So the commitment that undergirds bargain-based contracting must be tendered voluntarily to breathe life into the social division of labor, one bargain at a time. Only in this way does the bargain system actually author an individual's (or an organization's) set of social role definitions.

Because a deal (a term I use interchangeably with "bargain") is a bargained-for set of terms brought to life by commitment, there is a binary quality to its life cycle: at one point there is no deal, and then, perhaps through fits and starts or an incremental process, the deal materializes. Moreover, a deal can get layered with multiple amendments and adjustments, like coats of paint on a boat. The key point is that a bargained-for set of terms only blooms into a deal when sufficient commitment is applied by the parties.

The massive literature on the moral bindingness of promises establishes only that if you promised to do X or led others reasonably to believe you promised to do X, you should do it if it is reasonably within your power to do it. It says nothing about what the content of X is. The strict reading that liberal theorists have given to promissory language in the moral realm, like the strict reading they have given in the legal realm, I believe, is best understood as a judgment not about the sorts of commitments people ought to make to each other, but rather about the sort that they did make. That is to say, it too is an act of interpretation. In particular, it is based on a surmise that when parties make promissory noises about doing X, they usually mean to commit themselves to do X (or, on an objective interpretation of meaning, can reasonably be understood by the promisee to have done so) and, unless they expressly condition their promise, they intend (or can reasonably be understood by the promisee to intend) that commitment to hold unless it becomes impossible or extremely burdensome to do so.

For the avoidance of confusion, note that the human relationship that surrounds a deal—and exists in between deals—is commonly thicker than the definite and presentiated terms that parties articulate through their bargain. "Contract" as used in this dissertation means only those terms in a bargain that courts enforce (Corbin, 1917: 169), and the building blocks of a contract are the definite and presentiated terms of a bargain. Frequently, as in a joint venture, the human relationship is far thicker than the deal terms evidence.

1.3 *Forms of Commitment*

In bargain-based exchange, commitment takes various forms. The most obvious one is moral. Honoring one's contracts is consistently deemed a virtue across cultures.[30] Nevertheless, contracts break down throughout the world, and so naturally enough arms-length parties tend to require further evidence of commitment to supplement indications of the counterparty's moral virtue. Thus, moral virtue is a form of collateral.

A closely related form of collateral is character. A person's honor, in particular, can serve as security for deals. J. P. Morgan and Andrew Carnegie, for example, committed to the billion-dollar sale of Carnegie Steel to Morgan with only so much as a handshake to backstop their moral virtue as security.

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[30] According to Charles Fried (1980: 1863-64), the moral tenor of a promise provides a valuable form of commitment:

> The promise principle supplies a ground of commitment that justifies reliance. Promise is a social convention that will commit when invoked. Two things are necessary for the ensuing commitment to be plausible. First, the convention of commitment must serve a useful function, which it does by permitting reasonable reliance and, thereby, planning and coordination of complex activities. But this alone will not do. The person to be committed must be drawn into this useful social scheme in an acceptable way, or its imposition upon him will be unjustified. The institution of promising meets this second requirement as well, for typically one is committed by a promise only by intentionally invoking the forms (formal or informal) of promising. Thus, reasonable reliance presupposes obligation, which can be supplied by the invocation of the convention of promising.

Note, however, that what it means to honor one's contracts has hardly been a straightforward problem in philosophy. The Utilitarian Henry Sidgwick (1981: 295-311), for example, provides a detailed and elaborate account of honoring one's promises that considers the potential for disruption and how it impacts the requirements of morality.

Related to, yet different from the two forms of collateral already identified, is reputation.[31] Reputation is the first of the collateral forms discussed thus far to depend upon third-

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[31] According to Scott (2003: 1644), "reputation and the discipline of repeated interactions are efficient means of self-enforcement." Scott's later elaboration (2009: 1392-94) of the point is worth quoting at length:

> In many instances, an agreement between two commercial parties will be self-enforcing because both parties want to earn and preserve a good reputation so as to enhance their self-esteem and future business prospects. Moreover, agreements will also be self-enforcing to the extent that the parties anticipate that the expected profits from future dealings are greater than the gains from breaching the existing contract.
>
> Even where loss of reputation and the threat of retaliation are insufficient to induce performance, powerful norms of reciprocity appear to enhance and extend the reach of informal enforcement. A substantial body of experimental evidence shows that a preference for reciprocity--i.e., the willingness to reward cooperation and to punish selfishness--can motivate cooperation even in arms-length interactions between complete strangers.[45] This evidence suggests that contracting parties frequently can (and do) turn to informal means of enforcement based on trust and reciprocity in addition to the desire to maintain a good reputation or the prospect of profitable future dealings. And if parties are able to rely on these informal methods of enforcement, they may be able to create contractual commitments that are at once sufficiently credible to motivate efficient investments ex ante and sufficiently flexible to ensure efficient adjustment ex post.
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> So, what role does (and should) legal enforcement play in a world where informal enforcement is pervasive and robust? First, note that informal enforcement generally is cheaper than formal enforcement because a party needs to expend costs only to observe the other's behavior, while formal enforcement requires additional resources in verifying that behavior to a court. Moreover, informal enforcement is often better than formal enforcement: parties can make credible promises regarding observable but non-verifiable measures of performance, thus achieving contractual objectives that may not be possible with formal enforcement. To be sure, there is still an important role for formal contract enforcement. Common sense tells us that relationships relying on informal enforcement can break down, and when they do, the parties will resort to costly litigation. When reciprocity breaks down in complex transactions, the courts can serve a valuable function by making factual determinations to unravel complex behaviors.
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> Thus, a central question remains: how do the various means of enforcement interact with each other? The available evidence suggests that legal enforcement is often imperialistic--that an effort to superimpose legal enforcement on a regime of self-enforcement can displace or "crowd out" informal mechanisms. The experimental evidence of crowding out undermines the argument that courts should adopt a broad, fault-based approach to enforcing contracts. The understandable instinct to deter inefficient behavior may well prove counterproductive in the long run. As the evidence suggests, extending legal enforcement to the difficult-to-verify questions of willful breach and overreliance may well impair the efficacy of informal means of enforcement that rely instead on reciprocity norms.
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> As we have seen, common law contract doctrine has resisted the invitation to imply broad fault standards of behavior at the core of contract. Thus, if a promise falls within the core of legal enforcement, contract law fills only a few gaps, using simple, verifiable strict liability rules when it does so. The evidence that there are informal means of enforcing commitments that courts cannot readily verify supports this approach. The more general lesson for courts, therefore, is that an effort to judicialize notions of comparative fault and reciprocal behavior may well destroy the very informality that makes these mechanisms so effective in the absence of judicial enforcement.

parties to backstop a deal. The difference between character and reputation is well seen through Socrates's quip in the *Gorgias*, as he awaited prosecution for corrupting Athens' youth, "I won't have anything to say in court…For I will be judged as a doctor would be judged if a pastry chef accused him in front of a jury of children" (521e2-4). Socrates's *reputation* was at the mercy of the people's senses and sensibilities (like a child's taste for sweets) notwithstanding the true state of his character (like a doctor's evaluation of a patient's health).

Reputation can also be thought of as a hostage. After bargaining one's way into a deal, one's reputation gets held hostage by how one apparently conducts oneself in virtue of the deal. The fact that the preservation of a thing of value (one's reputation) depends upon another's determination (here, reputation in the opinion of the counterparty and third-parties) of one's fidelity to the bargain gives reputation the basic form that defines hostage-giving: something of value is delivered in trust (often to parties without a direct interest in the transaction) to show commitment.

Humans have long been delivered as hostages to back commitments. Oliver Wendell Holmes, Jr. (1881: 248), references this practice in recounting that "the surety of ancient law was the hostage, and the giving of hostages was by no means confined to international dealings" The human hostage as a contractual security seems to be uncommon today, certainly outside the realm of organized crime and terrorism. Still, the use of hostages is prevalent and typically takes the form of (i) forfeit or (ii) property as collateral (e.g., Williamson, 1983).

Forfeit represents a mutually self-administered species of hostage. Llewellyn (1931: 714) gives the following example: "the continuance of life insurance is set free of any promise by the insured to pay and is instead merely conditioned upon regular payment of the premiums." The insured party would forfeit coverage by failing to continue regular payments. Insurance coverage is the hostage here: no payments and the hostage of insuredness is sacrificed. Llewellyn

characterizes the logic as follows: "you have given up a thing which you can get back only by doing a stated thing."

The thing of value that secures commitment in a deal can also be exogenous to the parties' exchange. Nearly all of the loans made for the purchase of real property, for example, are secured by a mortgage. That means the borrower has made an irrevocable commitment at the time of closing that puts the bank in a position (pursuant to additional legal procedure) to take title to the property in case the borrower defaults on its commitments under the loan. The business deal between borrower and bank is a loan agreement—money today exchanged for a promise to pay—but the bank will not enter into a loan agreement unless the borrower turns over the "keys" to the real property as a hostage. Even the simplest transaction, like trading fifty cents for a pack of gum, can involve the use of hostages insomuch as a buyer is unwilling to hand over the money until the seller delivers the goods or vice versa (or both simultaneously).

Whereas the security for the gum sale was tangible and self-administered by the parties, the hostages that drive the business world usually take a form that is more saliently legal than tangible. The bank whose borrower has defaulted on its repayment obligations cannot grab the house like the sales clerk can grab the pack of gum. It takes a legal action called foreclosure involving a series of formalities and the judgment of a court before a bank gets the benefit of the collateral. And administration of the collateral is not by the parties themselves but by third parties: the courts and legal system of the applicable jurisdiction.

One could hardly overstate the significance of secured transactions to the functioning of the division of labor today. Still, administering legally-backed securities is not the sole or even the most celebrated contribution of our courts to bargain-based contracting. That is because courts (by which I will mean state and federal courts in the United States) do not, in fact, require a party to have given up or received a hostage as a predicate for entertaining jurisdiction to enforce a

bargain.[32] All that is required are definite enough terms to allow one party to hold the other clearly accountable, if a court is to do the same.[33] And if a court does hold the counterparty to account in an enforcement action, the plaintiff can achieve a feat of alchemy. A deal that might have been entered into without any collateral at all (beyond each party's word) yields, in its breakdown, a judgment that a sheriff will wield state powers to collect.[34] Garnishment of wages to repay bad credit card debt is but one example.

The no-cost alternative to capital that courts provide lubricates our system of enterprise with commitment "when reputational or self-enforcement sanctions will not avail" (Schwartz & Scott, 2003: 562), leaving large footprints in the practice of bargain-based contracting.[35] Only Pangloss would have the temerity to assert that the contract law we happen to have in the courts

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[32] *See infra* note

[33] *See infra* Section 2.3.

[34] By combining a contract (e.g., a loan) and a security (e.g., a mortgage upon assets to secure the commitment to repay the loan), parties get the security of the strong show of commitment that comes with a belt and suspenders approach to binding deals.

[35] This is not to deny that contract law may serve other functions other than surrogacy for collateral. Gregory Klass (2012: 155-56) outlines two potential alternatives:

> But contract law might have other sorts of moral functions. Here are two possibilities: First, contract law might aim to enforce not first-order obligations to perform, but second-order obligations that arise upon the breach of those first-order obligations. There are good reasons in many contexts to leave the performance decision to considerations of reputation, relationship, community norms, and morality. A contract law that is sensitive to those reasons might attempt not to deter or punish breach, but only to clean up the mess it leaves behind. Such a contract would serve morality under the heading of corrective justice. Second, and not incompatibly, the purpose of contract law might involve not enforcing individual parties' obligations, but fostering a moral culture in which people choose to perform for the right reasons. Contract law might, for example, have an expressive function. An award of expectation damages marks the fact that one party has wronged the other, and thereby supports the social practice of making and keeping agreements.

Moreover, Llewellyn (1931: 724) cautions in the drawing of the inference that the potential to provide a surrogate for collateral implies that is why parties enter into contracts in the first place.

> The remedy at law, then, good in the one case of need—wilful breach—becomes dubious in the other case of need-economic distress or dishonest bankruptcy. The results leave it dark as to how far legal enforceability is in truth a factor in the initial making of future commitments and in the giving of short-term credit. They leave it even darker as to how far such influence as is exerted on either is to be regarded as healthy.

today gives us the best of all possible governance.[36] This dissertation is written out of reverence for the system of law and the courts we do have and the conviction that the law we have today does *not* yield the best of all possible governance. The next section lays the initial groundwork for the legal fault line I will examine in this dissertation and the governance costs and benefits that are at stake.

1.4 *Contract Law and the Modes of Governance*

By contract law, I refer to the set of doctrines that govern judicial decision making in cases involving disputes that arise from bargains.[37] A doctrine is the building block of the common law, a teaching about the way courts should decide cases fitting a specific description. The modular nature of the common law as an assemblage of doctrines that courts mix and match to decide cases provides the basis for the Pareto-inspired method of doctrinal comparison I pursue in this dissertation: *Does replacing contract law doctrine X with contract law doctrine Y result in a law that renders contracts a comparatively superior instrument of governance under Y?*

I operationalize "superior as an instrument of governance" according to transaction cost economics as elaborated by Oliver Williamson (1991). This section sets forth Williamson's framework for conceptualizing the relation between legal doctrine and governance. This framework can be understood as having a horizontal and a vertical axis. The horizontal axis spans the various *modes* through which transactions can be governed in a jurisdiction. Each mode represents a discrete structural alternative to the problem of organizing transactions. The vertical

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[36] Liam Murphy (2014: 1-2) says it this way:

> Whatever the right methodology in moral theory may be, it is clear enough that normative legal theory should not treat existing law as presumptively good and seek only to show why this is so. Law is obviously a social, indeed a political, artifact. We don't need critical theory to tell us that law has a certain genesis and serves certain functions and that it would be perverse simply to *assume* that it deserves our approval.

[37] These doctrines naturally vary from court to court and across time. The discussion that follows assumes that a given contract law, i.e., a specific set of doctrines, prevails in the applicable jurisdiction.

axis of the framework involves a conception of each individual mode of governance that puts legal institutions at its foundation.[38]

At one end of the spectrum is the mode of governance (*market*) that relies upon markets that allocate goods and services through a price mechanism that interfaces supply with demand (Hayek, 1945). At the other end of the spectrum is the integration (vertically, horizontally or otherwise) of the two sides of a transaction within an incorporated legal entity. As incorporated organizations typically order their internal processes through fiat,[39] Williamson calls this second mode governance by *hierarchy*. The availability of market and hierarchy as alternatives through which a given transaction may be governed presents to managers and entrepreneurs what has been called the "make or buy" decision (e.g., Walker & Weber, 1984).

Williamson also includes a third mode in his basic framework. This mode, referred to as "hybrid," shares attributes of the first two. Hybrid bargains involve transactions between separate legal entities that become more or less entangled and utilize the commitment provided by legal enforceability to constitute contracts to govern joint activity.[40]

What I called the vertical axis of Williamson's view earlier dictates that each of these modes is supported by legal institutions that are distinctive and, thereby, define each mode. To start with hierarchy, the pivotal feature of integration *in legal terms* is that courts do not weigh in on disputes between the parts of a hierarchy. Think of a corporation that includes a forestry division and a paper division, and suppose they were merged yesterday, having operated as separate legal entities last week. Disputes about delivery timing and quality that, prior to merger,

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[38] In this regard, transaction cost economics recalls Marx's materialist conception of history, except that Marx visualizes the legal foundations of the division of labor as "superstructure" (Marx, 1857) rather than foundation, even as he anticipates Williamson's reliance on legal categories to distinguish modes of governance.

[39] *But see* Hamel (2011).

[40] Note that I have excluded entanglements that do not rely upon legal enforceability in defining the scope of hybrid bargains.

would have been heard by the courts would get shut out of the same courts the day after merger. That they do get shut out is a central part of what allows a hierarchical order to emerge within an incorporated entity. The executive function within the entity assumes the authority to mediate production disputes, and does so, not in view of legal doctrine as a court would, but on behalf of the merged legal entity itself, whatever aims that conjures. Williamson names this doctrine of staying on the sidelines *forbearance*, calling it the "implicit law of internal organization" (1991: 274).[41]

Whereas disputes within a hierarchy emerge from what courts implicitly deem a "not-bargain," disputes in market governance and hybrid governance each arise from bargain per se. They are nevertheless usefully conceptualized as distinct modes of governance—with distinctive legal foundations—in view of the far-reaching legal implications of an active market that prices standardized terms into a deal.

Williamson characterizes the contract *laws* that support the two bargain-based modes utilizing terms adopted by Ian Macneil (1978). The labels Macneil designates refer to historically successive accounts of what contract law is about: "classical contract law" and "*neo*classical contract law."

In this framework, market-based governance rests on "classical contract law," so named for the jurisprudence that took hold in the 19th century. This conception of law was epitomized by Samuel Williston's systematization of contract law in his authoritative treatise and the American

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[41] Note that corporations are not unique in commanding judicial forbearance. Macneil (1983: 369-70) calls the principle "sovereign nonintervention," finding a kind of anti-interventionist comity towards alien societies at work:

> An example of sovereign nonintervention is the great reluctance of American courts to interfere in any way at all in the internal affairs of churches. This reluctance is based on the constitutional provision that "Congress shall make no law respecting establishment of religion or prohibiting the free exercise thereof." Another example (in theory) is to be found in the treatment of British collective bargaining agreements as "gentlemen's agreements"' not enforceable in the courts. Yet another results from the doctrine of *pari delicto* when applied to illegal contracts. To the extent such a value prevails, it is as if the relation were occurring in some other society.

Legal Institute's first Restatement of Contracts, for which he served as Reporter (Schwartz & Scott, 2003: 549). Classical contract law is designed for highly presentiated bargains, that is, bargains that try to fully encapsulate the future of the deal in the present exchange consummated at closing. If successful, this bargaining results in a set of discrete (vis-à-vis each party) and definite obligations that can be neatly unpacked and discharged by each party independently of the other. Such presentiation achieves the greatest success in active markets that standardize a set of terms, making pricing signals effective for both parties and over a wide range of contingencies.[42] Enforceability of contracts is high under these market conditions.[43] These various properties capture the essence of the market bargain's legal foundations.

At the base of hybrid governance, Williamson finds two separate legal institutions: *neoclassical* contract law and excuse doctrine. Neoclassical contract breaks the classical mold—not necessarily by displacing it—but by creating a layer in a bargain that is over and above any definite and presentiated, i.e., classical, terms in the deal. These neoclassical terms are a different breed, and they generate different kinds of expectations. One can think of these as the terms that allow the parties to adjust to shifting winds in the future whose movements were not fully presentiated at closing, as opposed to the classical terms whose virtue is staking the deal down with definite commitment and predictable liability. These neoclassical terms are not readily enforceable because they lack definiteness and discretely determinable values (Macneil, 1978:

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[42] Lon Fuller (1941) , in terms that will be explored below in Section 2.2, hints at the significance of the market's role for governance in the way it overrides the need to enter into deals with formally drawn up contracts. Well-functioning markets "divide[human activity] into definite, clear-cut business categories."

> Where life has already organized itself effectively, there is no need for the law to intervene [to shape the bargaining process]. It is for this reason that important transactions on the stock and produce markets can safely be carried on in the most "informal" manner. (p. 806).

[43] "In this respect, the classical contract, along with the discrete transaction it parallels, is a sport. Generally speaking, a serious conflict, even quite a minor one such as an objection to a harmlessly late tender of the delivery of goods, terminates the discrete contract as a live one and leaves nothing but a conflict over money damages to be settled by a lawsuit. Such a result fits neatly the norms of enhancing discreteness and intensifying and expanding presentiation." (Macneil, 1978: 877).

865). Their virtue is bringing the relationship the adaptability that comes from what Williamson calls *elasticity* (Williamson, 1991: 271-74). Elastic terms are purposefully designed to enable cooperative governance that can provide for (i) adaptation to changes in the external environment and/or (ii) the resolution of internal disputes, including termination, often with recourse to third parties like mediators and arbitrators.[44]

There is a significant complication with Williamson's categorization. What makes market-based governance *market-based* is, as the label indicates, the effectiveness of a price mechanism. Nothing about classical contract law, however, has ever made the existence of a thick market—or any market at all—a predicate for the enforceability of a purchase and sale agreement that so far as possible presentiates the future life of the deal in definite terms. This point was implicit in my remark that neoclassical contract terms overlay the classical dimensions of a bargain. Consequently, the universe of classical contract law bargains out there is larger than the universe of market-based bargains. All market-based bargains rest upon classical contract law, but not all classical contract bargains rest upon a functioning market. Does that make these *off*-market classical contract deals a form of hybrid governance?

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[44] The elasticity of neoclassical contract law in hybrid bargains also draws upon a whole new vocabulary of standards that loosens expectations at the granular level of individual performance obligations. A good example is the qualification of obligations with "best efforts" or "reasonable efforts" clauses, a device relied upon heavily, for example, by investment banks in their business agreements. One cannot fully appreciate the significance parties attach to these terms without being involved in a negotiation with an investment bank in which the client would like to upgrade the bank's obligation from a "reasonable efforts" clause to a "reasonable best efforts" clause, or a "reasonable best efforts" clause to a "best efforts" clause. It seems likely that more than a prediction about judicial behavior contributes to strong feelings about these qualifications.

Notice that all these neoclassical devices that introduce additional elasticity into the agreement tend to promote communication before the ripening of any enforcement action. If there is a "reasonable efforts" qualification of an obligation to make timely regulatory filings, unexpected complicating factors that frustrate timeliness prompt a discussion about whether reasonable efforts were expended and if not, why not, prior to the availability of plausible unilateral resort to the courts. This sustains the contracting relationship in a way that the "sharp in, sharp out" (Macneil, 1974: 750) performance obligations of classical contract do not.

The answer to this question is obscure in Williamson's account: he simply does not discuss the case of definite, one-shot sales deals that do not transpire in thick markets. These are deals that do not enjoy a market-standardized set of terms and the other benefits of markets. And by definition, they lack neoclassical contract terms that supplement the core classical dimension of the bargain.

The solution that suggests itself—and which I adopt—to this problem of taxonomy is that there are *two* distinct legal foundations available for hybrid governance, one that gives rise to a mode that is more like market and the other that gives rise to a mode that is more like hierarchy (see Table 1 below). The mode that is more like market, the "classical hybrid" bargain, governs off-market one-shot sales deals. The heightened co-governance of these classical contract bargains involves, not neoclassical contract, but rather the selection of custom terms—without the guidance of the market—tailored around the actual parties' needs to suit the deal.[45] The one that is more like hierarchy, the "neoclassical hybrid" bargain, includes co-governance procedures and commitments that are not easily and/or meaningfully enforceable in court. The way in which courts are unable to provide ready enforcement of the neoclassical contract dimension of a hybrid bargain bears a family resemblance to the forbearance doctrine that keeps courts out of the internal disputes of a hierarchy. For the above reasons, I take the position that the classical hybrids do not rest on neoclassical contract law.

[45] I am in the middle of a hybrid governance negotiation as I evaluate whether to sell my home outside the standardized terms of the broker-led real estate sales market to capture the value we have created through a nightly rentals business (www.pinkhouseon45th.com). The alternative to a classical hybrid transaction of this sort is a neoclassical hybrid wherein we would enter into partnership with another family to occupy and manage the business on-site. This would have to be a neoclassical hybrid because we could not possibly aim to presentiate every aspect of the transaction, leaving broad swaths to discretion and coordination.

Table 1

Non-Hierarchical Modes of Governance

	Market	**Classical Hybrid**	**Neoclassical Hybrid**
Market	Yes	No	No*
Classical contract terms	Yes	Yes	Usually
Neoclassical contract terms	No*	No	Yes
Subject to excuse	Not usually	Yes	Yes, if there are classical contract terms, though neoclassical contract terms reduce incidence

*A deal might combine market terms and neoclassical terms, and in such a case what this matrix says is that conceptually this combination is to be understood as separate bargains.

Both hybrid sub-classes, however, are potentially subject to excuse doctrine, the second legal variable Williamson attributes to hybrid bargains. Because I discuss excuse at length below, my remarks here will be limited to points of taxonomy. The applicability of excuse doctrine to classical hybrid bargains is borne out by the leading cases that legitimated excuse doctrine (*Taylor v. Caldwell*, 1863; *Krell v. Henry*, 1903). On the other hand, the more effective the neoclassical terms that parties select to manage the future the less likely the parties will resort to litigation and have reason to defend against liability with resort to excuse. The reason why the typical market bargain is not subject to excuse doctrine is *not* that it is free of neoclassical contract terms. Otherwise, we would have no theory for why the classical hybrid bargain is subject to excuse. Market-based bargains elude excuse doctrine because the market standardizes the terms of the exchange sufficiently to establish definiteness and finality in the parties' future obligations under practically all events. One-shot deals that are bargained for outside the market, on the other hand, lack the standardized terms and procedural safeguards of the market and, for

that reason, remain potentially exposed to the vicissitudes that sometimes lead courts to apply excuse doctrine.

In addition to the split I have introduced into the category of hybrid bargains—classical versus neoclassical—one can find further gradations in the hybrid continuum by recalling, once again, the technological feasibility of mixing classical contract and neoclassical contract within a single bargain. There are certainly good reasons to mix terms. The more robust the *neoclassical* joint governance apparatus for managing uncertainty and cooperative adaption, the greater is a contract's resilience to the threat of litigation. Nevertheless, the attractiveness of a classical, i.e., definite and highly presentiated, dimension within neoclassical production relations is securing a credible commitment from the parties to perform within the mark established by those obligations that are bargained in definite terms that support accountability.[46] Absent the staked down commitment provided by classical contract a hybrid bargain might have been totally out of reach for these two parties, given their resource base (Williamson, 1983).[47]

As I will discuss further in section 1.7 below, since (i) it is the classical, rather than the neoclassical, terms of a hybrid bargain that support the pleading of a credible enforcement action and (ii) courts only access excuse doctrine in response to a credible enforcement action, it follows that it is the classical dimension of a hybrid bargain that opens the door to excuse (whether or not there are also neoclassical terms in the mix of the deal). Section 1.6 will show that the classical terms open the door to opportunism in cases of disruption for the very same reasons. Avoiding the transaction costs presented by opportunism will motivate this dissertation's search for an

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[46] Schwartz & Scott (2003: 559-62) "develop a simple model to explain why the state plays an essential role in encouraging investment."

[47] This is all the more true if egoism is assumed. Markovits (2004: 1420), for example, stipulates that "contracts typically arise among self-interested parties who aim to appropriate as much of the value that contracts create as they can."

improved legal foundation for hybrid governance, to be evaluated according to the methodology called comparative statics, discussed next.

1.5 *Comparative Statics*

The art of comparative statics (Williamson, 1991: 287) is to account for changes in institutional variables that raise (lower) the social capacity to transact, or shift the share of total transactions that get governed according to each or any of the modes. The thought experiment involves "consider[ing] how equilibrium distributions of transactions will change in response to disturbances in the institutional environment." The motivation is the notion that people will find their way, if they can do so, about the institutional context into the mode of governance that is most cost-effective, *for their transaction*. "Transaction-cost economics maintains that . . . transaction-cost economizing is the 'main case,' which is not to be confused with the only case" (Williamson, 1991: 286). A change in the institutional environment, such as a reform of contract law, impacts the comparative costs of the modes of governance in respect of transactions, and comparative statics aims to provide a structured way to evaluate the net effect.[48]

Bargains that the market helps to structure and price are pursued cost-effectively enough with classical contract terms, and typically neither the co-governance of a hybrid bargain nor the hierarchy of a corporation can add more value than cost to the business proposition. As a transaction comes to involve more and more mutual dependency between parties and entails specific investments by each, however, moving up the organization chain starts to pay off.

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[48] In this regard, "[a]n advantage of a three-way setup—market, hybrid, and hierarchy (as compared with just market and hierarchy) is that much larger parameter changes are required to induce a shift from market to hierarchy (or the reverse) than are required to induce a shift from market to hybrid or from hybrid to hierarchy" (1991: 287), thus enhancing the insight available through comparative statics thought experiments. By this logic, further fracturing of the modes, as I have done with the hybrid mode, enhances the tractability of comparative statics. *See infra* Chapter 4.

In accounting for the costs that channel transactions into the differing modes, Williamson has emphasized those imposed by opportunism. The idea is that integration and/or hybrid governance can potentially stem some form of opportunism that would otherwise manifest in a class of transactions, if governed as an anonymous classical contract on the market. The market remains the gold-standard for cost-effectiveness, meaning that when an alternative to the market enjoys a cost advantage it must be due to the way this alternative governance form better manages a class of transaction costs. The next section discusses the varieties of opportunism that stymie transactions.

1.6 *Varieties of Opportunism*

The most primitive form of opportunism involves willful non-performance: I get paid in advance and run away rather than deliver goods as bargained because I think I can get away with it (Posner, 2003).[49] The institutional adaptation to the potential for "take the money and run" opportunism is to escalate commitment by relying on hostages and/or bringing the transaction within the reach of contract law (viz., a lawyer is retained to document the terms). The healthy functioning of the "formal" economy (as opposed to the "informal" economy, which is formally outside the scope of this dissertation)[50] depends on the ability of the courts—by enforcing security arrangements and contracts—to largely stem "take the money and run" opportunism (Schwartz & Scott, 2003: 561).

A second variety of opportunism relies upon the existence of defection costs for the counterparty. A party has defection costs when investments it has made in a transactional

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[49] "Such conduct," Posner concludes, "has no economic justification and ought simply to be deterred" (pp. 118-19). Consideration the case of such opportunism in a gasoline station transaction, Macneil (1983: 418) points out that "[t]he time involved in the transaction is so short that a failure to pay or a failure to deliver paid-for gasoline would be viewed as deliberate from the start, and hence a theft, rather than a breach of a promise initially intended to be kept.

[50] There are important institutions to backstop commitment outside the "formal" sphere (Bernstein, 1992 (diamond traders); 2001 (cotton industry)).

relationship (e.g., electric plant gets built for A at mouth of coal mine owned by B) would plummet in value *outside* this specific relationship (value to A of plant at mouth of B's coal mine plummets if coal is not purchased from B any longer). In thick markets, parties tend to have low defection costs because sales are anonymous and terms are generic. Notwithstanding the formal anonymity of markets, relationships between parties still do arise, and this can lead to specific investments over time. Just think of the likelihood that a buyer repeats use of the same supplier, and then consider the potential for relational adaptations to evolve. If the parties have no deal that extends into the future, one of them may become vulnerable to opportunistic pricing (or slacking in quality) that seeks to capture an outsized share of the surplus by threat of defection.

Hybrid governance and, when the stakes are high enough, integration become progressively cost-effective as *antidotes* to "defection-cost" opportunists who capitalize on the no longer fitting anonymity that continues to structure the legal enforceability of their market-based relationship.

> Identity plainly matters if premature termination or persistent maladaptation would place burdens on one or both parties. Perceptive parties reject classical contract law and move into a neoclassical contracting regime because this better facilitates continuity and promotes efficient adaptation (Williamson, 1991: 271).

Note that the "lawful" version of defection-cost opportunism just described (defection is not legally redressable) has an "unlawful" cognate. This occurs when a party in an ongoing hybrid bargain threatens breach of contract as a gambit to favorably and forcibly renegotiate the deal by leveraging the counterparty's defection costs with what Schwartz & Scott (2003: 567) call *ex post* duress. The opportunity to do so exists when there is enough likelihood that the counterparty will not be able to successfully threaten a breach of contract suit—even though formally available—to fend off the gambit.

A third species of opportunism animates this dissertation with the transaction costs it inflicts upon hybrid bargains. Unlike the variety of defection cost opportunism just discussed, this form of opportunism is *lawful* in nature. Whereas the lawful variety of defection-cost

opportunism capitalizes on the *absence* of a contract over the reach of the transactional relationship (i.e., no overarching contract spans the repeated yet individualized market bargains), the lawful opportunism of concern here (henceforth "formalistic opportunism") capitalizes on the *availability* of a breach of contract claim against the counterparty.

The problematic context that gives rise to formalistic opportunism involves disruption that undermines the presentiation relied upon by parties to price a deal. If a single corporation owned the two parties to a disrupted transaction, it would absorb the entire shock internally and realign terms (or not) according to a hierarchical decision making process. But in a hybrid bargain involving separate legal entities, the shock hits parties with autonomous ownership status. How do courts distribute these costs between them? That depends on how they construct contracts.

1.7 *Formalistic Construction, Introduced*

In the Preface, I previewed and named the prevailing doctrine of construction *formalistic construction*. Williamson (1991: 273) calls it "literal enforcement" as the doctrine teaches a court to enforce a deal as if the verbal terms selected by the parties apply under all kinds of disruption, whether or not the parties planned for and priced performance in such circumstances. "This principle is part of the common law of contracts in all American jurisdictions" (Schwartz & Scott, 2008: 1669). The effect of formalistic construction is that "to a covenant to deliver goods, or carry a ship to such a place or at such a time, simply so expressed, [courts] add the words *at all events*, [even if they] never were or could be within the intention of the parties" (Am. Jur., 1833).

"[U]nder the principle of *Paradine v. Jane*, a contracting party is bound by the express terms of his promise. . . . In short, the seller has the right to stand on the contract" (Gilmore, 1995: 373). Formalistic construction means that the party who bargained for performance has a good claim for it, even under circumstances that "never were or could be within the intention of the parties" (Am. Jur., 1833). Having the power to sue that contract law provides is inherently conducive to exercising it, no matter how unjustly.

> It is usually to the interest of both parties that a contract be carried out. Where performance is prevented by an event, against the occurrence of which neither can reasonably be held to have warranted, both suffer a loss for which neither is responsible. In such circumstances it seems highly unjust to throw all the loss on the one whose performance may happen to have been interfered with (Harvard Law Review, 1901: 64).

The injustice that may result to the defendant from an enforcement action, all alone, is not always much of a deterrent to the plaintiff's taking advantage of the power to sue to gain personal advantage. The independent legal status of the parties makes *formalistic opportunism* a proposition that is so tempting, it is easily—if erroneously[51]—viewable as the professional responsibility of a manager.

> As disturbances become highly consequential, [hybrid bargains][52] experience real strain, because the autonomous ownership status of the parties continuously poses an incentive to defect. The general proposition here is that when the "lawful" gains to be had by insistence upon literal enforcement exceed the discounted value of continuing the exchange relationship, defection from the spirit of the contract can be anticipated (Williamson, 1991: 273).

Formalistic opportunism thus amounts to holding one's counterparty to perform according to terms that are legally enforceable, in light of the way courts happen to *construct* contracts, even though the constructed contract term may not reflect the "real deal" (Macaulay, 2003) that the parties knowingly entered into.

Knowing that one may be vulnerable to formalistic opportunism reduces the comparative attractiveness of hybrid bargains. Managers and entrepreneurs are rightly hesitant about binding themselves or their firms to a contract that might turn out to be all pain and no gain. As Williamson (1991: 273) recognizes, though, the courts do "avert[] truly punitive consequences [of formalistic construction] by permitting appeal to exceptions that qualify under some form of

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[51] I do not take a position on the professional responsibility of a manager in this dissertation. I do so in my companion paper, *Perfection as Moral Strategy: Planning for Disruption in Contracting,* under review with the Business Ethics Quarterly.

[52] Because Williamson ignores the case of classical hybrid bargains, i.e., those without neoclassical contract terms, he names only "neoclassical contracts" here. For reasons discussed earlier (namely, excuse doctrine applies to all hybrid bargains, whether or not neoclassical contracts), this is appropriately broadened to hybrid bargains in the context of this quotation.

excuse doctrine." Taking the status quo set of doctrines as a given, Williamson pins his hopes of enhancing the cost-attractiveness of hybrid governance on the potential to optimize excuse doctrine, as discussed next.

1.8 *Excuse Doctrine, Introduced*

In the absence of excuse doctrine, courts that follow the doctrine of formalistic construction never exercise mercy in respect of a defendant's vulnerability to a plaintiff's formalistic opportunism. Such a court invites lawsuits even under circumstances entirely outside the scope of the deal the parties knowingly struck. For the purely formalistic court, the incidence of a disruption between the inception of the deal and the litigation is of no moment to the construction and, hence, the enforcement of the deal's terms. Historically, excuse doctrine "appears in the nineteenth century as an exception grafted upon the general rule that every promise is binding according to its terms, even though through fortuitous events, entirely beyond the control of the promisor, it becomes extremely difficult and costly to perform" (Patterson, 1924: 348). The value of excuse doctrine for governance, given the considerations discussed thus far, comes precisely from the way and to the extent that it successfully mitigates formalistic opportunism, even if not perfectly.

Consequently, and without ever questioning formalistic construction itself, Williamson sets his sights on the optimization of excuse doctrine in respect of governance. Ironically, Williamson conceives of the problem as having a marginal solution—a socially complex Goldilocks problem—rather than a discrete structural solution of the sort his (1991) paper was written to explicate.[53] The rationale behind this framing of the optimization problem is that "too

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[53] Williamson motivates the importance of discrete structural analysis with Simon's (1978: 6-7) account.

> As economics expands beyond its central core of price theory, and its central concern with quantities of commodities and money, we observe in it ... [a] shift from a highly quantitative

much" of excuse doctrine is also bad for governance. An overly liberal excuse doctrine means that as soon as the "going gets tough" for the party obliged to perform, a court would typically withhold enforcement. Now if the going does *not* get tough, parties have little reason to withhold performance,[54] meaning that a contract law with a very liberal excuse doctrine would provide parties next to no commitment to help lift bargains off the ground. When parties need enforcement, they can't get it (except in cases of "take the money and run" opportunism), and when they don't need it, what is it good for?

In Goldilocks terms, the punishing injustice served up by formalistic construction is like the soup that is so hot it burns the tongue. Cooling things down, the dilution of the commitment provided when contract law is softened with liberal excuse yields a soup with too little heat to satisfy the palate.

> Improvements or not in a contract law regime can be judged by how the relevant governance-cost curve shifts. An improvement in excuse doctrine . . . would shift the cost of hybrid governance down. The idea here is that excuse doctrine can be either too lax or too strict. If too strict, then parties will be reluctant to make specialized investments in support of one another because of the added risk of truly punitive outcomes should unanticipated events materialize and the opposite party insist that the letter of the contract be observed. If too lax, then incentives to think through contracts, choose technologies judiciously, share risks efficiently, and avert adversity will be impaired (1991: 290).

So do we need to turn the lever to the right or to the left? The challenge of assessing the *status quo* of excuse is so vexing that Williamson does not hazard a guess.

The difficulty is that, as I will argue, this is not a Goldilocks problem at all. A true Goldilocks problem evokes a function that has a derivative, so that the solution is derivable at the

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> analysis, in which equilibration at the margin plays a central role, to a much more qualitative institutional analysis, in which discrete structural alternatives are compared.
>
> [S]uch analyses can often be carried out without elaborate mathematical apparatus or marginal calculation. In general, much cruder and simpler arguments will suffice to demonstrate an inequality between two quantities than are required to show the conditions under which these quantities are equated at the margin.

[54] See *infra* text accompanying note 150.

margin. It is true enough that if the only institutional alternative were between some and no excuse, the optimal level has to lie somewhere in the range of some or none. The problem is that, as a form of mercy, excuse doctrine cannot be pinned down. Williamson is unable to say whether excuse doctrine today is too liberal or too stingy for the very same reasons that excuse is a notorious doctrine.[55] When disruption strikes, parties cannot predict whether a court will exercise mercy because that exercise of mercy is not anchored in the terms of their deal. Rather, courts have to make judgments about what they think the parties intended, and the decisions have been unpredictable and inconsistent (DiMatteo, 2001: 639). Not only does this render contract law a shakier compass for governing enterprise whenever disruption rocks the boat, this uncertainty means that the defendant with a formalistic performance obligation remains vulnerable to the threat of legal action. The result is that courts' ability to reinforce contractual relations is stunted at the same time systemic litigation expenses are jacked up.[56]

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[55] Why courts would prefer this trade-off if another discrete structural alternative, as I will argue, was actually well-known and available is addressed in the concluding chapter. Here it suffices to point out that a flimsy, jurisdiction-granting doctrine like excuse is capable of making the tradeoff.

> We received the doctrines of mistake, impossibility and frustration long ago from 19th century English law. The Restatement, Article 2 of the UCC, and our case law have expanded impossibility into impracticability, but there has been little other change in the law as written. Of course, the law written is seldom the law applied. And any reader of a few cases on mistake or supervening causes appreciates how sloppy the standards on what is a sufficient mistake, an adequate frustration, or a large enough impracticability to void a contract really are. One man's frustration is another's hard bargain (White & Peters, 2002: 1969-70).

[56] I will speculate in the conclusion that the reason why excuse rather than perfectionistic construction won out in the 19th century—despite its inferiority—is that the former increases litigation. So what? It is well documented that the prestige and power of the judges of an English court tracked the number of cases fielded by the court. The Queen's Bench, by then the leading common law court (after surpassing the Court of Common Pleas in the 16th century) (*see infra* note 390), had felt threatened for centuries in the area of contracts by Chancery's courts of equity. Chancery, I will show, took a perfectionistic tack and aimed to screen out opportunistic litigation. In contrast, formalistic construction tells parties that opportunistic litigation is welcomed. Excuse adds that certain cases will fail depending on the court's judgment about features of the deal that were not express. Between the two discrete structural alternatives—formalistic construction with excuse or perfectionistic construction—I will sketch an argument to support the conclusion that the former presages significantly more litigation.

Fortunately, I will argue, there is a discrete structural alternative worth pursing, one that I have already framed in the distinction between a doctrine of construction and excuse. *Formalistically* is not the only way to construct contracts. Courts can also follow a doctrine that says plaintiffs will only be heard to enforce *perfected* contractual obligations in cases where the suit follows a disruption that was highly and negatively consequential for the alleged breach.

With this as my starting point, I extend the inquiry into the improvement of the institutional foundations of hybrid governance right where Williamson leaves off. Excuse covers a soft spot in contract doctrine that hides the potential to improve the institutions of governance. I will demonstrate in the next two chapters that trying to realize this potential by tweaking excuse doctrine is barking up the wrong tree. It is seeking a marginal solution where there is a discrete structural alternative that works better. Rather than fine-tuning the doctrine that courts rely upon as a corrective for the excesses of formalistic construction, courts can more realistically and effectively, I will show, take a radical position and "grasp things by the root" (Marx, 1844: 60). The faulty doctrine—notwithstanding centuries of legitimacy—is formalistic construction, and excuse doctrine (whose legitimacy has always been dubious) cannot save it. We need an institutional shift. So I will argue.

1.9 *Eunomics*

Comparative statics is best seen as providing what Michael Jensen (2002: 245) calls a "scorecard." A scorecard provides a way of ranking alternatives—whether they are managerial strategies, in Jensen's hands, or institutional variables, in Williamson's. Either way, a scorecard does not pretend to tell a manager *how* to manage a company (Jensen, 2002: 245) or a court *how* to decide a case. In Chapter 4, before concluding the dissertation, I will return to Williamson's scorecard to explore how formalistic construction, with or without excuse, fares against its obverse. To prepare for that face-off, the next two chapters develop my account of *perfectionistic* construction, the forgotten alter ego to formalistic construction.

While Williamson's comparative statics provides a powerful thought experiment for evaluating whether a change in contract doctrine contains the tendency to prove favorable or unfavorable for governance (in one or more respects), it is devoid of a theory that could link the *form* doctrine takes with its governance implications. The methodology invokes trial and error testing of alternative institutional variables (viz., doctrines) so it does not require a principle for actually formulating the doctrinal alternatives.[57] What it offers to get the ball rolling is an account of the injury the doctrine of formalistic construction introduces into hybrid governance. This injury is conceptualized in terms of the transaction costs posed by a propensity for formalistic opportunism.

In this section, I will introduce a theoretical conception that does have ambitions for elucidating the basis of good fit between governance and construction doctrine in a way that yields clarity about what good fit looks like within the common law. In this exercise, I take my lead from Lon Fuller—on the suggestion of Williamson (1996a) who recognizes that both his and Fuller's accounts are fundamentally committed to "the science or study of good order and workable arrangements" (Fuller, 1954: 477). Whereas Williamson conceives of his field of study as "governance," Fuller seeks progress in the science, theory or study he calls *eunomics.*

The way Fuller practiced eunomics in respect of contract law is epitomized by his two most famous pieces in contract.[58] The first, *The Reliance Interest in Contract Damages*, forever

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[57] Williamson cites Simon (1978: 6-7) for the proposition that "such analyses can often be carried out without elaborate mathematical apparatus or marginal calculation. In general, much cruder and simpler arguments will suffice to demonstrate an inequality between two quantities than are required to show the conditions under which these quantities are equated at the margin."

[58] Fuller is distinguished on many fronts. He is very well known for the legendary debate he had with H.L.A. Hart, arguing for a principle of fidelity to the law that rejects the positivist jurisprudence of his adversary. The following synopsis of his career reviews his stature:

> Fuller spent the first part of his law teaching career at the universities of Oregon and Illinois and at Duke University. He taught at Harvard Law School from 1939 until his retirement in 1972. He has been called by his biographer "one of the four most important American legal theorists" of the twentieth century (the other three being Oliver Wendell Holmes, Jr., Roscoe Pound, and Karl

changed the scholarly—and judicial—discussion of remedies. The second, *Consideration and Form*, articulates what remains an authoritative account of the role of formality in contract law. Fortunately, we also have a few pages where Fuller sketches out the theory of eunomics. Before diving into the applied eunomics of formality in contract in the next chapter, I will discuss Fuller's account of eunomics itself in the remainder of this section.

Fuller christened eunomics (Summers, 1984: 77) in the middle of a highly critical book review of *Jurisprudence, Men and Ideas of the Law* (1953), authored by a now-forgotten contracts professor, Edwin W. Patterson (Fuller, 1954). The review begins with pointed criticism—and defensiveness—towards Patterson's book. This leads Fuller to advance an argument in favor of natural law to challenge Patterson's ideas. Then, Fuller steps back to point out a different weakness in the book.

> Even if the reader is inclined to reject all that has been said here so far about natural law I should like to solicit sympathetic attention for another aspect of the natural law problem that is passed over in silence by Patterson. What I have in mind can best be approached by quoting a hypothetical assertion: "There are natural laws of social order."
>
> Does the reader accept or reject this statement? If he rejects it, what does his rejection imply? Does he mean to embrace what might be called the called the doctrine of the infinite pliability of social arrangements, the view that, given a sufficient agreement on ends or a dictator strong enough to impose his own ends, society can be so arranged as to effectuate (within the limits of its resources) any conceivable combination or hierarchy of ends?
>
> As a tacit and unexamined premise such a doctrine is, I think, very much alive today in some of the social sciences, including law. I believe the doctrine is wholly without foundation, and that it is working great damage by drawing attention away from the most vital problems of social order and welfare. The untenability of the doctrine can best be seen by passing in review three fields of study that have remained relatively untouched by it: business administration, economics, and political science. (1954: 473-74).

The doctrine of the infinite pliability of social arrangements says that with enough political consensus any hierarchy of ends can be pursued. This view minimizes concern over institutional

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Llewellyn). He published widely on the relation of law to morality and reason, legal process, legal method, and legal education. Although his writings on contract law are few in number, his article *The Reliance Interest in Contract Damages* remains one of the most influential in the field (Gerber, 2003: 599-600).

interaction effects because it views institutional commitments as infinitely pliable in respect of each other.[59]

In contrast, eunomics draws upon a mechanical, gear-like conception of institutional harmony: some institutions engage well together while others may be constantly at cross-purposes. So the idea of discrete structured alternatives is soaked into Fuller's conception of eunomics (contrast Williamson's view—faulty according to me—that formalistic opportunism can be tamed within the framework of formalistic construction). The motivation behind eunomics is the idea that the pieces of the social puzzle can have better or worse fit, and so the job of the eunomics theorist is to suss out how to adjust the pieces into a bespoke configuration.

Fuller provides a relevant illustration in discussing business administration's claims to eunomics. The problem he defines concerns the management of labor in a hierarchy. Management's desire to increase output in a manufacturing group depends on how tasks are divvied and allotted among workers.

> Obviously the rate of output of the factory will be affected by the manner in which these operations are allocated. The task of management is to select out of the countless ways of making this allocation the one that will produce the best results. Many factors must be reckoned with, involving individual and social psychology, the construction and operation of the human body, avoidance of interference between different workers, etc. But no one would doubt that the task is here that of searching out the compulsions and opportunities contained in a particular domain of objective reality. In this sense, management is concerned with the "natural laws" underlying the organization of machine-tending duties (1954: 474).

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[59] According to Duncan Kennedy (1976: 1702-03),

> It seems that the first self-conscious general statement of principles for the choice of form, at least by an American, is Pound's *Theory of Judicial Decision*, published in 1923. The thesis of the article is simple: "rules of law… which are applied mechanically are more adapted to property and to business transactions; standards where application proceeds upon intuition are more adapted to human conduct and to the conduct of enterprises." If we ask the criterion of "adaptedness," Pound had a ready but from today's perspective vacuous answer: "for the purposes of today our picture should be one, not … of a body of unchallengeable deductions from ultimate metaphysically-given data at which men arrived a century ago in seeking to rationalize the social phenomena of that time, … but rather a picture of a process of social engineering. Such a picture, I venture to think, would represent the social order as an organized human endeavor to satisfy a maximum of human wants with a minimum of sacrifice of other wants."

On the micro-scale—organization within a factory—eunomics seeks to adumbrate principles of human resource management, much as Frederick Taylor (1911) sought to do with his theory of scientific management.[60] The considerations that figure into eunomics range from human anatomy and psychology (such as the propensity to opportunism that is central in this dissertation) to organizational behavior and theory.

Not surprisingly, Williamson (1996a: 397) finds that eunomics "is very much in the spirit of what I refer to as governance."

> As Fuller subsequently remarks, "the primary concern of eunomics is with the means aspect of the means-end relation" (1954: 478). Governance is also very much an exercise in assessing the efficacy of alternative modes (means) of organization. The object is to effect good order through the mechanisms of governance. A governance structure is the institutional framework within which the integrity of a transaction, or related set of transactions, is decided (Williamson, 1996a: 397).

Williamson does not provide a definition of what he means by the "integrity of a transaction." Within the framework of comparative statics, though, it is clear enough that institutions that fail

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[60] The field of business administration recognizes the place for eunomics at a more macro scale as well. "It is assumed that the management of a corporation, for example, may be given different structures, or may be conducted according to different basic plans" (1954: 474). The task for the field is the comparative evaluation of the impacts of the various approaches to management. As against legal scholarship's adherence to the doctrine of infinite pliability, Fuller credits management theory, especially Chester Barnard's *The Functions of the Executive* (1938) (a work that was highly influential for Williamson's understanding of hierarchy (1991: 277-80; 1990), for advancing the aims of eunomics.

The example from economics concerns two extreme views from capitalism and socialism. The socialist view, dating to the early years of the Soviet Union, says "that under socialism there is no such thing as an 'economic law'" (1954: 473). The extreme capitalist view, from the United States, says that "in economics anything goes, and that it is all a question of where you sit, what you want, and what you are used to." These extreme views have been tempered by a recognition that a study of forms matters in economics.

> Today, however, economics has returned to the view that the forms through which economic objectives can be achieved are limited in number, and that for certain objectives certain forms (with their attendant costs) must be employed. In particular it is now realized that the maximum satisfaction of diverse wants out of scarce resources can only be achieved through something equivalent to a market mechanism. This is a proposition accepted by thoughtful socialist and even communist scholars.

The final example, from political science, speaks to the need to evaluate the consequences of adopting alternative schemes for conducting elections: "When proportional representation is urged as an improvement on existing ways of conducting elections, political science has no choice but to set about ascertaining what the adoption of this form of voting entails" (1954: 476).

to ensure the integrity of a transaction under a given mode of governance will render that mode comparatively less attractive.

In the case of hybrid governance, the specter of formalistic opportunism certainly cuts into the integrity of governance. At the front end, this specter introduces uncertainty and risk that call into question the attractiveness of putting the eggs of the transaction in this governance basket. At the back end, formalistic opportunism utterly undermines the integrity of a hybrid governance arrangement. My quest in this dissertation is to discover resources within the common law that can bolster integrity for governance through off-market bargains (classical or neoclassical hybrids). Comparative statics lacks the wherewithal to generate non-obvious forms more capable of furthering the integrity of transactions (*all it provides is a scorecard*). Thankfully, institutional integrity is more than the stuff of scorecards in Fuller's treatment:

> [In addition to rejecting the doctrine of the infinite pliability of social ends,] Fuller had still another concern in arguing that means were as important as ends. He thought that the processes and forms of socio-legal ordering have a certain inner integrity that needs to be studied and understood. If this integrity is not grasped—if social architects merely assume that the institutional means at hand is infinitely pliable and can be bent to just any purpose—then that means is sure to be misused. For example, when adjudication is bent to serve the ends of negotiation and mediation, misuse often results. To Fuller, eunomics was the study of *good* order and *workable* arrangements. The misuse of institutional forms would only bring bad order and unworkable arrangements (Summers, 1984: 78).

Now we have a more pointed lead for the pursuit of an alternative to formalistic construction in hybrid governance. In what sense is the integrity of formalistic construction questionable? What sort of doctrine would avoid this integrity deficit?

Fuller himself suggests the hypothesis I will pursue in the next two chapters. The integrity deficit in formalistic construction is related to a deficiency that has to do with the formalities parties bring to bear in consummating a bargain. The thought is, first of all, that parties cannot truly enter the realm of freedom of contract without undertaking the requisite formalities and, secondly, that formalities can extend the integrity of a contract to cases of disruption. Following an overview of the origins of the common law of contract, Chapter 2

continues with Fuller's account of the role of formality in contracts as part of my effort to pinpoint the integrity deficit in formalistic construction that only perfectionistic construction can cure.

CHAPTER 2: FORMALITY AND THE BOUNDS OF CONTRACT

My objective in this chapter is to defend the claim that perfectionistic construction ("PC") has a functional virtue in legal doctrine: contract doctrine *works better* with PC than with FCwE *insomuch* as the function of a court in contract follows from the fundamental jurisprudential tenet of freedom of contract: courts should not make contracts for parties; rather, courts should construct contracts out of the terms freely chosen by parties. My argument thus takes the form of a hypothetical imperative within the structure of common law doctrine, holding as the commitment to be reinforced the imperative not to make parties' contracts.[61] In the next chapter, I will evaluate doctrine instrumentally (i.e., as a hypothetical imperative) from the standpoint of parties: does FCwE or a PC better realize parties' freedom of contract? In this chapter, I evaluate doctrine from the judicial point of view, probing for its internal consistency with the doctrinal tenet of freedom of contract. My argument will boil down to this conclusion: FCwE necessarily implicates compromises with this tenet that a PC is constitutionally equipped to avoid.

Up to this point, all that I have specified about the common law of contracts in the courts of the United States of America and its states[62] is that courts enforce, rather than leave unenforced, deal terms, and that they do so moreover according to a formalistic construction, sometimes accessing an excuse doctrine (FCwE). I have said nothing specific about the common law's rationale for enforcement from a court's point of view. This chapter begins with a review of the origins of contract law to bring into perspective the basic doctrinal categories that support a

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[61] PHILIPPA FOOT, *Morality as a System of Hypothetical Imperatives*, in VIRTUES AND VICES AND OTHER ESSAYS IN MORAL PHILOSOPHY 314-15 (1978).

[62] Louisiana is the civil law exception to the rule of the common law in the United States.

common law court's enforcement of bargains. My question then becomes this: given the nature of the common law of contracts and assuming a judicial commitment not to make contracts for parties, should courts construct contracts formalistically, with or without excuse doctrine?

My argumentative strategy is to part from Fuller's account of courts' need for formality in contract enforcement. Fuller starts from an archetypal case of contract breach from which he thinks deviations either merit weaker enforceability or demand more fulsome formality. One black-letter deviation from this archetype is the "indefinite" bargain, where the parties failed to articulate terms definitely enough to create the conditions for the enforcement of their private autonomy. I show that disruption presents a deviation from the archetype, but that existing contract law has ambivalence towards the formality of perfection in such cases. If the parties did undertake to perfect performance obligations in respect of such a disruption, courts enforce the bargain as perfected. If the parties did not, courts enforce notwithstanding the lack of perfection, either formalistically or with excuse.

Fortunately, history reveals important sources of precedent for a perfectionistic approach that I discuss following a review of the status of perfection in black-letter law. I conclude by demonstrating that the ambition for a contract law that sheds the duty-imposing quality of tort law and that provides parties a transparent power-conferring law calls for perfectionistic rather than formalistic construction. Moreover, I show that the commonplace in contract theory that all contracts are incomplete is an accommodation to formalistic construction rather than a conceptual necessity. The notion of incompleteness justifies the judicial practice of making contracts for parties against the fundamental tenet of the freedom of contract. Perfectionistic construction allows for the view that contracts (being enforceable) are necessarily complete. An incomplete bargain implies an unperfected bargain deserving perhaps of tort-like remedies, but not the sanctity of contract.

2.1 *Origins of the Common Law of Contract*

The law of contracts has one major branch and offshoots of more ancient vintage.[63] The major branch is the law that enforces bargains as such. In the American Legal Institute's first Restatement of Contracts (1932), this branch was named the law of "*in*formal contracts"[64] by its Reporter Samuel Williston[65] to distinguish from the increasingly anachronistic family of "formal" contracts, including instruments signed under seal and other specialties.[66] The law of "informal contracts"—the law of the bargain—originates in the tort-rooted family of causes of action known as *actions on the case*. In this section, I sketch how contract emerged from tort and how the gist of assumpsit continues to color common law contracts' signal features. Doing so underscores the salience of bargain-enforcement as the theme of contract law, a perspective that will facilitate seeing through the Euthyphro bootstrap of FCwE later on in Chapter 3.

In the history of contract-related common law, the formal contract action like debt, detinue and covenant came first, fully established by the twelfth, if not, the thirteenth centuries.[67]

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[63] "Professor Maitland was not wide of the mark in his famous sentence, 'The forms of action we have buried, but they still rule us from the grave.'" Note, *Sum Certain in the Action of Debt*, 33 YALE L.J. 85 (1923) (quoting FREDERIC W. MAITLAND, LECTURES ON EQUITY AND THE FORMS OF ACTION 296 (1909), and citing Arthur L. Corbin, *Quasi-Contractual Obligations*, 21 YALE L.J. 533 (1912).

[64] *See* Restatement (First) of Contracts § 11 ("Informal contracts are all others than those enumerated as formal contracts in § 7.").

[65] Williston's own casebook illustrates the leading role of informal contracts. SAMUEL WILLISTON, A SELECTION OF CASES ON THE LAW OF CONTRACTS, vol. 1 (1903) (devoting the first 362 pages to the formation of "simple" or informal contracts and the next 19 pages to the formation of contracts under seal).

[66] Lon Fuller summarizes the key features of these ancient offshoots as follows:

> Prior to the development of the action of assumpsit it may be said that the English law recognized two bases of liability which we would classify as 'contractual.' *First*, a defendant who had promised to pay for goods or services became liable to pay the agreed price (which might be in terms of money or goods) *after* he had received the plaintiff's performance. The appropriate actions to enforce this liability were debt and detinue. *Secondly*, a defendant who had made a promise under seal was liable in an action of debt or covenant. The principles of liability involved in these two contracts of the early law were (1) that a man ought to pay for what he has bargained for and received and (2) that a formally-made promise should be binding.

FULLER, *supra* note *6* at 304.

[67] A.W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF

But these formal "contracts" and the later developing lineage of doctrine that gives rise to the informal contracts of today are about as related, in animal terms, as sharks and dolphins, for reasons we will now see. The formal contracts are claims about a property that, it is claimed, has to be returned or turned in to the plaintiff according to the terms of an instrument previously executed as a unilateral grant, whether a money loan or real property transfer or some covenant to perform.[68] They are called formal contracts because the common law would not recognize such grants unless made with specified formalities. The best known is the seal. Given the early genesis of these actions,[69] the civil procedure that accompanied them was, for many centuries, primitive. The most notorious feature of this civil procedure was the wager of law that allowed a complete defense if the defendant could gather ten men to take his side in court.[70]

The new civil action that started to take hold in fourteenth century courts comes on the heels of a totally different legal theory than the formal contracts property claim. The family of actions that includes today's informal contracts and tort law are *in personam* descending from a theory of trespass against persons and their property. They are not *in rem* actions on the property itself, constituted by the formality of a verbalization. [71] The claim of trespass became established

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ASSUMPSIT (1975).

[68] Simpson explains that "[i]In this respect trespass actions embodied a legal technique which was quite different from the . . . the ancient real actions, in which the claimant demanded the seisin of land, and quite different also from the technique of the ancient contractual actions of debt, detinue, and covenant where the plaintiff demanded the specific recovery of the debt, the chattel or the actual performance of the covenant." *Id.* at 199.

[69] *See* Arthur L. Stinchcombe, *Social Structure and Organizations*, *in* HANDBOOK OF ORGANIZATIONS 142 (ed. James G. March) (1965).

[70] *See* OLIVER W. HOLMES, JR., THE COMMON LAW (1881); J. B. Ames, *The History of Assumpsit*, 2 HARV. L. REV. 1, 53 (1888).

[71] Dean Ames explains that,

> A simple contract debt, as well as a debt by specialty, was originally conceived of, not as a contract, in the modern sense of the term, that is, as a promise, but as a grant. A bargain and sale, and a loan, were exchanges of values. The action of debt, as several writers have remarked, was a real rather than a personal action. The judgment was not for damages, but for the recovery of a debt, regarded as a *res.*

in the law through the cause of action known as an *action on the case*. Legal historian A.W.B. Simpson says these actions led the "steady increase in the jurisdiction of royal courts over actions for trespasses, or as we would say, torts or wrongs. The characteristic feature of these actions was that in them a plaintiff was allowed to claim damages by way of compensation for a wrong which had been done to him."[72] The miracle of the common law of contracts is how, out of the action on the case, it evolved the modern civil action for contractual liability.

In the sixteenth century, *assumpsit* emerged as "a special sub-species of the action on the case."[73] In the early cases, "the plaintiff sought to recover damages for a physical injury to his person or property caused by the active misconduct of the defendant."[74] Dean J. B. Ames, in an early issue of the Harvard Law Review, provides a series of examples involving cases:

> against a ferryman who undertook to carry the plaintiff's horse over the river, but who overloaded the boat, whereby the horse was drowned; against surgeons who undertook to cure the plaintiff or his animals, but who administered contrary medicines or otherwise unskillfully treated their patient; against a smith for laming a horse while shoeing it; against a barber who undertook to shave the beard of the plaintiff with a clean and wholesome razor, but who performed his work negligently and unskillfully to the great injury of the plaintiff's face; against a carpenter who undertook to build well and faithfully, but who built unskillfully.[75]

Ames explains that the significance of declaring an "assumpsit" in the complaint was to overcome the fact that back in that period of history (and still to a significant extent today) a tort, i.e., a trespass, would not lie where the plaintiff voluntarily entered into the context of confidence within which the claimed injury resulted. Courts would have held such a plaintiff to have assumed the risk of injury by a voluntary act.

Id. at 55.

[72] *See* SIMPSON, *supra* note 67 at 199.

[73] *Id.*

[74] Ames, *supra* note 70 at 2.

[75] *Id.* (notes omitted).

Consider the judicial opinions in the case of the plaintiff who sued a horse doctor caring for the plaintiff's horse when it died:

> Newton, C.J.: "Perhaps he applied his medicines *de son bon grè*,[76] and afterwards your horse died; now, since he did it *de son bon grè*, you shall not have an action . . . . My horse is ill, and I come to a horse-doctor for advice, and he tells me that one of his horses had a similar trouble, and that he applied a certain medicine, and that he will do the same for my horse, and does so, and the horse dies; shall the plaintiff have an action? I say, No." Paston, J.: "You have not shown that he is a common surgeon to cure such horses, and so, although he killed your horse by his medicines, you shall have no action against him without an assumpsit. Newton, C.J.: "If I have a sore on my hand, and he applies a medicine to my heel, by which negligence my hand is maimed, still I shall not have an action unless he undertook to cure me."[77]

Declaring an assumpsit, according to this characteristic holding, may suffice to open the door to the professional (or semi-professional) liability of defendants like the horse doctor.[78] Without the assumpsit, the law would not hold the defendant liable for falling beneath a standard of care unintentionally.

The importance of these cases for understanding contracts today is that liability in assumpsit, as progenitor of today's "civil action"[79] for breach of (informal) contract, is an incident of an *undertaking*. The assumpsit claim against the horse doctor hangs, not on the botched treatment on its own, but on the botched treatment that occurred *within the scope of* the doctor's undertaking. By like reasoning, the liability of a bailee in assumpsit would pivot on the joinder of an injury and an undertaking: "his act of taking possession of the goods, his assumpsit to keep them safely, and their subsequent loss by his default."[80]

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[76] Meaning out of the goodness of his heart rather than for pay.

[77] Ames, *supra* note 70 at 3-4.

[78] In Ames's words: "[t]he court accordingly decided that a traverse of the assumpsit [in the horse doctor case] made a good issue." *Id.*

[79] *See* FED. R. CIV. P. 2 ("There is one form of action—a civil action.")

[80] Ames, *supra* note 70 at 5.

This sense of undertaking took a sharp turn towards modern contract in the line of assumpsit cases involving the combination of (a) an undertaking constituted by money and (b) an injury caused by deceit. Ames explains how this form of assumpsit arose as a doctrinal accident waiting to happen:

> [I]f money was in fact paid for a promise to convey land, the breach of the promise by a conveyance to a stranger was certainly, as already seen, an actionable deceit by the time of Henry VII.[1485-1509]. This being so, it must, in the nature of things, be only a question of time when the breach of such a promise, by making no conveyance at all, would also be a cause of action. The mischief to the plaintiff was identical in both cases. The distinction between misfeasance and nonfeasance, in the case of promises given for money, was altogether too shadowy to be maintained . . . . The gist of the action being the deceit in breaking a promise on the faith of which the plaintiff had been induced to part with his money or other property, it was obviously immaterial whether the promisor or a third person got the benefit of what the plaintiff gave up. It was accordingly decided, in 1520, that one who sold goods to a third person on the faith of the defendant's promise that the price should be paid, might have an action on the case upon the promise.[81]

The action on the case here is assumpsit, and the undertaking comes in the form of a promise to perform. In Ames's analysis, the center of gravity in the doctrine is the inducement to act as from the bargain that was struck. From this foundation, the common law was only steps away from the doctrine of consideration still modeled by courts in today's treatises and casebooks.

The next major development was the generalization and formalization of the requisites of an actionable undertaking for any interpersonal exchange that leave something to be done in the future. By constructing a generic conception of the undertaking involved in a bargain, courts

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[81] *Id.* at 13. With respect to the case, Ames quotes:

> from the following extract from the opinion of Frowyk, C.J.: "And so, if I sell you ten acres of land, parcel of my manor, and then make a feoffment of my manor, you shall have an action on the case against me, because I received your money, and in that case you have no other remedy against me. And so, if I sell you my land and covenant to enfeoff you and do not, you shall have a good action on the case, and this is adjudged .... And if I covenant with a carpenter to build a house and pay him £10 for the house to be built by a certain day, now I shall have a good action on my case because of payment of money, and still it sounds only in covenant and without payment of money in this case no remedy, and still if he builds it and misbuilds, action on the case lies. And also for nonfeasance, if money paid case lies."

Id. (notes omitted).

could expand the reach of the action of assumpsit to parties injured on account of practically any uncompleted exchange.[82] What they needed was a common expression for the wide variety of commitments that parties make to bring bargains to life. The courts achieved this by operationalizing the requisite undertaking in terms of the *consideration* that constitutes the contractual commitment.[83]

> Promises not being binding of themselves, but only because of the detriment or debt for which they were given, a need was naturally felt for a single word to express the additional and essential requisite of all parol contracts. No word was so apt for the purpose as the word "consideration." Soon after the reign of Henry VIII.[1509-1547], if not earlier, it became the practice, in pleading, to lay all assumpsits as made *in consideratione* of the detriment or debt. And these words became the peculiar mark of the technical action of *assumpsit*, as distinguished from other actions on the case against surgeons or carpenters, bailees and warranting vendors, in which, as we have seen, it was still customary to allege an undertaking by the defendant.[84]

What the doctrine of consideration thus accomplished was a demarcation of a *species* in the genus *assumpsit* (of the *family* actions on the case, which originates in a trespass theory). This species is the direct ancestor of today's contract action.

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[82] For Corbin, an exchange which occurs entirely in the present tense would be "better described as a barter or an exchange of goods" because it "creates no contractual duty." Arthur L. Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L. J. 169, 171-72 (1917). The part of an exchange that courts are asked to enforce is not what was already tendered at the time the contract was formed, 17A Am. Jur. 2d Contracts § 19 (quoting *Larson v. Cole*, 76 N.D. 32 (1948) ("A contract is made at the time the last act necessary to its formation is done.")), but rather the part of the exchange that was left for another day. This untendered part of the contract is called executory, and every contract is executory in part, else as a completed exchange, it would be a barter. It is for this reason that promises play such an important role in contract law: it is through the syntax of a promise that a contract is created involving an exchange that has not yet taken place, and thus becomes susceptible to completion though litigation.

[83] In this dissertation, I will leave aside the serious difficulties with the concept of consideration that relate to the modification of bargains. According to Karl Llewellyn,

> The *Restatement of Contracts* achieves a semi-unity of concept and doctrine on "consideration" in the formation of promissory obligation; but it does so only at the expense of express recognition that its consideration doctrine does *not* cover the field of fact with which the same *Restatement* is concerned; while in regard to modification and waiver, the attempted unification of doctrine with that of "consideration," when it fails to provide an additional treatment of "modification without consideration" akin to that of "formation without consideration" is a disregard of going case-law that happens to be also very sensible case-law.

Karl N. Llewellyn, *Of the Complexity of Consideration: A Foreword*, 41 COLUM. L. REV. 777, 778 (1941).

[84] Ames, *supra* note 70 at 17-18 (notes omitted).

By the seventeenth century this species of cause of action, *in consideratione* assumpsit, had the makings of a law of contract. Legal historian and contracts scholar John Dawson:

> It became abundantly clear as the sixteenth century progressed that common-law courts had created the means for enforcing, and were prepared to enforce, a great variety of exchange transactions. In the transactions that were enforced there was one recurring element which provided the reason why they were enforced: each party had in fact desired some act or abstention of the other in return for which he had agreed to perform his own.[85]

The bargain gets born from commitment and, legally speaking, this occurs through the exchange of consideration, constituted of legal detriments, benefits or promised performances. By the nineteenth century—well into the growth spurt of industrializing urbanization in England—contract law had come of age doctrinally. Dean Roscoe Pound:

> In the nineteenth century it became settled that the common-law theory of enforcing simple contracts was one of giving effect to bargains. A simple [i.e., informal] contract was either an exchange of promises or an exchange of a promise for an act. In an exchange of promises each was the consideration of the other. In an exchange of a promise for an act the act was the consideration of the promise.[86]

This highly generalized conception of bargain has the implication that formality in the traditional sense of the term—the sometimes-costly symbols that conditioned the availability of the formal contract actions—has not been doctrinally essential to a breach of contract claim. The definiteness and conclusiveness of the exchange, without more, consummates the transaction as a legally actionable contract.

Built in this fashion, assumpsit could disseminate widely to exchange relations of all kinds, even to parties not consciously seeking to lock in the availability of an enforcement action in the courts.[87] According to Arthur Linton Corbin—who alone had a hand in both Restatements

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[85] JOHN P. DAWSON, GIFTS AND PROMISES: CONTINENTAL AND AMERICAN LAW COMPARED 203 (1980).

[86] Roscoe Pound, *Individual Interests of Substance - Promised Advantages*, 59 HARV. L. REV. 1, 29-30 (1945).

[87] *See generally* Gregory Klass, *Three Pictures of Contract: Duty, Power, and Compound Rule*, 83 N.Y.U. L. REV. 1726 (2008).

of Contracts[88]—"[t]here seems to be no serious doubt that a mutual agreement to trade a horse for a cow would be an enforceable contract, even though it is made by two ignorant persons who never heard of a legal relation and who do not know that society offers any kind of a remedy for the enforcement of such an agreement."[89] The fact of the bargain—that the commitments were exchanged—is the driving force behind the legal theory of the breach of contract action. The claim is not fundamentally about words: "Entering into an agreement is not in itself a legal speech act, in the way that executing a deed or issuing an executive order is. In fact, contemporary contract law does not even require that the parties express their agreement in so many words."[90]

This feature of contract law brings it enormous plasticity and makes it an attractive legal theory for plaintiffs for that reason alone, especially given that actions on the case, the family of

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[88] In addition to providing advisory assistance on the first Restatement as a whole, Corbin was Reporter of its chapter on Remedies and then decades later prepared extensive revisions of the first Restatement for the benefit of the American Legal Institute and the initial Reporter of the second Restatement, Robert Braucher, and also commented on early drafts of the second Restatement before his death in 1967. *See* Joseph M. Perillo, *Twelve Letters from Arthur L. Corbin to Robert Braucher*, 50 WASH. & LEE L. REV. 755 (1993). Samuel Williston, in his autobiography, says his "greatest indebtedness" in the preparation of the first Restatement was to Corbin:

> His mastery of contracts was only equalled by his generosity in contributing his best efforts to a work that for the most part would pass under another's name. He has moreover made a special study of terminology, and his keen eye for ambiguities and inexactness of expression saved me in many slippery places. His friendship and that of the Director and Professor Robert Thompson remain major benefits to me of my work with the Institute. For a part of the *Restatement of Contracts* Arthur Corbin assumed the position of reporter and I acted as one of the advisers.

SAMUEL WILLISTON, LIFE AND LAW 312 (1940).

[89] 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 34, at 135 (1st ed. 1950) (as quoted by Klass, *supra* note 87 at 1783. Corbin provides a list of further considerations:

> First, if the subject matter and terms of a transaction are such as customarily have affected legal relations and there is nothing to indicate that the one now asserting their existence had reason to know that the other party intended not to affect legal relations, then the transaction will be operative legally. Second, if the subject matter and terms are not such as customarily have affected legal relations, the transaction is not legally operative unless the expressions of the parties indicate an intention to make it so. Third, if the agreement or promise is such as customarily has affected legal relations and there is an expression of intention not to be bound, the situation is more complicated and no single answer will fit all the cases .

1-2 Corbin on Contracts § 2.13 (notes omitted).

[90] Klass, *supra* note 87 at 1748.

origin for assumpsit, were not subject to archaic defenses like wager of law.[91] In this milieu, it is not surprising that judges partial to ancient actions like debt would raise their eyebrows at the notion of a tort providing the pedestal of a serious business arrangement.

> The conception of a debt was clearly expressed by Vaughan, J., who, some seventy years after Slade's case [1596],[92] spoke of the action of Assumpsit as "much inferior and ignobler than the action of Debt," and characterized the rule that every contract executory implies a promise as "a false gloss, thereby to turn actions of Debt into actions on the case; for contracts of debt are reciprocal grants."[93]

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[91] Holmes describes the rise of assumpsit and the relevance of wager of law thus:

> The later fortunes of assumpsit can be briefly told. It introduced bilateral contracts, because a promise was a detriment, and therefore a sufficient consideration for another promise. It supplanted debt, because the existence of the duty to pay was sufficient consideration for a promise to pay, or rather because, before a consideration was required, and as soon as assumpsit would lie for a nonfeasance, this action was used to avoid the defendant's wager of law. It vastly extended the number of actionable contracts, which had formerly been confined to debts and covenants, whereas nearly any promise could be sued in assumpsit; and it introduced a theory which has had great influence on modern law, that all the liabilities of a bailee are founded on contract.

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[92] (1596, Q. B.) 2 Co. Rep. 501. Another major development in the history of assumpsit relates to a topic that falls outside the scope of my claims (but is discussed in Section 2.2): the enforceability of wholly executory bargains. Ames reviews the famous Slade's Case:

> Inasmuch as the simple contract debt had been created from time immemorial by a promise or agreement to pay a definite amount of money in exchange for a *quid pro quo*, the courts could not allow an action of Assumpsit also upon such a promise or agreement, without admitting that two legal relations, fundamentally distinct, might be produced by one and the same set of words. This implied a liberality of interpretation to which the lawyers of the sixteenth century had not generally attained. To them it seemed more natural to consider that the force of the words of agreement was spent in creating the debt. Hence the necessity of a new promise, if the creditor desired to charge his debtor in Assumpsit.
>
> . . . .
>
> It was accordingly resolved by all the justices and barons in Slade's case, in 1603, although "there was no other promise or assumption but the said bargain," that "every contract executory imports in itself an *assumpsit*, for when one agrees to pay money, or to deliver anything, thereby he assumes or promises to pay or deliver it; and, therefore, when one sells any goods to another, and agrees to deliver them at a day to come, and the other, in consideration thereof, agrees to pay so much money at such a day, in that case both parties may have an action of Debt, or an action on the case on *assumpsit*, for the mutual executory agreement of both parties imports in itself reciprocal actions upon the case as well as actions of Debt."

Ames, *supra* note 70 at 55-56.

[93] *Id.* at 55. Ames goes on to quote a judge who reveals disdain for the upstart cause of action.

> The conception of a debt was clearly expressed by Vaughan, J., who, some seventy years after Slade's case, spoke of the action of Assumpsit as "much inferior and ignobler than the action of

What exactly is ignoble about assumpsit for this judge? Perhaps it is that assumpsit relies on the idea of an injury to hold up commitments that, in the judge's view, would more appropriately have been executed with the formality of a grant.

Assumpsit begs to differ. There is enough sanctity in the interpersonal exchange of bargained-for consideration, according to this cause of action, to make a voluntary engagement actionable for interpersonal trespass, yielding a sword to enforce the deal. It is not fundamentally about a seal or a signature but about the commitment tendered. Even the formal-informal distinction, according to defenders of assumpsit-based contract liability, is overblown. Oliver Wendell Holmes, Jr., memorably demurs to the suggestion that assumpsit lacks the basis for respectability inhering in formal contracts: "consideration is as much a form as a seal."[94]

In what sense, though, is consideration a formality, and how is its formality important? These are the questions I take up next, taking the lead from Lon Fuller.

> Debt," and characterized the rule that every contract executory implies a promise as "a false gloss, thereby to turn actions of Debt into actions on the case; for contracts of debt are reciprocal grants."

A second such analysis concerns the pleading differences between formal and informal contract actions:

> Although the right to a trial by jury was the principal reason for a creditor's preference for *Indebitatus Assumpsit*, the new action very soon gave plaintiffs a privilege which must have contributed greatly to its popularity. In declaring in Debt, except possibly upon an account stated, the plaintiff was required to set forth his cause of action with great particularity. Thus, the count in Debt must state the quantity and description of goods sold, with the details of the price, all the particulars of a loan, the names of the persons to whom money was paid with the amounts of each payment, the names of the persons from whom money was received to the use of the plaintiff with the amounts of each receipt, the precise nature and amount of services rendered. In *Indebitatus Assumpsit*, on the other hand, the debt being laid as an inducement or conveyance to the *assumpsit*, it was not necessary to set forth all the details of the transaction from which it arose. It was enough to allege the general nature of the indebtedness, as for goods sold,[2] money lent,[3] money paid at the defendant's request,[4] money had and received to the plaintiff's use,[5] work and labor at the defendant's request,[6] or upon an account stated,[7] and that the ***58** defendant being so indebted promised to pay. This was the origin of the common counts.

Id. at 57-58.

[94] *Krell v. Codman*, 154 Mass. 454 (1891) (Holmes, J.).

2.2 *Private Autonomy and Formality in Contract*

In this section, I have two aims. The first is to briefly set forth Fuller's conception of consideration as a legal formality. Then I will show how Fuller applies this account to argue that consideration provides insufficient formality in a sub-set of exchanges, namely those in which only promises are exchanged (known as wholly executory or bilateral executory bargains). I spend time with this argument not because the enforceability of wholly executory bargains is critical to my dissertation's claims (it is not). What is important is the argument's form, providing the framework I will follow in the remainder of the chapter to argue that the relevance of perfection has been neglected as a formality in cases of severe disruption in a way that calls into question the proper functioning of existing doctrine given the commitment to freedom of contract.

In *Consideration and Form* (1941), Fuller examines the implications for consideration doctrine of the rationales for enforcing contracts, which he calls the "substantive bases of contract liability." Two of the three bases of substantive liability that he identifies are familiar from the article for which Fuller remains best known in contract theory, *The Reliance Interest in Contract Damages*.[95] One reason why courts enforce contracts is to prevent unjust enrichment. This

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[95] Lon L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 1 and 2*, 46 YALE L.J. 52, 373 (1936-1937). The organizing theme of the article is the idea that there are multiple, distinct interests that plaintiffs sue upon in a contractual context and that courts have different ways to vindicate the distinctiveness of each interest. Fuller and Perdue identify three: the expectation interest, the reliance interest, and the restitution interest. The following examples illustrate the meaning of these terms. The expectation interest is satisfied by the plaintiff whose civil action recovers $100 as compensation for the difference between the bargained-for price of $200 and the $300 the plaintiff had to spend on the market to cover non-delivery by the defendant. In contrast, a plaintiff that brings suit for the $20 in specialized and now useless parts it purchased to fulfill the defendant-buyer's order seeks to make good on its *reliance* interest. Finally, a plaintiff is awarded $1,000 in *restitution* to make up for the $1,000 the defendant received from the plaintiff before deciding not to provide anything in return. The major thrust of the article is to demonstrate the centrality of the reliance interest to contract remedies and to question the dominance of the expectation interest in the theory and practice of contract law.

In *Consideration and Form* (1941), *supra* note 11, the terms of the analysis shift from three interests in contract to three substantive bases of contractual liability. What is fascinating and at first puzzling is that the shining star of *Consideration and Form* takes the place of the bogey of *The Reliance Interest.* The expectation interest was set in parallel with reliance and restitution in *The Reliance Interest* because the doctrinal inquiry in that article is into the choice between remedial conceptions. Ever since the heyday of

rationale is called *restitution*, as illustrated by the following example. A plaintiff is awarded $1,000 in *restitution* to make up for the $1,000 the defendant received from the plaintiff before deciding not to hold up its end of the deal: the $1,000 unjustly enriched the defendant and by restitution is returned to the plaintiff.[96] A second basis of contract liability is reimbursing *reliance* upon a breached deal, as in a case where the court provides a remedial award to a plaintiff that brings suit for the $200 in specialized and now useless parts it purchased to fulfill the defendant-

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classical contract in the 19th century, expectation damages has served as the gold standard measure of contract damages. *See* RESTATEMENT (FIRST) OF CONTRACTS § 329 (1932) ("Where a right of action for breach exists, compensatory damages will be given for the net amount of the losses caused and gains prevented by the defendant's breach, in excess of savings made possible."); *see* Restatement (Second) of Contracts § 347 (1981) (providing first among all remedial conceptions that "the injured party has a right to damages based on his expectation interest"); Kevin Werbach, *Basic Concepts in the Law of Contracts*, Wharton Cases (2013) ("Expectation is the preferred formula. Whenever possible, this is what courts will use."). Now the *rationale* for enforcing contracts with expectation damages has always hung on the parties' freedom of contract—their freedom to shape their future legal obligations—and the doctrinal inquiry in *Consideration and Form* is into *this* rationale. In the texture of Fuller's position, his challenge in *The Reliance Interest* is not against private autonomy, just against the prevailing wisdom that contract law is all about vindicating the expectation interest.

We know from correspondence with Corbin the same year that *Consideration and Form* was published that Fuller changed emphasis in this article to serve his argument, not because his view changed.

> I have become convinced that contract law must be analysed in terms of what I called, in my Yale article, a hierarchy of interests. A court may interfere where a promise is broken (1) to prevent unjust enrichment of the promisor, (2) to reimburse the promisee's reliance or (3) to give the promisee the value of the promised performance. The incentives to judicial intervention to protect these interests decrease in the order in which I have named the interests. As to the first, courts will protect this often even in the absence of a promise, or where the promise is oral and "unenforceable" under the statute of frauds, etc.

Fuller letter to Corbin Nov. 24, 1941, Scott D. Gerber, *Corbin and Fuller's Cases on Contracts (1942?): The Casebook That Never Was*, 72 FORDHAM L. REV. 595, 617 (2003).

[96] Fuller explains the justice of restitution in Aristotelian terms:

> In return for B's promise to give him a bicycle, A pays B five dollars; B breaks his promise. We may regard this as a case where the injustice resulting from breach of a promise relied on by the promisee is aggravated. The injustice is aggravated because not only has A lost five dollars but B has gained five dollars unjustly. If, following Aristotle, we conceive of justice as being concerned with maintaining a proper proportion of goods among members of society, we may reduce the relations involved to mathematical terms. Suppose A and B have each initially ten units of goods. The relation between them is then one of equivalence, 10:10. A loses five of his units in reliance on a promise by B which B breaks. The resulting relation is 5:10. If, however, A paid these five units over to B, the resulting relation would be 5:15.20 This comparison shows why unjust enrichment resulting from breach of contract presents a more urgent case for judicial intervention than does mere loss through reliance not resulting in unjust enrichment.

Fuller, *supra* note 11 at 813.

buyer's order.[97] The third substantive basis of contract liability identified by Fuller is private autonomy, in the spirit of the freedom of contract, and it is the shining star of his 1941 paper.

Fuller's treatment of private autonomy in contract provides a glimpse into his eunomics. Look at how he thinks legal doctrine empowers a society to organize its division of labor and allocation of resources free from dictatorship and socialism:

> In modern society the most familiar field of regulation by private autonomy is that having to do with the exchange of goods and services. Paradoxically, it is when contract is performing this most important and pervasive of its functions that we are least apt to conceive of it as a kind of private legislation. If A and B sign articles of partnership we have little difficulty in seeing the analogy between their act and that of a legislature. But if A contracts to buy a ton of coal from B for eight dollars, it seems absurd to conceive of this act as species of private law-making. This is only because we have come to view the distribution of goods through private contract as a part of the order of nature, and we forget that it is only one of several possible ways of accomplishing the same general objective. Coal does not have to be bought and sold; it can be distributed by the decrees of a dictator, or of an elected rationing board. When we allow it to be bought and sold by private agreement, we are, within certain limits, allowing individuals to set their own legal relations with regard to coal.[98]

So for Fuller contract law is fundamentally about furthering private autonomy, even though not exclusively so (it is also about protecting reliance and guarding against unjust enrichment). In this sense—for Fuller as for Williamson—contract provides an instrument of governance akin to legislation and, thereby, grounds a social alternative to fiat and tradition.

The analytical challenge is that contract is an instrument of governance that comes with all kinds of baggage. That's because the specific way that the common law "allow[s] individuals to set their own legal relations"[99] has a provenance in assumpsit, with a theory of enforcement

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[97] Fuller cautions—for those making sense of *The Reliance Interest* together with *Consideration and Form*—that "[r]eliance as a basis of contract liability must not be identified with reliance as a measure of the promisee's recovery." *Id.* at 810.

[98] *Id.* at 809.

[99] *Id.*

rooted in a compensation logic. That gives contract law two simultaneous orientations.[100] On the one hand, contract law imposes a duty of interpersonal conduct, like the law of trespass in tort. This duty, in general terms, requires parties to act in conformity with their voluntary undertakings, lest they cause an injury on account of the counterparty's reliance thereon. On the other hand, the voluntariness of the undertakings that give rise to duties in assumpsit creates the conditions for parties to willingly alter their legal relations. This is like willingly procuring a sun tan by lying in the sun, where the sun in question is the counterparty's overt undertaking. By putting oneself in a position to have someone else make an assumpsit towards one (or vice versa), one gains a power to intentionally rely on a theory of tort that expands one's legal relationship with intentionally self-legislated duties. "When a court enforces a promise it is merely arming with legal sanction a rule or *lex* previously established by the party himself. This power of the individual to effect changes in his legal relations with others is comparable to the power of a legislature."[101] It is the reach of this law-making dimension of assumpsit that Fuller and I here are concerned to explore.

In a duty-imposing law, like tort is typically thought to be, obligations are court imposed. A power-conferring law, in contrast, parts from a policy judgment that courts should be basically "indifferen[t] as to which of a number of alternative relationships the parties decide to enter. Their purpose is to make sure, first, that the parties know what they are doing, and, second, that the judge will know what they did."[102] *Formality* is the way courts can make sure that alterations

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[100] For this reason, Gregory Klass describe modern contract law as a "compound rule." *See generally* Klass, *supra* note 87.

[101] *Id.* at 806-07. Fuller puts this act of self-legislation conceptually in common ground with the *in rem* theories of the formal contracts. "This principle simply means that the law views private individuals as possessing a power to effect, within certain limits, changes in their legal relations." *Id.* at 806. Accordingly, "[t]he man who conveys property to another is exercising this power; so is the man who enters a contract." *Id.*

[102] Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1691-92 (1976).

of legal relations were willed in a way that courts can assess.[103] Thus, Fuller's objective in *Consideration and Form* is to provide an account of the role of formality in legitimating the power-conferring role of contract law—that which is responsive to private autonomy as a substantive base of liability—so as to apply the account critically to existing doctrine. "From the fact that a principle of private autonomy is recognized it does not follow that this principle should be given an unlimited application. Law-making by individuals must be kept within its proper sphere, just as, under our constitutional system, law-making by legislatures is kept within its field of competence by the courts."[104] Ultimately, the problem for power-conferring legal doctrine is to answer the following question: "What is the proper sphere of the rule of private autonomy?"[105] Fuller develops an answer that bounds this sphere through an account of formality.

Fuller bases his account of legal formality in contract on the functions of formality, and he identifies three that are related and distinct: the evidentiary, the cautionary, and the channeling functions.[106] Duncan Kennedy provides a concise gloss of these three functions as applied to contract:

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[103] *Id.*

[104] Fuller, *supra* note 11 at 808-09.

[105] *Id.*

[106] Writing almost a decade before Fuller, Morris Cohen contributes to the conversation about formality that recognizes the role of ceremony:

> The history of forms and ceremonies in the law of contract offers an illuminating chapter in human psychology or anthropology. We are apt to dismiss the early Roman ceremonies of *mancipatio, nexum*, and *sponsio*, the Anglo-Saxon *wed* and *borh*, or the Frankish ceremonies of *arramitio, wadiatio*, and of the *festuca*, as peculiar to primitive society. But reflection shows that our modern practices of shaking hands to close a bargain, signing papers, and protesting a note are, like the taking of an oath on assuming office, not only designed to make evidence secure, but are in large part also expressions of the fundamental human need for formality and ceremony, to make sharp distinctions where otherwise lines of demarcation would not be so clearly apprehended.
>
> Ceremonies are the channels that the stream of social life creates by its ceaseless flow through the sands of human circumstance. Psychologically, they are habits; socially, they are customary ways of doing things; and ethically, they have what Jellinek has called the normative power of the actual, that is, they control what we do by creating a standard of respectability or a pattern to which we feel bound to conform. The daily obedience to the act of the government, which is the

> The reasons for imposing this kind of formal requirement, according to Fuller, were three: (1) to provide good evidence of the parties' agreement, (2) to make sure that they thought carefully before making the kind of promise in question, and (3) to make sure that they understood and could organize their behavior around a very clear distinction between legally enforceable and unenforceable promises.[107]

Formality is the vehicle for attaining the "definite marks"[108] needed to fulfill these three functions. Doing so well enough enables courts to remain indifferent about the substance of the

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> basis of all political and legal institutions, is thus largely a matter of conformity to established ritual or form of behavior. For the most part, we obey the law or the policeman as a matter of course, without deliberation. The customs of other people seem to us strange and we try to explain them as ceremonies symbolic of things that are familiar or seem useful to us. But many of our own customs can appear to an outsider as equally non-rational rituals that we follow from habit. We may justify them as the sacred vessels through which we obtain the substance of life's goods. But the maintenance of old forms may also be an end in itself to all those to whom change from the familiar is abhorrent.

Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 582-83 (1933).

[107] Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form"*, 100 COLUM. L. REV. 94, 102 (2000) (notes omitted). In his classic paper, *Form and Substance in Private Law Adjudication*, Kennedy takes the position that Fuller's three functions are reducible to two:

> The cautionary function, as I use it, includes both making the parties think twice about what they are doing and making them think twice about the legal consequences. The evidentiary function includes both providing good evidence of the existence of a transaction and providing good evidence of the legal consequences the parties intended should follow. For our purposes, it is unnecessary to subdivide further.

Kennedy, *supra* note 102 at 1778 n. 14. Here is a further decomposition of the concepts by Kennedy:

> These are often referred to as the cautionary and evidentiary functions of formalities. Thus the statute of frauds is supposed both to make people take notice of the legal consequences of a writing and to reduce the occasions on which judges enforce non-existent contracts because of perjured evidence. Although the premise of formalities is that the law has no preference as between alternative private courses of action, they operate through the contradiction of private intentions. This is true whether we are talking about the statute of frauds, the parol evidence rule, the requirement of an offer and acceptance, of definiteness, or whatever. In every case, the formality means that unless the parties adopt the prescribed mode of manifesting their wishes, they will be ignored. The reason for ignoring them, for applying the sanction of nullity, is to force them to be self-conscious and to express themselves clearly, not to influence the substantive choice about whether or not to contract, or what to contract for.

Id. at 1691-92 (notes omitted).

[108] Karl N. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704, 738 (1931) ("In all legal systems the effort is to find definite marks which shall at once include the promises which ought to be enforceable, exclude those which ought not to be, and signalize those which will be."). Fuller quotes the German jurisprude von Ihering for further intuition.

parties' deal, enforcing its terms as selected by the parties (subject to certain institutional constraints on enforcement).[109] So the instrument that has the seal is marked off as definitive evidence of the obligations voluntarily assumed by the obligor (evidentiary). Knowing that the instrument will be sealed and signed warns the potential obligor that legal relations will be changed thereby (cautionary). Think of the palpability of solemnity experienced by the present day mortgagor-borrower who sits in a bank's office beholding the closing set of documents, the very act of signing that will trigger the physical handing over of keys to the front door of the new house. Finally, the presence of the seal on the formal instrument—and not on other papers—identifies the scope of the legal obligations being assumed thereby (channeling).[110] What, though, has all this to do with consideration and assumpsit? That is the more concrete, doctrinal question that Fuller proceeds to tackle.

> Form is for a legal transaction what the stamp is for a coin. Just as the stamp of the coin relieves us from the necessity of testing the metallic content and weight—in short, the value of the coin (a test which we could not avoid if uncoined metal were offered to us in payment), in the same way legal formalities relieve the judge of an inquiry whether a legal transaction was intended, and—in case different forms are fixed for different legal transactions—which was intended.

Fuller, *supra* note 11 at 801.

[109] Fuller explains further how formality underwrites courts' deference to the parties' expressions of private autonomy:

> Where men make laws for themselves it is desirable that they should do so under conditions guaranteeing the desiderata described in our analysis of the functions of form. Furthermore, the greater the assurance that these desiderata are satisfied, the larger the scope we may be willing to ascribe to private autonomy. A constitution might permit a legislature to pass laws relating to certain specified subjects in an informal manner, but prescribe a more formal procedure for "extraordinary" enactments, by requiring, for example, successive readings of the bill before it was put to a vote. So, in the law of contracts, we may trust men in the situation of exchange to set their rights with relative informality. Where they go outside the field of exchange, we may require a seal, or appearance before a notary, for the validity of their promises.

Id. at 814.

[110] According to Fuller, "form offers a legal framework into which the party may fit his actions, or, to change the figure, it offers channels for the legally effective expression of intention. It is with this aspect of form in mind that I have described the third function of legal formalities as 'the channeling function.'" *Id.* at 801.

The analysis of the formality of consideration starts with the case he endows with special normative valence. This is the "contractual archetype." As the contractual archetype, this case provides a benchmark for a level of formality that legitimates enforcement as a matter of private autonomy.[111] Downward deviations from the contractual archetype in the functionality (evidentiary, cautionary, channeling) of the formalities performed call into question the legitimacy of private autonomy as a substantive base of liability. Depending on the extent of the deviation, courts should withhold enforcement, or demand additional formalities to compensate for the deficiencies evidenced.

For Fuller the contractual archetype is the "half-completed exchange."[112] A half-completed exchange is only partially executory: one party to the deal has tendered entire consideration, such as cash payment, whereas the consideration provided by the other party comes at closing in the form of a promise, such as a promise to deliver a good. Fuller's specific example recalls Corbin's[113]: "*A* delivers a horse to *B* in return for *B*'s promise to pay him ten dollars; *B* defaults on his promise, and *A* sues for the agreed price."[114] Note that it is significant to Fuller that reliance and restitution reinforce the rationale for enforcement in this case.[115] Nevertheless, he finds that "[o]n the side of form, the delivery and acceptance of the horse involves a kind of natural formality, which satisfies the evidentiary, cautionary, and channeling

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[111] Arguably, Fuller relies upon reliance and restitution as substantive bases of liability in supporting this legitimacy. In fact, though, our conceptualization of reliance (not so much restitution) concepts depends heavily on the existence of an assumpsit, of an undertaking that can give a horse doctor liability for the death of a horse poorly tended. The role of private autonomy in voluntary human interaction, the suggestion is, goes very deeply to the nature of the injuries resulting out of such contexts. This issue requires careful thought beyond the scope of this section. *See infra* text accompanying note 115.

[112] Fuller, *supra* note 11 at 815.

[113] *See supra* text accompanying note 89.

[114] Fuller, *supra* note 11 at 815

[115] *Id.* at 811 (noting that "[a]fter reliance, however, the court may be willing to incur the hazards involved in enforcing an indefinite agreement where this is necessary to prevent serious loss to the relying party"); *id.* at 815 (noting that unjust enrichment and detrimental reliance support enforcement in a "half-completed" exchange).

purposes of formalities."[116] Physically giving away the horse provides "evidence of the existence and purport of the contract, in case of controversy."[117] This act of tendering the horse also "perform[s] a cautionary or deterrent function by acting as a check against inconsiderate action."[118] Finally, the exchange that is consummated by the delivery of the horse "serves also to mark or signalize the enforceable promise; it furnishes a simple and external test of enforceability."[119] In sum, handing over, and receiving, that cow puts the parties clearly on notice that by their voluntary action and with transparent enough terms legal relations are transforming, endowing the exchange with a solemnity that is palpable even to Corbin's ignorant person.[120]

This account of consideration as formality lays the foundation for Fuller's critical agenda, which is to question the widespread "assum[ption] that so far as consideration is concerned the executory bilateral contract[121] is on a complete parity with the situation where the plaintiff has already paid the price of the defendant's promised performance."[122] Displace the tendering of the cow to the future and we have a promised cow swapped for a promised check. The gravitas of the deal is deflated.

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[116] *Id.* at 815.

[117] JOHN AUSTIN, *Fragments-On Contracts*, *in* 2 LECTURES ON JURISPRUDENCE 939-944 (4th ed. 1879) (as quoted by Fuller, *supra* note 11 at 800).

[118] Fuller, *supra* note 11 at 800.

[119] *Id.* at 801.

[120] Relatedly, Williston observes that,

> There was but little discussion or theorizing about mutual assent in the cases on assumpsit until nearly the end of the eighteenth century; and the basis of the action was conceived to be consideration rather than the mutual will of the parties. That the plaintiff had parted with something in reliance upon the defendant's promise, and that the defendant had made his promise in return for something requested by him, were the essential facts on which the earlier cases were decided.

Freedom of Contract, 6 Cornell L. Q. 365, 368 (1921).

[121] This is another way of referring to the contract that results from a wholly executory bargain, i.e., a promise exchange for a promise.

[122] Fuller, *supra* note 11 at 816.

> On the side of form, we have lost the natural formality involved in the turning over of property or the rendition and acceptance of services. There remains simply the fact that the transaction is an exchange and not a gift. This fact alone does offer some guaranty so far as the cautionary and channeling functions of form are concerned, though, except as the Statute of Frauds[123] interposes to supply the deficiency [by making the deal unenforceable if unwritten in certain contexts], evidentiary safeguards are largely lacking. This lessening of the factors arguing for enforcement not only helps to explain why liability in this situation was late in developing,[124] but also explains why even today the executory bilateral contract cannot be put on complete parity with the situation of the half-completed exchange.[125]

Because Fuller hangs the judicial enforceability of the parties' private autonomy on the capacity of consideration to serve these formal functions in the *ex ante* exchange, he questions a proposition that remains black-letter law today:[126] that informal contracts are, in terms of their enforceability, created equal regardless the form of consideration.

In the case of wholly executory contracts, though, important safeguards of formality are greatly diminished when the exchange that celebrates a contract involves nothing of economic value—besides the parties' words.[127] This is why Fuller thinks the claim to enforceability is weak or missing in these cases. Moreover, in his understanding of the case law,[128] courts actually

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[123] The Statute of Frauds heightens formality in certain subject-matter areas of contract, such as sales of land. Where it applies, a writing is required evidencing the terms of the deal.

[124] *See supra* note 92.

[125] Fuller, *supra* note 11 at 816-817.

[126] *Id.* at 816 ("It is now generally assumed that so far as consideration is concerned the executory bilateral contract is on a complete parity with the situation where the plaintiff has already paid the price of the defendant's promised performance."). RESTATEMENT (FIRST) OF CONTRACTS § 77 (1932) ("Except as qualified by §§ 78-80, any promise whether absolute or conditional is a sufficient consideration."); RESTATEMENT (SECOND) OF CONTRACTS § 72 (1981) ("Except as stated in §§ 73 and 74, any performance which is bargained for is consideration.").

[127] *Cf.* Roscoe Pound, AN INTRODUCTION TO THE PHILOSOPHY OF LAW 157 (rev. ed. 1954) (noting that "the reluctance of courts to apply the ordinary principle of negligence to negligent speech" has "persisted because of a feeling that 'talk is cheap,' that much of what men say is not to be taken at face value, and that more will be sacrificed than gained if all oral speech is taken seriously and the principles applied by the law to other forms of conduct are applied rigorously thereto").

[128] Which I have no reason to doubt.

decide cases consistently with this normative proposition: wholly executory contracts rarely get enforced as a matter of private autonomy.[129]

Having set forth the form of Fuller's argument that the claim of enforceability in the wholly executory exchange is far outranked by the enforceability of the contractual archetype, I move on to consider the substantive reach of contract law by deviating from Fuller's contractual archetype along several further dimensions and considering how a different sort of formality might address those deviations.

2.3 *Formality in First-Order Perfection: Damages*

Fuller's model of the 'contractual archetype' provides a benchmark for the evaluation of the formality required before courts should (or do) enforce party-selected terms.[130] In this section, I examine the role of verbalization, by which I mean the articulation of terms, as a formality that can surmount further deviations from the contractual archetype considered in the next two sections. Strikingly, Fuller says next to nothing about verbalization as a formality in contract (his challenge to the enforceability of wholly executory contracts does not require him to do so).[131]

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[129] As noted earlier, *supra* text preceding note 95, whether he is right or wrong here is immaterial to my argument. Nevertheless, it is worth noting the suggested potential for the actual case law to deviate markedly from black letter doctrine.

[130] Fuller explains:

> Here our 'archetype' is the business trade of economic values in the form of goods, services, or money. To the degree that a particular case deviates from this archetype, the incentives to judicial intervention decrease, until a point is reached where relief will be denied altogether unless the attenuated element of exchange is reinforced, either on the formal side by some formal or informal satisfaction of the desiderata underlying the use of legal formalities, or on the substantive side by a showing of reliance or unjust enrichment, or of some special need for a regulation of the relations involved by private autonomy.

Fuller, *supra* note 11 at 818.

[131] The exception comes with a passing reference to Demogue who thought of the verbalization of the intention to enter into exchange as itself a formality:

> Demogue has suggested that even the requirement, imposed in certain cases, that the intention of the parties be express, rather than implied or tacit, is in essence a requirement of form. If our object is to avoid giving sanction to inconsiderate engagements, surely the case for legal redress is

Before proceeding, we need to dwell on the unverbalized nature of Fuller's contractual archetype. How can consideration without words yield an enforceable exercise in private autonomy good enough to label the contractual archetype? We have the purchase of a horse for $10. The sole word exchanged might precisely have been "ten," synchronized with the handing over of the horse. The important point to see here is that the sufficiency of "ten" as an exercise of private autonomy depends very much on the specific way the deal could fall apart. Where the breach of the deal arises from the buyer's decision to skip town without paying, or perhaps even from the buyer's unilateral decision to return the horse so as to buy from someone else, the absence of articulated terms seems unproblematic from the standpoint of the three functions of formality. The buyer acted exactly opposite to its undertaking: the parties had good (i) evidence of that, (ii) notice about the undertaking they were about to commit when the exchange was about and did occur, and (iii) understanding of the scope of the undertaking, even if unschooled in law. Notice that this inquiry was *retrospective*, asking whether the formality surrounding the exchange sufficed for enforcement in light of the actual breach.

Now what should a court do if confronted with just such a case of a horse buyer who wouldn't pay? Assumpsit calls for compensation of the party injured by breach.[132] The plaintiff

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> stronger against the man who has spelled out his promise than it is against the man who has merely drifted into a situation where he appears to hold out an assurance for the future." *Id.* at 806 (citing 1 TRAITÉ DES OBLIGATIONS EN GENERAL (1923) 280).

Note the very narrow scope of potential verbalizations parties could have about a bargain that are covered by this reference. As noted earlier, *supra* text accompanying note 123, Fuller also observes the Statute of Frauds, but strictly this appears closer to the requirement of the seal than to verbalization as a formality. To be sure, the Statute of Frauds creates the space for the verbalization of terms before a deal closes.

[132] Justice Holmes gives a realistic account of bargaining.

> It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event.

Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543, 23 S. Ct. 754, 755, 47 L. Ed. 1171 (1903). Charles Fried adds:

> It is, of course, the case that many, perhaps most, contracts do not specify remedies in the event of breach. Indeed, all contracts fail to specify the parties' intentions in respect to matters that ex ante

should get paid as agreed, and as Fuller notes, principles of restitution and reliance bolster enforcement of the plaintiff's private autonomy.

What this analysis so far ignores is that the parties can take steps to displace the primacy of the compensation paradigm inherent in assumpsit by undertaking the additional formality of articulating the consequences of non-performance as part of their deal. This act of autonomy amounts to perfection with respect to the disruption that is the defendant's change of heart: the parties plan for a change of heart by pricing the consequence of such a breach, rather than leaving this to courts as a matter of *ex post* compensation.[133] Without this brand of perfection, parties have no chance to set their own terms in court. For this reason, and to distinguish from the brand of perfection that has been discussed this far and the further varieties I will discuss next two sections, I will this *first-order* perfection: perfection as to the consequences of one party's reneging on the deal under the very conditions anticipated and knowingly priced into the deal.

Contracts theorists Robert Scott and George Triantis have recently called for contract law to supersede the compensation paradigm inherent in assumpsit, such that "the consequences that

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> seem quite remote and, at any rate, not worth spelling out. So courts are regularly called upon to fill in details that only ex post may loom large. This is a task that *Contract as Promise* discussed under the term "gaps": "The gaps cannot be filled, the adjustments cannot be governed, by the promise principle."

Charles Fried, *Contract As Promise Thirty Years on*, 45 SUFFOLK U. L. REV. 961, 960-71 (2012). *See infra* Section 2.7.

[133] The concept of perfection is best known in the context of security interests: whereas a simple security agreement creates a contractual obligation, it takes perfection of that security interest to protect the interest from competing creditors in case of the debtor's bankruptcy. See, e.g., UNIF. COMMERCIAL CODE § 9-312 ("A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing."). This is readily accomplished by filing a copy of the agreement with the relevant state authority. As I develop the concept, perfection of a performance obligation protects the parties, not so much from third parties, but from each other in the case of changes in circumstances that cast doubt on the reach of the parties' performance obligations. Just like perfection of a security interest puts third parties on notice of its existence, perfection of a performance obligation is a formality that puts the parties (and a court) on notice that performance is expected or is not to be expected in case of this or that disruption with resulting losses to be allocated thus and so. This notice is valuable in itself—just like the notice provided to third parties with the perfection of a security interest—but for purposes of adjudication the heart of perfection lies in the evidence that reveals the reaches of the exchange that was formalized through the consideration.

should flow from nonperformance of the main subject of the contract"[134] get worked out entirely by the parties as options.[135] Seen in this light:

> The buyer holding an option has the right to avoid the exchange by paying either a termination fee or damages. The price of an embedded option is determined just as the price of any other product: It is a function of the option's value to the option holder, the cost to the option writer, and the competitiveness of the market in which they transact. Options are essentially insurance contracts that divide risks according to their respective exercise prices.[136]

Suppose the horse buyer and seller agreed that non-payment the following day would entail the buyer's obligation to pay $15 rather than $10 (like a late fee). Then the horse buyer would have the option to pay $10 one day after taking the horse, or $15 on the second day (perhaps a quick-turn around opportunity for arbitrage on the $5 arose). The key point is that agreeing to the consequences of non-performance transforms the first-order role of a court in a contracts dispute from assessing *injury* to enforcing private autonomy as such. As a matter of fact, what is fueling Scott and Triantis's argument is not concerns over compensation of broken horse trades but the endurance of a doctrine known as the rule against penalties that says that private autonomy concerning non-performance remains circumscribed by a compensation rationale: if the judgment required by the parties exceeds the judgment a court would impose the difference is seen as a "penalty clause" and remains unenforceable according to black-letter doctrine.[137] Because

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[134] Barbara H. Fried, *The Holmesian Bad Man Flubs His Entrance*, 45 SUFFOLK U. L. REV. 627, 629 (2012).

[135] Robert E. Scott & George G. Triantis, *Embedded Options and the Case Against Compensation in Contract Law*, 104 COLUM. L. REV. 1428, 1429 (2004) ("Rather than conceiving of damages as compensation, the right to breach and pay damages is better understood as a valuable option sold by the promisee to the promisor.").

[136] *Id.* at 1430.

[137] *Id.* at 1429 ("Rather than conceiving of damages as compensation, the right to breach and pay damages is better understood as a valuable option sold by the promisee to the promisor."); George Triantis, *Promissory Autonomy, Imperfect Courts, and the Immorality of the Expectation Damages Default*, 45 SUFFOLK U. L. REV. 827, 828 (2012) (noting that "if the parties are morally free to condition their promises, they should also be free to set their own level of damages"). *See also* Richard A. Epstein, Beyond Foreseeability: Consequential Damages in the Law of Contract, 18 J. LEGAL STUD. 105, 137 (1989) (arguing "that the question of contract damages can be examined by the same techniques that are ordinarily

"expectation damages [and other measures of damages] may not be preferred by parties," especially in case of parties contracting to extend credit or transfer risk,[138] its imposition by courts, like when a liquidated damages clause is struck down as super-compensatory, undermines the principle of private autonomy driving Scott and Triantis's critique.[139]

First-order perfection, executed through express verbal agreement over the consequences of non-performance, should be thought of as a *positive* deviation from the contractual archetype: the formality of perfection in respect of non-performance (in the fair-weather case, i.e., defendant's change of heart) leaves evidence of the intended consequence of non-performance and demonstrates to a court that the parties considered this possibility before consummating the deal. Enforceability of private autonomy is especially high in such a case (leaving aside the complications of the rule against penalty damages) and overshadows the reliance and restitution roles in the courtroom.

2.4 *Formality in Second-Order Perfection: Indefiniteness*

Bargains with *indefinite* terms deviate from the contractual archetype *negatively*. Suppose that, instead of agreeing to pay a sum certain for the horse ($10), the buyer merely said "I'll pay you tomorrow."[140] This may be analyzed as a defect with the buyer's consideration, and yet a

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used to handle other issues of contract interpretation"); *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 543 (1903) (Holmes, J.) ("[U]nlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured.").

[138] Triantis, *supra* note 137 at 837.

[139] As I will discuss below, what makes non-enforcement of a liquidated damages clause especially inconsistent with Scott's view is the rationale that compensation presents a ceiling on damages. A different rationale, such as one advanced by Seana Shiffrin, *see infra* note 296 and accompanying text, may avoid this inconsistency even while refusing to enforce a liquidated damages term as agreed. *See* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007) (arguing that the justification for a law, and not only the substance of the law, is morally significant).

[140] Indefiniteness often afflicts the price term of a deal as the following examples from Williston's treatise suggest: "'not exceeding $300 a week,' the cost plus a 'nice' profit, a division of profits 'upon a very liberal basis.'" *See* 1 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 41 at 131-32 (Walter H. E. Jaeger ed., 3d ed. 1957) (noting that when "the terms of a promise exclude the supposition that the

commitment to pay has been evidenced and accepted by the seller in exchange for the horse. What result, though, if the buyer fails to pay? In principle, the court would want to enforce the bargain as in the $10 case. The problem is that a court's hands are tied in enforcing the parties' private autonomy. The parties simply left no evidence of their deal if things went right (how much to pay?), much less if things went wrong (what if the buyer doesn't pay?).[141] In sum, a court could possibly step into this contracts dispute, but it would be falling back on the other substantive bases of liability to do so.[142]

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reasonable or market price was intended" the absence of a price term means that "no contract can arise"). Time terms also lend themselves to indefiniteness: "a promise for a 'long engagement' or 'so long as conditions warrant'"). *Id.* § 39 at 124. The problem manifests broadly according to one of two difficulties (which may overlap): first, determining whether the obligation was breached, as with "a promise to pay a note 'if the grain market shall advance enough to justify it;' or to pay a lawyer's fee 'as I am able,'" *Id.* §47 at 152-53, and second, determining what the plaintiff should recover in light of breach, as with "a promise to apply 'part' of certain wages to a debt; or to pay 'part of the cost of a building,' or . . . a promise to 'help another out on his pay roll.'" *Id.* at 153.

[141] As Judge Posner points out, "the common law principle that a contract cannot be enforced if its terms are indefinite" grooves with the way the lack of formality stretches the courts' institutional competence:

> If people want the courts to enforce their contracts they have to take the time to fix the terms with reasonable definiteness so that the courts are not put to an undue burden of figuring out what the parties would have agreed to had they completed their negotiations.

Goldstick v. ICM Realty, 788 F.2d 456, 461 (7th Cir. 1986) (citing E. ALLAN FARNSWORTH, CONTRACTS § 3.27 (1982)). Normatively, Posner does not rest on private autonomy but rather sees autonomy as an instrument of social efficiency. So goes his reasoning: "The parties have the comparative advantage over the court in deciding on what terms a voluntary transaction is value-maximizing; that is a premise of a free-enterprise system."

[142] The other theoretical option is for the court to make up the missing terms on the parties' behalf and enforce the contract as if it were the product of private autonomy. Fuller made his name in contracts questioning these kinds of determinations. In *Consideration and Form*, he notes the "hazards involved in enforcing an indefinite agreement" *See* Fuller, *supra* note 11 at 811. And in a letter to Corbin concerning a casebook they contracted to do, but never did, Fuller demonstrates why indefiniteness undermines a purported act of private autonomy.

> Your present first section also raises the problem of "indefiniteness." This in turn raises the following questions: (1) Will reliance by the plaintiff cure the objection of "indefiniteness" and make the court willing to enforce a contract it would not enforce in the absence of such reliance? (2) If the basis of judicial intervention is the protection of reliance, will the measure of recovery be in terms of reliance, or in terms of the expected profit? (There are cases both ways.) (3) If the court declares the contract too vague to give rise to any suit "on" it, is there a chance of quasi-contractual recovery?

Fuller letter to Corbin, Nov. 24, 1941, *in* Gerber, *supra* note 95 at 617-18. The difficulty of answering these sorts of questions without an appreciation for remedies was marshaled by Fuller in support of his view that

The indefiniteness of a bargain risks leaving the parties without judicial enforceability, a state of judicial forbearance. I have shown how the problem is helpfully conceived as a lack of formality: the parties may have had a bargain but they failed to articulate the terms required for a court to ascertain the fulfillment of the evidentiary, cautionary and channeling functions of formality.

Whenever a court stays out of a dispute for want of formality, the parties are left to each other's mercy, the enforceability of their bargain forgone (perhaps a reliance or restitution remedy is available). Kennedy labels this consequence the "sanction of nullity":

> The parties are told that unless they use the proper language [or other formality] in expressing their intentions, they will fail of legal effect. The result will be that a party who thought he had a legally enforceable agreement turns out to be vulnerable to betrayal by his partner. The law will tolerate this betrayal, although the whole purpose of instituting a regime of enforceable promises was to prevent it.[143]

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remedies should come first in a casebook. In the casebook he had in mind (and ultimately published as sole author) the first chapter on remedies

> would incidentally take up the problem of indefinite contracts, and show how restitution would be granted generally no matter how vague the contract, that what I call "the reliance interest" would, in case the contract were a little more definite, receive either direct (see Kearns v. Andree, 107 Conn. 181) or indirect (*see Morris v. Ballard*) recognition, and that the courts would be least inclined to protect the expectancy.

Fuller's letter to Corbin Oct. 7, 1940, in *id.* at 604. Charles Fried recognized the self-sufficient legitimacy of the reliance interest over thirty years ago: "American development, I believe, shows that compensation for reliance losses need not compete with the promise principle, but may comfortably supplement it." Charles Fried, *The Rise and Fall of Freedom of Contract. by P.S. Atiyah. Oxford: Clarendon Press, Oxford University Press. 1979. Pp. Xi, 791. $49.50.*, 93 HARV. L. REV. 1858, 1867 (1980); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 34(3) ("Action in reliance on an agreement may make a contractual remedy appropriate even though uncertainty is not removed.").

[143] Kennedy, *supra* note 102 at 1743. Kennedy recognizes the fundamental limitation with formality:

> In the context of formalities the problem is that general rules will lead to many instances in which the judge is obliged to disregard the real intent of the parties choosing between alternative legal relationships. For example, he will refuse to enforce contracts intended to be binding (underinclusion), and he will enforce terms in agreements contrary to the intent of one or even both parties (overinclusion). Since we are dealing with formalities, this is an evil: the lawmaker has no substantive preferences about the parties' choice, and he would like to follow their wishes.

Id. at 1697 (notes omitted).

The sanction of nullity illustrates the paradox inherent in judicial reliance upon formality in the fulfillment of private (or legislative) autonomy.

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The paradox that a judicial approach designed to promote the exercise of private autonomy will, in some cases, yield outcomes that conflict with party intent is inherent in a jurisprudence of formality. The sanction of nullity prospectively promotes and reinforces the discharge of the second-order formality of spelling out terms definitely for all parties who seek judicial enforceability.

Many cases that have been grouped under the heading of indefiniteness doctrine have little to do with the vagueness of the unpriced horse sale. Perhaps this is why the Restatements have favored "certainty" as the doctrinal heading. Consider Justice Cardozo's opinion in *Sun Printing & Publishing Assn. v. Remington Paper & Power Co.*, summarized neatly by Professor Farnsworth as follows:

> The controversy arose out of a contract for the sale of 1,000 tons of paper each month for 16 months. The price for each of the first four months was stated in the agreement. For the remaining 12 months, the agreement contemplated one or more renegotiations, under which both the price and the period of its duration were to be agreed on by the parties, but the price was not to be higher than that charged by a named Canadian supplier. At the

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[144] *Id.* (notes omitted). Fuller elaborates on the paradox:

> It has been suggested that in some cases the courts might properly give an interpretation to a written contract inconsistent with the actual understanding of either party. What justification can there be for such a view? We answer, it rests upon the need for promoting the security of transactions. Yet security of transactions presupposes "transactions," in other words, acts of private parties which have a law-making and right-altering function. When we get outside the field of acts having this kind of function as their *raison d'etre*, for example, in the field of tort law, any such uncompromisingly "objective" method of interpreting an act would be incomprehensible.

Fuller, *supra* note 11 at 809.

> end of four months, in a rising market, the seller refused to make further deliveries and the buyer, after demanding delivery and offering to pay the Canadian supplier's price for the month of delivery, sued for breach of contract. The New York Court of Appeals held that the agreement was unenforceable. Because the parties were to agree on both the price and the period of its duration, the price would not automatically change when the Canadian supplier's price changed. If the Canadian price should rise, the buyer's concession that the price should be that price prevailing in one month would not, Cardozo explained, "bind it to proceed at the price prevailing in another." And if the Canadian price should fall, "without an agreement as to time, the maximum would be lowered from one shipment to another." The parties had guarded "against the contingency of failing to come together as to price" but not "against the contingency of failing to come together as to time." On the court's own reasoning, had the buyer offered to pay the Canadian supplier's highest price for the month of delivery or any preceding month during the period subject to agreement, instead of merely offering to pay the Canadian supplier's price for the month of delivery there would appear no reason to refuse to enforce the agreement.[145]

As with indefiniteness due to vagueness, the court lacks definite guidance to evaluate the existence of breach and to establish a suitable remedy. Unlike indefiniteness due to vagueness, the judicial obstacle is not bringing precision to an obligation that appears to have been agreed to, though too vaguely to support a definite remedy. The judicial obstacle in *Sun Printing* leads to the same sanction of nullity—or forbearance—as an instance of problematic vagueness but for a very different reason. The failure of formality was not expressly extending the bargain to the potential "contingency of failing to come together as to time."[146]

The formality that cures indefiniteness due to open terms, I suggest, is better conceptualized as a problem of a *third-order* perfection. The issue here is not one of second-order perfection, bringing definition to an obligation clearly bargained for (if indefinitely). As *Sun Printing* demonstrates, the problem with open terms is not on the spectrum of vagueness but binary in nature: either there is or there is not an obligation. In *Sun Printing*, the parties entered into a supply agreement that worked fine during the fair-weather conditions of the initial period,

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[145] E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 3.29 at 412-13 (2d ed. 1998) (notes omitted) (emphasis in the original).

[146] *See id.* §3.29 (reviewing "Indefiniteness in Agreements with Open Terms").

and they had set forth a skeleton of an agreement following the initial period. What they did not do is negotiate terms—*other than the de facto termination of the agreement*—in respect of the potential that they would not be able to agree to price and duration following the initial period. As Justice Cardozo explains,

> Very likely they thought the latter contingency [failing to come together as to time] so remote that it could safely be disregarded. In any event, whether through design or through inadvertence, they left the gap unfilled. The result was nothing more than 'an agreement to agree.'[147]

In other words, the breakdown in relations can be seen as a failure of third-order perfection (i.e., for disruption as an open term) of their bargain in respect of non-agreement.

The Restatements' conceptualization of the defect presented by indefiniteness of both kinds in terms of *certainty* is helpful, as the absence of certainty over the applicable circumstances is an apt characterization of the defect that bars the enforceability of an unperfected obligation, whether in the second or third order. The way to provide courts certainty is through formality, here, second-order perfection for indefiniteness in terms of vagueness and third-order perfection in respect of open terms.

2.5 *Formality in Third-Order Perfection: Disruption as an Open Term*

The deviation from the contractual archetype due to unplanned disruption is closely related to the problem of indefiniteness. A bargain that is unperfected in respect of a potential disruption as is the focus of this dissertation can also be seen as having an open term, like *Sun Printing*. Taking this perspective is exactly what perfectionistic construction demands of a court: refusing to read the defendant's performance obligation formalistically from the deal's verbal terms absent evidence of bargaining in respect of the disruption that thwarted performance. So in *Taylor v. Caldwell*, the leading case of excuse involving a bargain to let a theater that burns

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[147] 235 N.Y. at 345.

down, perfectionistic construction leads a court to ask the following question: what is required in case of destruction of the theater? Since the agreement (as we shall see below)[148] says nothing, and there is no other evidence the parties bargained around that potential disruption, the perfectionistic court finds an open term that falls outside the bargain and, thus, concludes there is no contract, as did Cardozo's Court of Appeals in *Sun Printing.* No enforcement of the bargain is awarded—forbearance means the sanction of nullity. But it is not because of the vagueness of defendant's obligation to make the theater available or, in *Sun Printing*, vagueness about the paper supplier's obligation to sell the buyer paper. It is because that definite enough obligation *was not evidently given reach* over the circumstances that obtained: in both cases, the court finds the parties left the performance obligation open in respect of the circumstances that obtained (burnt theater and lack of agreement on price and duration, respectively).

In contrast, certainty about enforceability in a case of "fair-weather breach" is easier to establish: less formality is required in retrospect. Formation and terms are easily determined because the simple terms consummated fit the facts. Therefore, the primary concern of a court in a fair weather breach case is to determine how to *compensate* the breach of contract, unless the parties have undertaken first-order perfection (i.e., pricing fair-weather breach as in 'price goes to $15 if buyer does not pay the next day'). But fair-weather breach is hardly the typical case presented in court. According to Alan Schwartz and Robert Scott, outside the case of take-the-money-and-run opportunism,[149] the fair-weather case usually gives parties no reason to regret their deal and breach.

> Two plausible theories help explain why people breach. First, contract parties sometimes breach inadvertently. . . . Second, a party has an incentive to breach when future events

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[148] *See infra* text accompanying note 153.

[149] *See supra* Section 1.6.

> cause him to regret having made the bargain. In other words, breach is often a function of changed circumstances.[150]

Changed circumstances can be (using Williamson's terms): inconsequential, consequential or highly consequential.[151] When they are highly consequential to the costliness of a party's performance obligation, strains are put on the functions of formality *in retrospect*. By stipulation, the parties did not plan for the highly consequential disruption in question. In evidentiary, cautionary and channeling terms, the way they closed the deal no longer goes so far in court. How can judges know what the parties bargained for under these circumstances? Could the parties really know what they were signing up for should this disruption (which they did not plan for or price) manifest?[152]

Consider the formality of the bargain struck by the parties in *Taylor v. Caldwell*:

> Agreement between Messrs. Caldwell & Bishop, of the one part, and Messrs. Taylor & Lewis of the other part, whereby the said Caldwell & Bishop agree to let, and the said Taylor & Lewis agree to take, on the terms hereinafter stated, The Surrey Gardens and Music Hall, Newington, Surrey, for the following days, viz. :—
>
> Monday, the 17th June; 1861,
> " " 15th July, 1861,
> " " 5th August, 1861,
> " " 19th August, 1861,
> for the purpose of giving a series of four grand concerts and day and night fêtes at the said Gardens and Hall on those days respectively at the rent or sum of 100l. for each of the said days.[153]

The articulation of terms here is far more thorough than the "ten" of the horse trade. This was necessary to specify with certainty the particularity of the far more intangible good being

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[150] ALAN SCHWARTZ AND ROBERT E. SCOTT, COMMERCIAL TRANSACTIONS: PRINCIPLES AND POLICIES 415 (1982).

[151] Williamson, *supra* note 19 at 272.

[152] *Cf.* Randy E. Barnett, *Contract Is Not Promise; Contract Is Consent*, 45 SUFFOLK U. L. REV. 647, 658 (2012) ("If the law is doing its boundary-defining job, each person should know, or be able to find out, what physical resources belong to her for her use, and what belongs to others, as well as how to use what is hers without interfering with the similar rights of others.").

[153] 3 B & S 826, 828 (1863).

exchanged by the parties (second-order perfection). Suppose now that between the date of the agreement and June 17, 1861, Caldwell and Bishop got an offer from another group to use the Music Hall the nights reserved by Taylor and Lewis. For whatever reason, Caldwell and Bishop prefer the other offer and renege on the deal with Taylor and Lewis. Taylor and Lewis would have a strong claim for breach of contract. Since they did not perfect the bargain in this regard (i.e., plan and price for such a breach), a court would default to assumpsit's compensation paradigm, evaluating how to make Taylor and Lewis whole.

Now suppose the variation in facts that actually obtained. The Music Hall burns down between the date of the agreement and the date of the first performance. According to a formalistic construction of the deal, the fire means that Caldwell and Bishop must almost certainly breach: there is no practicable way to do what they agreed to do.[154] What is a court to do if Taylor and Lewis sue? Is the court in a position to enforce the parties' private autonomy? There is a serious problem of formality.

Justice Blackburn, for the Queen's Bench, finds that "[t]he parties when framing their agreement evidently had not present to their minds the possibility of such a disaster."[155] This language reveals the difficulty that non-fulfillment of the evidentiary function of formality (given the circumstances that obtained) presents a court. Since the parties "made no express stipulation with reference to [the possibility of such a disaster], . . the answer to the question must depend upon the general rules of law applicable to such a contract."[156] The court is conceding that the principle of private autonomy, on its own, cannot resolve the dispute. As Charles Fried says, "on

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[154] To underscore the "inappropriateness of the term 'impossibility'" which colors doctrine in such cases (which was demoted in favor of impracticability as the umbrella term), Fuller suggests that "it is probable that the lessors in *Taylor v. Caldwell* . . . by the expenditure of huge sums could have rebuilt the Music Hall in time for the scheduled concerts." FULLER, *supra* note 6 at 661.

[155] 3 B & S at 833.

[156] *Id.*

the issues in question, the parties *had no will at all*."[157] Had they discussed the risk, Caldwell and Bishop might very well have agreed to be liable to Taylor and Lewis in case they could not make the facilities available. But what liability would they have agreed to bear? Insuring an estimate of lost profits? Perhaps they would have agreed to refund Taylor and Lewis's wasted investments in preparing for the show?[158] Or to pay a flat rate, i.e., liquidated damages? And, in respect of any of these alternatives, how can we know whether Caldwell and Bishop would have taken on express liability without any additional payment? And if they would have required payment, how can we know how much?

Formalistic construction stumbles on these questions in the absence of perfection of the parties' obligations in respect of the disruption that actually obtains.

> That there is in the instant case a lack of evidentiary and cautionary safeguards is obvious. As to the channeling function of form, we may observe that the promise is made in a field where intention is not naturally canalized. There is nothing here to effect a neat division between tentative and exploratory expressions of intention, on the one hand, and legally effective transactions, on the other. In contrast to the situation of the immediate gift of a chattel (where title will pass by the manual tradition), there is here no 'natural formality' on which the courts might seize as a test of enforceability.[159]

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[157] CHARLES FRIED, CONTRACT AS PROMISE 65 (1980) (emphasis in the original).

[158] FRIEDRICH KESSLER & GRANT GILMORE, CONTRACTS, CASES AND MATERIALS 785 (2d ed. 1970) (noting that "plaintiffs were suing to recover money spent in advertising the concerts and in other unspecified preparations"). Justice Holmes provides a helpful bridge between the old and the new classicism:

> When a man makes a contract, he incurs, by force of the law, a liability to damages, unless a certain promised event comes to pass. But, unlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured. The old law seems to have regarded it as technically in the election of the promisor to perform or to pay damages. *Bromage* v. *Genning*, 1 Rolle, 368; *Hulbert* v. *Hart*, 1 Vern. 133. It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter.

Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. at 543.

[159] Fuller, *supra* note 11 at 815.

Perfection (in the third order) is that natural process that can give shape to an exchange through agreement terms that demonstrate that each party paid or got paid (with money or other valuable consideration) for a performance that was defined not generally or vaguely, i.e., in an unperfected manner, but through dickering over the manifested contingency of disruption and loss.[160] In adjudicating a perfected obligation, a court has a tangible basis for finding that liability over the disruption that sent the case to court was (or was not) part of the bargain.[161]

Perfecting agreements, as transactional attorneys know implicitly, makes an enormous difference (a difference parties sometimes prefer not to make).[162] Parties can exert increasing amounts of control over the allocation of liabilities in case of non-performance the more carefully they negotiate, exchange and articulate[163] a definite array of obligations and liabilities subject to conditions that account for the possibility of disruption and loss. Even the simplest commercial loan agreement demonstrates that the varieties of potential breach are clearly written into the agreement as events of default that trigger specific rights for the creditor and the debtor. If Taylor, Lewis, Caldwell and Bishop had made an express part of their exchange that Caldwell and Bishop would be responsible for any of Taylor and Lewis's reasonable investments in preparing for the show in case the facilities could not be made available,[164] there is every reason to think a court would have honored the terms with a judgment based, not on evaluation of compensation due

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[160] *See* Richard Craswell, *Promises and Prices*, 45 SUFFOLK U. L. REV. 735, 736 (2012) (criticizing philosophers for failing to take account of the role of pricing in contract).

[161] Breach of contract cases involving no unanticipated disruption are atypical, but in any event, the obligation to perform over the "fair-weather" facts that motivated the unperfected bargain in the first place cannot be gainsaid, by party or court. The point is that the remedy in such a case falls under the law of unperfected obligations.

[162] See Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641 (2003) (inquiring why many parties enter into indefinite agreements that rely upon self-enforcement).

[163] Documenting in writing the articulated obligations in writing is helpful but not essential in this account. The issues raised by the parol evidence rule fall mostly outside my project.

[164] *See infra* note 318.

Taylor and Lewis for the civil wrong of failing to make the facilities available, but rather on the term stipulated by the parties as an exercise in private autonomy.[165]

The question for the next section is to what extent and in what ways does existing law, FCwE, recognize third-order perfection (hereinafter "perfection" whenever unqualified).

2.5 *(Third-Order) Perfection in Black-Letter Contract Law*[166]

My objective in this section is to demonstrate that while courts acknowledge the creditability of perfection, they do not require it of parties as a condition to enforcement. To the contrary, in cases of unplanned disruption, courts either enforce contracts to the full extent of the terms actually formalized by the parties (formalistic construction) or they write the parties' contract on their behalf with excuse doctrine. I will begin by reintroducing excuse doctrine, this time doctrinally,[167] emphasizing its rationale for looking past the absence of perfection where it is found lacking around disruption, as a preliminary to discussing ways courts do credit perfection.

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[165] See RESTATEMENT (SECOND) OF CONTRACTS § 261 ("Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, *unless the language or the circumstances indicate the contrary*.") (emphasis supplied).

[166] By referring to black-letter law, I mean to refer to the law of the casebook, the second Restatement and treatises as a set much more so than the law that would emerge from a grounded-theory evaluation of every contracts case decided in every United States jurisdiction. The latter was precisely Arthur L. Corbin's research question: he read the advance sheets for every opinion marked as a contracts decision in the United States for decades. *See* Joseph M. Perillo, *Twelve Letters from Arthur L. Corbin to Robert Braucher*, 50 WASH. & LEE L. REV. 755 (1993).

It is worth recognizing that formalistic construction is alive and well in the courts today, as the following language from the Michigan Supreme Court demonstrates.

> [U]nless a contract provision violates law or one of the traditional defenses to the enforceability of a contract applies, a court must construe and apply unambiguous contract provisions as written. We reiterate that the judiciary is without authority to modify unambiguous contracts or rebalance the contractual equities struck by the contracting parties because fundamental principles of contract law preclude such subjective post hoc judicial determinations of "reasonableness" as a basis upon which courts may refuse to enforce unambiguous contractual provisions.

Rory v. Cont'l Ins. Co., 473 Mich. 457, 461, 703 N.W.2d 23, 26 (2005).

[167] *See supra* Section 1.8 (introducing the function of excuse doctrine).

By doing so, I will show that this approach, FCwE, cannot mimic demandingness about the formality of perfection. It is its nature to be *un*demanding about the formality of perfection.

Under a pure version of formalistic construction—one that never lets the defendant off the hook of the deal's verbal terms—the formality of perfection is credited but not required. This is precisely what the *Paradine v. Jane* court is understood to have held in saying: "when the party by his own contract creates a charge upon himself, he is bound to make it good, if he may, notwithstanding accident by inevitable necessity, because he might have provided against it by his contract." The "charge" of the verbalized terms gets extended to their maximal reach (*perfection not required for enforcement*) *unless* the parties' formally qualified that reach (*perfection credited*).

As noted in Section 1.8, excuse doctrine "appears in the nineteenth century as an exception grafted upon the general rule that every promise is binding according to its terms, even though through fortuitous events, entirely beyond the control of the promisor, it becomes extremely difficult and costly to perform."[168] How, in doctrinal terms, did the common law arrive at this grafting of excuse upon FC? E. Allan Farnsworth, later to be appointed Reporter of the second Restatement, summarizes its historical antecedents:

> Courts in the seventeenth century, with a literalism characteristic of their time, sought to confine themselves to the bare framework provided by the parties through the letter of their contract language. . . . The first relaxation of this literalism came through a more liberal interpretation of contract language. Courts still purported to regard the agreement of the parties as an exclusive source. But while confining themselves to the framework provided by the language of the contract, they began to take greater liberties in defining its scope. . . . Slowly the courts began openly to go beyond the letter. But they still attempted to preserve the illusion that the agreement of the parties remained their exclusive source. Therefore these excursions were made in the name of the parties, by basing the result on their "intention," and they were carried out in the style of the parties, by casting the result in the form of the contract term that they had "intended." In this way courts constructed fictional extensions of the original framework provided by the parties to yield an edifice ample enough to encompass the dispute. . . . For the law of

[168] Edwin W. Patterson, *The Apportionement of Business Risks through Legal Devices*, 24 COLUM. L. REV. 335, 348 (1924).

> impossibility[, the leading doctrine of excuse,[169]] the case was *Taylor v. Caldwell* in 1863[.]"[170]

In *Taylor v. Caldwell*, the "fountainhead of the modern law of impossibility,"[171] as introduced in the previous section, the owner of a Music Hall agreed to let the facility for four days for a theatrical presentation. The Music Hall subsequently burned and the producer of the show sued the owner of the Music Hall. The agreement was thin beyond second-order perfection: there was no evidence at all that the terms were dickered around contemplation of the potential for destruction of the Music Hall—or any other disruption. Rather, "[t]he parties when framing their agreement evidently had not present to their minds the possibility of such a disaster, and have made no express stipulation with reference to it."[172]

According to formalistic construction, the lack of formality about what the deal would require in case of a fire does not matter: the theater owner would clearly bear liability. From this perspective, the liability of the theater owner would be seen as plainly written into the agreement, and the court begins by quoting authorities to that effect. The contract that showed up in court has no condition on the obligation to make the Music Hall available, and the Music Hall owner could have demanded such conditions. Ducking the formalistic implications, however, the court implemented a novel approach. It would "perfect" the agreement on behalf of the parties with the following rule for expressing the missing, outcome-determinative term into the deal:

> [W]here, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence of any express

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[169] The major excuse doctrines are impossibility, frustration of purpose and impracticability, discussed *infra* in Section 2.5.

[170] E. Allan Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860, 863-64 (1968).

[171] FARNSWORTH, 2 CONTRACTS § 9.5 *supra* note 145 at 599.

[172] 3 Best & S. 826, 833 (Q.B. 1863).

> or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor.[173]

Applying this heuristic (*if something essential appears to have been taken for granted in the deal, condition performance 100% upon its continued existence*), the court concludes that the "Music Hall having ceased to exist, without fault of either party, both parties are excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and other things."[174] Case closed and reasoning spun to "further the great object of making the legal construction such as to fulfill the intention of those who entered into the contract."[175] The freedom of contract flag is waved in the act of writing the contract for the parties.

In *Krell v. Henry*,[176] the second leading excuse case and the best known of a series of decisions known as the *coronation cases*, the Queen's Bench extends the logic of *Taylor v. Caldwell* to release a defendant that failed to perform because the benefit it would obtain from the counterparty's consideration suddenly evaporated. Identified as *frustration of purpose*, this strand of excuse doctrine has had less influence in the courts than its fame in casebooks and articles would suggest.[177] Still, the fame is well-earned since the decision bolsters the plausibility of excuse by making its reach symmetrical as between the giving and receiving of performance.

In 1902, Edward VII. was about to be crowned. The defendant Henry contracted to let from Krell a flat that would have a view of the royal procession route from Westminster Abbey

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[173] *Id.* at 833-34.

[174] *Id.* at 840.

[175] *Id*.

[176] *Krell v. Henry*, [1903] 2 KB 740.

[177] *See* Wladis, *supra* note 12 at 1629 ("The *Krell* principle, which might have provided a basis for expansion of the doctrines of excuse, has been uninfluential.").

down the Pall Mall on June 26. The deal was memorialized with an agreement on June 20 according to which Henry would pay Krell £75, with a £25 deposit at signing. On June 24, the procession was postponed because Edward became ill and required immediate surgery. Henry did not pay the remainder, and Krell sued to recover the balance of £50. Note that both Krell and Henry could have performed their commitments without any difficulty whatsoever. It is not an *impossibility* case quite like *Taylor v. Caldwell*. Nevertheless, the performance that Henry bargained for had lost all value, leading him to withhold the final payment and raising a question of law.

The leading opinion of Lord Judge Vaughn Williams is known for the construction of an implied term excusing performance along the lines of *Taylor v. Caldwell*, extending that rationale to a case where performance was still possible but was rendered valueless (this is known as frustration). In keeping with *Taylor v. Caldwell*, Vaughn Williams articulates the following test:

> In each case one must ask oneself, first, what, having regard to all the circumstances, was the foundation of the contract? Secondly, was the performance of the contract prevented? Thirdly, was the event which prevented the performance of the contract of such a character that it cannot reasonably be said to have been in the contemplation of the parties at the date of the contract? If all these questions are answered in the affirmative (as I think they should be in this case), I think both parties are discharged from further performance of the contract. I think that the coronation procession was the foundation of this contract, and that the non-happening of it prevented the performance of the contract . . .[178]

This test reflects a commitment to overlook the *absence* of formality: "it is sufficient if that condition or state of things clearly appears by extrinsic evidence to have been assumed by the parties to be the foundation or basis of the contract, and the event which causes the impossibility is of such a character that it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made." (To complicate doctrinal matters further,

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[178] [1903] 2 K.B. 740 (C.A.).

note that excuse calls on a court to pierce through the parol evidence rule and consider extrinsic evidence.)

This exercise in judicial imagination provides the parties' legislative content, just not any legislative content authored by them. In these cases, writes Farnsworth, "where it will often seem doubtful that the parties could have given any thought at all to the situation, [this] fiction [of implied terms], although logical, may seem contrived."[179] The contrivance is captured in Lord Sands's parody:

> It does seem to me somewhat farfetched to hold that the non-occurrence of some event, which was not within the contemplation or even the imagination of the parties, was an implied term of the contract . . . . A tiger has escaped from a travelling menagerie. The milkgirl fails to deliver the milk. Possibly the milkman may be exonerated from any breach of contract; but, even so, it would seem hardly reasonable to base that exoneration on the ground that 'tiger days excepted' must be held as if written into the milk contract.[180]

A more realistic formulation, Farnsworth argues, eschews notions of hypothetical contract and implied conditions,[181] and this approach has been modeled in the United States, from the first Restatement through to the UCC and the second Restatement.[182]

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[179] Farnsworth, *supra* note 170 at 867.

[180] *See id*. Farnsworth explains the development thus,

> [T]he more sophisticated courts in the twentieth century began to denigrate the first fiction. As Judge Clark expressed it, "'Intention of the parties' is a good formula by which to square doctrine with result." The extent to which courts were substituting their own judgment for the expectations of the parties in filling in the contractual framework was no longer a matter to be concealed. It was admitted that the agreement of the parties was not an exclusive source, but only one to be deferred to when it could be established.

Id. at 866 (notes omitted).

[182] *See* UNIF.COMMERCIAL CODE § 2-615 (excuse "if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made"); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 261 ("Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary."); *Id.* § 265 ("Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.).

In the second Restatement, Farnsworth as Reporter comments on the trend away from implied terms in the Introduction to the "Impracticability" chapter.[183] The mystification of classical excuse doctrine is scrapped. In its place, judges should undertake an "inquiry [into] whether the non-occurrence of the circumstance was a 'basic assumption on which the contract was made.'"[184] The words in this doctrinal test may be different—basic assumption versus implied term [185]—but the doctrine works the same way. Parties get a pass on perfection, and courts decide the case as if some additional condition identified by the court was inherent in the

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[183] Excuse doctrine works best in cases of total impossibility or total frustration. These are cases where there is clearly something very fishy about enforcing the terms as verbalized without any third-order perfection in evidence for the court to rely upon. *See* Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271 (1992). Cases where the complication increases costs without rendering a total loss potentially fall in the zone of what evolved doctrinally as "impracticability." The Restatement applies the same standard to these cases as impossibility, and frustration is also conceived as a variety of impracticability doctrine. In this dissertation, I prefer excuse as the umbrella term to focus on the functionality of the doctrine.

[184] RESTATEMENT (SECOND) OF CONTRACTS 11 IN NT (citing Comment f to § 2 of the Uniform Commercial Code). Professor Farnsworth adds that "[i]n order for the parties to have had such a 'basic assumption' it is not necessary for them to have been conscious of alternatives. Where, for example, an artist contracts to paint a painting, it can be said that the death of the artist is an event the non-occurrence of which was a basic assumption on which the contract was made, even though the parties never consciously addressed themselves to that possibility." *Id.* What is essential to my argument below is that the inquiry is into something that *was made* part of the actual bargain, as opposed to something that *was left out* of the actual bargain.

[185] In the introduction to the chapter on impracticability, Farnsworth provides a thorough note on how judges can establish basic assumptions.

> Determining whether the non-occurrence of a particular event was or was not a basic assumption involves a judgment as to which party assumed the risk of its occurrence. In contracting for the manufacture and delivery of goods at a price fixed in the contract, for example, the seller assumes the risk of increased costs within the normal range. If, however, a disaster results in an abrupt tenfold increase in cost to the seller, a court might determine that the seller did not assume this risk by concluding that the non-occurrence of the disaster was a "basic assumption" on which the contract was made. In making such determinations, a court will look at all circumstances, including the terms of the contract. The fact that the event was unforeseeable is significant as suggesting that its non-occurrence was a basic assumption. However, the fact that it was foreseeable, or even foreseen, does not, of itself, argue for a contrary conclusion, since the parties may not have thought it sufficiently important a risk to have made it a subject of their bargaining. Another significant factor may be the relative bargaining positions of the parties and the relative ease with which either party could have included a clause. Another may be the effectiveness of the market in spreading such risks as, for example, where the obligor is a middleman who has an opportunity to adjust his prices to cover them.

Id.

bargain. Nineteenth century judges justified this surrogacy of the parties' private autonomy via implied terms whereas twenty-first century judges prefer to talk about tacit or basic assumptions. Williston, in the first Restatement in between these two periods,[186] left the rationale undertheorized.[187] Regardless the reasoning, formalistic construction's commitments show through the seams of excuse: it is more important for the court to have a contract to enforce—by its verbal terms or by the court's implied terms—than it is to enforce only contract terms selected by the parties. It just happens to be that "enforcing" the contract in excuse doctrine means *discharging* the defendant.[188]

The bottom line concerning the status of perfection in contract law today is that though courts do not require the formality of perfection, it is credited.[189] This was seen in the PvJ

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[186] *See* RESTATEMENT (FIRST) OF CONTRACTS § 457 ("[W]here, after the formation of a contract facts that a promisor had no reason to anticipate, and for the occurrence of which he is not in contributing fault, render performance of the promise impossible, the duty of the promisor is discharged, unless a contrary intention has been manifested, even though he has already committed a breach by anticipatory repudiation; but where such facts occur after the time when performance of a promise is due, they do not discharge a duty to make compensation for a breach of contract."); *id.* § 288 ("Where the assumed possibility of a desired object or effect to be attained by either party to a contract forms the basis on which both parties enter into it, and this object or effect is or surely will be frustrated, a promisor who is without fault in causing the frustration, and who is harmed thereby, is discharged from the duty of performing his promise unless a contrary intention appears."). In support of these rules, Williston says that

> the harsh rules of the early Common Law holding promisors liable in spite of supervening impossibility have largely been changed so that they nearly correspond to the more liberal rules of the law of Continental Europe, but instead of stating the results thus achieved as depending on rules imposed by the law upon the parties, English and American courts have professed to find an intention of the parties relating to the matter to which they give effect.

Williston, *supra* note 10 at 371.

[187] *See* Mark L. Movsesian, *Rediscovering Williston*, 62 WASH. & LEE L. REV. 207, 215 (2005) (discussing why "Williston's jurisprudence strikes a contemporary academic reader as greatly undertheorized").

[188] Discharge in excuse makes no sense to Corbin who points out that the defendant "may waive the condition if he likes, and perform his promise or pay damages for non-performance." Arthur L. Corbin, *Discharge of Contracts*, 22 YALE L.J. 513, 521 (1913). The Restatement (Second) of Contracts adopted the discharge model that Corbin rejects. See note 215 (noting Williston's procedural criticism of excuse doctrine).

[189] Clayton Gillette discusses the availability of remedies by agreement.

> With respect to disruptive events that are expressly identified, the parties may negotiate over who ought to bear the risk and what price the other party ought to pay in exchange. For an identified,

opinion, and it is recorded transparently in the second Restatement, in an "unless" clause that tracks the scope of the law of perfected obligations today. Section 261, dealing with impracticability, provides that:

> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, *unless the language* or the circumstances *indicate the contrary*.[190]

Combine this systematization of the law, one that frames the law of perfected obligations as an exception to the rule, with the sorts of messy, unperfected cases taught in law school:

> Outside the areas of fraud, duress, and unconscionability, few of the cases in law school casebooks would have arisen had the parties included an express clause in their agreement to govern the problem that arose between them.[191]

One gets the impression that the contracts that do not get litigated are perfected, and that black-letter law is dominated by the alleged breach of obligations that lacked first, second or third-order perfection, as the case may be. The failure of doctrine is to overweight the law of unperfected obligations, rather than emphasize the private autonomy achievable through perfection. Now to consider precedents for perfectionistic construction.

2.6 *Legal Precedents for Perfectionistic Construction*[192]

There are three primary sources of precedent for perfectionistic construction in the courts

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> negotiated risk, no reason exists for the law to impose a subsequent adjustment should the risk actually materialize. The party to whom the recognized risk was allocated by negotiation presumably believed itself in a superior position to avoid the risk or to insure against its materialization. That party either obtained or had the opportunity to obtain compensation for taking the risk through ex ante adjustment of the contract price. When the risk materializes, therefore, even those who advocate adjustment in other circumstances reject pleas for court-imposed modification.

Gillette, *supra* note 3 at 532 (notes omitted).

[190] RESTATEMENT (SECOND) OF CONTRACTS § 261 (emphasis supplied).

[191] Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 825-26 (1992).

[192] A third source for the idea of perfectionistic construction is Williamson's theory itself. This intuition is discussed in Chapter 4.

of common law and equity, only one of which can truly be said to have any currency today. Given my account thus far of black-letter common law, it will not be surprising that the surviving thread of perfectionistic construction descends from the courts of equity and lives on in doctrines associated with equitable relief.

In Fuller's treatment, the remedy that chancery alone administers directly remedies private autonomy.[193] This is a decree that the defendant shall perform the contract, an order known as specific performance. Naturally, the courts of equity evolved their own doctrines of enforcement, and these were imbued with the heightened burden of putting the authority of the King/Queen behind an order to do a specific thing. This represents a potentially much more serious intrusion into liberty than an award of money damages still to be collected by the victorious plaintiff.[194] Reconciling this burden, courts of equity developed a forbearance doctrine to deal with disruption that amounts to perfectionistic construction.

The second source of precedent for perfectionistic construction comes from the Queen's Bench, the same court responsible for *Paradine v. Jane* and *Taylor v. Caldwell*.[195] The third comes to us from the contracts opinions of Mr. Justice Holmes writing for the Supreme Court of the United States.

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[193] Expectation damages at law seeks to mimic this remedy. In *The Reliance Interest*, Fuller and Perdue explain that, in crafting a remedial scheme,

> without insisting on reliance by the promisee or enrichment of the promisor, we may seek to give the promisee the value of the expectancy which the promise created. We may in a suit for specific performance actually compel the defendant to render the promised performance to the plaintiff, or, in a suit for damages, we may make the defendant pay the money value of this performance. Here our object is to put the plaintiff in as good a position as he would have occupied had the defendant performed his promise. The interest protected in this case we may call the expectation interest.

Fuller & Perdue, *supra* note 95 at 54.

[194] *See generally* Barnett, *supra* note 191.

[195] In the concluding chapter, I will advance a hypothesis about why the excuse paradigm and formalistic construction beat out perfectionistic construction in the Queen's Bench. The perspective I take is of the Queen's Bench as a player in a highly competitive oligopoly: the three court systems administering justice in England: the King's/Queen's Bench, the Court of Common Pleas and Chancery.

It is worth recognizing that, despite its formalistic construction, black-letter jurisprudence is already perfectionistic in an important regard: in its reluctance to enforce indefinite bargains, as discussed earlier in Section 2.4.[196] Another way of framing my argument in this chapter is that I am calling into question the discontinuity in the perfectionistic jurisprudence of contract law today. *Why should a court demand evidence of party-bargained definiteness before enforcing in the fair-weather case (second-order perfection) but not demand evidence of party-bargained definiteness in the foul-weather case (third-order perfection)?* The point of this section is to show the doctrinal viability of taking the position that courts *should* be consistent in this regard. I proceed by discussing the three lines of precedent in the order introduced.

Chancery, the progenitor of equitable powers in our courts today, was empowered by the King/Queen of England to award decrees of specific performance to remedy breaches of contract. Whereas the authority of the courts of common law to assume jurisdiction was narrowly circumscribed around technically-defined causes of action, like an action on the case or debt,[197] the authority of the chancellor was to act on behalf of the sovereign to remedy injustice, however the need presented itself, and often it did so to counteract the rigidity of the formalistic approaches of the common law courts, shaped as they were by jurisdiction narrowly drawn around sharply-defined causes of action. Indeed, parties who lost a case at law could go to chancery to block enforcement on account of the injustice of collecting the award.[198] Chancery

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[196] This is the case even under a liberal neoclassical approach that evinces a willingness to fill in terms. Every court reaches a point where it finds too little to go on in the definition of the parties' bargain to enforce as a matter of the parties' private autonomy. The controversy here is a matter of where that line should be set, not whether it exists.

[197] *See supra* Section 2.1.

[198] This can be thought of as *forbearance* (as discussed in the next paragraph) in the common law but given effect by chancery. This power to overrule the common law courts was a source of friction between chancery and the courts of common law and led to a famous showdown between Edward Coke, Chief Judge of the Court of Common Pleas and Chancery. Protesting a decree that purported to displace the jurisdiction of the common law courts, Coke was humiliated when King James I removed Coke from his

conceived itself a court of conscience and for centuries the closest it had to jurisprudence were the maxims of equity,[199] of which the most fundamental is that relief in equity presupposes the petitioner's "clean hands."[200]

For all these reasons, it was in the chancellors' job description (in a way it was not for the common law judge) to be sensitive to the way changed circumstances could impact the justice of enforcing a bargain.[201] According to Lord Redesdale,[202] sitting in the High Court of Chancery in Ireland in 1805, there are two major doctrines of non-enforcement, or forbearance, in the

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judgeship, and appointed his political rival, Francis Bacon, Chancellor, reaffirming Chancery's power over the common law. *See* Morton Gitelman, *The Separation of Law and Equity and the Arkansas Chancery Courts: Historical Anomalies and Political Realities*, 17 U. ARK. LITTLE ROCK L.J. 215, 225-27 (1995) ("The order of King James I firmly settled the political star of the Chancery Court.") (citing 1 WILLIAM S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 450-465 (7th rev. ed. 1956)).

[199] *See* Kraus & Scott, *supra* note 233 at (noting that "for many years the Chancery's decrees had no formal precedential effect").

[200] The following principle from the Delaware Court of Chancery provides an unpacking of the clean hands doctrine:

> If the complainant has attempted in the first instance to commit a fraud, or if the claim is wholly inequitable, or there has been great laches, the court may, upon the fact of the omission of part of the contract being shown, dismiss the bill notwithstanding the complainant offers to take his order for a specific performance of the contract as modified, by supplying its omissions.

Connaway v. Wright's Adm'r, 5 Del. Ch. 472 (1883).

[201] "The granting or the withholding of a decree for specific performance is in the discretion of the court; and in every case the question must be whether the exercise of the power of the court is demanded to subserve the ends of justice." *Connaway v. Wright's Adm'r*, 5 Del. Ch. 472.

Notice the phrasing in Benjamin Cardozo's reference to the doctrine in *The Paradoxes of Legal Science*:

> Changes of circumstances brings hardship. The Chancellor withholds his remedies, and remits the suitor to a claim for damages which is known to be futile. Justice again is done by making charity a duty.

BENJAMIN N. CARDOZO, THE PARADOXES OF LEGAL SCIENCE 41 (1928).

[202] I would like to thank the University of Pennsylvania Law Library, first of all, for helping me decipher a citation to this reporter of Irish Chancery cases by the Supreme Court (*Willard v. Tayloe*, 75 U.S. 557, 567-68 (1869) (quoting *Davis. v. Hone*, 2 Schoales & Lefroy 341, 348 (Ireland High Court of Chancery, 1805) (Redesdale, L.) (arguing for a species of remittitur in cases where "specific performance, according to the letter of the covenant, . . . would be unconscientious against the Defendant in consequence of the change of circumstances"). Especially, though, I would like to thank the library for owning and maintaining this obscure and hardly cited volume. Browsing through the reporter according to the index, I found the opinion quoted from here, which put my then-burgeoning account in the most eloquent way and inspired me enormously. In the Appendix, I include two pages including this long quotation, with beautiful typeset.

equitable enforcement of contracts. The first is to avoid decreeing specific performance when an agreement calls for the performance of illegal acts (illegality doctrine). The second is to address changed circumstances.

> There is also another ground on which Courts of Equity refuse to enforce specific execution of agreements, that is, when from the circumstances it is doubtful whether the party meant to contract, to the extent that he is sought to be charged. All these [illegality and changed circumstances] are held sufficient grounds to induce the Court to *forbear* decreeing specific performance; that being a remedy intended by the Courts of Equity to supply what are supposed to be the defect in the remedy given by the Courts of Law. Under these circumstances therefore, I think considerable caution is to be used in decreeing specific performance of agreements: and the Court is bound to see that it really does that complete justice which it aims at, and which is the ground of its jurisdiction. [203]

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[203] *Harnett v. Yeilding*, 2 Schoales & Lefroy 550, 554-55 (High Court of Chancery in Ireland 1805) (Redesdale, L.) (emphasis supplied); see also *Davis. v. Hone*, 2 Schoales & Lefroy 341 ("The court ought not, I think, to give specific performance, according to the letter of the covenant, for that would be unconscientious against the Defendant in consequence of the change of circumstances."). FRED F. LAWRENCE, A TREATISE ON THE SUBSTANTIVE LAW OF EQUITY JURISPRUDENCE 310, n. 27 (1929) (numerous cases reflect the "well-established principle" for withholding relief in case of "chang[ed] circumstances making impossible any performance which would not defeat the object of the parties and therefore the contract itself"); *id.* § 99 at 136-137 ("[I]n equity where performance is the objective, and where relief is granted as of the date of the decree, no party will be compelled to do anything in pursuance of a contract which on account of altered conditions will not further the real purpose of the parties.") (citing 200 N. W. 332; 2 Paige 84; 183 N. Y. 35; 75 N.E. 961; 5 Ann. Cas. 45; 165 N. Y. S. 608; 113 Va. 134); WILLIAM F. WALSH, A TREATISE ON EQUITY § 104 at 483 (1930) ("The courts have refused specific performance in many cases in which changes occurring after the contract was made but before the time for performance, which could not fairly be regarded as contemplated or expected by the parties when the contract was made, and for which neither of the parties are responsible, make performance of the contract a hardship to one and an unfair advantage to the other."); HENRY L. MCCLINTOCK, HANDBOOK ON EQUITY § 70 at 190 (1936) ("When courts of equity speak of hardship as a ground for refusing specific performance of a contract, they almost always refer to hardship resulting from subsequent change in conditions surrounding the performance."); 65 A.L.R. 7 (1930) ("A court of equity, in the exercise of its discretionary powers, will refuse a decree for the specific performance of a contract where the performance would produce hardship or injustice to the defendant not reasonably within the contemplation of the parties at the inception of the contract."); JOHN NORTON POMEROY, A TREATISE ON EQUITABLE REMEDIES – SUPPLEMENTARY TO POMEROY'S EQUITY JURISPRUDENCE (1905) ("Where the court is satisfied that the result which bears so hard upon the defendant, though legally a constituent part of the contract, was not intended by the parties at the time of the agreement,—in fact, was not in contemplation as the effect of the agreement, which was expressed in terms too unqualified, it will not specifically enforce the agreement."). Whether such performance was "legally a constituent part of the contract," as Pomeroy indicates, or not is the essential divide between *Taylor v. Caldwell* and *Baily v. De Crespigny*, between excuse and the no-contract approach of perfectionistic forbearance. *See infra* Section 2.7. In other words, the formalistic construction that dovetails with excuse necessitates the forbearance approach of Chancery, else Chancery could (*ex hypothesi* following Common Law) say there is no contract thereby mooting the question of hardship from enforcement.

This doctrine of forbearance, a mainstay in chancery, came to be known as hardship doctrine,[204] and it has tracked the territory of disruption covered by the excuse doctrines that developed later in the courts of common law.[205]

Notice that Lord Redesdale articulates a doubt standard ("when from the circumstances it is *doubtful* whether the party meant to contract, to the extent that he is sought to be charged"), as this provides the clue that we are beholding concern for formality. The court's doubt owes to the fact that on its face the parties' articulation of terms did not provide sufficient evidence that the bargain was given scope over the actual circumstances that obtained.[206] Put otherwise, chancery does not lower the bar of formality for cases of disruption as has the common law. Rather, chancery upholds the same high standard for clearly-bargained terms—for evidence of an assumpsit—that it demands in the fair-weather enforcement of contracts. There is no discontinuity of the sort present in the common law as between indefiniteness doctrine and FCwE. The following principle applies across the board in chancery:

> A complainant seeking the specific performance of a contract is bound to establish

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[204] Note that another variant of hardship doctrine asked a different sort of question. In this varietal, the inquiry is less overtly based on the parties' bargain than on the consequences of enforcement: Would the defendant suffer more hardship than the plaintiff would benefit from an enforcement decree? This approach seems to have waned in prevalence with the end of the nineteenth century. Even here, though, the comparative unjustness of enforcement versus non-enforcement is unavoidably measured by the court's normative conception of the allocation of risks.

[205] Typically characterized as impossibility, impracticability and frustration of purpose. *See, e.g.*, Schwartz, *supra* note 183.

[206] "Equity regards the substance of the agreement and the object and intention of the parties; it will not, therefore, permit nonessential terms to be set up as a reason for refusing to fulfill." *Connaway v. Wright's Adm'r*, 5 Del. Ch. 472. Equity's approach recalls Aristotle's account of equity, as applied by Thomas Aquinas in adopting a perfectionistic account of the morality of promise-making.

> Thomas Aquinas used Aristotle's theory of equity to explain why [the condition "if matters remain in the same state" should be implied in every promise]. According to Aristotle, whenever a law is made, particular circumstances may arise in which the lawmaker would not want it to be applied. As a matter of "equity," the law should not be applied in those circumstances. Aquinas concluded that similarly, promises are a kind of law one gives to oneself, and they are not binding in circumstances where the promisor would not have intended to be bound.

Gordley, *supra* note 7 at 526.

> clearly and satisfactorily the existence of the contract, and its terms. If certainty in the proof be wanting, or if the testimony be contradictory or doubtful, a decree for specific performance will be refused.[207]

In its concern for the functions of formality, this doctrine of forbearance helps answer a court's need to preserve legitimacy in the extension of the state police power to the enforcement of private autonomy when things did not work out between the parties quite as intended.[208] Crucially, limiting the reach of contracts through a doubt standard that keeps the bar high for formality manages to reinforce the ideal of freedom of contract, from the standpoint of the court's own commitments (as discussed further in the next section) and also for parties desiring to realize the autonomy of their deal through contract (as discussed further in Chapter 3).

Before introducing the common law's precedents for perfectionistic construction, it will help to comment on the *form* perfectionistic construction doctrine can take. This is best done with comparison to illegality doctrine. The common law recognizes a limitation to the enforcement of

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[207] *Connaway v. Wright's Adm'r*, 5 Del. Ch. 472. *See also Lord Walpole v. Lord Oxford*, [1797] 3 Ves.Ch. 402; SIR EDWARD FRY, A TREATISE ON THE SPECIFIC PERFORMANCE OF CONTRACTS § 380 (6th ed. 1921). In *Connaway v. Wright's Adm'r*, the court notes that "[a] valuable consideration, *particularity, certainty*, mutuality and a necessity for performance are requisites upon which the equity of a case for specific performance arises." 5 Del. Ch. 472 (emphasis supplied).

[208] *See* Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 583 (2003) ("Judges are reluctant to invoke the coercive machinery of the state to require a party to perform a contract (or to pay damages) unless the judge is satisfied that the contract actually directed what the party failed to do."); Todd D. Rakoff, *The Implied Terms of Contracts: Of 'Default Rules' and 'Situation-Sense', in* GOOD FAITH AND FAULT IN CONTRACT LAW 191, 201 (Jack Beatson & Daniel Friedmann eds. 1997) ("Responsible judges, judges who face up to the seriousness of what they do, have to work not merely in the realm of efficiency, but also in the realms of distributive justice, cultural symbolism, procedural fairness, and so forth."); e.g., *Lynch v. Union Institution for Sav.*, 159 Mass. 306, 308-09 (Mass. 1893) ("[W]here, by an innocent mistake, erections have been placed a little upon the plaintiff's land, and the damage caused to the defendant by removal of them would be greatly disproportionate to the injury of which the plaintiff complains, the court will not order their removal, but will leave the plaintiff to his remedy at law [in the absence of a clear bargain to do so]."); *Gotthelf v. Stranahan*, 138 N.Y. 345 (1893) ("Equity will not decree a specific performance of a contract in a manner which would work injustice and bring about results not within the intent or understanding of the parties in making the bargain.").

illegal contracts as chancery does,[209] even if interpreted somewhat differently. Common law illegality doctrine sounds in forbearance, as the public policy rationale for withholding enforcement is clearly the driving consideration for refusing a remedy.[210] Even here, though, it is natural and accurate enough within the logic of assumpsit to conceptualize illegality as a formation doctrine: performance obligations that are illegal provide no consideration and thus no contract forms. In the context of disruption, the same is all the more true. Chancery certainly characterizes the perfectionistic refusal to grant relief as a forbearance doctrine,[211] yet in the common law the doctrine sounds naturally in formation: without sufficient formality in respect of the actual disruption, there is no contract to enforce (that applies in the actual circumstances). Think of this as the court seeing that the bargain was entered into with an open term about what would be required in the case at bar. Since there is an open term for the case at bar, there is no contract. If there is no contract, then no action in contract lies and, necessarily, there is no enforcement. In Hohfeld's terms, this would be a case in which the plaintiff, in fact, has a no-

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[209] *See* RESTATEMENT (FIRST) OF CONTRACTS § 598 ("A party to an illegal bargain can neither recover damages for breach thereof nor, by rescinding the bargain, recover the performance that he has rendered thereunder or its value, except as stated in §§ 599- 609.").

[210] The Reporter's note in the Introduction to the chapter on "Unenforceability on Grounds of Public Policy" explains the countervailing considerations that apply:

> In general, parties may contract as they wish, and courts will enforce their agreements without passing on their substance. Sometimes, however, a court will decide that the interest in freedom of contract is outweighed by some overriding interest of society and will refuse to enforce a promise or other term on grounds of public policy. Such a decision is based on a reluctance to aid the promisee rather than on solicitude for the promisor as such. Two reasons lie behind this reluctance. First, a refusal to enforce the promise may be an appropriate sanction to discourage undesirable conduct, either by the parties themselves or by others. Second, enforcement of the promise may be an inappropriate use of the judicial process in carrying out an unsavory transaction. The decision in a particular case will often turn on a delicate balancing of these considerations against those that favor supporting transactions freely entered into by the parties.

RESTATEMENT (SECOND) OF CONTRACTS 8 Intro. Note.

[211] This owed at least in part to the availability, formally anyway, of relief at common law to the unsuccessful petitioner in chancery.

right, i.e., no contract.[212]

This was the approach taken by the Queen's Bench in the 1861 case, *Baily v. De Crespigny*,[213] which is the leading authority for "Impossibility" doctrine in Samuel Williston's casebook (rather than the earlier decided and far better known *Taylor v. Caldwell*).[214] According to the *Baily v. De Crespigny* court,

> Where the [frustrating] event is of such a character that it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made, they will not be held bound by general words which, though large enough to include, were not used with reference to the possibility of the particular contingency which afterwards happens.

Notice that the court's phrasing of its standard in the negative ("cannot reasonably be supposed") renders it functionally equivalent to Lord Redesdale's doubt standard.[215] In this way, the common

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[212] *See* W. N. Hohfeld, *The Relations between Equity and Law*, 11 MICH. L. REV. 537, 553 (1913) ("In the ordinary case where J has not contracted to convey his property to K or done any other act relating to K, J's privilege of not conveying such property to K and, correlatively, K's 'no-right' as to J's doing so are concurrently legal and equitable. J's privilege would be vindicated in a court of law by the refusal of a judgment for damages to K; and in a court of equity by the refusal of a decree for specific performance or damages.").

[213] 4 Q.B. 180 (1869).

[214] SAMUEL WILLISTON, A SELECTION OF CASES ON THE LAW OF CONTRACTS 713 (2d ed. 1922); A SELECTION OF CASES ON THE LAW OF CONTRACTS, vol. 2 286 (1904).

[215] The gulf between the forbearance approach of *Baily v. De Crespigny* and the approach of excuse doctrine is, unfortunately, too easy to miss. This student note, for example, conflates the doctrines:

> A man may bind himself by an absolute contract to perform at all events or to do the impossible. But there is an accepted doctrine in qualification. Where the event is of such a character that it cannot reasonably be supposed to have been in the contemplation of the parties when the contract was made, a party will not be held liable by mere absolute words which, though large enough to include the contingency, were not used in view of it. *Baily v. De Crespigny*, L. R. 4 Q. B. 180; *Harrison v. Muncaster*, [1891] 1 Q. B. D. 680. So confident are the courts of their rule and of their reason that they now assert that these provisions against various impossibilities are conditions of the original promise — that to enforce them is simply to enforce the actual contract which the parties have made. *Howell v. Coupeland*, L. R. 1 Q. B. D. 258; Chicago, M. & St. P. R. R. v. Hoyt, 149 U. S. 1.

Impossibility of Performing Contracts As A Defense, 15 HARV. L. REV. 418 (1902). The Note then goes on to criticize excuse, with an argument that poses no challenge to perfectionistic construction:

> The truth of the matter is that the courts of law, recognizing the injustice of enforcing under all circumstances an absolute legal obligation, have interposed in certain cases what must be regarded

law courts themselves articulated a formality-based jurisprudence to deal with disruption. Moreover, it is one that the Supreme Court of the United States followed in numerous cases, including the next and final source of perfectionistic precedent to which I will refer.[216]

To appeal to *Baily v. De Crespigny* ("BvDC") as an inimitably distinct alternative to excuse doctrine may appear a fetishism of nicety on my part. After all, as with excuse, the principle here articulated brings the courts' eye to the *ex ante* contract as a basis for making inferences about intent and, only then, as to the suitability of enforcement. And the result for the defendant is also, if applicable, no liability.[217] The difference is that the court in BvDC does not hold that the non-applicability of the contract's "legislation" to the facts was, in fact, a basic

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> as an equitable defense. Such a recognition of equitable principles at law is not unprecedented. Thus, a fraudulent vendee, who is in the position of a constructive trustee, has been held liable to his vendor in trover. 1 HARV. L. REV. 4, note 2. If the courts will recognize this truth they will then be in a position to cast aside arbitrary fictions, and accept a rule working justice in all cases. A proper rule, it is suggested, is that impossibility should be recognized as a defense wherever it seems reasonable that, had the contingency which renders performance impossible been contemplated by the parties, they would have both agreed that its introduction into the contract, as a condition terminating the obligation, would be just.

Id. at 418-19. It seems likely that Williston, who was the professor of contracts and involved with the Harvard Law Review (including as one of its founding editors) would have reviewed this Note. In any event, Williston adopts a consistent viewpoint in his treatise:

> If the explanation were sound that the promise in question is subject to a condition, the burden of proving such a state of facts as to bring the promise within the terms of the conditional promise would be on him, but in fact the burden should be placed on the promisor to establish the defense of excusable impossibility; and such seems to be the law whether the promisor is sued on his promise, or as plaintiff seeks to recover on a *quantum meruit* for part performance.

WILLISTON, *supra* note 140 § 1937 at 34. This approach is in contrast with the perfectionistic construction adopted by the Supreme Court in the 19th century.

> There can be no question that a party may, by an absolute contract, bind himself or itself to perform things which subsequently become impossible, or pay damages for the nonperformance; and such construction is to be put upon an unqualified undertaking, where the event which causes the impossibility might have been anticipated and guarded against in the contract, or where the impossibility arises from the act or default of the promisor. But, where the event is of such a character that it cannot be reasonably supposed to have been in the contemplation of the contracting parties when the contract was made, they will not be held bound by general words, which, though large enough to include, were not used with reference to, the possibility of the particular contingency which afterwards happens.

Chicago, M. & St. P. Ry. Co. v. Hoyt, 149 U.S. 1, 14-15 (1893).

[217] There is also a symbolic difference that I explore in the next chapter.

assumption of the parties (implying that the deal was balanced and well-formed). The court holds that, for want of formality, it does not have a reasonable basis for saying that legislation as to these facts *was* part of the bargain. There was not clearly enough an assumpsit as to these circumstances. Hence the existence of a no-contract for the court to enforce. Doctrinally, this is a species apart from the thinking an excuse court relies upon to imagine the bargain's assumptions and enforce the deal accordingly, even when that means discharging the defendant. Under a perfectionistic doctrine like BvDC, it makes no difference what the court imagines about the basic assumptions of the bargain at bar. What matters is the palpable presence or absence of formal indicia of legislative action, for without them no contract can be constructed or enforced.

In the history of the common law, BvDC was soon overshadowed by the formality-ignoring FCwE, even as it led Williston's cases on disruption.[218] Ironically, the logic of BvDC seems to have been the basis for the unanimity secured among the three judges in *Krell v. Henry*, in support of an opinion that followed decisively in the mold of *Taylor v. Caldwell* and may have cemented the dominance of formalistic construction and the excuse paradigm that relegated BvDC to obscurity today. A brief excursion to reconsider *Krell v. Henry* will elucidate the distinction between the two approaches further.

As introduced in the previous section, the plaintiff Krell sued for the payment the defendant Henry agreed to make to let a flat on the Pall Mall. The lease was timed with the coronation procession of Edward VII., and the coronation was cancelled just days after the deal closed. In the lead opinion, Lord Judge Vaughn Williams hinges his judgment on the following thought: "I think that the coronation procession was the foundation of this contract, and that the non-happening of it prevented the performance of the contract . . . ."[219] This is not based on

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[218] Published in 1903-1904 and 1922 respectively.

[219] [1903] 2 KB 740.

anything overt in the parties' bargain. Rather, Vaughn Williams holds that there is no need for the parties to have actually formalized their deal on the conditional terms found by the court,

> if that condition or state of things clearly appears by extrinsic evidence to have been assumed by the parties to be the foundation or basis of the contract, and the event which causes the impossibility is of such a character that it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made.[220]

Note that even though this is the primary ground for Lord Judge Vaughn Williams's decision—and this is understood to be the holding of the decision—the lead opinion goes on to articulate as a secondary ground the logic of *Baily v. De Crespigny*.[221]

Even more significant (and completely overlooked) is the second opinion in the case which rejects the distinctive, formality-piercing rationale of *Taylor v. Caldwell*, instead adopting a perfectionistic approach. Lord Judge Roemer says he endorses the lead opinion "with some doubt" that the case fits the principle of *Taylor v. Caldwell*, which is to construct contracts formalistically and enforce accordingly *unless* the parties are supposed to never have contemplated the highly consequential disruption that frustrated the contract, in which case, the court is to discharge the defendant's obligations.

> The doubt I have felt was whether the parties to the contract now before us could be said, under the circumstances, not to have had at all in their contemplation the risk that for some reason or other the coronation processions might not take place on the days fixed, or, if the processions took place, might not pass so as to be capable of being viewed from the rooms mentioned in the contract; and whether, under this contract, that risk was not undertaken by the defendant. But on the question of fact as to what was in the contemplation of the parties at the time, I do not think it right to differ from the conclusion arrived at by Vaughan Williams L.J., and (as I gather)[222] also arrived at by my

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[220] *Id.*

[221] "[S]econdly, I think that the non-happening of the procession, to use the words of Sir James Hannen in *Baily v. De Crespigny*, was an event "of such a character that it cannot reasonably be supposed to have been in the contemplation of the contracting parties when the contract was made, and that they are not to be held bound by general words which, though large enough to include, were not used with reference to the possibility of the particular contingency which afterwards happened." *Id.*

[222] Lord Judge Stirling appears to have weighed in on the judgment *in absentia*, as the reporter includes his opinion in the third person ("STIRLING L.J: said he had had an opportunity of reading the judgment delivered by Vaughan Williams L.J., with which he entirely agreed. Though the case was one of very great difficulty, he thought it came within the principle of *Taylor v. Caldwell*."). *Id.*

> brother Stirling. This being so, I concur in the conclusions arrived at by Vaughan Williams L.J. in his judgment, and I do not desire to add anything to what he has said so fully and completely.

Despite his doubt, he votes to discharge. According to the forbearance principle articulated by Lord Redesdale, one would say that it is *because of* L. J. Roemer's doubt that he *should* vote to withhold enforcement.[223]

Notice what is legally at stake between L. J. Roemer's having broken rank with the panel and his actual decision to go along with the majority. Suppose Roemer held the majority to the logic of excuse doctrine *and* pressed his doubt. If Krell and Henry had had the possibility of cancellation before them, the court would have been locked into the logic of PvJ: enforce the bargain to pay in full. Roemer's quibble about doubt was very much outcome determinative, and he chose to let it go. The doctrinal wrinkle is this: should parties be allowed to contemplate a contingency and then decide to leave it outside their deal? Suppose Krell and Henry did foresee the possibility of a cancellation, and Henry asked Krell what would happen in that contingency. Krell says, "I don't know. Do we need to settle this now?" Henry says "no" and pays an advance with an agreement that makes no provision for cancellation. A perfectionistic approach is consistent with refusing enforcement to parties like these who chose to leave a contingency they jointly contemplated outside the deal they formalized. Excuse doctrine, however, is not consistent

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[223] A perfectionistic approach is also consistent in important respects with the enforcement doctrine that Andrew Kull has defended as the "windfall principle." Andrew Kull, *Mistake, Frustration, and the Windfall Principle of Contract Remedies*, 43 HASTINGS L.J. 1 (1991). According to the windfall principle, it is not judicial gap filling that best resolves cases of unexpected circumstances but rather a clear rule that leaves losses where they have fallen, for the parties to resolve without a judicial remedy. In terms of forbearance, the windfall principle can be described as a principle of executory forbearance whereby the parties to a contract thwarted by unexpected circumstances will be able to obtain a judicial remedy only with respect to those aspects of the deal that had ripened past the executory stage at the time of frustration. *Id*. at 55 n. 82 ("enforcement of the matured obligation, though it might seem inconsistent with a principle favoring judicial inertia, gives effect to the parties' privately negotiated, ex-ante allocation of the incidence of possible loss should their contract be frustrated"). What is not as obvious is whether cases of sequenced performance, like progress payments, are intended as down payments that effect final property transfers, such that a court exercising executory forbearance should leave them untouched or as financing terms, like layaway payments in a department store, that should be refunded on a principle of restitution if the merchandise is destroyed.

with this outcome, even though studies show that parties to contracts not infrequently choose to simply leave terms outside the deal. [224]

Moving on to the third source of perfectionistic construction, exactly one year before *Krell v. Henry* was decided, Oliver Wendell Holmes, Jr., then an Associate Justice on the Supreme Judicial Court of Massachusetts, was appointed to the Supreme Court of the United States. Justice Holmes wrote several significant opinions on contracts for the Court.[225] *The Kronprinzessin Cecilie*, from 1917, deals precisely with the problem of enforcement in cases of unplanned disruption. The Kronprinzessin Cecilie was a German steamship that received gold in New York under contract to deliver the gold to ports in France (Cherbourg) and England (Plymouth), on the eve of the First World War After dropping off passengers in Germany on July

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[224] *See* Scott, *supra* note 162 (noting prevalence of indefinite agreements and theorizing that parties often intend to rely on self-enforcement); Omri Ben-Shahar, *"Agreeing to Disagree": Filling Gaps in Deliberately Incomplete Contracts*, 2004 WIS. L. REV. 389 (2004).

[225] The first came in Justice Holmes's first year:

> When a man commits a tort, he incurs, by force of the law, a liability to damages, measured by certain rules. When a man makes a contract, he incurs, by force of the law, a liability to damages, unless a certain promised event comes to pass. But, unlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured. The old law seems to have regarded it as technically in the election of the promisor to perform or to pay damages. *Bromage* v. *Genning*, 1 Rolle, 368; *Hulbert* v. *Hart*, 1 Vern. 133. It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter. But a man never can be absolutely certain of performing any contract when the time of performance arrives, and, in many cases, he obviously is taking the risk of an event which is wholly, or to an appreciable extent, beyond his control. The extent of liability in such cases is likely to be within his contemplation, and, whether it is or not, should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind. For instance, in the present case, the defendant's mill and all its oil might have been burned before the time came for delivery. Such a misfortune would not have been an excuse, although probably it would have prevented performance of the contract. If a contract is broken, the measure of damages generally is the same, whatever the cause of the breach. We have to consider, therefore, what the plaintiff would have been entitled to recover in that case, and that depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.

Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543-44 (1903).

28, one thousand miles away from Plymouth, the master of the ship turned back to the United States without delivering the gold, having learned

> that war had been declared by Austria against Servia (July 28), that Germany had declined a proposal by Sir Edward Grey for a conference of Ambassadors in London; that orders had been issued for the German fleet to concentrate in home waters; that British battle squadrons were ready for service; that Germany had sent an ultimatum to Russia; and that business was practically suspended on the London Stock Exchange. He had proceeded about as far as he could with coal enough to return if that should prove needful, and was of opinion that the proper course was to turn back. He reached Bar Harbor, Maine, on August 4, avoiding New York on account of supposed danger from British cruisers, and returned the gold to the parties entitled to the same.[226]

Though the record suggests that the ship could have made it to Plymouth without incident, the fact is that war was declared by Germany on July 31 and, in the view of the Court, the master acted reasonably given the uncertainty of new war and pressed with a limited supply of coal on the ship. The question in the case, given the Court's reading of the facts, is whether non-delivery of the gold was actionable under the contract at bar.

The contract comes in the form of a bill of lading. The only expression in the text of potential relevance would have the effect of suspending the obligation to deliver the gold in case of "arrest and restraint of princes, rulers, or people."[227] Holmes chooses not to stretch that phrase beyond its literal intent. Instead, his opinion speaks against the rule of *Paradine v. Jane,* with citation to *Baily v. De Crespigny*:

> The seeming absolute confinement to the words of an express contract indicated by the older cases like *Paradine v. Jane* has been mitigated so far as to exclude from the risks of contracts for conduct (other than the transfer of fungibles like money)[228], some, at least, which, if they had been dealt with, *it cannot be believed* that the contractee would have

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[226] *The Kronprinzessin Cecilie*, 244 U. S. 12 (1917).

[227] *Id.* at 22.

[228] I interpret this parenthesis to account for what Williamson calls market transactions, which, as discussed in Section 1.4, also take the form of contracts. The importance of the market is to govern the standardization of terms and sharpen the price terms. These conditions bring contracts as close as they get to fungibility with money, a domain where formalistic construction arguably has greater purchase.

demanded or the contractor would have assumed.[229]

Once again, a doubt standard is adopted that shifts the burden to the plaintiff to produce *evidence* that the parties bargained over these facts. In this way, the approach that Holmes lays down is perfectionistic.[230] This is demonstrated by the absence of recitals of the foreseeability test that controlled the leading opinions in *Krell v. Henry* and *Taylor v. Caldwell* or the interpolation of basic assumptions to the parties' bargain. Holmes was one to seek the external evidence of the parties' bargain,[231] much like the chancellors, always disfavoring inquiries into intent of the sort entertained by judges applying excuse doctrine.[232]

There is a twist, however, in Holmes's rendering of BvDC's perfectionistic approach. His doctrine can be interpreted as a weaker form of perfectionistic construction, modeling a hybrid or compromise strategy to construction that is worth studying further.[233] The orientation is clearly

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[229] *Id.* at 22 (citing *Baily v. De Crespigny*, 4 Q. B. 180 (1869)) (emphasis supplied).

[230] Whereas Holmes's view on disruption in contracts has been forgotten or conflated with excuse, he has been completely rejected and even ridiculed for his view on the question of consequential damages. Whereas the rule of *Hadley v. Baxendale* makes consequential damages available so long as foreseeable (like excuse makes a performance obligation binding so long as the relevant contingency was foreseeable), Holmes made the bargain the touchstone in a decision that is followed only in Arkansas today. According to Holmes, "[t]he extent of liability in such cases is likely to be within his contemplation, and, whether it is or not, should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind." *Globe Ref. Co. v. Landa Cotton Oil Co*., 190 U.S. at 543. Larry Garvin has called *Globe Refining Co. v. Landa* the worst Supreme Court decision ever. Larry T. Garvin, *Globe Refining Co. v. Landa Cotton Oil Co. and the Dark Side of Reputation*, 12 NEV. L.J. 659 (2012). Assessing perfectionistic construction in the context of consequential damages is a natural, and in many ways more contentious, follow on project.

[231] Morton Horwitz writes that "If there is a single, overriding, and repetitive theme running through Holmes's writing, it is the necessity and desirability of establishing objective rules of law, that is, general rules that do not take the peculiar mental or moral state of individuals into account." Morton Horwitz, *The Place of Justice Holmes in American Legal Thought*, in THE LEGACY OF OLIVER WENDELL HOLMES, JR. 32 (Robert W. Gordon ed., 1992).

[232] *Id.*

[233] The distinction between a strong and weak form of perfectionistic construction is present in the prescient critique of *Paradine v. Jane* introduced in the Preface.

> although courts may shelter themselves under the very correct principle that they are only to expound, not to *make* contracts,[233] I say that they *make* contracts by means of this doctrine [of *Paradine v. Jane*]; that what they miscall a *strict* is in fact an enlarged construction; for to a

perfectionistic: he says that the assumption of a risk (an assumpsit) is certainly not going to be enforced as the legislation of private autonomy, unless the parties formalized the assumpsit, but he adds one more condition upon the holding. Without the additional condition, his statement would represent a full strength perfectionistic approach. The supplemental condition softens the perfectionistic edge of the holding by limiting its reach to a sub-set of cases. This sub-set includes all those where "it cannot be believed" that the risk of having to perform under the disruption at issue would have been demanded by the plaintiff, or assumed by the defendant. Seen for his judicial minimalism, Justice Holmes avoided tying the hands of a future court that might think it appropriate to enforce performance under disruption *despite* the absence of third-order perfection, so long as it could be believed that the plaintiff would have demanded the risk be assumed, and it can be believed the defendant would have assumed it. But what about a case where what can be believed is that the risk would have been assumed, but for a price, and it is not clear what the risk bearer's price sensitivity would have been? What result in this case? Would Holmes enforce or not enforce? This theme will be discussed further in Section 3.2.

To conclude the section, perfectionistic construction is not an impossibility for our courts. The civil procedure of today results from the fusion of the courts of common law and the courts of equity.[234] Therefore, the three lines of precedent discussed in this section flow through fusion

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> covenant to deliver goods, or carry a ship to such a place or at such a time, simply so expressed, they add the words *at all events*, which never were or could be within the intention of the parties.

Strong PC rejects enlarged constructions that "never were . . . within the intention of the parties" so far as the formalities go. Weak PC rejects enlarged constructions that "never . . . could be within the intention of the parties" (if not recorded with formality).

[234] The influence of equity in contract law has been far reaching, to the disappointment of some. Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1040 (2009) ("Fundamentally . . . the institutions of the common law and the Chancery were at cross purposes."). The overwhelming influence of equity in our civil procedure has been overlooked. Stephen N. Subrin, *How Equity Conquered Common Law: The Federal Rules of Civil Procedure in Historical Perspective*, 135 U. PA. L. REV. 909, 940 (1987).

and become the heritage of today's courts. If learning is, as Plato suggests, a form of recollection, then our courts have all they need to learn to enforce contracts perfectionistically once again.

Having discussed the doctrinal sources for PC, I can complete my argument that courts committed to the freedom of contract have reason to prefer PC over FCwE.

2.7 *Rethinking Incompleteness and the Bounds of Contract*

Having provided an account of formality and its functions in contract law—from consideration to first, second and third-order perfection—I now proceed to make out and defend the claim that PC better realizes a commitment to freedom of contract than does FCwE. My argumentative strategy takes its lead from Grant Gilmore's well-known proclamation of the death of contract. Gilmore argues that contract is collapsing back into tort. I argue that a perfectionistic contract law can distinguish itself from tort and withstand doctrinal collapse, but that a formalistic contract law cannot. The inability to cleanly distinguish itself from tort, I will claim, undermines FCwE's capacity to live up to the ideal of the freedom of contract.

I will then challenge the received wisdom in the legal, economic and management literatures to the effect that contracts are necessarily "incomplete." I argue that incompleteness fills a conceptual void that results from FC and that a shift to PC would allow for a different account, one where contracts are seen as having bounds beyond which there is "no contract," but within which they are complete.

In doctrinal terms, the difference between the *aspirations* of tort and classical contract is fundamental. According to Holmes, "[t]he liabilities incurred by way of contract are more or less expressly fixed by the agreement of the parties concerned, but those arising from a tort are independent of any previous consent of the wrong-doer to bear the loss occasioned by his act."[235]

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[235] HOLMES, *supra* note 70 at 77. There are other ways to conceive of the difference between contract and tort. Kennedy draws a distinction between the two in terms of altruism and individualism. Contract can be

Jay Feinman captures the essence of classical contract in a way that fits the perfectionistic construction I am defending and also the tort-contract distinction I am drawing:

> [A]s conceived by classical contract law, liability was always voluntarily assumed by the individual through his making of a promise or an agreement, unlike in tort law, in which liability was imposed by the legal system without regard for the individual's consent. Contract doctrines such as narrow formation rules and bargain consideration followed logically from these principles and assured that the individual actually had consented to a bargained-for exchange. When courts mechanically applied these abstract, formal doctrines, they protected the individual's right to assume contractual obligation or to avoid it at the same time as they provided a predictable basis for commercial transactions.[236]

Over the last century, however, it appears the doctrinal lines drawn by classical contract as inspired by the freedom of contract ideal have been blurring as courts have expanded contract law with doctrines, like excuse, that supplement parties' actual agreements with obligations they never expressly chose to become subject to,[237] sometimes interceding to write the contracts for the parties.[238] This neoclassical approach to contract law, memorialized in Farnsworth's Restatement, has drawn the support of a broad base of scholars, from relational contract

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understood like tort to promote altruism from the point of view of the imperative not to disappoint expectations:

> The rules of tort law can likewise be seen as enforcing some degree of altruism. Compensation for injuries means that the interests of the injured party must be taken into account by the tortfeasor. In deciding what to do, he is no longer free to consult only his own gains and losses, since these are no longer the only gains and losses for which he is legally responsible. Likewise in contract, when I want to breach because I have found a better deal with a new partner, the law makes me incorporate into my calculation the losses I will cause to the promisee. If my breach is without fault because wholly involuntary, I may be excused for mistake or impossibility.

Kennedy, *supra* note 102 at 1719.

[236] Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283, 1286 (1990).

[237] GRANT GILMORE, THE DEATH OF CONTRACT 96 (2d ed. 1995) (reviewing "[a] number of developments . . . in tracing the twentieth century decline and fall from nineteenth century theory" of contract).

[238] *See generally* Gillette, *supra* note 3 (criticizing the decision in *Aluminum Co. of America v. Essex Group, Inc.*, 499 F. Supp. 53 (W.D. Pa. 1980)).

theorists[239] to law and economics scholars who have sought out terms for courts to insert into parties' agreements in order to create incentives that promote economic efficiency.[240]

Taking stock of this trend, Grant Gilmore announced the death of contract forty years ago. Gilmore emphasized the rising influence of reliance theories of contractual liability,[241] very much legitimated by Fuller and Perdue's pioneering work. Over the course of the twentieth century, a new theory of liability, known as "promissory estoppel,"[242] that does not depend on the existence of a bargain found growing acceptance, leading Gilmore to think that the "classical" bargain theory of contractual liability[243] would soon be swallowed up by tort, whence it came.[244] But as a matter of fact, the classical theory has thrived—certainly in the scholarship and apparently in the courts[245]—even while reliance theories have continued to expand their reach.[246]

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[239] *See, e.g.*, Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 NW. U. L. REV. 877, 903 (2000) ("Relational contract law should generally track the relational behavior and norms found in the relations to which it applies.").

[240] *See* Robert E. Scott, *Rethinking the Default Rules Project*, 6 VA. J. 84 (2003).

[241] Under a reliance theory of contractual liability, liability is contingent upon the plaintiff's out-of-pocket losses and other changes in position that result from the contractual encounter. The mere exchange of promises is insufficient to create any liability under a reliance theory.

[242] This theory was legitimated by the RESTATEMENT (FIRST) OF CONTRACTS § 90(1). *See id.* ("A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.").

[243] The crucial feature of classical liability—for Gilmore and more generally—is that the source of liability is the bargain itself. In formal terms, classical liability does not rest upon the plaintiff's change of position, even though the reliance interest may reinforce the rationale for the enforcement of private autonomy.

[244] GILMORE, *supra* note 237; *see id.* at 95 ("Speaking descriptively, we might say that 'contract' is being reabsorbed into the mainstream of 'tort.'"); *see* Ames, *supra* note 70 at 15 (1888) ("Both in equity and at law . . . a remediable breach of a parol promise was originally conceived of as a deceit; that is, a tort."). *See generally supra* Section 2.1.

[245] *E.g., Tractebel Energy Mktg., Inc. v. E.I. Du Pont De Nemours & Co.*, 118 S.W.3d 60 (opinion supplemented on overruling of reh'g, 118 S.W.3d 929) (Tex. App. 2003) (overturning jury verdict discharging defendant due to a finding of impracticability and holding defendant liable on a formalistic construction).

[246] In *The Death of Contract Law*, Robert Scott recognizes that,

> If anything, the trend that Gilmore identified has accelerated. After the adoption of the Uniform Commercial Code (UCC), the last half of the twentieth century witnessed a dramatic expansion in

Gilmore ignited an ideologically charged debate, and though it continues to simmer unresolved, the détente struck by the Second Restatement's "neoclassical" rendering of contract law has kept the pot from boiling over.[247] After all, advocates of tort-like reliance theories have their Section 90,[248] allowing recovery of reliance expenditures *without* a bargain, and also Section 349,[249] departing from the first Restatement (and following Fuller and Perdue) in sanctioning a reliance remedy even *with* a bargain. At the same time, advocates of a classical approach are appeased by Section 71,[250] defining the formation of a contract out of the exchange of *ex ante* commitments, and Section 347,[251] making recovery of the expectation interest the gold standard for measuring damages.

Today, contract finds itself at a crossroads that once again cuts to the very core of its essence as an area of law. This time, however, the stakes concern the nature of classical liability itself, and the battle lines divide the mainstream theorists who rallied against Gilmore and his

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> the domain of contract law. Courts deployed creative and expansive strategies to find promissory liability that would not have been recognized under the classical model. But despite the accuracy of Gilmore's empirical observations, his prediction that the bargain theory of contract was dying could not have been more inaccurate. Indeed, almost from the moment his book was published, contract theorists of various persuasions set out to demonstrate the vitality and coherence of the bargain paradigm. Legal philosophers argued that the state's role in enforcing bargains is both explained and justified by moral theories grounded in notions of autonomy.' Law and economics scholars proposed the efficiency criterion (in one form or another) as the basis for the bargain theory. Equally important is the fact that contract theory became one of the most significant fields in modern economics. Three Nobel prizes have been awarded largely for work in contract theory, even though the field is less than thirty years old.

Robert E. Scott, *The Death of Contract Law*, 54 U. TORONTO L. J. 369, 369 (2004).

[247] *See* Feinman, *supra* note 236 at 1285 ("The essential quality of neoclassical contract is that it is the product of the attempt to accommodate classical contract law and subsequent critiques of it.").

[248] *See* note 242.

[249] *Id.* § 349 ("As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.").

[250] *Id.* § 71(2) ("A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.").

[251] Entitled "Measure of Damages In General," Section 347 provides that "the injured party has a right to damages based on his expectation interest." *Id.* § 347.

allies.[252] This coalition of scholars, economists[253] and moralists[254] alike, wholeheartedly reject the idea that the real (or sole) root of contractual liability is in the plaintiff's detrimental reliance upon the defendant's promissory representations.[255] Instead, they have sought to account for contract as a kind of property,[256] a legal entitlement that emerges from the executed will of the parties quite independently of any subsequent reliance thereon.[257] Nevertheless, in various ways, many of these scholars have perpetuated a tort-like approach to contract that gives courts the role of assigning liabilities the parties never agreed to.

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[252] *E.g.*, Morton Horwitz, *The Rise of Legal Formalism*, 19 AM. J. LEG. HIST. 251, 263 (1975); Kennedy, *supra* note 102, ROBERTO UNGER, LAW IN MODERN SOCIETY 203-16 (1976); PATRICK ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT (1979).

[253] *E.g.*, Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980) (defending traditional contract rules based on congruence with optimal promissory enforcement); Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683, 686 (1986) ("For the economist the question has become not whether the law of damages should deter breach but rather how much deterrence is desirable and what remedies induce this optimal amount of deterrence."); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 41-65 (1972) (providing for enforcement of executory contracts).

[254] *E.g.*, Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989) (the law should protect a promisee's legal entitlement like property); FRIED, *supra* note 157 (reliance theorists "provide the foil for much of [his] affirmative argument" that contract law enforces promises with expectation damages); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986) (contracts come from consenting to transfer legal entitlements); Peter Benson, *The Unity of Contract Law*, *in* THE THEORY OF CONTRACT LAW (Peter Benson ed., 2001) (accounting for contract law according to the logic of the transfer of ownership); STEPHEN A. SMITH, CONTRACT THEORY (2004) (concluding that rights-based theories provide the best justification for contract law and that promissory theories provide the best analytic account of contract law).

[255] Fuller too emphasized the similarity of contract and property, but without overlooking reliance as a substantive base of liability. *See* Fuller, *supra* note 11 at 806 ("The man who conveys property to another is exercising this power; so is the man who enters a contract." *But see* FRIED, *supra* note 157 at 65 (stating that in cases of impracticability "there has just been an accident, and any resolution of the accident is a kind of judgment, a kind of intervention").

[256] *See* Thomas W. Merrill & Henry E. Smith, *The Property/contract Interface*, 101 COLUM. L. REV. 773 (2001) ("explor[ing] the distinction between in personam contract rights and in rem property rights").

[257] The sense in which I use property-like entitlement here evokes both sides of the property-rule and liability-rule distinction developed by Guido Calabresi and A. Douglas Melamed. *See Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). *See* Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939 (2011) (advocating a stringent liability rule for contract that creates a property-like entitlement to expectation damages—in this sense a liability rule—or the promised performance—in that sense a property rule).

The identity crisis facing classical liability today comes down to this: are courts right to embellish parties' voluntary agreements with obligations and liabilities they never expressly agreed upon? Put differently, should contract provide parties a facilitative apparatus for self-governance through legal obligations and liabilities that are entirely of their choosing?

The tendency towards a tort-like, duty-imposing[258] conception of contract is evinced by the most outspoken opponents of the reliance school as well as the most respected law and economics scholars. For example, in *Contract as Promise*, Charles Fried recognizes that contractual relationships suffer "contractual accidents" that are not accounted for in any promises.[259] In these cases, he thinks, courts should impose liability as they judge best, much as they do in a tort suit, unmoored from the bonds of the parties' intended commitments. This enforcement strategy consists in what Robert Scott calls *ex post efficiency*: the court evaluates what to do where the parties' agreement runs thin with an after-the-fact, case specific analysis.[260]

A different tack is taken by the default rules paradigm,[261] a law and economics approach to doctrinal analysis that is so influential it has achieved taken-for-granted status.[262] The basic

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[258] *See* Klass, *supra* note 87 (distinguishing duty-imposing rules from power-conferring rules and arguing that contract is a "compound" rule).

[259] *See supra* note 255; *see also* Klass, supra note 87.

[260] Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 Nw. U. L. Rev. 847, 850 (2000) (defining strategy). *See also* ROBERT E. SCOTT & JODY KRAUS, CONTRACT LAW AND THEORY 26 (3d ed. 2003) ("Autonomy theories of contract take an ex post perspective in adjudication. They view adjudication as an occasion for identifying and vindicating the pre-existing rights of the litigants. Thus, autonomy theories tend to view adjudication primarily as a mechanism of resolving a dispute between litigants."). Fuller explains how the need for formality dissipates with a reliance or restitution theory of liability:

> To the extent, then, that the basis of promissory liability shifts from the principle of private autonomy to the reimbursement of reliance or the prevention of unjust enrichment, to that extent does the relevance of the channeling function of form decrease. This function loses its relevance altogether at that indefinite point at which it ceases to be appropriate to refer to the acts upon which liability is predicated as a "transaction."

Fuller, *supra* note 11 at 814.

[261] Randy Barnett likens the default rules approach to the way computer programs include default settings for many features:

idea behind this research agenda is that courts should supply terms that provide parties optimal incentives, even though they never actually agreed to these terms. Parties remain free to expressly opt out of the default term in their next agreement, but not when they arrive at court with a dispute. This enforcement strategy consists in what Scott calls *ex ante efficiency*: the court inserts a term designed to promote efficiency from the *ex ante* standpoint.[263] Richard Craswell acknowledges that the substantive difference between tort-like reliance theories and the default rules project is only skin deep.[264] And according to Alan Schwartz, "[t]o dissolve contract into tort [as Gilmore foresaw] would be a less radical break than might initially appear because a

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> The default rule approach analogizes the way that contract law fills gaps in the expressed consent of contracting parties to the way that word-processing programs set our margins for us in the absence of our expressly setting them for ourselves. A word-processing program that required us to set every variable needed to write a page of text would be more trouble than it was worth. Instead, all word-processing programs provide default settings for such variables as margins, type fonts, and line spacing and leave it to the user to change any of these default settings to better suit his or her purposes.

Barnett, *supra* note 191 at 824.

[262] *See id.* at 826 (noting that "[t]he rhetoric of default rules is in the process of becoming the terminology of choice for contract theorists"); Fried, *supra* note 132 at 971 ("The most convincing contemporary literature (and it has grown very large) analyzes the specification of remedial regimes as a question of fashioning appropriate default rules; that is, rules that the courts will imply unless the parties specify something else.").

[263] Scott, *supra* note 260 at 849-50 (2000) (defining strategy).

[264] Comparing incentive-based default rules arguments and Patrick Atiyah's reliance theory, Richard Craswell explains that

> it is a mistake to assume that there is any necessary or inherent conflict between reliance theories, on the one hand, and the second economic theory [that seeks to optimize incentives for efficiency], on the other. Individual reliance theorists may of course differ—both with economists, and with each other—but the extent of their differences will depend on how each answers Atiyah's more specific policy question, about just which kinds of reliance ought to be encouraged. And any differences that do result should be attributed to their different stance on this policy question, not to their initial choice of a "reliance" or an "economic" perspective. On this issue, then, the devil really is in the details, and the choice of initial perspectives determines much less than is usually supposed.

Two Economic Theories of Enforcing Promises, *in* THE THEORY OF CONTRACT LAW 40 (Peter Benson ed., 2001).

similar intellectual approach should be taken to problems in both fields."[265] In sum, these ex post and ex ante strategies have in common the insertion of terms into parties' deals that were never bargained for, and this characteristic puts them on the tort end of the liability spectrum.

Recently, Robert Scott and other scholars have begun a campaign to expunge all tort-like liability from contract.[266] Not only are "courts . . . instructed not to create ex ante defaults or undertake any ex post adjustments,"[267] these scholars also go so far as to disclaim the compensation logic of expectation damages that today fills in for the absence of first-order perfection.[268] According to this new and radical classicism, the civil injury of breach and "the

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[265] Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. CAL. INTERDISC. L.J. 389, 419 n. 43 (1993).

[266] Richard Craswell anticipates the thrust of the new classicism, but note that what Craswell finds "uninteresting" to recognize about contract law provides the fodder for the new classicism's doctrinal campaign:

> If the essence of contract law lies in its formal predictability, or in the parties' ability to determine what responsibilities they have assumed without having to speculate about how a court might later view the case, obligations based on an assessment of the efficiency of B's reliance do indeed depart from an ideally predictable regime. Of course, the same could be said of nearly all rules of contract law—not just the rules of offer and acceptance, but also the default rules governing implied excuses (when does a contract implicitly allocate the risk of a sudden increase in costs?) or the remedies for breach (when it is appropriate to award the full cost of fixing some defect in performance?). On this view, virtually all of contract law would be "tort-like" or "involuntary,"--thus confirming Grant Gilmore's thesis about the death of contract, but only in an uninteresting way.

Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 STAN. L. REV. 481, 544-45 (1996) (notes omitted).

[267] Scott, *supra* note 260 at 851.

[268] Fried, *supra* note 134 at 629 (rejecting idea "that the consequences that should flow from nonperformance of the main subject of the contract are external to the parties' agreement, rather than an integral part of that agreement"); Scott & Triantis, *supra* note 135 at 1429 ("Rather than conceiving of damages as compensation, the right to breach and pay damages is better understood as a valuable option sold by the promisee to the promisor."); Triantis, *supra* note 137 at 828 (noting that "if the parties are morally free to condition their promises, they should also be free to set their own level of damages"); Epstein, *supra* note 137 at 137 (arguing "that the question of contract damages can be examined by the same techniques that are ordinarily used to handle other issues of contract interpretation"); *Globe Ref. Co. v. Landa Cotton Oil Co*., 190 U.S. at 543 (Holmes, J.) ("[U]nlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured.").

consequences that should flow from nonperformance of the main subject of the contract"[269] should be fully for the parties' to work out as options.[270] Viewing remedies as options sheds from contract the lingering resemblance with tort reflected in different ways by Charles Fried's adherence to expectation damages,[271] Richard Craswell's "sliding scale" damages default rule[272] and even the liability rule recently defended by Daniel Markovits and Alan Schwartz.[273] The fundamental commitment of Scott's new classicism is to empower parties to back their bargains with those, and *only those*, liabilities they wished *ex ante* to make part of their commercial exchange. Because "expectation [or other measures of] damages may not be preferred by parties,"

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[269] Fried, *supra* note 134 at 629.

[270] *See supra* text accompanying note 136.

[271] In connection with the conference organized around the thirty-year anniversary of his *Contract as Promise*, Fried now takes the position that:

> It is, of course, the case that many, perhaps most, contracts do not specify remedies in the event of breach. Indeed, all contracts fail to specify the parties' intentions in respect to matters that ex ante seem quite remote and, at any rate, not worth spelling out. So courts are regularly called upon to fill in details that only ex post may loom large. This is a task that Contract as Promise discussed under the term "gaps": The gaps cannot be filled, the adjustments cannot be governed, by the promise principle.

Fried, *supra* note 132 at 970-71 (internal quotation marks omitted). Fried's new view includes remedies within the gaps that courts fill, rather than deem expectation damages naturally evocative of the requirements of promise. *See also* Triantis, *supra* note 137 at 835 (noting that the commitment to expectation damages in *Contract as Promise* "leaves us with an important question for Professor Fried and other moral theorists: Is the expectation measure of damages compensation for the wrong committed by breach, or is it a default term of the contract, like implied conditions?").

[272] According to Craswell,

> some remedies seem usefully understood as attempting to approximate the plaintiff's expectation interest as nearly as the available evidence allows-- including some remedies that may be designated "reliance" damages, but which actually serve to estimate the expectation interest. Other remedies seem to aim for compensation above the expectation interest: not just in the case of punitive damages, but also in the case of some ways of measuring expectation or restitution damages. Still other remedies attempt to limit the plaintiff to something below his expectation interest--including some cases awarding reliance or restitution damages, and most of the cases employing the doctrines that limit expectation damages.

Against Fuller and Perdue, 67 U. CHI. L. REV. 99, 156 (2000) (notes omitted).

[273] Markovits & Schwartz, *supra* note 157.

especially in case of parties contracting to extend credit or transfer risk,[274] its imposition by courts, like when a liquidated damages clause is struck down as super-compensatory, undermines the principles behind the new classicism.[275]

The central doctrinal prescription of this classicism, accordingly, seeks to upend the default rules paradigm that Scott helped to erect.[276] Defecting from the pursuit of *ex ante efficiency* through default rules drawn to guide behavior prospectively, Scott is now of the view that "less contract law is better than more."[277] The mandatory, or immutable,[278] rules that have become part of the law over the last hundred years, such as the obligation to deal in good faith, should be scrapped for similar reasons: imposing immutable terms leaves parties without a clean slate for drawing up their "constitution"[279] of enforceable options. The new classicism thus rejects what Scott calls the "imperialism" of contract law, the profusion of rules that has resulted from a kind of "hubris, . . . the belief that more contract law is always better than less."[280] The austerity

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[274] Triantis, *supra* note 137 at 837.

[275] As I will discuss below, what makes non-enforcement of a liquidated damages clause especially inconsistent with the new classicism is the rationale that compensation presents a ceiling on damages. A different rationale may avoid this inconsistency even while refusing to enforce a liquidated damages term as agreed. *See* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007) (arguing that the justification for a law, and not only the substance of the law, is morally significant).

[276] *See* Scott, *supra* note 240 (noting with "a mixture of pride and chagrin" that he "bear[s] a large responsibility for the formalization in the law and economics of contracts of what has come to be called 'the default rule paradigm'").

[277] Scott, *supra* note 246 at 370.

[278] Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

[279] See Lon Fuller, *The Lawyer as an Architect of Social Structures*, *in* THE PRINCIPLES OF SOCIAL ORDER 264-65 (Kenneth L. Winston ed. 1981) ("By the necessities of his profession the lawyer is frequently called upon to become the architect of social structure. This is true not only where great affairs of state are involved and constitutions or international treaties are being brought into existence, but in the most commonplace arrangements, like working out a contract for a two years' supply of paper towels for the rest rooms of a chain of service stations. In a sense, every contract, every testament, every lease—in short, every legal instrument is a kind of constitution establishing a framework for the future dealings of the affected parties.").

[280] Scott, *supra* note 246 at 370.

of the new classicism would eliminate the vast majority of default and/or mandatory rules[281] in contract law. Certainly, "courts should refrain from filling contractual gaps with broad standards in cases where the parties are silent."[282]

My purpose in this section is not to evaluate the whole reach of Scott's classicism, including his rejection of the default rules paradigm and the rule against penalties in liquidated damages.[283] Rather, I will argue that the coherent path to the legislative conception of contract law sought by Scott rejects formalistic construction. Yet Scott continues to embrace the formalistic rule of PvJ,[284] as part of a larger platform that has been called a "new formalism."[285] Central to this version of formalism—as with the old version—is a formalistic approach to the

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[281] I do not draw a distinction between default rules and default standards in this dissertation, using the former as the umbrella term. *But see* Schwartz & Scott, *supra* note 208 at 601 (arguing that "the cost concern forces contract law commonly to regulate with standards rather than rules, when it regulates at all").

[282] Robert E. Scott, *In (Partial) Defense of Strict Liability in Contract*, 107 MICH. L. REV. 1381, 1391 (2009).

[283] Scott's advocacy of classicism has consistently been part and parcel of his defense of formalist commitments, which have generated much more controversy to date. Though commentators have trenchantly criticized Scott's formalism, *see* Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 964 n. 6 (2010) (collecting authorities regarding criticism of the new formalism), his classicist commitments have received minimal scrutiny. *But see* William C. Whitford, *Relational Contracts and the New Formalism*, 2004 WIS. L. REV. 631 (2004) (arguing that Scott's classicism cannot promote relational virtue in contracting for want of necessary empirical predicates).

[284] Scott, *supra* note 260 (arguing that a classicism that "resolutely declines to fill any gaps at all" is characteristic of a "formalist approach, [according to which] courts are instructed not to create ex ante defaults or undertake any ex post adjustments, but to enforce the (facially unambiguous) express terms of the contract literalistically or 'as written'"); *see* Macneil, *supra* note 239 at 902 (noting that, according to Scott, contract law "is formal, classical (to use that terminology), and simple").

"Under classical contract law . . . a contracting party is bound by the express terms of his promise. Absent an excusing condition, each party bears the risk of unanticipated hardship that makes its contractual obligations more difficult to perform. In short, the seller has the right to stand on the contract." Scott, *supra* note 246 at 373.

[285] *See, e.g.*, Scott, *supra* note 260 at 876 ("Formalism in contract interpretation is not new, of course. But the 'new formalism' rejects the categorical imperative to deduce rules from first principles that characterized classical formalism as practiced by the late-19th-century Langdellians."); David Charny, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842 (1999) (reviewing the critique of Karl Llewellyn that spurred the new formalism).

construction of parties' obligations, justified in part by the difficulty of inserting the right terms into parties' contracts.[286]

> If, as theory suggests, the state is simply incapable of supplying parties in a complex economy with useful defaults ex ante or imposing fair outcomes ex post, the better instrumental strategy is for courts to accept the limits imposed by legal formalism and interpret the facially unambiguous terms of disputed contracts literalistically. [287]

Scott also justifies his embrace of formalistic construction in terms of the virtues of predictability and transparency:

> [T]he invitation to courts to create broadly useful default rules or to undertake equitable adjustment of apparently harsh contract terms threatens a parallel goal of predictable, transparent interpretation of explicit contract terms.[288]

Neither of these justifications, though, explains why, to realize Scott's classicist vision, courts should not embrace perfectionistic construction, which is also controlled by objective criteria (third-order perfection) rather than terms imputed by courts.

Perfectionistic construction, like formalistic construction, provides parties predictability. Substantively, the predictability is arguably far superior to that provided by formalistic construction as of the moment the bargain is entered into, since the parties have themselves established the reach of the deal terms through perfection rites. With formalistic construction, the parties may come to realize how far a court could enforce the terms, but the prejudiced party will have the experience of heteronomy, not autonomy, with the surprise over how much the bargain will end up costing given the unplanned disruption. I will pursue this theme further in Chapter 3.

The additional advantage of perfectionistic construction, from the standpoint of transparency and predictability, is its internal resilience to disruption. Perfectionistic construction

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[286] Formalism also rests on a strict parol evidence rule but the strictness of a parol evidence rule is orthogonal to the main argument.

[287] Scott, *supra* note 260 at 848.

[288] *Id*.

has a built-in solution to the problem of disruption: *no enforcement of unperfected bargains*. Formalistic construction really does not, other than the bitter balm of PvJ's Euthyphro bootstrap. This puts enormous pressure on formalistic courts whenever performance under the disruption at bar is too outlandish to enforce. After all, "[j]udges are reluctant to invoke the coercive machinery of the state to require a party to perform a contract (or to pay damages) unless the judge is satisfied that the contract actually directed what the party failed to do."[289] Formalistic courts will try to find ways to avoid becoming the instruments of injustice, and this make formalistic construction unstable and unpredictable and less preferable from a court's point of view.

Given the factors concerned, perfectionistic construction is at least as favorable to the ends sought by Scott as formalistic construction, and it seems to have significant advantages. The conceptual obstacle between Scott's aspirations for contract law and the embrace of PC may well come from the theory of contracting that has arisen to make sense of the contract law we have at hand. Contracts, according to Scott and scholars of all stripes, are *incomplete*. Steven Shavell defines a contract as "incomplete if it is not completely specified, which is to say, if the contract does not list explicitly all the possible conditions in the universe under consideration."[290]

There are, however, two sense of incompleteness—the legal version and the economic version—that need to be distinguished.

> To a lawyer, a contract may be incomplete in failing to describe the obligations of the parties in each possible state of the world. Should a state of the world materialize that falls within the gap, the enforcing court must choose either to decline to enforce the contract or to fill the gap with a default obligation.[291]

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[289] See Schwartz & Scott, *supra* note 208 at 583.

[290] STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 292-293 (2004).

[291] Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187, 190 (2005).

This definition of incompleteness could apply to *Sun Printing*, where the parties did not specify what should happen if they could not agree on the time term.[292] According to Alan Schwartz, any bargain which is not perfected in the first order (damages) is *legally* incomplete: "the contract is silent respecting the parties' payoffs if one of them breaches."[293]

The cases of disruption discussed in this dissertation have not tended to be incomplete in the legal sense (on the *third* order—they have been legally incomplete on the first order, relying on the default provided by assumpsit's compensation paradigm). The difficulty before the court exists because the bargain *is not* legally incomplete: the terms call for performance under disruption that was not bargained for. It is the economic sense of incompleteness that has play in these cases and in contract theory. This economic sense of incompleteness goes to the heart of the entire economic exchange. According to Scott and Triantis:

> A contract is incomplete [in the economist's sense] if it fails to provide for the efficient set of obligations in each possible state of the world. Such a contract is "informationally incomplete" even though it is "obligationally complete" in the sense that it does not contain any gaps. Suppose that, in return for a payment of $10,000, the seller promises to deliver a blue widget to the buyer on a specified date. As just noted, this contract is obligationally complete. But if there are circumstances in which the widget costs more to produce than it is worth to the buyer, the performance of this contract is inefficient. Thus, the contract is incomplete in the economic sense.[294]

Appealing to the economist's sense of the term, Scott thinks that contract law is fundamentally about making sense of the problem of incompleteness.

> [T]he central task in developing a plausible normative theory of contract law is to specify the appropriate role of the state in regulating incomplete contracts. Complete contracts (to the extent that they exist in the real world) are rarely, if ever, breached since by definition the payoffs for every relevant action and the corresponding sanctions for nonperformance are prescribed in the contract. In the case of incomplete (or relational) contracts, however,

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[292] *See supra* text accompanying notes 145-147.

[293] Alan Schwartz, *Incomplete Contracts*, *in* NEW PALGRAVE DICTIONARY OF LAW AND ECONOMICS 277, 277 (Peter Newman, ed., 1998).

[294] Scott & Triantis, *supra* note 291 at 190-91. Schwartz says that "[e]conomists have not settled on a definition of incompleteness but agree on a paradigm case: a contract is incomplete when it is insufficiently state contingent." Schwartz, *supra* note 293 at 277.

> parties have incentives to breach by exploiting gaps in the contract. Making the verifiable terms of the contract legally enforceable and regulating incompleteness in a consistent manner reduces, but does not eliminate, these incentives to breach. There still remains the fundamental question: should the law seek to complete the contract for the parties? And, if so, from what vantage point should the contractual gaps be filled? Determining the answers to these questions has preoccupied contract law scholars for the past twenty-five years.[295]

Scott's answer to this problem has already been stated. He has abandoned the quest for economically-efficient default rules, and now holds that the best enforcement strategy in contract draws upon formalistic construction.

But is contract law fundamentally about incompleteness? This depends on whether contract law is perfectionistic or formalistic. In a perfectionistic contract law, incompleteness falls out of the equation, leading to a conception of the task of contract law that diverges sharply from Scott's. The first challenge for a perfectionistic contract law is discerning whether an obligation that is presented for enforcement was perfected or not. This determination relies upon external evidence—formalities—rather than states of mind. With respect to perfected obligations, the problem for doctrine concerns the legitimacy of enforcement, not the incompleteness of the parties' deal. Lord Redesdale mentions only the doctrine of legality, in addition to the forbearance of perfectionistic construction. There are, however, numerous other doctrines of forbearance, such as the rule against penalties in liquidated damages, unconscionability, and others. These are doctrines that reflect institutional limitations on what courts can legitimately do and thus need not be conceived as restrictions on private autonomy.[296]

The point is that a starkly incomplete (in economic terms) bargain is, necessarily, unperfected and thus not contractual in a perfectionistic contract law. Incompleteness is an indicator that a bargain is *not* a contract. So in a perfectionistic law, contracts are complete,

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[295] Scott, *supra* note 260.

[296] Seana Valentine Shiffrin, *Paternalism, Unconscionability Doctrine, and Accommodation*, 29 PHIL. & PUB. AFF. 205 (2000).

obligationally and economically, and bounded. From this perspective, even the contract in *Sun Printing* is seen as complete *within its bounds.*[297] There is a set of facts—the one that actually obtained—for which the contract in that case did not dictate terms. As I see it, the contract was bounded, and its bounds did not extend to the case before Judge Cardozo.

The other significant difference between Scott's conception of contract law and that which follows from perfectionistic construction concerns the status of *un*perfected bargains. Because of Scott's formalistic approach (which is, in this regard, no different from the Restatements), unperfected bargains are mixed in the same bag with perfected bargains to be enforced under what is ostensibly the same law. I showed that black-letter law does credit perfection, but because perfection is not required, unperfected bargains get "contractual" treatment. The thrust of my argument is to partially endorse Gilmore's notion of "contorts."[298] Whereas Gilmore would combine the whole field of contract law with tort law, my suggestion is that there should be three realms of doctrine: the law of perfected bargains (*contracts*), the law of unperfected bargaining (*contorts*) and tort law as such.

The doctrinal significance of this taxonomy is calling into question the appropriateness of judge-made law in the realm of contorts. The incompleteness paradigm gives judges a significant role establishing the obligations and liabilities in this realm of contorts as questions of law. Given their unperfectedness, though, shouldn't questions about obligations and liabilities that arise in contorts go to the jury? Classical contract law sought to keep the jury out of commercial

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[297] *See supra* text accompanying notes 145-147.

[298] GILMORE, *supra* note 237 at 98 ("I have occasionally suggested to my students that a desirable reform in legal education would be to merge the first-year courses in Contracts and Torts into a single course which we could call Contorts.").

adjudication;[299] the implications of a switch to perfectionistic construction call this division of labor into question.

Where I differ with Gilmore, therefore, is in my view of the potential of our contract law to yield a law of *perfected* obligations that can take the aspirations of classical contract law to new—and defensible—heights. One conceptual contribution I hope to make with this dissertation follows from seeing these two separate layers of liability—the law of perfected obligations and the law of unperfected obligations—as overlapping and, sometimes, interacting but always conceptually distinct. A court's finding that an obligation is unperfected leaves open the question whether, as an unperfected obligation, the plaintiff can advance a theory of recovery that,

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[299] Classical contract has many rough edges that I have left out of the account. Kennedy describes the breakdown of "protective doctrines" and the creation of damages law (none really existed before this period), *see* Simpson, *supra* note 67, that came with the rise of classical contract in the mid-nineteenth century that brought excuse doctrine:

> For example, the contract law of 1825 was full of protective doctrines, such as the incapacity of married women, infants, lunatics and seamen. The consideration doctrine often functioned to enforce an altruist contractual morality, as did the doctrines of fraud, mistake, duress, undue influence and unconscionability. Jury discretion in setting damages provided a further vehicle for importing community standards of fair conduct. For antebellum legal thought, there was not much difficulty in explaining all of this: the doctrines represented the legal enforcement of straightforward moral norms, but raised questions of policy in so much as an insistence on policing bargains might be harmful to the goal of economic development.
>
> During the latter part of the century, some of these doctrines were cut back, and others expanded somewhat. But *all* of the doctrines were recast as implications of the fundamental idea that private law rules protect individual free will. The basis of restrictions on capacity is that infants and those like them lack free will; duress is the overbearing of the will, undue influence its subversion; fraud leads to a consent that is only apparent; mistake meant that the wills of the parties had miscarried; the measure of damages was defined by the will of the parties with respect to the extent of liability. Recast in terms of will, the rules of contract law still represented a moral as well as a practical vision, but that vision was no longer perceptibly altruist. The new premise was that people were responsible for themselves unless they could produce evidence that they lacked free will in the particular circumstances. If no such evidence was available, then they were bound to look to their own resources in performing what they had undertaken. In place of a situational calculus of altruistic duty and an equally situational calculus of economic effects, there was a single individualist moral-political-economic premise from which everything else followed.

Kennedy, *supra* note 102 (notes omitted).

perhaps, can go to the jury despite the failure of the classical theory.[300] Charles Fried recognized this phenomenon in the law over thirty years ago: "American development, I believe, shows that compensation for reliance losses need not compete with the promise principle, but may comfortably supplement it."[301]

Perfectionistic construction is demandingness about formality—the refusal to recognize a contract as such that does not walk and talk like a contract. The approach is opposed, not only to formalistic construction, but also to the effort to establish parties' hypothetical bargains, as in excuse. David Charny pushes back against conventional wisdom and suggests, as I have argued, that the refusal to entertain hypothetical bargains can very much advance party autonomy, in part through its prospective, disciplining influence.

> Consider, for example, the adjudicator who values autonomy because she considers that it serves an important disciplinary function to require persons to specify their arrangements and then live by them. This approach to autonomy would not lead the adjudicator to be sympathetic to careful reconstruction of the individual parties' choices for cases in which they were silent. Indeed, the adjudicator might be inclined to think that for her to "help the parties out in this way" might dilute the disciplinary force of her adherence to express agreements. She might then proceed by other hypothetical bargain rules - for example, she might assume that parties meant to reserve discretion on all issues on which their agreements were silent.[302]

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[300] See ROBERT A HILLMAN, THE RICHNESS OF CONTRACT LAW: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 75-76 (1997) (arguing that the tort-contract debate is "symptomatic of the unwillingness to admit that the law of promise entails multiple norms and goals and therefore reflects both principles of fairness and autonomy" and noting that "a court may validate a contract defense, but conclude that the promisee's reliance also merits some relief").

[301] Fried, *supra* note 142 at 1867. Duncan Kennedy describes a proposal contemporary with the first Restatement that would have created a law consistent with these propositions.

> By far the most striking work in this genre was George Costigan's brilliant article, "Implied-in-Fact Contracts and Mutual Assent," arguing for allowing reliance recoveries on "implied-in-fact contracts" imposed by the court as a default rule in the absence of express agreement to the contrary.[176] He proposed to "imply" such contracts to reimburse reliance in a variety of situations in which the standard approach was either to enforce, and grant the expectancy, or not to enforce, leaving the parties to restitutionary remedies.

Kennedy, *supra* note 107 at 148.

[302] Charny, *supra* note 8 at 1834.

How courts enforce contracts tells parties how to enter into them. A perfectionistic approach says to undertake formalities so far as the intended reach of the bargain. This is the "disciplinary force" of the doctrine. Rather than interpreting a judicial refusal to enforce inadequately formalized terms as another "hypothetical bargain rule," however, I have presented perfectionistic construction as a demand for formality.[303]

This demand for formality is based on the heightened risk of *infringing* party autonomy when enforcing terms around disruption. The court wants good evidence of the agreement about the appropriate remedial action in that scenario, and the escalation of required formalities above those required in the fair-weather case can be analogized to the way a higher ratio of the Senate must vote to ratify a treaty (two thirds) than a bill (half).

> Where men make laws for themselves it is desirable that they should do so under conditions guaranteeing the desiderata described in our analysis of the functions of form. Furthermore, the greater the assurance that these desiderata are satisfied, the larger the scope we may be willing to ascribe to private autonomy. A constitution might permit a legislature to pass laws relating to certain specified subjects in an informal manner, but prescribe a more formal procedure for "extraordinary" enactments, by requiring, for example, successive readings of the bill before it was put to a vote. So, in the law of contracts, we may trust men in the situation of exchange to set their rights with relative informality. Where they go outside the field of exchange, we may require a seal, or appearance before a notary, for the validity of their promises.[304]

Judges who follow perfectionistic construction can sleep at night with the peace that they are not enforcing contracts that the parties did not enter into. From time to time, parties will have failed to formalize the deal as they may have contemplated it should work in case of disruption, giving one party the opportunity to take advantage of the failure of formality.[305] In these cases, perfectionistic courts at least have the peace that the ground rules for obtaining access to the realm of perfected contracts are consistent and clear, giving parties prospectively adequate

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[303] *Cf.* Corbin, *supra* note 19.

[304] Fuller, *supra* note 11 at 814.

[305] *See supra* text accompanying note 144.

guidelines for reaching the realm of private legislation.[306]

[306] BENJAMIN N. CARDOZO, THE GROWTH OF THE LAW 111 (1924) ("The end to be attained in the development of the law of contract is the supremacy, not of some hypothetical, imaginary will, apart from external manifestations, but of will outwardly revealed in the spoken or the written word. The loss to business would in the long run be greater than the gain if judges were clothed with power to revise as well as interpret. Perhaps, with a higher conception of business and its needs, the time will come when even revision will be permitted if it is revision in consonance with established standards of fair dealing, but the time is not yet.").

CHAPTER 3: FREEDOM WITH THE FORMALITY OF PERFECTION

In the previous chapter, I argued that courts that seek to honor the freedom of contract by enforcing only contract terms selected by parties find greater doctrinal congruence with perfectionistic construction than with FCwE. The constitutional basis for this difference is the formality that marks the parties' exercise in private autonomy when they perfect terms in respect of disruption. Whether a court enforces a contract formalistically or discharges the defendant based on excuse doctrine, FCwE overlooks the absence of formality in respect of the parties' bargain over the case of disruption.

Law and economics scholars, who view contracts as inherently incomplete, argue that FCwE—usually FC *without* excuse—best realizes parties' autonomy. A typical statement sounds like this: "Courts must fill the gap (or interpolate) somehow in order to enforce the promise; if they fail to do so, they undermine the liberty of the individual to promise."[307] In this chapter, I will reject this proposition, making the case that parties concerned to contract as an exercise in private autonomy will prefer a PC to FCwE. The thrust of my argument can be summarized by counterposing two Latin phrases, *pacta sunt servanda* ("agreements are to be observed"),[308] which formalists who defend FCwE claim to hold dear, with *non haec in foedera veni* ("It was not this that I promised to do"[309]) which inspires the perfectionistic proposal advanced here.

Autonomy in my argument refers to the realization of the deal the parties made. So if I agreed to sell for $10, the realization of my autonomy depends on the enforceability of the $10 payment term. But suppose that a lawyer convinces me that I could sue and, for whatever reason, recover $20. I like $20 more than I like $10, and I want the extra $10. This $10 bonus, however,

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[307] Triantis, *supra* note 137 at 829.

[308] *See* E. Allan Farnsworth, *An International Restatement: The UNIDROIT Principles of International Commercial Contracts*, 26 U. BALT. L. REV. 1, 7 (1997).

[309] *Davis Contractors Ltd v. Fareham Urban District Council*, [1956] A.C. 696 at 729 (Radcliffe, L.).

has no place in the evaluation of my autonomy in this sale deal. So we will not say that my autonomy gets frustrated by the unavailability of the damages my lawyer told me I could recover. What we must say, though, is that my autonomy in the relevant sense *does* get advanced by the availability of a legal action against me to enforce my commitment to sell even though at the time of the suit I wished not to sell—whether because I tried to take the money and run, say, or because I chose to take my last unit and sell it to someone else for $20. On the other hand, we will not say that the buyer's autonomy is enhanced if I can bring suit to enforce the $10 payment without living up to my end of the bargain.

My contention is simply that FCwE cannot honor this sense of autonomy. Sections 1 and 2 spell out FCwE's weakness in this regard. FC alone and FC with excuse each evaluate the bargain in total abstraction from the pricing of the risk of disruption and loss that is embedded in any deal and, consequently cannot help but impose remedial and, therefore, price terms on parties who never chose them. I then consider a variation on the argument for FCwE. Taking the parties' bounded rationality into account, this rational actor argument says that FCwE successfully advances autonomy *synthetically*, based on what it would have been rational for parties to want even though they did not say so. I reject this argument in Section 3, and I rehabilitate the plausibility of PC in Section 4 by disarming the bounded rationality objection constructively.

3.1 *Heteronomy in Formalistic Construction*

Put simply, my contention is that a formalistic construction of contracts, as inspired by the rule of *Paradine v. Jane*,[310] imposes a default rule frustrates party autonomy (just like all the other default rules Scott's new classicism seeks to displace).[311]

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[310] Aleyn 26, 82 Eng. Rep. 897 (1647). The case appears to have become popular only in the 19th century. *See* Gordley, *supra* note 7 at 521 (noting "the case was [not] discussed by pre-19th century treatise writers); KESSLER & GILMORE, *supra* note 158 at 758 ("The modern vogue of the case may date from Serjeant Williams' note to Walton v. Waterhouse, 2 Wms. Saund. 420, 85 Eng. Rep. 1233 (K.B. 1684). According

This phenomenon was noticed by an astute American writing well before the rise of excuse doctrine:

> although courts may shelter themselves under the very correct principle that they are only to expound, not to *make* contracts,[312] I say that they *make* contracts by means of this doctrine [of *Paradine v. Jane*]; that what they miscall a *strict* is in fact an enlarged construction; for to a covenant to deliver goods, or carry a ship to such a place or at such a time, simply so expressed, they add the words *at all events*, which never were or could be within the intention of the parties.[313]

The substance of the challenge is that FC does not render a faithful likeness of the parties' deal, enlarging the parties' deal by adding "at all events" to every performance term.

This feature of formalistic construction is readily seen by revisiting *Taylor v. Caldwell*. Here, once again, is the agreement that memorialized the deal:

> Agreement between Messrs. Caldwell & Bishop, of the one part, and Messrs. Taylor & Lewis of the other part, whereby the said Caldwell & Bishop agree to let, and the said Taylor & Lewis agree to take, on the terms hereinafter stated, The Surrey Gardens and Music Hall, Newington, Surrey, for the following days, viz. :—
>
> Monday, the 17th June; 1861,
> " " 15th July, 1861,
> " " 5th August, 1861,
> " " 19th August, 1861,
> for the purpose of giving a series of four grand concerts and day and night fêtes at the said Gardens and Hall on those days respectively at the rent or sum of 100l. for each of the said days.[314]

Next add the fact that the Music Hall burned down between the date of the agreement and the date for the first performance. According to formalistic construction, the fire means that Caldwell

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to the Dictionary of National Biography, Williams prepared his edition Saunders between 1799 and 1802.").

[311] An additional difficulty that I will not emphasize in my argument is that courts do not like to enforce agreements inconsistently with the parties' apparent deal, even if the agreement's terms appear plain. In other words, unmitigated formalism is jurisprudentially unstable. Even Schwartz and Scott recognize this tendency in the judiciary. *See* Schwartz & Scott, *supra* note 208 at 583 ("Judges are reluctant to invoke the coercive machinery of the state to require a party to perform a contract (or to pay damages) unless the judge is satisfied that the contract actually directed what the party failed to do.").

[312] *See infra* note 329 (describing history of judicial preference not to make parties' contracts).

[313] *Execution of a Contract Impossible*, 10 AM. JUR. at 251-52 (emphasis in the original).

[314] 3 B & S 826, 828 (1863).

and Bishop must necessarily breach their obligation under the agreement: there is no realistic way to do what they agreed to do.[315]

Seen this way, the formalistic court fulfills the freedom of contract by compensating the injury of the breach. The classical measure of damages is calculated to compensate Taylor and Lewis for the disappointed expectation, and ever since the second Restatement,[316] the reliance measure, which may instead be awarded,[317] compensates what Taylor and Lewis actually sued to recover—marketing and other preparation expenses for the show.[318] Now suppose we ask Caldwell and Bishop to sit down for a few questions, certain they will answer sincerely. We explain that the clearest way to understand a bargain is to know what one is obliged to do in case of non-performance. One case of non-performance is in case of a fire. What do you, Caldwell and Bishop, say this term of the deal provided? Did it say you would have to pay expected profits? Or did it say you would have to make Taylor and Lewis whole for their reasonable outlay? What can we expect Caldwell and Bishop to say? Surely, that they are not sure what it said, because the agreement did not say anything about this contingency. Justice Blackburn, for the Queen's Bench,

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[315] *See supra* note 154.

[316] See, e.g., RESTATEMENT (FIRST) OF CONTRACTS § 329 ("Where a right of action for breach exists, compensatory damages will be given for the net amount of the losses caused and gains prevented by the defendant's breach, in excess of savings made possible.")

[317] RESTATEMENT (SECOND) OF CONTRACTS § 349 (holding as an alternative to expectation damages that "the injured party has a right to damages based on his reliance interest").

[318] KESSLER & GILMORE, *supra* note 158 at 785 (noting that "plaintiffs were suing to recover money spent in advertising the concerts and in other unspecified preparations"). Justice Holmes provides a helpful bridge between the old and the new classicism:

> When a man makes a contract, he incurs, by force of the law, a liability to damages, unless a certain promised event comes to pass. But, unlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured. The old law seems to have regarded it as technically in the election of the promisor to perform or to pay damages. Bromage v. Genning, 1 Rolle, 368; Hulbert v. Hart, 1 Vern. 133. It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter.

Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. at 543.

concludes just that: "[t]he parties when framing their agreement evidently had not present to their minds the possibility of such a disaster."[319] Since the parties "made no express stipulation with reference to [the possibility of such a disaster], . . the answer to the question must depend upon the general rules of law applicable to such a contract."[320]

It is no secret, of course, that contract law has its default rules to "fill in gaps."[321] What is usually not noticed is that formalistic construction is among them, perhaps because it cuts so deeply to the core of what we think a contract is (making us susceptible to the Euthyphro bootstrap).[322] The central difficulty is that courts see bargains through formalistic lenses so long as the parties failed to perfect the litigated performance obligation. That is precisely the order in which Justice Blackburn's inquiry runs. In this section, I am challenging FC without excuse. According to this contract law, courts can have no doubt what the general rules of law require: the contract is to be enforced against Caldwell and Bishop. (How damages will be assessed is another story, discussed further in Section 2.3.)

The conflict between this rule and the autonomy of the parties is easy to show. In such cases, as Charles Fried says (and Justice Blackburn indicates), "on the issues in question, the

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[319] 3 B & S at 833.

[320] *Id*.

[321] Ayres & Gertner, *supra* note 278. Duncan Kennedy, writing decades before Ayres and Gertner, called defaults "suppletive rules":

> The ambiguity of the legal directives in this category is easiest to grasp in the cases of interpretation and excuses. For example, the law of impossibility allocates risks that the parties might have allocated themselves. Doctrines of this kind, which I will call suppletive, can be interpreted as merely facilitative. In other words, we can treat them *not* as indicating a preference for particular conduct (sharing of losses when unexpected events occur within a contractual context), but as cheapening the contracting process by making it known in advance that particular terms need not be explicitly worked out and written in. The parties remain free to specify to the contrary whenever the suppletive term does not meet their purposes.

Kennedy, *supra* note 102 at 1693.

[322] Arguably, Randy Barnett succumbs to this error. *See* Barnett, *supra* note 191.

parties *had no will at all*."[323] Had they discussed the risk, Caldwell and Bishop might very well have agreed to be liable to Taylor and Lewis in case they could not make the facilities available.[324] But would they have agreed to turn over an estimate of lost profits? Perhaps they would have agreed to refund Taylor and Lewis's wasted investments in preparing for the show? Or to pay a flat rate, i.e., liquidated damages? And, in respect of any of these alternatives, how can we know whether Caldwell and Bishop would have taken on express liability without any additional payment? And if they would have required payment, how can we know how much? The inability of formalistic construction to address these questions is a restatement of my case for perfectionistic construction.

3.2 *Heteronomy in Excuse*

If a court rejects FC as the "general law" that is suitable for making sense of the deal between Taylor and Lewis and Caldwell and Bishop, then what? We already have discussed historical developments, but conceptually, what kinds of alternatives are there? According to Fried (in an unpublished paper), the opposite of formalism is purposivism."[325] Purposivism, in the context of statutory interpretation (whence Fried draws the term), "assumes that fidelity to background statutory purpose, rather than textual detail, is more likely to reflect the actual intent or will of a Congress that is sometimes imprecise in its expression"[326] and guides courts to interpret the text accordingly. I rely on Fried's introduction for the conceptual emphasis it provides on the *way* excuse works, and also because Fried, as most do, misses the conceptual space for a third way occupied by the formality approach of PC.

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[323] FRIED, supra note 254 at 65 (emphasis in the original).

[324] *See supra* text accompanying notes 233-235 (characterizing Holmes's version of perfectionistic construction as a weak form).

[325] Charles Fried, *The Ambitions of Contract as Promise Thirty Years on* (unpublished manuscript, 2012).

[326] John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 9 (2001).

The excuse doctrine that grew out of *Taylor v. Caldwell* is applied by courts to evaluate the breach of contract defense that asserts impracticability of performance, such as the impossibility of making available the Music Hall after the fire. A court that recognizes the impracticability defense does so based on the affirmative determination that the parties' agreement contains an unwritten condition—an implied term or basic assumption[327]—making liability for the allegedly breached performance obligation contingent on the non-occurrence of the circumstances that, in this case, made performance impracticable. In the words of Justice Blackburn, in cases that warrant application of excuse doctrine,

> there [was not] any express stipulation that the destruction of the person or thing shall excuse the performance; but that excuse is by law implied, because from the nature of the contract it is apparent that the parties contracted on the basis of the continued existence of the particular person or chattel. In the present case, looking at the whole contract, we find that the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance.[328]

Excuse doctrine adds a term to the parties' agreement that makes it address the disruption they appear not to have considered.

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[327] The second Restatement distinguishes between these two formulations. The Introductory Note explains that,

> The rationale behind the doctrines of impracticability and frustration is sometimes said to be that there is an "implied term" of the contract that such extraordinary circumstances will not occur. This Restatement rejects this analysis in favor of that of Uniform Commercial Code § 2-615, under which the central inquiry is whether the non-occurrence of the circumstance was a "basic assumption on which the contract was made." See Comment f to § 2. In order for the parties to have had such a "basic assumption" it is not necessary for them to have been conscious of alternatives. Where, for example, an artist contracts to paint a painting, it can be said that the death of the artist is an event the non-occurrence of which was a basic assumption on which the contract was made, even though the parties never consciously addressed themselves to that possibility.

RESTATEMENT (SECOND) OF CONTRACTS 11 IN NT. Though there may be conceptual differences between the constructs—finding implied terms suggests interpretation whereas finding a basic assumption suggests construction—they are not material to my analysis. *But see* Corbin, *supra* note 303 at 849 ("It has long been observed by the more analytically inclined judges that the asserted 'intention of the parties' is often in fact the intention of the judges. The process is one of judicial 'construction' even though expressed in terms of mere 'interpretation.' While it is literally true that the courts do not make a contract for the parties, it is also literally true that it is the courts and not the parties who determine the legal operation of any contract that the parties have made.").

[328] 3 B & S at 839.

Notice that despite the willingness to insert this term, the court does not feel at liberty to establish an adjustment of the consideration to compensate for the change it makes to the parties' deal.[329] Lest it blatantly offend the tenet of the freedom of contract that courts shall not make contracts for parties, the excuse court feels locked into two choices: enforce the verbalized terms *at all events or* discharge all obligations.[330] The finding of excuse in *Taylor v. Caldwell* led the "parties [to be] excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and other things."[331]

How could the court possibly know that Taylor and Lewis agreed to expose themselves to making significant investments in preparing for the performances without any protection against the risk of non-performance? Would they not have demanded to pay less if Caldwell and Bishop insisted that in case they could not make the facilities available, Taylor and Lewis would bear all

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[329] Professor Farnsworth summarizes the pre-history of excuse doctrine which demonstrates why overtly tinkering with pricing has always been out of the question:

> Courts in the seventeenth century, with a literalism characteristic of their time, sought to confine themselves to the bare framework provided by the parties through the letter of their contract language. . . . The first relaxation of this literalism came through a more liberal interpretation of contract language. Courts still purported to regard the agreement of the parties as an exclusive source. But while confining themselves to the framework provided by the language of the contract, they began to take greater liberties in defining its scope. . . . Slowly the courts began openly to go beyond the letter. But they still attempted to preserve the illusion that the agreement of the parties remained heir exclusive source. Therefore these excursions were made in the name of the parties, by basing the result on their "intention," and they were carried out in the style of the parties, by casting the result in the form of the contract term that they had "intended." In this way courts constructed fictional extensions of the original framework provided by the parties to yield an edifice ample enough to encompass the dispute. . . . For the law of impossibility the case was Taylor v. Caldwell in 1863, where the court reasoned that a promise to furnish a music hall must be "construed ... as subject to an implied condition that the parties shall be excused in case ... performance becomes impossible," and that this would "further the great object of making the legal construction such as to fulfill the intention of those who entered into the contract."

Farnsworth, *supra* note 170 at 863-64.

[330] This has certainly been the case in courts of law and largely in courts of equity. But Lord Redesdale lent legitimacy to the alternative of scaling down the performance sought in a petition for a decree of specific performance to accord, with the plaintiff's consent, to accord with the justice of the changed circumstances. The Supreme Court endorsed this strategy. *See supra* note 202.

[331] 3 B & S 840.

the risk? Of course, we can only speculate here. What we know is that the court imposed a risk allocation term where there was none, and this necessarily imposes a new price term. One party gets their performance obligation conditioned, and the other didn't even have to pay for the condition. Its insensitivity for the autonomy of pricing is a decisive strike against excuse doctrine from the standpoint of the freedom of contract.

At its best, excuse doctrine prices deals heteronomously. At its worst, excuse becomes a factor that makes contract law less predictable. Notice the implications of purposivism in contract law. By definition, excuse does not draw the line between FC and discharge by evaluating the formalities the parties undertook to commit to the deal. The fact that the excuse court is attempting to divine the nature of the deal, without regard for the parol evidence rule and without any consensus from the parties (they are in court because they do not agree), makes the doctrine notoriously inconsistent.[332] An inconsistent doctrine confounds party autonomy by making it difficult for parties to plan. Most unfortunately, the party prejudiced by a disruption cannot confidently refuse to perform without risk of protracted litigation that cannot be settled on the papers, i.e., without a trial.

Because excuse is insensitive to autonomy in pricing and notoriously unpredictable, the doctrine cannot meet the aspirations of the freedom of contract (FCwE yields inadequate freedom *from* contract). The freedom of contract, therefore, requires a different kind of anti-formalist alternative than the one offered by excuse's purposivism.

FC and excuse doctrine both fail to protect party autonomy for a common reason: neither approach recognizes that the terms of an agreement are priced as part of a commercial

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[332] See Donald J. Smythe, *Bounded Rationality, the Doctrine of Impracticability, and the Governance of Relational Contracts*, 13 S. CAL. INTERDISC. L.J. 227, 229 (2004) (noting that "the inconsistencies in the case law merely reflect the confusion and disagreement among the courts about the appropriate role to assign to the excuse doctrines").

exchange.[333] (Excuse is also unpredictable). It is useful to recognize the disanalogy with statutory legislation. Congress does not pay or get paid to impose binding obligations upon others.[334] In contract, the opposite is true: each party is paid by the other—with performance or other consideration—to take on the liabilities that constitute the deal. FC, however, enforces agreements as if they were statutes to be interpreted in textual fashion in a vacuum from the commercial deal (and subsequent circumstances).[335] This suggests the interpretation of formal contracts, which do not issue from exchange but rather emerge as *grants*. Excuse doctrine also enforces agreements like statutes, except it interprets them purposively (with a standardized heuristic). But because both FC and excuse doctrine treat the verbalizations of deals like quasi-statutes, these approaches lead courts to completely ignore the fact that parties strike a price point up front that encompasses all the risks of disruption and loss that accompanied their exchange. Add one more risk to one side, and the court has priced the deal heteronomously. There is no analogy to this pitfall in statutory interpretation (without segmenting Congress into parties and interest groups that deal in legislation).

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[333] As Richard Craswell explains,

> there are a number of reasons why reasonable actors might sometimes prefer to pay a higher price for their contract, if doing so allows them to collect a more generous remedy in the event of a breach. For one thing, paying for such a remedy might get the buyer a more reliable product or service, if the larger sanctions give sellers greater incentive to reduce the number of preventable defects. And even for those defects that are not practicably preventable, paying for a higher remedy could give buyers additional insurance, which would be particularly valuable if private insurance is unavailable, and if the law's usual damage remedy provides less insurance than buyers want. Higher prices might also correct for some kinds of imperfect information, if the higher prices reflected (as they might in a strict-liability regime) the cost of risks that consumers would otherwise underestimate. And in any situation where enforcement of legal rules is less than perfect, buyers might prefer to pay higher prices (up to a point) to cover the extra penalties needed to increase deterrence.

Craswell, *supra* note 160 at 739 (notes omitted).

[334] Though Congresspersons may be paid to do just that.

[335] *See supra* note 313 and accompanying text.

Consider another example. The price I am willing to pay a firm to shovel my driveway for the winter season, if I have any choice about it,[336] depends on what will happen if, for whatever reason, no one shows up after it snows. Whether the problem is that the firm is too busy or its shoveler breaks a leg or the firm's equipment is stolen or broken, an unshoveled driveway is a problem I would want to avoid. I may want to pay more to a firm that accepts liability of some sort for these possibilities than one that does not. Especially if I have a steep and long driveway, I will place a significant value on having assurance that reliance on a firm to handle this potentially life-saving (or endangering) job is reasonable. But suppose the firm and I enter into a deal that does not price non-performance, and then performance becomes an impracticability for the firm. I sue and the firm asserts the impracticability defense, for whatever reason. Both FC and the purposivism of excuse doctrine can only address the pricing issues presented by this scenario in the crude way available with a statutory approach: either enforce the "statute" formalistically or "nullify" it so as to discharge all performance and payment obligations. Either way, the court imposes upon the parties a price structure that was never agreed to. Arguably, there would be a dose of corrective justice in adjusting the counterparties' consideration retrospectively: discharge for the defendant is contingent of payment of a late "insurance" fee to the plaintiff to cover the assignment of the risk to the plaintiff. That might present PC a stronger defense. A price for that risk is more just than no price for that risk (as happened to Taylor and Lewis), perhaps, but that still does not make it a fair price, much less an autonomously bargained one.

What the freedom of contract needs is an anti-formalism that is rooted in the parties' exchange and is, therefore, sensitive to pricing. The alternative I have advanced depends upon formality: perfectionistic construction. The very first question for a court according to this

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[336] If there is a competitive market that standardizes terms then we fall out of hybrid governance and there is less choice about configurations of terms. In my experience, snow shoveling is an excellent example of classically hybrid governance.

alternative strategy is whether the parties negotiated performance and remedial terms in respect of the disruptive circumstances that actually sent the matter to court. For example, the agreement to let the Music Hall was silent as to the risk of Caldwell and Bishop's inability to let the facilities for any reason, including fire. In the terminology I developed in Chapter 2, this obligation was perfected in the second order (not indefinite) but not as to the (first or) third. The parties left what should happen if Caldwell and Bishop were unable to let the facilities, for reason of fire or otherwise, a wide open term, outside the bounds of their expressed bargain.

If the same agreement had had an additional term providing that, in case of their inability to let the facilities, Caldwell and Bishop would be liable for reasonable investments made by Taylor and Lewis or for a sum certain, it would seem to have been *perfected* with respect to the disruption that occurred. The court would have had a basis for finding that the parties negotiated a price for the allocation of this risk of disruption and loss. Absent third-order perfection, however, party autonomy as to the pricing of this risk is a legal fiction, pure and simple, and the only available argument for the party autonomy of FCwE is a hypothetical one, of the kind disarmed in the next section.

With such a pointed attack against FCwE, how do I respond to natural puzzlement over the fact that, in liability terms, the outcome in *Taylor v. Caldwell* is identical (none) to that required by PC? There are three points to make. First, as I have already noted, not all cases of disruption pretend to line up so neatly in the two doctrines. Where the conditions of disruption were pondered jointly and the parties decided under the light of day to pay that risk no mind at all in the deal structure and pricing (this is the alter ego version of *Krell v. Henry* imagined by Lord Judge Roemer),[337] the two doctrines diverge: excuse enforces formalistically, whereas PC leads to forbearance. Second, doctrines are not all cut from the same cloth when it comes to the virtue of

[337] *See supra* Section 2.6.

predictability. Moreover, as a general matter, doctrines that rely on mental states (excuse) are more challenged in their tendency towards predictability than doctrines that rely on external evidence (PC). I highlighted this point when I discussed Justice Holmes and *The Kronprinzessin Cecilie* in Section 2.6. Excuse doctrine shows consistent signs of being an underperformer on the predictability scale, and this puts FCwE at a huge handicap in furthering party autonomy.

In the rest of the section, I will discuss the third difference, which is symbolic or ceremonial. The difference is that the excuse court does not merely stay its hand, as under PC, leaving the parties to sort things out themselves without the jurisdiction of a court. Rather, the excuse court, under *Taylor v. Caldwell* as under the second Restatement, decides the case by holding that Caldwell and Bishop's "duty to render that performance is discharged."[338] What under PC remains a contracting problem for the parties to work out is, under excuse, given a definite solution, and it is by dictating a solution—by giving certainty where a perfectionistic court accurately sees none—that excuse imposes price terms on the parties where PC does not.[339] As discussed earlier, discharge makes it the case that Taylor and Lewis *in fact* had a contract that required them to bear full risk for their expenditures in preparation for the performances in case the Music Hall turned out to be unavailable for any reason (at least in case of fire). That was news to Taylor and Lewis. And on Caldwell and Bishop's side, the contract, it turns out, actually said they had no legal obligation at all to back Taylor and Lewis's commitment of time, money and reputation to put on the performance at its Music Hall, regardless of fire. Bonus for Caldwell and Bishop. In sum, by holding the contract discharged, the court is saying the bargain is complete, no matter that the justice of the matter *in fact* could very well be that the parties have a mess to clean

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[338] RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981). Corbin was opposed to discharge in cases of excuse. *See* Corbin, *supra* note 188.

[339] *Cf.* Scott, *supra* note 162 at 1645 ("The experimental evidence suggests that transforming an informal, indefinite agreement into a legally binding obligation is often counterproductive; legal liability can increase moral hazard and it may also 'crowd out' the parties' self-enforcing mechanisms.").

up, all hands on deck.[340] The perfectionistic refusal to enforce the deal terms leaves it a *question mark* whether Caldwell and Bishop or Taylor and Lewis have open obligations to each other. All that gets clarified by the perfectionistic judgment is that a court will not step in with the power of the state to back that deal under those circumstances.

To conclude the section, excuse mystifies the formation of contracts. The hypothesis of what the deal really would have said about the damned disruption is stuck inside the unmoving terms articulated at formation to set price and deal structure. If the disruption had *actually* figured into the ritual of third-order perfection, there are all sorts of potential answers and the court's handcuffed selection—giving the defendant a complete pass on the risk—has no *a priori* claim to prominence among the diversity of alternatives. This means that excuse frustrates autonomy over deal structure. In *Taylor v. Caldwell*, for example, the agreement was fairly elaborate with respect to cooperation for putting on the performances, and Taylor and Lewis spent enough before the fire to make a lawsuit to recover those payments worth the expense.[341] Given that Taylor and Lewis knew they would invest in putting on the show, what makes it so likely that they would agree to accept full risk for their investment? Perhaps that would be the case because Caldwell

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[340] Barbara Fried points out the Euthyphro bootstrap to undercut the presumption for hypothetical bargains in contract enforcement.

> Most of the cases in which liberal contract theorists have strong convictions that X—specific performance, expectation damages, etc.—is the appropriate term for the court to impose can best be explained, I believe, not by a first-order belief that X is what a (generic) promisor owes a (generic) promisee in the event of nonperformance, but instead by an intuition that X is what this particular promisor and promisee had in mind, or would have said they had in mind, if they had spoken to the issue ex ante. Those intuitions may well be right much of the time. But right or wrong, they are an exercise in contract interpretation, not first-order morality.
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> Finally, if the court has no evidence from which to infer the parties' intent, it will have to choose a gap-filling term on some other basis. At that point, [liberal contract theory] LCT is out of a job, for the reasons eloquently stated by Prof. Fried with respect to changed circumstances and other unprovided-for cases: Once we are outside the scope of the parties' voluntarily assumed obligations, we are outside the domain of LCT.

Fried, *supra* note 134 at 629-30.

[341] *See* KESSLER & GILMORE, *supra* note 158 at 485.

and Bishop were taking on other risks that counterbalanced the fire risk. But perhaps they were not. Perhaps Taylor and Lewis would accept liability for a flat fee payment to cover that risk. The excuse court cannot process these possibilities as a matter of the parties' actual expressions of autonomy. It is locked into a gross oversimplification of the contracting process by the fact that it lacks the legitimacy to do anything other than enforce as per the literal terms or withhold a remedy.[342]

More pointedly than the frustration of autonomy over deal structure, the discharge of excuse distorts the price balance of the deal. So long as a court limits itself to working on one side of the bargain, adding a condition to a contract gives to one party what it says the other party had to have given. But for nothing? Perhaps the only certainty about the parties' hypothetical deal is that inserting a material condition as to the defendant's performance obligation (as excuse does) *would* change the price. Excuse, therefore, cannot help but frustrate the autonomy of pricing.

Finally, rounding out excuse's deficiency, it (along with related doctrines that I have left out of the analysis) frustrates autonomy by its unpredictability.

> We received the doctrines of mistake, impossibility and frustration long ago from 19th century English law. The Restatement, Article 2 of the UCC, and our case law have expanded impossibility into impracticability, but there has been little other change in the law as written. Of course, the law written is seldom the law applied. And any reader of a few cases on mistake or supervening causes appreciates how sloppy the standards on what is a sufficient mistake, an adequate frustration, or a large enough impracticability to void a contract really are. One man's frustration is another's hard bargain.[343]

3.3 *The Rational Actor Argument for Party Autonomy under Formalistic Construction*

This third chapter seeks to identify the most defensible principle for the construction of contracts instrumentally to realize the autonomy of parties. This is a difficult problem precisely

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[342] *See supra* note 306 (quoting Justice Cardozo for the proposition that for the time being courts may only legitimately enforce contracts as parties bargain them).

[343] James J. White & David A. Peters, *A Footnote for Jack Dawson*, 100 MICH. L. REV. 1954, 1969-70 (2002).

when it comes to unperfected obligations. David Charny considers this case in the employment context.

> To take a simple example, consider the question whether an employer may fire an employee to avoid paying him a share of merger gains. The employment contract does not address the question, for the parties articulated no explicit term to cover the question. The court imposes a duty to share merger gains on principles of hypothetical bargain that are paternalistic: the adjudicator asks what the "ideally rational" employee would have bargained for. If the contract is silent, the parties made no explicit choice on the issue. The principle of autonomy that requires courts to honor parties' choice is simply not in play: the parties made no choice. The adjudicator should therefore consult other principles of autonomy.[344]

Charny concludes, as I did in Section 3.1, that FC fails as a principle of autonomy and consequently that courts must look for another. Perfectionistic construction is a different breed of principle of autonomy, based on formality and the sanction of nullity, and it provides one solution to the puzzle of unplanned disruption left by FC. Excuse doctrine provides a third principle, enforcing a hypothetical sense of autonomy that I discredited in the previous section as against PC.

Writing to oppose the *ex post* adjustment of contracts (through excuse doctrine or otherwise), law and economics scholar Clayton Gillette answers Charny's quandary by recycling FC with a rational choice model. This model is to support the claim that FC advances a synthetic sense of autonomy based on a reconstruction of the silent preferences of the parties. The methodology is to try to identify what parties meant when they did not perfect the disrupted term. After expounding Gillette's argument, I will counter that, notwithstanding Gillette's rational actor hypotheses, parties who care about autonomy have reason to prefer PC. Gillette's error, I will show, is falling prey to Euthyphro's bootstrap. My interest in Gillette's argument is testing the robustness of the conclusion thus far (that PC bests FC and FCwE in advancing autonomy) by considering a different argument for FC. I will show that PC has every virtue Gillette espouses

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[344] Charny, *supra* note 8 *at* 1833 (notes omitted).

for FC as against adjustment and that on Gillette's own terms his defense of FC depends on the non-existence of PC as a viable alternative. Once PC is acknowledged as an alternative, Gillette is left without a basis to defend FC.

Gillette's question is whether "the law ought to require the advantaged party to adjust the original agreement."[345] He opposes adjustment, but not because he disagrees with the premise that "contractual expression is necessarily fragmentary due to the incapacity of commercial actors to foretell completely events that might disrupt original expectations."[346] Gillette acknowledges the bounded rationality of parties but does not think courts should become activists to work out the meaning of silences in deals.

> From my perspective, the adjustment arguments assume a view of rational commercial behavior that understates the ability of commercial actors to engage in conduct for which they can be considered, from an ethical or behavioral perspective, responsible. I argue that even if commercial actors cannot foretell the occurrence of events, they can plan rationally with the inevitable uncertainty of the future in mind to estimate and control the consequences of those events. If a commercial actor is able to bargain with uncertainty in mind, I suggest the law ought to consider a such bargain the product of a cognitive and analytical process for which the actor can be held accountable, notwithstanding the intervention of specific events that the actor did not predict. The failure of the law to respect decisions made under these circumstances is unjustifiably paternalistic towards individual actors and frustrates individual effort that would otherwise generate greater personal and social welfare.[347]

The logic here is not an innovation—this is *Paradine v. Jane* all over again (viz., Jane *chose* to pay rent every year regardless whether he could or could not occupy the land, therefore, enforcement is warranted). What is new is arguing that the reason to see the defendant as responsible for non-choices is *not only* that this is how courts enforce contracts *but also* that the party in question was "able to bargain with uncertainty in mind." Gillette wants to try to penetrate the rationality of bargaining with uncertainty in mind.

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[345] Gillette, *supra* note 3 at 522.

[346] *Id.* at 523.

[347] *Id.* at 524.

The starting point is a definition of rationality. There is some minimum amount of information about the potential for disruption that is required for rationality, but Gillette concludes that minimum is not easy to define. Accordingly, "for now it is perhaps best understood by its consequences: a rational decision is a decision that a court should not override on the basis that the decision maker was deprived of the ability to make a meaningful choice."[348] The test, therefore, is whether courts have reason to override FC for want of meaningful choice over applicable terms. Gillette sets aside the easy case where the parties have perfected the disrupted obligation, arguing that courts should respect the conscious allocation that was negotiated.[349] So what is left for analysis, as usual, are cases involving unperfected terms.[350]

Recognizing the strength of the arguments behind some form of adjustment,[351] Gillette questions the proposition that silence during negotiations about the risk that later materializes

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[348] *Id.* at 525.

[349] Gillette explains that

> For an identified, negotiated risk, no reason exists for the law to impose a subsequent adjustment should the risk actually materialize. The party to whom the recognized risk was allocated by negotiation presumably believed itself in a superior position to avoid the risk or to insure against its materialization. That party either obtained or had the opportunity to obtain compensation for taking the risk through ex ante adjustment of the contract price. When the risk materializes, therefore, even those who advocate adjustment in other circumstances reject pleas for court-imposed modification.

Id. at 532 (notes omitted)

[350] *Id.* at 533 ("The argument for adjustment, therefore, concerns those events that have not been the subject of negotiation.").

[351] According to Gillette,

> For those who favor adjustment, the allocational bargain that creates responsibility also limits it; because contractual liability is predicated on consent to take certain risks, unanticipated risks not the subject of bargaining fall outside the area of consent. Thus, no obligation to accept those risks flows from the promises that the parties have made to one another. When the unforeseen risk materializes, the world has changed from the one anticipated by the parties during negotiation. The resulting loss must be borne by someone; the deal originally contemplated has gone awry. Since it would be unfair to visit the unforeseen adverse consequences on a single party who did not consent to take the risk, either the contract should be dissolved or some compromise or adjustment should be imposed.

Id. at 533.

"means that the risk was not identified or allocated."[352] To the contrary, he says, "the parties' silence about the risk that ultimately materializes requires that an allocation of risk be imputed."[353] Why? In a statement that smacks of the Euthyphro bootstrap (by deeming there to be agency where only inaction is evidenced), Gillette remarks that "[v]iewing the allocational bargain as an attempt by parties to reduce the existence and consequences of risk and uncertainty, it follows that the parties will sometimes attempt to attain that result by implicit allocations or by acceptance of state-imposed allocations."[354] Given Gillette's framing, this proposition is analytically true, but it doesn't tell us why parties would leave it to the state to establish risk allocations on their behalf. Gillette finds the answer to that puzzle in the costs and benefits of negotiation (and the prevalence of FC) and based on the assumptions of his rational actor model: "The actor will seek to eliminate *only* that degree of unpredictability that can be reduced at a cost perceived to be less than the expected costs of the risk itself; to invest more would be contrary to the assumption of self-interest."[355]

Two metrics are to be compared: the costs of perfection and the costs of unplanned disruption. Gillette thinks that the former "requires the actor to expend resources to determine historical patterns of how similar contracts have been derailed and to predict future

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[352] Gillette counters the intuition that the failure to expressly bargain for a term means that the term was not given effect by the bargain.

> Given that the parties ought to be held to their bargains with respect to expressly allocated risks, it does not follow that a contract's failure to include a clause expressly addressing an event that subsequently occurs means that that risk was not identified or allocated. Risks may be allocated by an implicit process, inferred from circumstances and usage of trade.

Id. at 534.

[353] *Id.*

[354] *Id.* at 535.

[355] *Id.* (emphasis supplied).

disruptions,"[356] a proposition I will question in the next section. The costs associated with perfection, ex ante and ex post, could in fact exceed the costs of unperfected disruption. "If that point is reached, even a commercial actor with perfect information would not seek to include a contract provision concerning that particular risk."[357]

Gillette relies upon his definition of rationality (a decision a court should not overturn) to extract the implications of this conclusion. If we should impute rationality to the plaintiff for impliedly calculative non-perfection, the counterparty is an automatic loser. Whenever a plaintiff is armed for suit post-disruption by FC and the parties' failure to perfect, a court is to deem the defendant responsible for the mirror image calculation, whether accurately or inaccurately performed.

> Consequently, if one of the excluded contingencies arises, the party on whom the loss initially falls cannot complain, provided its estimates of the probability of occurrence and the cost of dispute resolution are accurate. Similarly, if it underestimated the probability of the occurrence or the cost of dispute resolution, its ex ante calculations were no less purposive and do not by themselves justify a rule that requires sharing of the loss.[358]

The argument is rigged once FC is assumed: the defendant is guilty for its silence and all that Gillette has added to *Paradine v. Jane* is the inference that the plaintiff may well have been rational in choosing not to perfect the term. Nowhere in his paper is a test articulated to capture plaintiffs who were *irrational* in failing to perfect the deal and should be overridden. To the contrary, Gillette reads his argument to support the general unavailability of ex post adjustment in contracts, even when the plaintiff knew about the disruption but chose to leave it out of the deal.

Gillette handles this case of the plaintiff who left a trap for the defendant by stretching the rational choice model even further. A party, Gillette assumes, has the prerogative to act self-

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[356] *Id*. He also holds the bizarre view that perfection can lead to increased enforcement costs: "In addition, a contractual provision concerning the risk may be the subject of an enforcement action if the risk materializes and the party to whom the risk is allocated fails to perform." G at 535.

[357] *Id.* at 536 (notes omitted).

[358] *Id.* at 536-37.

interestedly and leave out known potential for disruption out of the deal. Here, Gillette works out a hypothetical involving a Buyer and a Supplier.

> Indeed, the inference from contractual silence that the parties were ignorant of the disruptive event's possibility may disserve the negotiation process, at least if that process is predicated on pursuit of self-interest. For instance, Supplier alone might fail to identify a risk, the materialization of which would place it at a disadvantage. [Buyer] may identify the risk but consider that, from its perspective, materialization of the event threatens no harm and could make the contract more profitable. In addition, [Buyer] may recognize that bringing the risk to Supplier's attention will require additional negotiation costs and require [Buyer] to compensate Supplier if the latter is to bear the risk. Absent any duty to disclose, [Buyer] is unlikely to bring the risk to Supplier's attention. As a result, the risk will not be allocated expressly, even though one of the parties has identified it and considers it an appropriate subject for negotiation. In this situation, a gap exists in the contract just as if neither party had identified the risk. Nevertheless, given the general absence of a duty to disclose, only a will theory of contract, requiring meeting of the minds on all contract terms, would support the conclusion that the gap emanates from a failure to reach agreement that warrants modification to save Supplier from its own folly.[359]

Formalistic opportunism is endorsed by Gillette even when the plaintiff calculatedly left the disruption off the table intentionally to secure a valuable option later. What I wish to point out is that Gillette throws up his arms at the harshness of FC because there is no general duty to disclose (and he rejects a will theory, such as that given effect by excuse, out of hand). This is where the narrow mental model of FC shows its limitations. There is another way to cause knowledge about disruption to emerge during negotiation: construct contracts perfectionistically rather than formalistically. No general duty to disclose needs to be imposed.

How well does PC fare under Gillette's rational choice model? All of a sudden, by swapping construction doctrines, it becomes rational for parties to divulge known risks to perfect the deal, even if they would have a formalistic right absent disclosure under FC. When enforcement is not so important, parties will not invest in perfection.

The harder but more interesting question is whether the rational choice model can suggest

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[359] *Id.* at 539-40 (notes omitted)

a choice between FC and PC. The party with knowledge of a risk may prefer FC in that case, but as a general rule, risks could be known by either party, and there is no reason *a priori* to assume that one would repeatedly benefit from FC. The reasonable assumption is that this potential advantage is a wash, and that the control and predictability provided by PC is preferable. What about cases of unknown risk? Again, there is no way to predict whether unknown risks will come to haunt one or provide one the basis of a formalistically opportunistic lawsuit. The incentives provided by PC for parties to divulge information about risk for the perfection of the deal *and the overall benefit of both parties* seems to stand out to give PC the advantage from a rational choice perspective.

I have shown that the effort to justify FC in the face of disruption is extremely fraught, and that resorting to a rational choice account fails to provide a clear and convincing reason to prefer FC over PC. Rather, intuitive assumptions about a rational actor's preferences suggest that PC has only advantages over FC. Gillette's argument, however, raises the concern that parties in PC will be plagued with unperfected terms, not only because FCwE prevails today but because parties are limited by bounded rationality. In the next section, I attempt to put this worry in perspective.

3.4 *Disarming the Bounded Rationality Objection*

The bounded rationality objection says that the stakes of switching to PC are really high, because parties are limited by their bounded rationality, which makes it impossible to foresee all the ways deals fall apart. The intuition that might then follow from this objection is that contractors require FC if they are to contract at all. The literature on contracting—whether legal, economic or managerial—has certainly emphasized the impact of bounded rationality on

contracting.[360] As discussed in Section 2.7, it is today a commonplace that all contracts are incomplete,[361] and as with Gillette, this is often explained (and even justified) as an artifact of rationality in respect of the time and energy worth investing in closing a transaction. If the lesson of bounded rationality is that parties cannot foresee every potential disruption, does this mean that a switch to PC will prejudice parties that find themselves unable to adequately perfect their deals?

In their obsession with incompleteness, I argue, scholars have missed the forest for the trees. While parties often cannot predict *how* disruption will manifest (the trees), the *fault lines* are in plain view (the forest). Perfection in contracting is about openly confronting these fault lines and squaring the deal accordingly. Though he does not speak to the technology represented by perfection, Williamson corroborates the potential to contract perfectionistically: he says transaction cost economics "concedes that comprehensive contracting is not a feasible option (by reason of bounded rationality), yet it maintains that many economic agents have the capacities both to learn and to look ahead, perceive hazards, and factor these back into the contractual relation, thereafter to devise responsive institutions."[362]

In a basic supply agreement, there are three fundamental fault lines. The first is the supplier's ability to supply the good; this was the downfall in *Taylor v. Caldwell*. The second is

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[360] *See* OLIVER E. WILLIAMSON, MARKET AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION 21 ("Bounded rationality refers to human behavior that is *intendedly* rational, but only limitedly so.") (italics in original, internal quotation marks and citations omitted); Melvin Eisenberg, *Impossibility, Impracticability and Frustration of Purpose*, 1 J. LEGAL ANALYSIS 207, 246 n. 72 (2009) (citing "evidence [that] shows the existence of systematic cognitive problems affecting decision-making, such as bounded rationality, which limits the future scenarios that actors can be realistically expected to envision; overoptimism; and defects in capability, including systematic underweighting of future benefits and costs as compared to present benefits and costs and systematic underestimation of low-probability risks").

[361] Scott, *supra* note 260 *at* 847 (stating that "the central task in developing a plausible normative theory of contract law is to specify the appropriate role of the state in regulating incomplete contracts"); *see* Schwartz, *supra* note 293 at 277 ("In the lawyer's view, a contract is incomplete when it has a true gap: for example, the contract is silent respecting the parties' payoffs if one of them breaches. Economists have not settled on a definition of incompleteness but agree on a paradigm case: a contract is incomplete when it is insufficiently state contingent.").

[362] OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 9 (1996).

the buyer's ability to pay for the goods. The third is the value of the good to the buyer; this was the frustration in *Krell v. Henry*. Perfection requires the parties to bargain over what should happen in case either party cannot deliver, even in complete blindness of the contingencies that could bring this about, and they should also consider the possible vanishing of value from the deal for the buyer. Likely this dickering will lead the parties to make distinctions about different sources of difficulty in planning for and pricing the allocation of risks between the parties. My contention is not that perfection in contracting, under PC, can ensure enforceability wherever desired by the parties.

The bounded rationality objection fails, therefore, because, in order to perfect their performance obligations, parties like Taylor, Lewis, Caldwell and Bishop did not need to envision that the Music Hall would burn. They would have been able to anticipate the disruption substantially simply by asking about the generic fault lines of a supply agreement: what should happen if Caldwell and Bishop were to have difficulties making the Music Hall available for any reason? Planning for and pricing this potential generic risk would have created price and deal terms that could have equipped the parties to handle the fire without a court.

Notwithstanding the ability to perfect along the three generic fault lines, there remains the possibility that under PC a plaintiff will be surprised by the way the parties left the deal unperfected. In such cases, the contract the court will enforce does not line up with that plaintiff's expectations.

> It has been suggested that in some cases the courts might properly give an interpretation to a written contract inconsistent with the actual understanding of either party. What justification can there be for such a view? We answer, it rests upon the need for promoting the security of transactions. Yet security of transactions presupposes "transactions," in other words, acts of private parties which have a law-making and right-altering function. When we get outside the field of acts having this kind of function as their *raison d'etre*, for example, in the field of tort law, any such uncompromisingly "objective" method of interpreting an act would be incomprehensible.[363]

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[363] Fuller, *supra* note 11 at 808 (notes omitted).

The perfectionistic approach towards the autonomy of the parties represents a divergence from FC but a convergence with existing law's demand for second-order perfection (indefiniteness): "If a plaintiff sues upon an agreement that is too indefinite, the common law refuses relief for precisely this reason: there is not a clear enough contract binding the defendant to perform."[364]

[364] *See* Schwartz & Scott, *supra* note 208 at 619 n. 108 ("A court instead can refuse enforcement when gaps cause a contract to be obligationally incomplete—that is, when the terms the contract does contain provide an insufficient basis on which to ground a remedy. The common law rule is that contracts leaving material terms incomplete or indefinite are not legally binding.").

CHAPTER 4: COMPARATIVE STATICS APPLIED

In this chapter, I will develop the claim that perfectionistic construction outranks FCwE on Williamson's comparative statics scorecard. I begin by considering potential implications of the finding that forbearance is a feature of contract doctrine, not only with respect to hierarchy as Williamson (1991) finds, but also in hybrid governance, especially under perfectionistic construction but also in many respects under existing law (indefiniteness doctrine as applied to classical and neoclassical terms). Then I attempt to set forth a discrete structural factor analysis (FCwE versus PC) with which to populate a comparative statics scorecard (from FCwE to PC).

4.1 *Varieties of Forbearance*

In Section 2.6, I discussed the legal precedents for perfectionistic construction. These doctrines all counsel forbearance towards relations that are *un*formalized in one of three senses. What is the family resemblance between this breed of forbearance[365] and the law of hierarchy that Williamson calls by the same name?[366]

The forbearance of perfectionistic construction derives doctrinally from the sixteenth century rationale for forbearance towards a horse doctor who makes no assumpsit.[367] In the case of the horse doctor and the breach of an unperfected bargain term, forbearance results from an unwillingness to judge the presence of an interpersonal breach due to the insufficiency of the commitment expressed between the parties. The forbearance towards disputes between divisions of a corporation is the mirror image. The court stays out because of the *strength* of the commitment expressed between the parties, not its *weakness*. This is reflected in the idea that

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[365] Note that contract law today is emphatically not perfectionistic about the first order, damages.

[366] *See* Section 1.4.

[367] *See supra* text accompanying notes 76-77.

sometimes courts *pierce* the corporate veil. The veil is what keeps courts from adjudicating disputes within the corporation.[368]

From the perspective of a manager or entrepreneur selecting a governance structure, hybrid governance and hierarchy are just two ways to get the same kind of thing, different means to pursue the transaction at hand.[369] Much has been written in the management literature about the

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[368] Williamson explains that:

> The implicit contract law of internal organization is that of forbearance. Thus, whereas courts routinely grant standing to firms should there be disputes over prices, the damages to be ascribed to delays, failures of quality, and the like, courts will refuse to hear disputes between one internal division and another over identical technical issues. Access to the courts being denied, the parties must resolve their differences internally. Accordingly, hierarchy is its own court of ultimate appeal.

Williamson, *supra* note 19 at 271. The point is most salient if one starts by considering separate firms doing business through contracts, where their disputes would be subject to judicial hearing, and to then suppose that the firms merge and vertically integrate production. Following merger, the disputes about quality and timing that are typical in production processes could only be adjudicated through hierarchal processes, as courts would not assume jurisdiction to hear such disputes.

Macneil provides an example to demonstrate that the economic tragedy of contract "breach" is no less significant when the "contract" has been internalized within a corporation:

> When, for example, an automobile manufacturer orders from another manufacturer with which it regularly deals, thousands of piston rings of a specified size, no amount of relational softening of discreteness and presentiation will obscure the disaster occurring if the wrong size shows up on the auto assembly line. Nor would the disaster be any less if the failure had occurred in an even more relational pattern, e.g., if the rings had been ordered from another division of the auto manufacturer.

Macneil, *supra* note 1 at 887. Note that corporations are not unique in commanding judicial forbearance. Macneil calls the principle "sovereign nonintervention," finding a kind of anti-interventionist comity towards alien societies at work:

> An example of sovereign nonintervention is the great reluctance of American courts to interfere in any way at all in the internal affairs of churches. This reluctance is based on the constitutional provision that "Congress shall make no law respecting establishment of religion or prohibiting the free exercise thereof." Another example (in theory) is to be found in the treatment of British collective bargaining agreements as "gentlemen's agreements" not enforceable in the courts. Yet another results from the doctrine of pari delicto when applied to illegal contracts. To the extent such a value prevails, it is as if the relation were occurring in some other society.

Ian R. Macneil, *Values in Contract: Internal and External*, 78 Nw. U. L. Rev. 340, 369-70 (1983) (notes omitted). *See supra* Section 1.4.

[369] The idea of governance mode as means is fundamental to Williamson (as well as Fuller):

> In parallel with *von* Clausewitz's (1980) *views* on war, I maintain that hierarchy is not merely a contractual act but is also a contractual instrument: a continuation of market relations by other means. The challenge to comparative contractual analysis is to discern and explicate the different

choice of governance structure as between joint ventures, mergers and acquisitions and other means. A contribution of my dissertation is to undercut the idea of three discrete modes of governance that necessarily differ in their essence. There are a *range* of ways to keep courts at bay, on the sidelines or ready to enforce. Forbearance can be woven into a contract to release the parties from access to enforcement—or to ensure its availability—domain by domain. The *neoclassical* dimension of hybrid governance provides the means to maintain forbearance alongside an otherwise classically sharp contract: commitments are loosened up, co-governance structures are constituted, dispute resolution procedures are formalized and standards, like "best efforts," are sprinkled on top to taste. All of these features can be used to yield a cooperative production space with properties like hierarchy.

On the side of hybrid governance without any neoclassical contract devices, I showed in Section 1.4 why *classical* hybrid governance should be conceived as a discrete structural alternative to *neo*classical hybrid governance. This reconceptualization identifies additional variability in the alternatives for governing a transaction. Even within the space of classical hybrids, perfectionistic construction provides parties the latitude to introduce domains of forbearance insomuch as the parties intentionally (or unintentionally) leave unperfected space in the arrangement.

On the flip side, there may be additional, largely untheorized permutations of forbearance in organizational life. The fascinating case of the Morning Star Company, a 400-employee food processor, is discussed by Gary Hamel in *First, Let's Fire All the Managers*.[370] Morning Star is

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> means. As developed below, each viable form of governance—market, hybrid, and hierarchy—is defined by a syndrome of attributes that bear a supporting relation to one another. Many hypothetical forms of organization never arise, or quickly die out, because they combine inconsistent features.

Williamson, *supra* note 19 at 271.

[370] Gary Hamel, *First, Let's Fire All the Managers*, 89 HARV. BUS. REV. 48 (2011).

an incorporated legal entity that can bind itself to contracts like any other corporation. Inside, however, there is no hierarchy. There are not even managers. Hamel draws upon open-source software projects with hundreds of programmers without managers to help ground intuition for the remarkable properties exhibited by this firm:

- No one has a boss.
- Employees negotiate responsibilities with their peers.
- Everyone can spend the company's money.
- Each individual is responsible for acquiring the tools needed to do his or her work.
- There are no titles and no promotions.
- Compensation decisions are peer-based.[371]

These properties suggest that within Morning Star employees operate like independent contractors bargaining for the internal division of labor in a lateral way. Instead of hierarchy, the organization chart would seem to consist of a tangle of classical hybrid relationships geared towards a shared end.[372] Many questions can be asked. What systems of justice are applied to adjudicate production disputes? Is the judicial rationale for forbearance towards corporations eroded by the absence of hierarchy, as in Morning Star?

It may well be within non-hierarchical zones of forbearance, like Morning Star, that the human resources of a large organization have the best chance to experience freedom through their work.

> At the core of Morning Star's eccentric yet effective management model is a simple idea: freedom. "If people are free, they will be drawn to what they really like as opposed to being pushed toward what they have been told to like," says [founder Chris] Rufer. "So

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[371] *Id.* at 51.

[372] For example,

> Every employee at Morning Star is responsible for drawing up a personal mission statement that outlines how he or she will contribute to the company's goal of "producing tomato products and services which consistently achieve the quality and service expectations of our customers." Take Rodney Regert, who works in the company's Los Banos plant. His mission is to turn tomatoes into juice in a way that is highly efficient and environmentally responsible.

Id.

> they will personally do better; they'll be more enthused to do things." Morning Star's employees echo this sentiment. "When people tell you what to do, you're a machine," says one operator.[373]

Such a forbearance model may point the way to governance structures that help workers in large scale operations realize not only transactional autonomy (vis-à-vis the terms of their employment) but also the sense of autonomy that comes from being treated as an end, and not a means.

4.2 *Williamson's Scorecard: Discrete Structural Factor Analysis*

In this section, I review and tabulate the several factors that have been developed for comparing FCwE with PC, first, in discrete structural factor analysis and then, in the next section, in a comparative statics analysis premised upon a transition from FCwE to PC.

Perfectionistic enforcement should be embraced, I have argued, because, as between FCwE and PC, it is the only way to deliver parties enforcement they autonomously selected. This doctrine of construction provides parties the utmost congruence between the deal they strike and what courts will later do, and this congruence strengthens contractual relationships. These benefits not only enhance the encounter with the legal system for parties already in the habit of contracting but also improve access to this instrument of governance by making reliance upon contractual liability attractive to a larger population of commercial parties, especially smaller commercial players that lack the advice of counsel.[374] Parties avoid entering into deals under the existing regime of FCwE for fear of being threatened with liability they never planned to give away. But that is what happens when the counterparty gets moved by the legitimacy of filing suit opportunistically so long as formalistically colorable. Moreover, attorneys are permitted, and

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[373] *Id.* at 54.

[374] *Cf.* MICHAEL S. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 268 (1993) (arguing that "we need to be much more alert to the possibilities of adopting public policies that broaden (rather than restrict) access to market opportunities for members of the community who either historically, or as individuals through more specific sources of misfortune or disadvantage, would otherwise be denied these opportunities") (emphasis in the original).

arguably are required, to advise the party with the formalistic right about the merits of enforcement.[375]

Perfectionistic construction provides parties a good reason to think they can enter into mutually beneficial agreements without this risk of opportunism even if circumstances take the performance obligation outside the scope that was planned and paid for. Formalistic courts, in contrast, provides parties good reason to think that the deal that got memorialized apportions every potential risk by its terms.[376] This stands to raise the capital stakes of enterprise to a level that only highly-capitalized hierarchies can absorb.

Under perfectionistic construction, in contrast, responsible attorneys would advise parties that courts will not back them if they lean on terms formalistically, absent evidence that the risk

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[375] *Cf.* J. Van Oosterhout, Pursey Heugens & Muel Kaptein, *The Internal Morality of Contracting: Advancing the Contractualist Endeavor in Business Ethics*, 31 ACAD. MGMT. REV. 521, 524 n. 4 (2006) (under the assumption of the bindingness of contract law, arguing "that contractors should practice forgiveness over litigation in case conditions become maladapted to the terms of the contract through no fault of the parties involved").

[376] George Triantis has argued that this is the proper way to interpret parties' bargains. *See* George C. Triantis, *Contractual Allocation of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability*, 42 U. TORONTO L.J. 450 (1992). Melvin Eisenberg is dubious of the potential of Triantis's approach to provide insight into the real world of contracting.

> Triantis's claim that contracting parties allocate all risks flies in the face of both ordinary experience and experimental evidence, and Triantis offers neither experiential nor experimental evidence to support his claim. Instead, Triantis rests his claim entirely on a long and highly complex model of decision theory as applied to the allocation of unknown risks under conditions of uncertainty. However, Triantis here mistakes a normative theory for a descriptive theory. Triantis assumes that decision theory, on which his claim rests, is a descriptive theory about how real actors actually make decisions. It isn't. Rather, decision theory is a normative or prescriptive theory about how rational actors should make decisions. Within the last thirty or forty years, psychologists (and increasingly, economists) have experimentally and theoretically established that real actors routinely and systematically deviate from the prescriptive dictates of decision theory. Triantis's claim that contracting actors allocate all risks, therefore, is contradicted not only by ordinary experience but by a mass of experimental evidence. This evidence shows the existence of systematic cognitive problems affecting decision-making, such as bounded rationality, which limits the future scenarios that actors can be realistically expected to envision; overoptimism; and defects in capability, including systematic underweighting of future benefits and costs as compared to present benefits and costs and systematic underestimation of low-probability risks.

Melvin Eisenberg, *Impossibility, Impracticability and Frustration of Purpose*, 1 J. LEGAL ANALYSIS 207, 246 n. 72 (2009) (internal citations omitted).

of performing under the materially changed circumstances that manifested was made part of the deal. The deal needs to show for the assumpsit that has bite here. Given these considerations, another important reason to adopt perfectionistic construction—other than fidelity to classicism and autonomy—is that it stands to significantly expand access to the benefits of state enforcement of private agreements. State enforcement of private agreements provides a valuable surrogate for collateral[377] and represents a public subsidy of private activity that should not be withheld inequitably.[378]

Think of the scores of unsophisticated contractors undone by formalistic construction over the centuries.[379] If people are afraid of entering into agreements, formalistic construction bears a share of the responsibility. And excuse doctrine is not a game changer. This corrective doctrine provides the party at risk of formalistic opportunism a frail veil from liability. A potential defendant cannot wield excuse as a shield against the sword of the formalistic opportunist. At its best, excuse throws some uncertainty the way of the calculating opportunist, so the *probability* of formalistic opportunism, one would predict, would tend to be lower, all other things equal, in an excuse jurisdiction than in a strictly formalistic one. Moving beyond this "public health" perspective to the first-person perspective facing managers and entrepreneurs, the inconsistent availability of excuse is impotent to decisively strike back against formalistic opportunism.

Through these micro-advantages, the shift to perfectionistic construction could lower the costs of valuable experimentation and production in our economy, promoting innovation by

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[377] See Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519 (1983) (expressing skepticism on the robustness of the collateral provided by contract law and discussing the important role of hostages in undergirding credible commitments).

[378] *See* Shiffrin, *supra* note 296 at 221 ("taking it for granted that the institution of contract is an institution in which the community assists people who make agreements by providing a measure of security in those agreements").

[379] *See supra* note 5.

expanding the networks through which complex production can be synthesized.[380] Parties who have information to share but little cultural or relational capital in common can take advantage from the collateral of contract law to make mutual commitments, the more so the less fear of formalistic punishment fits into the equation. Thinking about a company like Amazon, for example, the intuition is that it could not have succeeded to the same extent if its governance alternatives fifteen years ago (and since) were *either* to vertically integrate a delivery function, *or else* purchase delivery on the open market parcel-by-parcel. For many smaller players, though, a hybrid arrangement of the sort Amazon has with FedEx and UPS is unavailable today due partly to the costs imposed by FCwE. Large players like Amazon, FedEx and UPS have big reputations that can be committed to help counterbalance the risks of FC.

In addition to the governance implications spelled out in the next section, a shift to PC promises economic advantages, at two junctures. The immediate one is at the parties' re-bargaining table following disruption, helping make sure that the option the parties select creates more aggregate surplus (as would be the case in the frictionless world of the Coase Theorem), rather than "a modification [favored by one party and not the other] that would create no new wealth but rather would only redistribute the contractual surplus differently."[381] Secondly, PC provides parties a strong incentive to conduct due diligence and plan for their transaction in a way that neither a liberal excuse doctrine nor formalistic construction are prone to do.[382]

Because PC relies on external evidence of formality rather than judgments about parties' unarticulated contemplations and assumptions, it also promotes more transparent judicial opinions. This is helpful for planning production relations and avoiding the opportunism that

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[380] *Cf.* JOHN F. PADGETT & WALTER W. POWELL, THE EMERGENCE OF ORGANIZATIONS AND MARKETS (2012).

[381] Schwartz & Scott, *supra* note 208 at 567 (describing utility of duress doctrine in terms of the modifications it prevents, but measuring private advantage based on price-term change from ex ante).

[382] Williamson, *supra* note 19 at 271-72, 290 (discussing excuse doctrine).

capitalizes on uncertainty.

Finally, let us consider the multiplier effect of yanking formalistic opportunism from the business equation. Today, the idea that the law of contracts can be punishing is uncontroversial, as is the idea that parties may enjoy valuable legal rights vis-à-vis their counterparties that emerge as artifacts of contracts, rather than from conscious bargains. By reducing the extent to which the legal system grounds opportunistic lawsuits, PC chips away at the law's encouragement of opportunism, helping to create the conditions for non-opportunistic character and, consequently, stability in justice.[383]

Table 2 organizes the categories of consideration discussed in this section, using a qualitative analysis (where "+" means "weak" and "++" means "strong").

Table 2

Discrete Structural Factor Analysis: PC v. FCwE

	Fear of Opport'ism	Promotes Opport'ism / Litigation	Preferred for Autonomy	Surplus Maximizing	Access to Contracting	Incentive to Plan	Predictable Opinions

[383] There is a beautiful, fractal-like quality to justice in this problem. As Artistotle describes the *phronimos*, she is characterized by forbearance, the kind of forbearance for rights that Joel Feinberg sees as an essential element of moral thriving: "the person who never waives a right, never releases others from their correlative obligations, or never does another a favor when he has a right to refuse to do so is a bloodless moral automaton." Joel Feinberg, *A Postscript to The Nature and Value of Rights*, *in* BIOETHICS AND HUMAN RIGHTS (Elsie L. Bandman & Bertram Bandman eds. 1978). The doctrinal path to the encouragement of this forbearance is forbearance from bringing the state police power to bear on private relations by judges. Aristotle's second most important treatment of the virtue of epieikeia is in the *Rhetoric* (1374b) and is there directed at judgment by jurors (who were the judges in private and public law disputes) from the standpoint of the attorneys who seek the virtue of rhetoric in addressing them. ARISTOTLE, ON RHETORIC 105-106 (trans. George A. Kennedy) (1991) ("if someone wearing a ring raises his hand or strikes, by the written law he is violating the law and does wrong, when in truth he has [perhaps] not done any harm, and this [latter judgment] is *epieikēs*") (brackets in original). *See* JOHN RAWLS, A THEORY OF JUSTICE 231 (1971) ("[T]he requirement of stability and the criterion of discouraging desires that conflict with the principles of justice put further constraints on institutions. They must be not only just but framed so as to encourage the virtue of justice in those who take part in them stability argument.").

PC	+	+	++	++	++	++	++
FCwE	++	++	+	+	+	+	+

++ = strong; + = weak

4.3 *Williamson's Scorecard: Comparative Statics*

An analysis that relies upon the methodology of comparative statics takes into account the positive or negative impact that shifting an institutional variable poses for governance. The utility of comparative statics is to help organize intuitions about the systemic consequences of making a shift. The implicit idea is that in addition to the frustrating impact ill-fitting contract law can have upon a deal after it is already underway, contract law has significant prospective consequences on the transactions that are pursued and the means through which they are pursued. This impact owes directly to the shift in the comparative costs of governance, being reinforced over time by the anti-opportunistic character perfectionistic construction helps to foment around disruption.

The discrete structural factor analysis of the previous section shows PC outranking FCwE on several parameters. These propositions are translated this into comparative statics with the thought experiment that asks what happens to the social pursuit of transactions as a result of a shift from FCwE to PC. There are several buckets to consider. The first consists of transactions that are priced out of society due to FCwE, but become pursuable under FC. The other three consist of transactions that are differentially pursued in each of the three modes of governance—market, hybrid and hierarchy.

More specifically, the expected salutary governance consequences of an increase in the attractiveness of hybrid governance through PC can be conceptualized through:

(i) the lost transactions that could be executed in cost-effective ways through hybrid governance in PC but are not pursued at all in FCwE;

(ii) the transactions that could be executed in more cost-effective ways through hybrid governance in PC but are pursued in the market in FCwE with vulnerability to defection cost opportunism;

(iii) the transactions that could be executed in cost-effective ways through hybrid governance in PC but are pursued in more vertically integrated and heavily capitalized organizations that are less accountable to the market in FCwE;

The directionality of the expected shifts in these three buckets under transition to PC are represented in Table 3. The intuition for the governance superiority of PC runs with the following predictions: that *more* transactions will be pursued, and that two sub-sets of transactions will shift from markets and hierarchies to their more cost-effective pursuit in hybrid governance. Note that the sense of cost-effective that I drew upon concerns not only the parties concerned but also society, as I suggest that hybrids tend to be more responsive to the market and society than hierarchies and that this is socially beneficial.

Table 3

Comparative Statics: Transaction Shift to PC from FcwE

	Transactions Not Pursued At All	**Market**	**Hybrid**	**Hierarchy**
FcwE	++++	++++	++++	++++
PC	++	+++	++++++++	+++

Each + represents a zero-sum unit of transactions

What this analysis has so far ignored is my finding that hybrid governance contains classical hybrids and neoclassical hybrids. What inferences can be drawn about the governance implications of a shift to PC in this regard? To answer this question, it is necessary to go underneath the hood. What we see is that the hybrid governance engine contains two sub-types: classical hybrids and neoclassical hybrids. *Both* provide the structure for one-shot deals *or* ongoing transactions (like a long-term supply agreement). Recall that classical hybrids and

market transactions both rely on definite and presentiated bargains that translate well as contracts. The difference between the two is the absence of the invisible due diligence provided by a well-functioning market's virtue of standardizing deal terms, and that is why classical hybrids are vulnerable like neoclassical hybrids, with the advantage oftentimes of being of shorter duration and the disadvantage of lacking neoclassical terms to help with any bumps.

Table 4

Classical and Neoclassical Hybrids Matrix

1. Classical **One-Shot Deal**	**2. Neoclassical** **One-Shot Deal**
3. Classical **On-Going Deal**	**4. Neoclassical** **On-Going Deal**

As represented in Table 4, the two parameters of identification introduced create four buckets of transactions. The impact of FCwE on these four buckets of hybrid governance is raising the stakes for a sub-set of transactions that remain out of reach from, or get pursued with a handicap by, (the relevant sub-set of) contractors in FCwE. What can we observe at the level of the four sub-categories? Most strikingly, the classical on-going deal is something of a unicorn these days.[384] Strapping on a set of formalistic commitments that involve on-going exchange is extremely discomfiting under FCwE, unless there is a thick enough human relationship that changes the calculus. This is why Williamson says that "perceptive parties" whose bargains make them "bilaterally dependent to a non-trivial degree . . . reject classical contract law and move into

[384] I suspect this fact partly explains the limitations in Williamson's analysis of the contract law of hybrid governance identified in Section 1.5.

a neoclassical contracting regime because this better facilitates continuity and promotes efficient adaptation."[385]

The second thing we can observe is that perfectionistic construction dissolves the walls between neoclassical and classical contract, especially in on-going deals. This comes from the way PC reduces the need for these neoclassical devices, since the court defaults to forbearance where the deal is *un*perfected. In the unperfected space, it is the relationship between the parties that they have to fall back on, not the collateral provided by contract.

Remember that transactions go to the customizable workshop of hybrid governance because a well-functioning market that fits the offering does not exist. Of course, one reason the market might not fit is because the fruits of long-term cooperation outweigh the governance advantages of the market, such as when an electric company passes over the spot market in coal to build a power plant at the mouth of a mine. Due to examples like these, I can support the intuition for the comparative statics implications of PC in the bucket of market transactions identified earlier in this section.

The prediction, then, is that the lost transactions that a shift to PC ushers into pursuit will be primarily of the on-going sort, where the difference between classical and neoclassical contracts substantially collapses. Market transactions in FCwE have no special reason to shift off-market into a classical hybrid with the introduction of PC. Wherever long-term cooperation, as in the coalmine case, is newly cost-effective for a market *or* classical hybrid transaction under a shift to PC, the prediction is that this bucket will grow. In addition, any transaction being pursued under FCwE in a hierarchy for which hybrid governance is newly cost-effective is almost certainly going to join the on-going transaction club rather than fracture into classical hybrids (though Morning Star could present an exception).

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[385] Williamson, *supra* note 19 at 271).

Another way to access the intuition of this discussion is that hybrid governance of the on-going or long-term sort is the most cost-effective way for parties to avoid the risk of defection cost opportunism experienced in recurring relationships in market and especially in classical hybrids. The governance implication of a switch to PC is heightening the attractiveness of long-term contracts, so the bucket of hybrid transactions that swells from a shift to PC is the on-going deal, where the distinction Williamson draws between classical and neoclassical contracts loses purchase (as a binary construct; as a variable construct it may remain valuable).

A suggestive case I recently encountered involves taxi drivers who lease medallions week to week. Despite the significant investment owner-drivers make in purchasing and maintaining their cabs, they are vulnerable to cancellation and opportunistic repricing every single week by the medallion owner. The intuition is that a shift to PC makes long-term contracts more accessible to these sorts of transactions *in a way* that pours acid over defection cost opportunism.

CHAPTER 5: CONCLUSION: THE CEREMONY OF THE BARGAIN

Classical contract law has created a well-deserved reputation problem for the freedom of contract ideal that enshrouds the doctrine. Freedom of contract has often been associated with harsh enforcement, notably so in the early nineteenth century when the rule of PvJ was hardening into law and yet before the rise of excuse. The following is a representative decision:

> In *Marquis of Bute*,[386] the purchaser of certain mining rights agreed to pay, for a period of fifty years, a fixed yearly rent. The amount of rent was based upon an estimated annual extraction of 13,000 tons of coal. A year or two later the mine was so depleted that less than one-fourth of 13,000 tons could be extracted. The purchaser refused to pay the fixed rent, and the vendor sued. The court held the vendor entitled to the rent.[387]

The harshness of such cases has usually been thought to be a property of the freedom of contract—the price we pay to give effect to party autonomy—and not merely a doctrinal correlation. What my dissertation has argued is that much, if not most, of the harshness and injustice of classical contract has not come from the *autonomy* of contract. Rather, the harshness and injustice have come from the *heteronomy* of formalistic contract, the chains we find the law binds us with even though we never went through the motions of getting bound.

The thesis of my project is that a classicist conception of contract law can overcome its formalistic heritage, and thereby better promote the freedom of contract ideal. Formalistic construction provides a kind of certainty about enforceable terms—though that certainty often buckles with excuse when disruption looms too large. In a formalistic sense, there is autonomy to being bound by terms that are the causal consequence of one's voluntary acts, but this is a hollow sense of autonomy indeed. Realizing that the voluntary terms one selected will, following a

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[386] 13 M. & W. 487, 153 Eng. Rep. 202 (Ex. Ch. 1844).

[387] Wladis, *supra* note 12 at 1588-93. Wladis chronicles ten different cases that "all evidence a strict view of excuse: the obligor is excused from performing only if the contract so provides, even if his performance becomes impossible." *Id.* at 1592.

disruption, be wielded to extract one's performance on terms one never would have accepted is more plausibly described as heteronomy. Perfectionistic construction provides a doctrinal roadmap for purging this absence of freedom *from* contract right from out of existing doctrine.

The resulting reinvention of the role of the courts, I have shown, lays the foundation for enhanced freedom *through* contract, by opening up contract to provide the hybrid governance canvas for transactions either priced out of society today, or relegated to one-shot deals that leave parties vulnerable to defection cost opportunism. I suspect also that hierarchies that are insulated from the social price mechanism hold back transactions that could more responsively and cost-effectively be pursued outside integration in long-term contracts.

In this conclusion, I will tie together the several arguments that feed into the slogan "no contractual rights without perfection rites," which I propose as a way of avoiding the harshness and injustice that have come from the heteronomy of formalistic contract. I will characterize this slogan as a principle of eunomics, owing to the positive reinforcement achieved *inter se* by perfectionistic construction, the practice of perfecting bargains and the achievement of private autonomy. The many advantages of PC—at the level of eunomics and otherwise—beg the question why FCwE won out historically. I speculate briefly on this question as a matter of the eunomics of judicial systems. Finally, I discuss the implementation of PC in the courts.

5.1 *Integrating the Arguments in Eunomics*

I have argued that the contract law that best serves the purpose of an organ of private law-making is perfectionistic. Its reliance upon formality better advances the autonomy of parties than FCwE by insulating them from the heteronomy of formalistic construction or excuse. Courts committed to the freedom of contract achieve greater doctrinal coherence when they enforce contracts perfectionistically than when they enforce formalistically.

The critical edge of the eunomics argument says that formalistic construction and excuse do not have the doctrinal pliability to function as faithful organs of private autonomy. Whether to

demand the formality of perfection for enforcement is a constitutional difference between FCwE and PC that cannot be finessed through gap-filling doctrine like excuse.

The constructive edge of the eunomics argument says that the demand for formality has the virtues it does, not coincidentally, but because of a natural law about the human social order. This natural law dictates that the forms of human life are fundamental, and that the expression of private autonomy depends on the suitability of the form relied upon. The rites of perfection are not merely techniques that courts do or do not require for unrelated reasons of positive legitimacy but rather they *symbolize* the shared expression of private autonomy. Business lawyers every day document transactions to give effect to such rituals.

Formality fulfills deep-seated needs that may go even beyond the three functions identified by Fuller: (1) courts want evidence of the deal; (2) parties should be put on notice of the impending change in legal relations; and (3) parties have to understand exactly what—of the breadth of their interactions— makes legal difference. This last function—the channeling role of formality—comes closest to speaking to the value of formality *for its own sake*. This is to say that, besides the way a signing ceremony affects saliency of term-channeling, there is the way a ceremony is ceremonial. According to Morris Cohen,

> We are apt to dismiss the early Roman ceremonies of *mancipatio*, *nexum*, and *sponsio*, the Anglo-Saxon *wed* and *borh*, or the Frankish ceremonies of *arramitio*, *wadiatio*, and of the *festuca*, as peculiar to primitive society. But reflection shows that our modern practices of shaking hands to close a bargain, signing papers, and protesting a note are, like the taking of an oath on assuming office, not only designed to make evidence secure, but are in large part also expressions of the fundamental human need for formality and ceremony, to make sharp distinctions where otherwise lines of demarcation would not be so clearly apprehended. Ceremonies are the channels that the stream of social life creates by its ceaseless flow through the sands of human circumstance.[388]

Fuller's functions are powerful, and yet he seems to leave aside the sacred function of formality. Why shouldn't courts think of the union of two wills in an act of legislation as a sacred

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[388] Cohen, *supra* note 106 at 581-82.

occurrence? If they do, then ceremony marks it that way. Perfectionistic construction is the judicial doctrine that recognizes a sanctity in contract, not a pretentious sanctity, but a pedestrian, workaday sanctity: those two parties really *did* make a deal, the solemnity of their exchange before the facts at bar evident. Eunomics is a perspective that grasps through this principle to make sense of the myriad positive reinforcements set in motion by perfectionistic construction, from parties' experience of autonomy to courts' experience of fidelity to parties to further realization of the social potential of voluntary human activity.

5.2 *Corruption by Competition in the Common Law*

Why, if my argument holds water, should the courts have adopted a second-best doctrine? Recall that the pivotal decisions came down at the end of the 19th century and the beginning of the 20th in the Queen's Bench. The hypothesis I will now spell out is a sinister one, so sinister that it would be blasphemous if the judges of the Queen's Bench had ever been thought to be saints.[389] My hypothesis is that judges in the Queen's (or King's) Bench were predisposed to rule on cases in a manner that would increase or sustain jurisdiction rather than turn away a dispute, risking sending cases to Chancery or the other common law court, the Court of Common Pleas.

The support for this hypothesis comes from three propositions. The first is that judges of the King's/Queen's Bench had a long history of using doctrinally questionable means to enhance the court's jurisdiction to outcompete the other court systems (the Court of Common Pleas and Chancery).[390] Second, courts faced a strong incentive to take more and more cases each year:

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[389] Their jurisdiction-increasing gambits makes this an unlikely assessment. *See infra* note 390.

[390] The series of judicially-endorsed fictions which allowed bill procedure (rather than costlier and more constraining writ procedure which had to originate via distinct process in Chancery) to grow in the King's Bench through "Bills of Middlesex" provides ample motivation for this hypothesis—it seems far less egregious and, in any event, burdensome to adapt syntax than to institutionalize a system of procedure based on the bald-faced fictions of the Bills of Middlesex. *See* J. H. BAKER, AN INTRODUCTION TO ENGLISH

caseload stood for the strength of a court and its judges, like sales numbers and market share for a corporation. Third, a formalistic approach produces more litigation.

The strength of the hypothesis comes from the natural experiment presented by the Queen's Bench's rulings in the period when excuse doctrine took hold. Two separate approaches were evolved by the Queen's Bench in the 1860s to restrict the excesses of FC: excuse (*Taylor v. Caldwell*) and PC (*Baily v. De Crespigny*). As between FCwE and PC, the hypothesis says that the Queen's Bench would prefer excuse doctrine for two main reasons. The first is that excuse sustains FC, which keeps the bar of contract enforcement open to many parties (no matter how informally they entered into their deal). In addition, FC makes litigation a very attractive option for opportunists post-disruption. The second reason is that excuse doctrine invites lawsuits by entertaining final awards (liability or discharge) rather than acting as a forbearance doctrine that turns suits away. The result in *Taylor v. Caldwell* was not that the parties could get no justice from the court, but that each party was "discharged."[391] This sustains the impression that the court awarded relief and also effectively precludes the parties from seeking more justice post-hoc from Chancery.

The closest this dissertation came to viewing this process in action was in *Krell v. Henry*, where a judgment that depended on perfectionistic voting was dressed up in the garb of excuse. Why was Lord Judge Vaughn Williams so intent on following the precedent of *Taylor v. Caldwell* when *Baily v. De Crespigny* better fit the votes? Ultimately, this hypothesis may best pursued through quantitative analysis of the cases.

LEGAL HISTORY 41-43 (describing legal basis for Bills of Middlesex and the resulting cost savings for litigants which led King's Bench suits to increase tenfold from 1560 to 1640, largely at the expense of the Court of Common Pleas).

[391] *See supra* note 188.

5.3 *Implementing Perfectionistic Construction in the Courts*

If I have been normatively persuasive, then the question to ask is: how can the common law of contract can reinvent itself perfectionistically? There are two basic approaches to reform contract law: legislatively and judicially. The legislative approach has been the instrument of choice over the last hundred years, as uniform laws of commercial law have propagated through the states over specific substantive domains, such as sales law.[392] In closing this dissertation, I wish to make some general remarks about the potential to reinvent the common law of contract judicially—from within, by courts themselves, one judgment at a time. Then I will return to the suitability of legislation for contract law reform.

The justice meted out by a court has immediate as well as systemic consequences (as discussed in Section 4.2). In terms of the immediate justice involved in refusing a remedy to the parties at bar where the bargain did not reach the disruption, the difference between excuse and perfectionistic construction comes down, in cases like *Taylor v. Caldwell*, to the symbolism of discharge.[393] When it comes to selecting a doctrine, of course, this is a deal-breaker quality about FCwE (as discussed in Section 3.2), but for a judge today who needs to decide between awarding or not awarding the plaintiff a remedy, and not, strictness about the distinction between a no-right and a no-remedy does not likely factor high in the court's judgment. The point about discharge, to a judge today, could even seem a formality. In any event, it does not seem likely that in cases like these a court would have much difficulty shifting the reasoning of the opinion perfectionistically. In their appointments, courts enjoy enough latitude for the reasoning of their judgments that the idea of judges here and there shifting their orientation perfectionistically without so much as

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[392] Schwartz and Scott question the legitimacy of the Restatements and the Uniform Commercial Code in light of their private status that lacks political accountability. Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

[393] *See supra* notes 188 and 338 (Corbin's views on discharge in excuse).

fanfare strikes me as entirely plausible. The legal precedents cited in Section 2.6 can certainly help courts make sense of a shift in rationale.

The ripest case for a tilt toward PC is not the *Taylor v. Caldwell* set up but rather the alter ego *Krell v. Henry* facts that Lord Judge Roemer worried were before the court.[394] If the parties plainly contemplated the disruption that manifested but just as plainly chose to leave the complication outside the deal, FCwE and PC diverge in outcomes. In these cases, adopting PC represents a departure that goes beyond the form of the judgment. The significance of PC for a court in these cases is providing a basis for refusing to enforce formalistically. Other than fudging the facts (as did Lord Judge Roemer), this is the only way for courts to avoid imputing 100% of the risk of loss on the defendant. The challenge for courts to adopt PC is accepting that "no" justice (the sanction of nullity) can be more just than adjudicating a contract formalistically constructed. In practice, this is very much like letting a corporation sort out its own internal disputes.

With the lead of judges who embrace the justice of refusing jurisdiction (based on the non-construction of a contract) to the alter ego *Krell* plaintiff, my vision is that PC can spread organically, one decision at a time, helping courts make sense of their current experience of deciding cases, including the intuitions of justice that FCwE suppresses.

The alternative to a more or less organic judicial conversion is legislation, as modeled by the Uniform Commercial Code's adoption across states. I see no reason why, in principle, legislation at the state level could not be used to achieve the transition to perfectionistic construction.

While important complications stand in the way of such an effort, I choose here to discuss the potential to use legislation to restore the formal contract to its ancient glory (whatever

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[394] *See supra* notes 222-224.

that was). Consideration doctrine has been under attack in the scholarship for a century—Charles Fried and Randy Barnett are just two notable critics.[395] An objective of this dissertation has been to push back against these criticisms by emphasizing the distinctive features of assumpsit that make the doctrine such a good fit with the hybrid governance of commercial exchange. I am, therefore, fundamentally opposed to the evisceration of assumpsit to better accommodate formalist accounts of contract. I am not, however, opposed to lobbying by supporters of formalist accounts of contract to create vehicles for the formalization of commitments through grants, rather than through exchange.[396] Doing so responsibly would require advocates of formal contract to determine exactly what formalities courts should require grantors to observe, and how courts should enforce purported grants in the absence of the specified formalities, among other scenarios. I hope that my treatment of the role of formality in informal contracts could provide assistance in such an effort.

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[395] Because the value of perfection is as a mirror of the conscious exchange of consideration, the account I am proposing challenges the hundred year decline in significance given to consideration. In recent scholarship, Charles Fried is the most outspoken opponent of the doctrine, as he seeks to make the naked promise the normative foundation of contract. *See* Fried, *supra* note 132 at 967 ("The largest quarrel *Contract as Promise* has with standard doctrine is in the latter's doctrine of consideration."). Randy Barnett, in contrast, recognizes a role for consideration but it has nothing to do with exchange or demonstrating the reach of performance obligations. It is simply the way that a party's consent to incur legally enforceable obligations is recognized. Barnett, *supra* note 254 at 312 ("A consent theory acknowledges that, if properly evidenced, a recital by the parties that 'consideration' exists may fulfill the channeling function of formalities, whether or not any bargained-for consideration for the commitment in fact exists."). Even Robert Scott, who nominally emphasizes the importance of the bargain, does not appear to give any jurisprudential significance to the reciprocity of consideration. In *The Death of Contract Law*, for example, Scott cites Fried and Barnett, among other moral thinkers who disregard the significance of consideration and/or exchange, for the proposition that "the state's role in enforcing bargains is both explained and justified by moral theories grounded in notions of autonomy." Scott, *supra* note 246 at 369. This absence of emphasis on the exchange of consideration is not surprising given Scott's affinity for classical doctrine with its fundamentalist unwillingness to evaluate the adequacy of the consideration in the name of freedom of contract. *See* RESTATEMENT (SECOND) OF CONTRACTS § 79, Illustration c ("Valuation is left to private action in part because the parties are thought to be better able than others to evaluate the circumstances of particular transactions. . . . Ordinarily, therefore, courts do not inquire into the adequacy of consideration.").

[396] *See supra* text accompanying notes 66-70.

APPENDIX

Appendix A: *Articulation of Empirical Propositions in Comparative Statics*

As set forth in Chapters 1 and 4, the comparative statics of economic governance (Williamson, 1991: 286) involves an evaluation of the impact of changes in the institutional environment upon the costs of organizing transactions under the various modes of governance. Under the transaction cost economics paradigm, entrepreneurs and managers are seen to organize transactions according to one of three broad modes of economic governance: (i) governance through sales contracts executed in markets according to the price mechanism, (ii) hybrid governance, meaning co-governance by distinct legal entities using contracts, without effective market governance and (iii) governance outside of the reach of contract law through hierarchies like corporations. In the empirical extension of my comparative statics project, I seek to probe the impact that two proposed changes in the institutional environment would seem to have upon the relative costs of organizing transactions under hybrid governance. My research question is whether the manipulations in the institutional environment described below impact the decision making of managers-entrepreneurs charged with entering into and conducting a contract *in a manner* that signals reduced costs of organizing transactions through hybrid governance. I will test the two hypotheses developed below experimentally, with contracting simulations that involve differing institutional treatments. From the microfoundations of hybrid governance demonstrated by these experiments, I seek to aggregate to macro-level propositions concerning the comparative attractiveness of hybrid governance under variant conditions.

Formalistic Opportunism in Hybrid Governance

The chief cost Williamson identifies with hybrid governance is the opportunism that tends to result when the bargaining context unfolds in a way the parties did not plan for that is highly consequential for the cost of performing under the formalized terms (p. 273). In cases where disruption undermines the economics of performance, Williamson finds "[t]he general

proposition here is that when the 'lawful' gains to be had by insistence upon literal enforcement exceed the discounted value of continuing the exchange relationship, defection from the spirit of the contract can be anticipated" (p. 273). This 'lawful' opportunism depends on the formalistic approach courts take to the construction of contracts, and it makes hybrid governance potentially devastating and comparatively less attractive. Williamson's "general proposition" represents a macro-level assessment meant to capture the "main case,"[397] and in that manner represents an implicit finding of the typical decision made by individual managers when confronted with disruptive circumstances. In a companion paper (under review with *Business Ethics Quarterly*),[398] I explore the organizational factors that translate into the micro-reality of the manager making judgments about the reach of the contract being enforced. My objective in the empirical extension of my dissertation described here is to tackle the comparative statics of formalistic opportunism in hybrid governance by evaluating the impact that two parameters of institutional changes have upon the decision making context of the individual manager in charge of one side of contract.

The first parameter I propose to test involves the way courts enforce contracts. The second involves the way managers enter into bargains (given the formalistic approach courts currently take to enforcing contracts). To understand the methodology for testing variations in the law and managerial practice, it is important to review several concepts developed in this dissertation.

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[397] *See* Williamson, *supra* note at 4 ("Transaction-cost economics maintains that (1) transaction cost economizing is the 'main case,' which is not to be confused with the only case.").

[398] Presently titled, "*Perfection as Moral Strategy: Planning for Disruption in Contracting*."

Perfecting Contracts, Formalistic Enforcement, Perfectionistic Enforcement

The key concepts are best reviewed through a concrete example.[399] In 1998, Tractebel had plans to build a new power plant in New England. The regulations of the Environmental Protection Agency required Tractebel to offset the new plant's nitrogen oxide emissions. The way to do so was by cashing in with the EPA credits earned by emissions reductions at other plants. Relying on a broker, Tractebel connected with DuPont, which had earned the needed credits from emissions reductions at a New Jersey plant in the 1980s. DuPont and Tractebel agreed to a trade of 1,000 tons per year of credits (1,000 credits) for US$1 million.

This agreement did not address any contingencies. The parties did not discuss what would happen in any of the three principal fault lines of a supply agreement: (i) if DuPont encountered a difficulty transferring the credits, (ii) if Tractebel encountered a difficulty making payments or (iii) if Tractebel's need for the credits dissolved for any reason.[400] In my terminology, the fact that a disruption is unplanned makes the corresponding performance obligation *unperfected*. This deal was unperfected in multiple respects because it was perfected with respect to none of the potential for disruption.

And then disaster struck. DuPont's credits were revoked by the New Jersey Department of Environmental Protection, leaving DuPont unable to sell its credits to Tractebel. Tractebel then sued DuPont for breach of contract. What rights did Tractebel then have under its contract? Under *formalistic* enforcement, Tractebel had rights to credits to be tendered by DuPont. And though for

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[399] The example is based upon the dispute adjudicated in *Tractebel Energy Marketing, Inc., and Tractebel Power, Inc., v. E. I. DuPont de Nemours and Co.*, 2000 WL 35723233 (Tex. Dist.); *Tractebel Energy Marketing, Inc., and Tractebel Power, Inc. v. E. I. DuPont de Nemours and Co.*, 2003 WL 25759876, at25 (Tex.App.-Hous. (14 Dist.)); and *Tractebel Energy Mktg., Inc. v. E.I. Du Pont De Nemours & Co.*, 118 S.W.3d 60, 66-67 opinion supplemented on overruling of reh'g, 118 S.W.3d 929 (Tex. App. 2003).

[400] Logically, there is a fourth category: when DuPont's interest in selling the credits dissolves for any reason. I leave this out (from the management perspective taken here) because the ritual of the bargain provides evidence that this risk was priced in the typical bargaining context. What it usually means to sell through a contract is to have given up any claim not to have to sell on the buyer's option.

150 years they have also been willing to occasionally apply excuse doctrine to avoid imposing damages in such cases, courts do not do so consistently enough to provide managers impacted by disruption the basis for avoiding their performance obligations without being subjected to costly litigation.

These features of the law were revealed after Tractebel sued DuPont. The trial court found excuse doctrine applicable, but the appellate court reversed, assessing US$1.2 million of damages to compensate for the increase in the price for NOx credits (DuPont's credits represented 60% of the global supply).

Hypothesis 1: Manipulating the Legal Environment

In this dissertation, I have argued that the opportunism fomented by formalistic construction cannot be squelched by excuse doctrine, but that *perfectionistic* enforcement undercuts the foundations of formalistic opportunism. The distinctive feature of perfectionistic enforcement is an unwillingness to enforce unperfected obligations. Perfectionistic enforcement, I have argued, encourages parties to make specific investments *and* to plan transactions thoughtfully and openly so far as they desire the surrogate for hostages provided by judicial enforcement.

What I seek to test in this extension of my dissertation is the hypothesis that as compared with a legal regime characterized by formalistic enforcement, a regime of perfectionistic enforcement in fact undercuts the foundations of formalistic opportunism and thereby enhances the attractiveness of hybrid governance. This micro-finding bears out the potential advantage to entrepreneurs and managers at the macro level of more attractive conditions for hybrid governance.

Hypothesis 2: Manipulating Managerial Practice

Managers, of course, cannot wait for the law to change, and the companion paper to my dissertation, *Perfection as Moral Strategy: Planning for Disruption in Contracting*, addresses

inadequacies in the justice of managerial practice under status quo law that have a bearing on the availability of formalistic opportunism. The costs that this paper and this dissertation seek to mitigate are, in that sense, one and the same: managers often fail to plan for disruption, and this plants the seeds of costly opportunism where unplanned disruption prejudices a manager's counterparty. The constructive thesis in the companion paper is that even under status quo law, managers can take steps at the negotiation phase to displace the temptation to act opportunistically in case of disruption. Specifically, they should confront the potential for disruption and plan and price around it. This process is what I have called the perfection of bargained terms.

The second experiment, therefore, will test the impact of an institutional environment that promotes the perfection of contractual obligations by managers. Once again, the purpose is to test the potential of institutional transformation to favorably alter the comparative statics of hybrid governance.

Experimental Design

In both experiments, one of the institutional treatments will represent the status quo: formalistic enforcement without additional encouragement to perfect the obligations in the contract. The way I expect to provide this treatment is to administer several brief business contracting and law cases for the participants to read (or otherwise take in, e.g., by video) that show the way courts handle the enforcement of unperfected performance terms in formalistic law, with and without excuse. The Tractebel and DuPont case would fit this need. This includes both the ways that one party can get away with and take advantage of the enforcement rights that come from unperfected terms (with the risk allocated formalistically to the counter-party who may have been ignorant about the salience of this risk) and the ways that the other party may be forced to bear the brunt of disruption, even though unconsidered.

Next, two participants who will be participating jointly are assigned a contracting problem, whether as buyer and seller or otherwise as co-venturers, to be played out between the two. Each participant will be provided background information for the simulation, from each participant's point of view as a manager in a particular firm in a specific competitive and regulatory environment. The participants will be provided asymmetric information concerning risk. In the first wave of experiments, only the party with the formalistic right to the performance that will get frustrated later in the simulation is primed with information suggesting the risk that materializes.

The basic terms of the bargain are provided to the parties as boilerplate (consistent with the express terms set forth in the background cases) with a prompt to each participant to add any desired terms to the bargain (also as suggested by the background cases). The two parties disclose any terms they would like to add and settle on the terms (other than pricing) before proceeding to pricing. Each party will have been primed with variant pricing information by the case narrative, including reservation prices that are established so as to provide the potential for a deal. Each participant is instructed by its upper management to try to lock down the most favorable price available but that ultimately what matters is closing above/below the reservation price. The participants are given a reasonable period of time to reach a deal. If the parties fail to close within a reasonable period of time (despite overlapping reservation prices), the contracting simulation is terminated, and survey instrument A is administered.

After the bargain is formalized and before any party makes an investment in reliance upon the bargain, the simulation will introduce a severe disruption. In formalistic terms, this disruption imposes a tremendous penalty on the party required to perform (like DuPont). Whether excuse would be available under the facts is not evident from the background cases. The performing party is prompted to determine whether it will (a) perform under the existing price, (b) require a renegotiation of the price or (c) refuse performance outright. If the party

communicates (a), then the simulation is terminated and survey instrument B is administered. If the performing party communicates (b), the counterparty is prompted to determine whether it will (i) demand performance at the bargained price or (ii) will renegotiate, and if so, at what reservation price. Iterations may ensue before either (x) there is a new agreement to perform or (y) there is an impasse. In case of (x), survey instrument C is administered. In case of (c) above or (y), the party with the formalistic right to performance determines whether or not to sue. If it chooses not to, survey instrument D is administered. If it chooses to enforce, survey instrument E is administered.

The various instruments are distinguished by the point at which the contracting problem resolved or broke down. Nevertheless, they all have the same basic aim of surveying for perceptions of rights, breach, injustice, and opportunism. In addition, the objective is to evaluate participants' assessment of the attractiveness of hybrid governance as a way to organize transactions.

In the first experiment, the alternative institutional treatment will involve perfectionistic contract enforcement by courts. Participants will acquire a sense for perfectionistic enforcement by reading the alter ego cases of the background cases for the formalistic treatment. The best reading of these cases says that the party expecting performance following the disruption cannot expect to have an enforceable right to performance, absent evidence of formality with respect to the reach of the bargain under the disruption at issue. Hypothesis 1 provides that this difference will substantially alter the distribution of variance between scenarios A through E (categorized by their survey instrument) and to the perceptions of injustice overall. Hypothesis 1 also provides that this difference increases the attractiveness of hybrid governance at the same time it decreases perceptions of injustice and opportunism.

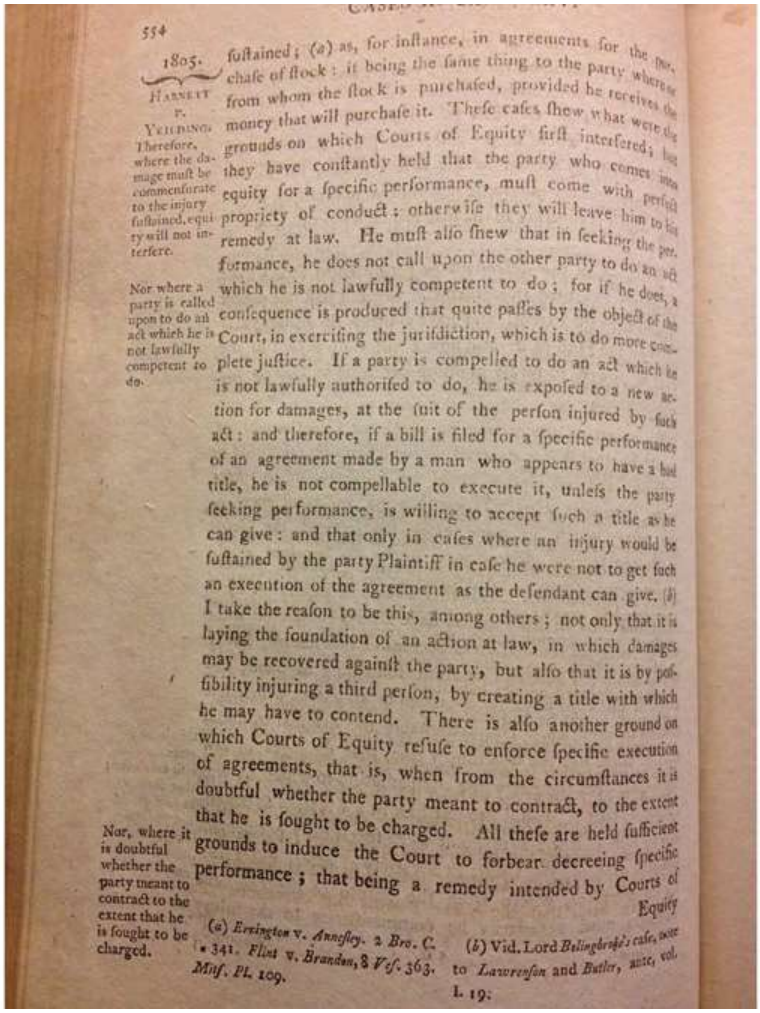
In the second experiment, the alternative institutional treatment involves a culture of perfection by managers, notwithstanding the predilection of courts to enforce contracts

formalistically. This treatment is administered in two parts. First, the formalistic background cases are complemented by variants in which contract failure was avoided by perfection of terms, including perfection sought by the party to be entitled to performance and with the superior information. Second, basic principles of perfection are communicated, as discussed in Section 3.4.

Summary

My purpose in this empirical research is to validate sources of institutional stability for governance built on contracts. In this dissertation, I have argued for perfectionistic enforcement by courts as a jurisprudence that undercuts the basis for formalistic opportunism and makes governance by off-market contracts more attractive. In its companion paper, I have argued for perfection as a moral strategy that managers can employ to forestall the temptation to be formalistic opportunists. My concrete goal is to test the efficacy of these two strategies in a behavioral laboratory. The unit of analysis is the individual manager, and by investigating the impact of differing institutional conditions on managerial decision making, I hope to develop robust claims about the potential to lower the costs of hybrid governance at the macro scale.

Appendix B: *Lord Redesdale in Harnett v. Yeilding*



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1805. HARNETT v. YEILDING.

sustained; (a) as, for instance, in agreements for the purchase of stock: it being the same thing to the party whether from whom the stock is purchased, provided he receives the money that will purchase it. These cases shew what were the grounds on which Courts of Equity first interfered; but they have constantly held that the party who comes into equity for a specific performance, must come with perfect propriety of conduct: otherwise they will leave him to his remedy at law. He must also shew that in seeking the performance, he does not call upon the other party to do an act which he is not lawfully competent to do; for if he does, a consequence is produced that quite passes by the object of the Court, in exercising the jurisdiction, which is to do more complete justice. If a party is compelled to do an act which he is not lawfully authorised to do, he is exposed to a new action for damages, at the suit of the person injured by such act: and therefore, if a bill is filed for a specific performance of an agreement made by a man who appears to have a bad title, he is not compellable to execute it, unless the party seeking performance, is willing to accept such a title as he can give: and that only in cases where an injury would be sustained by the party Plaintiff in case he were not to get such an execution of the agreement as the defendant can give. (b) I take the reason to be this, among others; not only that it is laying the foundation of an action at law, in which damages may be recovered against the party, but also that it is by possibility injuring a third person, by creating a title with which he may have to contend. There is also another ground on which Courts of Equity refuse to enforce specific execution of agreements, that is, when from the circumstances it is doubtful whether the party meant to contract, to the extent that he is sought to be charged. All these are held sufficient grounds to induce the Court to forbear decreeing specific performance; that being a remedy intended by Courts of Equity

Therefore, where the damage must be commensurate to the injury sustained, equity will not interfere.

Nor where a party is called upon to do an act which he is not lawfully competent to do.

Nor, where it is doubtful whether the party meant to contract to the extent that he is sought to be charged.

(a) *Errington* v. *Annesley*. 2 *Bro. C.* 341. *Flint* v. *Brandon*, 8 *Ves.* 363. *Mitf. Pl.* 109.

(b) Vid. Lord *Bolingbroke's* case, note to *Lawrenson* and *Butler*, ante, vol. I. 19.

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Equity to supply what are supposed to be the defect in the remedy given by the Courts of Law. Under these circumstances therefore, I think considerable caution is to be used in decreeing specific performance of agreements: and the Court is bound to see that it really does that complete justice which it aims at, and which is the ground of its jurisdiction.

Now, there are several objections to enforcing this contract. I agree with Mr. *Hartas*, that if a contract be so completely uncertain as to be void here, it must also be void at law: and if it is certain to a degree, but doubtful as to the extent, equity would, I think, act infinitely more wisely in leaving the party to the old remedy by action for damages, than to run the hazard of doing injustice, in doing what is said to be more complete justice, by decreeing a specific performance. If the contract therefore in this case is perfectly uncertain, the ground on which the Court would act, would be that it is a contract on which no action could be sustained, and no equity could be sustained, unless there were particular circumstances binding the conscience of the party, which in some cases has induced the Court to decree specific performance where no damages could be recovered at law. As to directing an action, it is putting the parties to great expense, and is not to be done therefore without great consideration, and for the sake of quieting a question, which may arise frequently, as in *Cooke* v. *Booth*. That was decided upon a case stated; if it had been upon an action, it might be said that it was for the purpose of ascertaining in one instance what was the tenure; for the question being whether it was a covenant for perpetual renewal, the effect of it would be to bind the title for ever. In later cases (*a*) which have occurred on the subject of covenants of this kind; (where, for instance, there as a lease for lives with a covenant to execute a further lease, with like covenants,) it has been held, that the words "with like covenants," do not

(*a*) Vid. *Bayham* v. *Guy's Hospital*, 3 *Ves. jun.* 295. *Iggulden* v. *May*, 9 *Ves. jun.* 325.

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