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**Contracts Small and Contract Large:  
Contract Law Through the Lens of Laissez-Faire  
by  
Richard A. Epstein\***

Introduction: A Fallen Theory? Laissez-faire capitalism, and its associated doctrine of freedom of contract, had many stalwart defenders during the nineteenth century. But it has received a rocky reception from many legal and philosophical commentators in the twentieth century. Freedom of contract often been pronounced "dead on arrival" as an organizing principle for complex contemporary societies. That principle has been said to be insensitive to differences in wealth, status, position and power that make the exercise of contractual choice a myth for the weak and dispossessed. Within the legal literature, it has been attacked as ignoring the large concentrations of wealth that distort market processes and that trample down the rights of consumers and workers. Modern writers often rejoice in pointing out the intellectual narrowness and class bias of the leading judicial defenders of the principle, of whom Baron Bramwell was surely one.<sup>1</sup>

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<sup>1</sup> See, e.g., David Abraham, Liberty and Property: Lord Bramwell and the Political Economic of Liberal Jurisprudence, Individualism, Freedom, and Utility, 38 AM. J. OF LEGAL HIST. 288 (1994); Anita Ramasastry, The Parameters, Progressions, and Paradoxes of Baron Bramwell, 38 AM. J. OF LEGAL HIST. 322

This sustained attack on laissez-faire political theory has taken place on two levels. The most obvious addresses grand themes of industrial capitalism and political discontent. These challenges to laissez-faire found their most vivid expression in several contexts: the role of assumption of risk in torts cases;<sup>2</sup> the role of contract and combination in labor cases,<sup>3</sup> antitrust cases, and the requirements of constitutional rates of return for public utilities and other regulated industries.<sup>4</sup> But a second level of concern has also exerted a surprising influence, especially in legal circles. There freedom of contract has been criticized, not only for its social consequences, but doctrinally and internally, for its unsatisfactory and confused conceptual foundations. Three of the most influential legal critiques of laissez-faire theories have bored at the system from within instead of assaulting it from without. I speak here of Friedrich Kessler's early critique of Contracts of Adhesion,<sup>5</sup> Grant Gilmore's highly influential set of lectures, The Death of Contract;<sup>6</sup> Lawrence Friedman's Contract Law in

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(1994). For my qualified defense of Baron Bramwell, see Richard A. Epstein, For a Bramwell Revival, 38 AM. J. OF LEGAL HIST. 246 (1994).

<sup>2</sup> For discussion, see e.g., \_\_\_ \_\_\_ Bohlen, Voluntary Assumption of Risk, 20 HARV. L. REV. 14 (1906).

<sup>3</sup> See, e.g., *Loewe v. Lawlor*, 208 U.S. 274 (1908) (holding labor unions subject to the Sherman antitrust law, at least when boycotted goods were shipped across state lines). See also *Duplex Printing Press v. Deering*, 254 U.S. 443 (1921) (holding unions liable under Clayton antitrust act for secondary boycotts).

<sup>4</sup> See, e.g., *Smyth v. Ames*, 169 U.S. 466 (1898).

<sup>5</sup> Friedrich Kessler, Contracts of Adhesion—Some Thoughts About Freedom of Contract, 43 COLUM. L. REV. 629 (1943).

<sup>6</sup> Grant Gilmore, THE DEATH OF CONTRACT (1974).

America;<sup>7</sup> and Patrick Atiyah's massive study of contract theory, The Rise and Fall of Freedom of Contract.<sup>8</sup>

In these writings the emphasis shifts from contract large to contracts small. Although these authors advert to the major social themes that surround the debate over laissez-faire, they focus on contract doctrines, such as the rules relating to offer and acceptance or consideration, which at first blush are the stuff of lawyer's law, and not the stuff of political controversy and intellectual unrest. They find that nineteenth century synthesis of contract law contains errors, confusions, and equivocations that undercut its intellectual vitality. In one sense, these writers have picked odd doctrinal targets for their work, but the influence of their writing calls for a more sustained examination of their position. This paper therefore has two central objectives. The first of these is to show that the disputes found in classical contract law, and indeed today, operate for the most part at the fringes of any functioning legal system. No system has to be perfect to survive, and the perceived defects of the nineteenth-century legal regime can be fixed without any major changes in its overall structure. Its second objective dovetails with the first. It is to establish the internal coherence of the classical system in order to explain why it should withstand the doctrinal and political attacks launched against it.

This essay seeks to discharge these missions by using both a top down and a bottom-up approach. The bottom-up approach is the worm's eye view of contract law that examines such issues as offer and acceptance, consideration, and conditions. The plural "contracts" is used to stress the diversity of doctrinal and technical issues that are incorporated into this overall mosaic. The top-

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<sup>7</sup> Lawrence Friedman, *CONTRACT LAW IN AMERICA* (1965)

<sup>8</sup> Patrick S. Atiyah, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1979).

down approach, contract large, uses the singular. It examines the social and intellectual linkages between contract law, writ-large, and laissez-faire.

The specific doctrines of contract law, which form the core of standard treatises and casebooks, do not bear any simple relationship to the principles of laissez-faire. Much of contract law is compatible with extensive systems of social regulation, both foolish and wise. Accordingly, the efforts of modern writers hostile to laissez-faire— Kessler, Gilmore, Friedman and Atiyah— falsely posit an intimate connection between the formal doctrines of contract and the political philosophy of laissez-faire. But they cannot bring down laissez-faire by pointing out the perceived inadequacies and rigidities of the nineteenth century doctrines of offer and acceptance, or consideration. Nor do the twentieth century doctrinal developments in these areas presage the inevitable rejection of laissez-faire. Indeed some developments, such as the explicit articulation of the principle of promissory estoppel, are more consistent with freedom of contract than with its rejection.

The received wisdom on this relationship is often otherwise. Friedrich Kessler's influential critique of the contract of adhesion dwelled at great length on the perceived mischief the rules of offer and acceptance generated in insurance contracts. He deplored the outcome when individual insureds were denied coverage because their policies had not been approved by the home office.<sup>9</sup> Yet he never once asked about the centrality of this issue to the overall scheme of insurance regulation, or addressed the principled defenses of the earlier rules.<sup>10</sup> Similarly, Grant Gilmore thought that the survival of the larger

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<sup>9</sup> Kessler, Contracts of Adhesion, supra note XX, at 632-639.

<sup>10</sup> For a strong defense of the earlier common law position, see William L. Prosser, Delay in Acting on an Application for Insurance, 3 U. CHI. L. REV. 39 (1935). Prosser rejected efforts to impose duties to respond to offers under

principle of laissez-faire stood or fell with the nineteenth-century contractual synthesis of offer, acceptance and consideration.<sup>11</sup> Lawrence Friedman found a still tighter connection between the two sets of principles.

Basically, then, the "pure" law of contract is an area of what we can call abstract relationships. "Pure" contract doctrine is blind to details of subject matter and person. It does not ask who buys and who sells, and what is bought and sold. In the law of contract it does not matter whether the subject of the contract is a goat, a horse, a carload of lumber, a stock certificate, or a shoe. As soon as it matters— e.g., if the sale is of heroin, or of votes for governor, or of an "E" Bond, or labor for twenty-five cents an hour— we are in one sense no longer talking about pure contract. In the law of contract, it does not matter if either party is a woman, a man, an Armenian-American, a corporation, the government, or a church. Again, as soon as it does matter— if one party is a minor, or if the transaction is one in which a small auto company sells out to General Motors, or if a seller of legal services happens to be a corporation instead of a partnership or individual— we are no longer talking pure contract. When the relationship of parties to land is involved, this is land law or property law, but not contract. In contract cases land is treated as a commodity on the market, the same as every other commodity, and the rules are supposed to be the same as the rules for horses and cows. If a court says that an insurance contract is "just another contract," or that contracts between the state of Wisconsin and a citizen follow the same rules as any other contracts, the judges are making the same kind of point, are

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contract law, *Id.* at 45. He also opposed manufacturing new torts out of the failure to respond. *Id.*

<sup>11</sup> Gilmore, *THE DEATH OF CONTRACT* at 106

asserting the same abstraction. Contract law is abstraction— what is left in the law relating to agreements when all particularities of person and subject-matter are removed.

The abstraction is not what people think of when they criticize the law as being too abstract, implying that the law is hyper-technical or unrealistic. (Though often it is.) The abstraction of classical contract law is not unrealistic; it is a deliberate renunciation of the particular, a deliberate relinquishment of the temptation to restrict untrammelled individual autonomy or the completely free market in the name of social policy. The law of contract, therefore, is roughly coextensive with the free market.<sup>12</sup>

Friedman's obvious foil was Christopher Columbus Langdell, the originator of the Socratic method, and the author of the first casebook on the law of contract, for which he prepared a companion volume, his well-known A SUMMARY OF THE LAW OF CONTRACTS.<sup>13</sup> Langdell is a tempting target for any writer, but even so it is dangerous to overstate the connection between legal formalism and laissez-faire, or to assume that Langdell's view of the law of contract dominated the judicial writing of the time. The judges who pondered grand theory also had to make peace with the routine tasks of contractual interpretation, and on these issues they well understood that no market could ever be sustained by the pure theory of contract law standing alone. Contract law must supply default terms for key elements of common transactions both to

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<sup>12</sup> Friedman, CONTRACT LAW *supra* at 20. The passage was cited favorably in Gilmore, THE DEATH OF CONTRACT, 5-8, and in Atiyah, RISE AND FALL at 402-405.

<sup>13</sup> Christopher Columbus Langdell, A SUMMARY OF THE LAW OF CONTRACTS 18-19 (2d ed. 1880)

reduce the costs of forming contracts in the first place and to eliminate uncertainty in contract disputes after the fact. Choosing default terms that lend business efficacy to transactions takes more than abstract principles that transcend commercial categories. It requires good situation sense as well, which the best nineteenth century judges surely possessed.<sup>14</sup> Ironically, it was Gilmore who devoted far too much energy in The Death of Contract to the sterile dispute over whether the development of general contract principles preceded or followed the emergence of law for particular types of contracts— sales, partnerships, leases, mortgages— and missed the obviously correct answer.<sup>15</sup> The two sets of rules developed side by side with reference to each other. Every system of contract law needs both, and this parallelism long antedated the nineteenth century rise of laissez-faire and continues happily after its demise.

It is therefore critical to unpack the larger relationship between contract doctrine and laissez-faire. In order to do so, it is necessary to distinguish clearly among three interrelated concepts. The narrowest idea is security of exchange: whenever there is a bargain the party who performs first must be secure in the knowledge that it can enforce the agreement against the other side. The

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<sup>14</sup> See, e.g., Bowen, L.J.'s remarks in The Moorcock, 14 P. 64, 68 (1889): "I believe if one were to take all the cases, and they are many, of implied warranties or covenants in law, it will be found that in all of them the law is raising an implication from the presumed intention of the parties with the object of giving the transaction such efficacy as both parties must have intended that at all events it should have." 14 P. at 68. As applied in that case, Bowen made the sensible judgment that a defendant wharfinger who operated over public waters was under a duty to warn about risks of which he had superior knowledge but under no duty to repair the condition over waters over which he had no control.

<sup>15</sup> Gilmore, THE DEATH OF CONTRACT 8-12. Note that Gilmore does not cite or discuss John Joseph Powell, ESSAY UPON THE LAW OF CONTRACTS AND AGREEMENTS (1790), which, heavily influenced by Lockean principles, seeks to develop a general theory of contract law.



grandest conception is freedom of contract, which includes, in addition to the security of exchange, the right to choose one's contracting partners and to trade with them on whatever terms and conditions one sees fit. Midway between them is the doctrine of the sanctity of contract. Under this doctrine the parties may not have perfect freedom to form whatever contract they choose, but once a contract is made, then one side is not free as a matter of course to vary its terms at will, even if it is prepared to compensate the other side for its losses. The sanctity of contract is analogous to the absolute rights of private property in a world devoid of the power of eminent domain. More specifically, sanctity of contract rejects the principle of efficient breach, and for that reason it exerts a powerful hold on classical contract theorists and ordinary traders, both of whom who resist the facile substitution of cash for performance.<sup>16</sup>

Believers in the freedom of contract are committed to both the sanctity of contract and the security of exchange. But the progression does not operate in reverse. It is possible to defend security of exchange and reject both the sanctity and freedom of contract. Or to defend both the security of exchange and the sanctity of contract and still accept limitations on contractual choice. The law may limit an individual right's to chose his trading partners, and still provide remedies for the contracts so made. The nineteenth century law imposed restrictions against wages paid in kind,<sup>17</sup> and the twentieth century law requires

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<sup>16</sup> See, e.g., Lisa Bernstein, Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms, 144 U. PA. L. REV. 1765, 1801-1802 (1996), noting the industry loyalty to the perfect tender rule. For discussion, see *infra* at .

<sup>17</sup> See, e.g. George White, THE LAW RESPECTING MASTERS AND WORK PEOPLE 5-6 (1824), defending the prohibition on in-kind payments against the delusions of "your theoretical political economists." These restrictions were the subject of the Truck Acts (as in barter and exchange). See, e.g., the opinions in

the payment of some minimum wages, thereby rejecting freedom of contract but accepting security of exchange. The use of specific performance remedies accepts the sanctity of contract but is consistent with the rejection of freedom of contract, when for example land is inalienable by public decree.

Most importantly, most of the law of contract is not about the principle of freedom of contract. The rules of contract formation, interpretation, discharge and enforcement consonant with a system of laissez-faire apply with undiminished force to the truncated system of contracts that survive scrutiny in the modern regulatory state. The benefits from security of exchange survive in a legal regime that pays less than total homage to freedom of contract. Indeed, it is hard to think of any philosophical or economic reason to abandon security of exchange as a principle of human interaction.<sup>18</sup>

My object in this paper is to develop and explore these themes at greater length. Part one of the paper summarizes the key philosophical assumptions about the exchange relationship under a system of laissez-faire. Part two then looks at some specific areas of doctrine which have often identified as integral parts of the edifice of laissez-faire, and advances what might be called the "separation thesis." Contract doctrine, dealing largely with security of exchange, and freedom of contract evolve along parallel but independent paths.

In order to develop these themes, this article is organized as follows. Section one deals with the general theory of laissez-faire in relationship to the

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Archer v. James, 121 Eng. Rep 998 (Ex. 1861). For discussion, see Richard A. Epstein, BRAMWELL, 38 Am. J. Legal History, at 253-255.

<sup>18</sup> See, e.g. David Hume, A TREATISE OF HUMAN NATURE, Part II, Book III, Section V, at 520 (L.A. Selby-Bigge ed. 1888): "Besides, the commerce of mankind is not confin'd to the barter of commodities, but may extend to services and actions, which we may exchange to our mutual interest and advantage. Your corn is ripe to-day; mine will be so to-morrow. 'Tis profitable for us both, that I shou'd labour with you to-day, and that you shou'd aid me to-morrow."

principle of freedom of contract. Section two uses this framework to examine the law, first of offer and acceptance, and then of consideration. Section three takes a closer look at the principle of the sanctity of contract in its relationship to doctrines of necessity, frustration, contract modification, damages, and specific performance. FLESH OUT

I. Laissez-Faire: Through the Eyes of Foe and Friend. Laissez-faire is a general political philosophy that in its popular sense stresses that government should keep its hands off the economy. While that crude formulation evokes the correct mood, it does not deny government any place at all in the running of the economy. Quite the opposite, laissez-faire, at least as viewed by its proponents, conceives a role for government in the creation and stabilization of property rights and in the enforcement of voluntary exchanges as between adult parties.<sup>19</sup> The belief in freedom of contract does not banish the tort law from the legal

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<sup>19</sup> Thus Jacob Viner writes:

I will carefully avoid using the term laissez faire to mean what only unscrupulous or ignorant opponents of it and never its exponents make it mean, namely, philosophical anarchism, or opposition to any governmental power or activity whatsoever. I will in general use the term to mean what the pioneer systematic exponents of it, the Physiocrats and Adam Smith, argued for, namely, the limitation of governmental activity to the enforcement of peace and of "justice" in the restricted sense of "commutative justice," to the defense against foreign enemies, and to public works regarded as essential and as impossible or highly improbable of establishment by private enterprise or, for special reasons, unsuitable to be left to private operation.

Jacob Viner, An Intellectual History of Laissez-Faire, 3 J. LAW & ECON. 45, 45 (1960).

Such attacks have legion. See, e.g., statement of Frederick Harrison that claimed that the "sticklers for absolute respect for Liberty and Property" should favor the repeal of laws against fraud, monopoly, and infectious diseases, quoted without criticism in Atiyah, RISE AND FALL, at 587, who should know better. See, e.g., Jessel M.R.'s statement of the principle, infra at .

system: the law of trespass, nuisance and defamation, insofar as they protect strangers, forms a key, regulatory, element of the basic system. Laissez-faire is not anarchy. Like other normative theories, it makes explicit substantive judgments about which kinds of regulation work in the common interest and which do not.

The philosophical foundations of laissez-faire rest on an uneasy admixture of natural law and social contract theory. In contrast, its practical side stresses the bad consequences to civil society that flow from ambitious government regimes of taxation and regulation that violate its precepts. The youthful Herbert Spencer, for example, commingled ideas of natural rights, social contract and social consequences within the confines of a single essay.<sup>20</sup> This intermingling of rights-based, contracts-based and consequence-based arguments do not reveal some necessary weakness in the philosophical foundations of his system; indeed most eighteenth and nineteenth century writers thought that these three approaches worked in tandem and not in

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[T]he well being of a community, depends upon a thorough knowledge of social principles, and an entire obedience to them.” “What, then, do they want a government for? Not to regulate commerce; not to educate the people; not teach religion; not to administer charity; not to make the roads and railways; but simply to defend the natural rights of man– to protect person and property– to prevent the aggressions of the powerful upon the weak– in a word to administer justice. This is the nature, the original, office of a government. It was not intended to do less; it ought not be allowed to do more.

Herbert Spencer, Six Essays on Government, Society and Freedom, Letter I, found in MAN VERSUS THE STATE 184,187 (Liberty Press ed. 1843). He makes no allowance for an eminent domain power independent of taxation.

opposition.<sup>21</sup> While Spencer was quite categorical in his delineation of government functions, the common law, to use the felicitous phrase of Aaron Director, softened that position to provide that government actions that went beyond these limited tasks should be evaluated under a presumption of error.<sup>22</sup> In its heyday, laissez-faire hardly preserved the status quo or glorified the position of the privileged. Rather, it reflected and nurtured strong reformist impulses.<sup>23</sup> Its historical targets were mercantilism, and the welter of special privileges and franchises that operated with government favor and support. In their place, laissez-faire displayed a marked affinity for open competition as the engine of social progress, a view that went hand in hand with the principle of freedom of contract.

Freedom of contract has been attacked, of course, for the restrictive assumptions on which it is said to rest. In particular Patrick Atiyah noted that the system assumed that "the parties dealt with each other 'at arm's length,'" in a regime where neither was bound to offer any information to the other side, and where "the content of the contract, the terms and the price and the subject-

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<sup>21</sup> N---- Simmonds, *THE DECLINE OF JURIDICAL REASON: DOCTRINE AND THEORY IN THE LEGAL ORDER* 54 (1984).

<sup>22</sup> "Laissez-faire has never been more than a slogan in defense of the proposition that every extension of state activity should be examined under the presumption of error." Aaron Director, *Parity of The Economic Market Place*, 7 *J. LAW & ECON.* 1, 2 (1964). Director does not specify what it takes to override the presumption, on which see infra at .

<sup>23</sup> "The sort of men who became judges towards the middle of the century were imbued wit the creed of 'philosophical Radicals' who drove the chariot of reform, and for whom the authority of the orthodox economists came second only to Bentham's." Frederick Pollock *A Plea for Historical Interpretation*, 39 *LAW QUART. REV.* 163, 165 (1923). The one judge named was Baron Bramwell. *Id.* at 165. For a guarded assessment of Bramwell's role, which emphasizes his gradual disenchantment with the English politics of his time, see Anita Ramasastry, *Paradoxes*, supra note .

matter, are entirely for the parties to settle."<sup>24</sup> All this is said to make sense because individuals are the best judges of what is in their personal interest.<sup>25</sup>

This stark portrait of the common law surely contains important elements of the truth, but it misses out on several elements of the system. First, the rule on "arm's length transactions" was never universal, nor should it have been. Contracts for insurance, for example, were contracts *uberimmae fides*, about which Judge Bayley wrote in 1828, "I think that in all cases of insurance, whether on ships, house or lives, the underwriter should be informed of every material circumstance within the knowledge of the assured; and that the proper question is, whether any particular circumstance was in fact material, not whether the party believed it to be so."<sup>26</sup> The duty, as codified by statute, applies with special strictness for marine insurance: "the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract."<sup>27</sup> Whether by statute or by contract, this rule makes good sense given the obvious asymmetry of information with respect to the covered risks. Likewise, many of the default

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<sup>24</sup> *Id.* at 403.

<sup>25</sup> *Id.* For Mill's version of the argument, see John Stuart Mill, *On Liberty*, at , which emphasizes the harm, or tort, side of the nineteenth century liberal position. For my views, see Richard A. Epstein, *The Harm Principle— And How it Grew*, 45 *TORONTO L.J.* 369 (1995).

<sup>26</sup> *Lindenau v. Desborough*, 108 Eng. Rep. 1160, 1162 (1828). For similar sentiments, see Lord Mansfield's earlier opinion in *Carter v. Boehm*, 97 Eng. Rep. 1162 (1766); *London Assurance v. Mansel*, 11 Ch.D. 363, 368-369 (1879), holding that an insured must disclose all that is known to him, even if he does not understand why the information is material to the evaluation of the risk.

<sup>27</sup> Marine Insurance Act, 1906, s. 18(1).

terms at contract contain implied warranties of seaworthiness or merchantability, which again match the commercial intuitions of both the nineteenth century and our own.

Nor was the content of the bargain left to the desires of the parties in all cases. Common carriers had long been under an obligation to take all comers, whom they could charge only a reasonable price— not whatever price they wanted.<sup>28</sup> It is both odd and regrettable that neither the supporters nor the detractors of laissez-faire paid much attention to this critical class of institutions in working out their general theories. The failure to note these important institutional exceptions to the basic rule makes laissez-faire appear more extreme than it is— an all too inviting target that its adversaries can then attack for its thoughtless absolutism in defense of individual choice.

Often the criticisms are less focused. Atiyah's prose is characterized by a pervasive undercurrent of skepticism which defies easy summary. Gilmore's vision of laissez-faire comes across at best tongue-in-cheek, and stands in sharp contrast to the careful treatment that he gives discrete, tricky issues in the law of contracts: "I suppose that laissez-faire economic theory comes down to something like this: If we all do exactly as we please, no doubt everything will work out for the best."<sup>29</sup> And further: "It seems apparent to the twentieth century mind, as perhaps it did not to the nineteenth century, that a system in which everybody is invited to do his own thing, at whatever cost to his neighbor, must work ultimately to the benefit of the rich and powerful, who are

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<sup>28</sup> Allnutt v. Inglis, 12 East 525, 104 Eng. Rep. 206 (1810). I discuss this problem at length in Richard A. Epstein, Principle for a Free Society: Reconciling Individual Liberty with the Common Good, ch. 10, forthcoming (1998).

<sup>29</sup> Gilmore, THE DEATH OF CONTRACT, at 95.

in a position to look after themselves, and to act, so to say, as their own self-insurers."<sup>30</sup> Thus the theory is often presented as though individuals are entitled to advance themselves by causing greater harm to their neighbors. Faced with such caricature, I will set out its philosophical presuppositions in a fashion that commends itself to the sympathizers, and not the critics of the theory.

As noted earlier, laissez-faire did not (and still does not) reflect a single intellectual tradition. Natural law theories, contractarianism and utilitarianism are all mixed together in uncertain proportions. But the elements of this admixture are not randomly thrown together.<sup>31</sup> Utilitarianism may seek to reflect the overall welfare of individuals within society. But so long as utility is not a disembodied spirit, it must find some way to sum utility over separate persons. Voluntary contracts do that job quite well for their participants, and contractarian views seek to find the utility of the group in the hypothetical contracts that its members would accept if transactions costs are low. The two set of solutions tend to converge even though utilitarianism in theory focuses more on outcomes and contractarianism focuses more on process. Within both theories, natural rights fit into the picture as a means to secure the desired social outcomes. A contractarian can hardly take a uniformly hostile view to private contracts; and a utilitarian can hardly fail to see their utility in daily life. Sophisticated utilitarians (and sophisticated contractarians) tend to despair of direct social measurements of utility, and thus seek to find ways in which private actors can express their own preferences, for which a system of property

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<sup>30</sup> Id. at 95.

<sup>31</sup> For a fuller account of my own views on the interconnections, see Richard A. Epstein, *The Utilitarian Foundations of Natural Law*, 12 Harv. J. of Law & Public Policy 713 (1989); Richard A. Epstein, *The Ubiquity of the Restitution Principle*, 67 So. Cal. L. Rev. 1369 (1994).



and contract rights offers the best starting point, even if it does respond fully to the full range of collective action problems found in modern social organizations. These theories thus differ on the extent to which they tolerate social justifications for the limitation on individual rights, but the family preference in favor of strong private rights is nonetheless fairly secure.

This intellectual convergence can be traced in the philosophical literature. Here the most convenient point of departure is Thomas Hobbes's account of ordinary contracts. His initial query was sociological in nature: why do individuals make promises and form contracts in the first place? That question is not answered by stressing the sanctity of the promise. We must first explain why anyone should take the trouble to be bound by a promise in the first place. Hobbes's answer was the self-interest of both parties, each of whom surrenders by agreement something he values less to receive that which he values more. But how does a simple exchange create gain sufficient to justify the cost of transacting? Before the exchange I had a cow and you had a horse. Afterwards I have the horse and you have the cow. Same horse, same cow. So where is the gain? To this skeptical inquiry Hobbes gave an indispensable part of the overall picture: subjective value. Each side has its own unique ranking of goods and services, based on complex private motivations that can be satisfied without giving explanations to others. Thus his famous remark:

As if it were Injustice to sell dearer than we buy; or to give more to a man than he merits. The value of all things contracted for, is measured by the Appetite of the Contractors: and therefore the just value, is that which they be contented to give. And Merit (besides that which is by Covenant, where the performance on one part, meriteth the performance

of the other part and falls under Justice Commutative, not Distributive) is not due by Justice; but is rewarded of Grace onely.<sup>32</sup>

Hobbes chose his words, and his targets, carefully. His reference to the commutative and distributive theories of justice is a veiled attack on Aristotle,<sup>33</sup> and his dismissal of the just price takes after the Church doctrines of the same name.<sup>34</sup> For Hobbes, the mere fact of making the bargain generated the obligation: measuring return benefit, direct or indirect, was for each party to

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<sup>32</sup> Thomas Hobbes, *LEVIATHAN*, ch. 15, at 105 (R. Tuck, ed. 1991), picked up by Atiyah, *RISE AND FALL* at 71, and just about everyone else. For a perceptive account of how Hobbes could be regarded as both the father of the totalitarian state and the early champion of economic liberty, see Viner, *Laissez-Faire*, 3 *J. LAW & ECON.* at 57, noting that Hobbes contemplated the virtuous sovereign as using his power largely for national defense. And for Hume's version of the same point see, D. Hume, *TREATISE*, supra at note .

<sup>33</sup> Aristotle's *Ethics* contains a discussion of justice commutative and distributive in his treatment in his ethics, and treats (for reasons that escape me) the first as arithmetical and the second as geometrical. *Nicomachean Ethics*, Book V, Chapter 4. But Aristotle does offer a defense of private property against common ownership that relied on the superior incentive effects when a single person is placed in charge of a give resource. "Property should be in a certain sense common, but, as a general rule, private; for, when every one has a distinct interest, men will not complain of one another, and they will make more progress, because everyone will be attending to his own business." See Aristotle, *POLITICS*, 1263a25-29 (Jowett trans., 1943). But his hostility to the retail trade makes him at most a partial forbearer of *laissez-faire*. See *Id.* at 1256b40-1258b8, condemning the retail trade as "unnatural, and a mode by which men gain from one another." The gist of the passage is to make Pareto-efficient exchanges immoral, in favor of a regime of self-sufficiency in production— a far cry from *laissez-faire*.

<sup>34</sup> There is a learned dispute as to whether the just price referred to some external standard, typically administered by the state. For the opposite position, see Jacob Viner, *Laissez-Faire*, 3 *J. LAW & ECON.* at 53, noting that "the standard late-medieval meaning of 'common estimation' was market price under free competition, . . ." The text was designed to filter out the short-term perturbations brought on by sudden famine, plague, siege and the like, which sounds like a far more sensible doctrine.

decide. He did not see, or impose, any independent judgment of what was or not valuable about the property or services exchanged. His choice of the word "appetite" consciously elicited images of subjective desire as the animating force of exchange and the source of mutual gain. We attach different values to the horse and the cow, which our conduct reveals to the world.

His position runs through the laissez-faire period. It is implicit in the duel between Justice Pitney and Justice Holmes in Coppage v. Kansas,<sup>35</sup> which rightly struck down a law that prohibited so-called "yellow-dog" contracts, whereby an employer could condition the offer of work on the willingness of an employee not to join a union. Pitney's words echo the classical conception of contract (and property) that animated both Hobbes and Hume.

As to the interest of the employed, it is said by the Kansas Supreme Court to be a matter of common knowledge that "employés, as a rule, are not financially able to be as independent in making contracts for the sale of their labor as are employers in making contracts of purchase thereof." No doubt, wherever the right of private property exists, there must and will be inequalities of fortune; and thus it naturally happens that parties negotiating about a contract are not equally unhampered by circumstances. This applies to all contracts, and not merely to that between employer and employé. Indeed a little reflection will show that whenever the right of private property and the right of free contract co-exist, each party when contracting is inevitably more or less influenced by the question of whether he has much property, or little, or none; for the contract is made to the very end that each may gain something the he

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<sup>35</sup> 236 U.S. 1 (1914).

needs or desires more urgently than that which he proposes to give in exchange.<sup>36</sup>

The brief Holmes dissent showed a much weaker understanding of the logic of contract:

In present conditions a workman not unnaturally may believe that only by belonging to a union can he secure a contract that shall be fair to him. If that belief, whether right or wrong, may be held by a reasonable man, it seems to me that it may be enforced by law in order to establish the equality of position between the parties in which liberty of contract begins.<sup>37</sup>

Yet Holmes offers no independent account of fairness. He does not explain why it depends exclusively on the sentiments of one side to the potential arrangement. Likewise, he does not tell us why contracts cannot secure mutual gain even when the wealth of the parties are unequal at the time of formation. And he surely has no grasp of the threat potential when workers in a group withdraw their labor after the employer has committed extensive capital to the venture. Yet just that risk is inherent in the monopoly position that compulsory unionization creates.

It would, however, be a mistake to assume that all gains from trade derive solely from differences in subjective value. Thus we speak of the sale of "goods" not just because they are chattels, but because they are in fact perceived as "good" by all who observe them. I may prefer the horse to the cow, and you may prefer the reverse. But typically neither of us attaches a negative value to either. I may want your horse because mine has just died. You might be willing

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<sup>36</sup> Id. at 17.

<sup>37</sup> Id. at 27.

to give me your horse because you have an extra in the barn, but have no cow. Markets work because they allow a ranking of preferences by their intensity. This matching of scarcity and superfluity is a very old theme in contract law, and can be found in explicit form, for example, in Justinian's Digest in the opening passages on the law of sale.<sup>38</sup> It was picked up in the political economy literature of the eighteenth century, even before Smith.<sup>39</sup> These dual rationales—subjective value and situational needs—differ on points of detail. The latter refers to things which are desired in and of themselves, but for which a party has an adequate supply. But in dealing with exchanges, the differences between them are unimportant. What matters is that they reinforce each other, by highlighting the different paths to the gains from trade on which so much of liberal theory insists.

So understood, the lifeless abstractions of contract law are not just idle formalisms; they function as a precondition to voluntary exchange, the precursor to mutual gain. Freedom of contract as such does not go to the interpretation of the contracts validly made. It addresses the question of the right to make them, or not make them, in the first place. Freedom of contract therefore is at one with

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<sup>38</sup> D. 18.1.1. "Sale originates in barter. For in the early days there was no such thing as money nor were there distinct terms for the merchandise and the price, but according to his occasions and needs a man would barter what was useless to him for what was useful, since it commonly happens that what one man has in superfluity another lacks." The text does not quite get the principle of comparative advantage because it never quite says that you will trade that which you value less for that which you value more. Instead of exploiting the gains from gradation, the passage presupposes the stark but unnecessary contrast between useless and useful.

<sup>39</sup> "Trade was a 'commutation of superfluities' in which each gave what he could spare in exchange for what he needed." Atiyah, RISE AND FALL at 72. The enclosed words come from Sir Dudley North, DISCOURSES ON TRADE, which according to Atiyah date from the end of the 17th Century, about the time of Locke's Treatise on Government.

the basic doctrines of property law. The ability not to have offers forced down one's throat is part and parcel of the right to exclude others from your land, or to justify the refusal to hire or be hired. The proposition that made each person the "master of his own offer" does not state what terms an offer should contain, but leaves all parties free to decide what offers to make or reject. Beliefs of this sort were very much a part of the nineteenth century thought,<sup>40</sup> but, notwithstanding their central substantive importance, they functioned as the backdrop to more specific doctrinal disputes. Most typically, they were not the focal of any sustained doctrinal discussion or dispute.

In this environment, contract law plays an instrumental and facilitative role. Individual intentions must be discerned for promises to be enforced. This separation of freedom of contract from contract law is evident from the topics covered by Langdell in his Summary of Contracts published in 1880 as the handmaiden to the 1879 (second edition) of his casebook. His table of contents is most notable for its truncated choice of topics: mutual consent, consideration and conditions.<sup>41</sup> Mutual consent exhaustively discussed the endless variations on the theme of offer and acceptance. Consideration received still more extensive treatment, both theoretically and with specific topics such as forbearance, compromise, moral consideration, gratuitous bailments, consideration void in part, and executed consideration. The third section parsed the law of conditions precedent, subsequent and concurrent; independent and mutual covenants; and waiver and performance.

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<sup>40</sup> See, e.g., Boston Ice Co. v. Potter, 123 Mass. 28 (1877).

<sup>41</sup> 1 Christopher Columbus Langdell, CASES ON CONTRACT xi-xii (2d ed. 1880).

These topics, however important, do not come close to exhausting contract law, as Langdell acknowledged in the Preface to the First Edition.<sup>42</sup> The remarkable list of contemporary omissions includes: frustration, including Taylor v. Caldwell;<sup>43</sup> damages, including Hadley v. Baxendale;<sup>44</sup> privity, assignment and third party-beneficiaries, including both Lawrence v. Fox,<sup>45</sup> and its English rival, Tweddle v. Atkinson;<sup>46</sup> restitution for a plaintiff in default, including Britton v. Turner<sup>47</sup> from 1834 and its opposite number, Smith v. Brady.<sup>48</sup> In addition, Langdell offers no discussion of the public policy limitations on freedom of contract (a subject that does implicate the principles of laissez-faire), nor does he include the oft-quoted judgment of Sir George Jessel: "If there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts, when entered into freely and voluntarily, shall be held sacred and shall be enforced by courts of justice."<sup>49</sup> These omission cover many cases on which both Gilmore and Atiyah lavish considerable attention. So the agenda is now fairly set. To what extent do these doctrines

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<sup>42</sup> Reproduced, id. at vii-ix.

<sup>43</sup> 3 B. & S. 825, 122 Eng. Rep. 309 (Q.B. 1863).

<sup>44</sup> 9 Ex. 341, 156 Eng. Rep. 145 (1854).

<sup>45</sup> 20 N.Y. 268 (Ct. App. 1859).

<sup>46</sup> 1 B.& S. 393, 121 Eng. Rep. 762 (Q.B. 1861).

<sup>47</sup> 6 N.H. 481 (1834).

<sup>48</sup> 17 N.Y. 173 (Ct. App. 1858).

<sup>49</sup> Printing and Numerical Registering Co. v. Sampson (1875), L. R. 19 Eq. 462, 465, quoted inter alia in Kessler, Contracts of Adhesion, at 631; Cheshire & Fifoot, THE LAW OF CONTRACT 21 (6th ed. 1964), the edition from which I learned contract law when a student at Oxford from 1964-1966.

form a constituent part of laissez-faire? In order to examine this inquiry, I shall look at a number of discrete doctrinal developments with an eye to showing the separation between contract law as such and the grander theories of laissez-faire.

II. From Contract Theory to Contract Law. The next question is how the broad interest in laissez-faire translates into particular contracts doctrine. Here there is no short-cut to dealing with this matters on an issue by issue basis.

Many contract scholars treat offer and acceptance as a linchpin of laissez-faire. One notable battleground has stressed the tension between subjective intention to be bound, under the so-called will theory, and the overt manifestations of intention, under the objective theory of contracts. Do the nineteenth century theories of laissez-faire incorporate some version of the will theory because of its emphasis on subjective value and individual choice in voluntary exchange? Cheshire & Fifoot, that solid barometer of modern English sensibilities, write in criticism of the ostensible nineteenth century views: "Agreement, however, is not a mental state but an act, and, as an act, is a matter of inference from conduct," a matter in which "external appearances" play a central role. This point is one that Baron Bramwell, a chief judicial defender of laissez-faire, was said to have misunderstood. Then to clinch the argument, Cheshire and Fifoot quote the famous 1478 dictum from Chief Justice Brian: "As for the other conceit, it seems to me that the plea is not good without showing that he has certified the other of his pleasure; for it is common learning that the intent of a man cannot be tried, for the Devil himself knows not the intent of a man." Outward signification of intention are therefore required.<sup>50</sup>

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<sup>50</sup> Cheshire & Fifoot, *CONTRACT*, at 22. The only portion of the quotation found there reads: "the intent of a man cannot be tried, for the Devil himself knows not the intent of a man."



The point, however, has no theoretical bite. Any legal system must deal with errors in communication, both in the transmission of contracts at a distance and with the ordinary slips of the tongue (and pen), a phrase highlighted by Kessler and Gilmore.<sup>51</sup> These errors in communication by definition could have been avoided by prudent conduct of the speaking or receiving party, or perhaps both. In an ideal world, these errors never crop up because the outward expression of desires corresponds perfectly with one's inner thoughts. Chief Justice Brian's rumination on the devil does not dispute this proposition. It points out the difficulty of trying mental states. It does not offer the behavioralist manifesto that banishes mental states from the list of respectable concepts. Brian's only point was that in the case at hand the plaintiff gave no indication of an acceptance.

But what happens when the external words do not match the internal intentions (as proved by other means)? An exchange is not a solipsistic act, but involves the cooperation of two or more individuals. Who should bear the costs of error in transmission— the party who made the error, or the party forced to rely on those incorrect statements? One sensible rule places the risk of error on the party who makes it, for he is usually, all things considered, in a better position to prevent it. The "objective" theory of contract interpretation simply crystallizes that view that parties are strictly responsible for their errors. But this doctrinal move hardly embodies some philosophical view about the dominance of external appearances. I wish to sell my cow, but say horse by mistake. From the context, you understand that the cow is meant. Now that the error is known to the opposite party, the dual subjective intentions will, or at least should, normally trump the objective slip of the tongue. The Restatement of Contracts,

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<sup>51</sup> Kessler & Gilmore, at 686.

which once fought this conclusion, has now adopted this sensible view.<sup>52</sup> The objective theory applies only when one party makes a mistake of which the other is ignorant. It does not dispense with mental states in cases where the second party is aware of the first party's mistake,<sup>53</sup> or from objective circumstances has reason to believe that the offer is too good to be true (as when the buyer "snaps up" the seller's offer for Rolls Royce at \$1600.00 when \$160,000 is the market price.)<sup>54</sup>

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<sup>52</sup> The Restatement flip-flop on the issue goes as follows. The first Restatement found no contract when A said he offered his horse for sale, when he meant his cow, even though B knew that cow must meant. RESTATEMENT OF CONTRACTS § 71, illustration 2. The second Restatement shifts course and concludes that the contract is made, for the sale of the cow (which both parties meant) but not for the horse. RESTATEMENT (SECOND) CONTRACTS, § 71, Illustration 2.

<sup>53</sup> See, Hotchkiss v. National City Bank of New York, 200 F. 287, 293 (1911 S.D.N.Y.), which begins with the proposition that "A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties." The point of that remark is that a one-sided mistake does not furnish an excuse against performance. But even Learned Hand goes on to create an exception for "some mutual mistake, or something else of the sort." It took the more dogmatic mind of Williston to assert a contract on the terms that neither side accepted. "It is conceivable that contract may be formed which is in accordance with the intention of neither party." 1 Williston §95. Both passages set out seriatim in Kessler & Gilmore, CONTRACTS, at 707. Williston's position, for what it is worth, is that it is conceivable that if A says pig, but thinks horse, while B hears cow, there is a contract for the sale of a pig. So who will sue, and for what?

<sup>54</sup> For discussion, see Andrew Kull, Unilateral Mistake: The Baseball Card Case, 70 WASH. U. L. Q. 57 (1992). Kull's example was the real cases where a 12-year-old card collector purchased a Nolan Ryan/Jerry Koosman rookie card worth about \$1,200 for \$12. The card had been marked at 1200/, which had been misread by an inexperienced clerk to mean \$12.00. For a another example, see the 1961 Cary Grant, Audrey Hepburn classic Cherade, where irreplaceable stamps were traded by a young boy for a large set of worthless ones. The stamps were returned by the apologetic dealer who was pleased to have gazed on them.

So arrayed how do these rules prop up laissez-faire? The objective interpretation of words and conduct reduces communication errors and thus helps both parties realize their subjective desires through exchange. No serious defender of laissez-faire could object to the objective theory suitably qualified. Nor could any opponent of laissez-faire. To be sure, people may wish to ban or restrict certain types of transactions by statute or common law rule. But even if some transactions are deemed exploitive or against public policy, why attack them by criticizing the objective theory of contract interpretation? Even the attackers of freedom of contract should support the security of exchange for that subset of voluntary transactions of which they approve. They too should endorse the traditional mix between subjective and objective interpretation.

To see why consider that great nineteenth century classic, Raffles v. Wichelhaus,<sup>55</sup> which arose when the buyer rejected a shipment of cotton, Bombay ex Peerless, on the Liverpool docks at the height of the United States Civil War. The basic contract did not refer specifically to either the December Peerless (the ship intended by the plaintiff-seller) or the October Peerless (the ship intended by the defendant-buyer). The identification of the ship was surely relevant if one ship lost its cargo at sea. The plaintiff argued that with the cargo safely delivered the "ex Peerless" term was at best a minor condition of the contract whose breach (if there were breach) did not allow the buyer to reject the cotton from the later ship, even if he had meant to purchase cotton shipped on the earlier one— a view that Gilmore found persuasive,<sup>56</sup> and which Simpson

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<sup>55</sup> 2 Hur & C. 906, 159 Eng. Rep. 375 (Ex. 1864).

<sup>56</sup> Gilmore, DEATH OF CONTRACT, at 35-43.

found more problematic.<sup>57</sup> But the court treated the term as essential, just as if the ship was the object of sale, and allowed parol evidence to expose the latent ambiguity that defeated consensus.<sup>58</sup>

The numerous post-mortems on the case often pay too much attention to resolving the particular dispute, and not enough attention to its limited institutional significance.<sup>59</sup> Brian Simpson is the notable exception.<sup>60</sup> As he notes the identification question can be sidestepped by listing either the name of the captain or the registration number of the ship.<sup>61</sup> No matter whether we endorse the objective or subjective theory of contracts, no one profits from commercial surprises. It is better to insure correspondence between objective manifestation and subjective intent than to be forced to choose between them when a dispute arises.

This need for avoiding slippage between word and thought takes on added urgency in markets where prices fluctuate widely (as they did during the Civil War, owing to the end of the blockade of the American South) and thus open windows for strategic litigation. Accordingly, we should expect members

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<sup>57</sup> A.W. Brian Simpson, Contracts for Cotton to Arrive: The Case of the Two Ships Peerless, 11 CARDOZO L. REV. 287, 288-293 (1989)

<sup>58</sup> Where everyone agrees the result is correct. See Gilmore, DEATH OF CONTRACT, at 121, n. 91 citing Kyle v. Kavanagh, 103 Mass. 356 (1869).

<sup>59</sup> For example, see Judah Benjamin, A TREATISE ON THE LAW OF SALE OF PERSONAL PROPERTY; REFERENCE TO THE AMERICAN DECISIONS AND TO THE FRENCH CODE AND THE CIVIL LAW 51 (J. Perkins, first American edition 1875); Frederick Pollock, PRINCIPLES OF CONTRACT AT LAW AND IN EQUITY 2 (1876) (opting for a subjective view); William Anson, PRINCIPLES OF THE ENGLISH LAW OF CONTRACT 130 (1879)(subjective view); Oliver Wendell Holmes, THE COMMON LAW **XX** (1881)(taking the objective view).

<sup>60</sup> Simpson, Contracts for Cotton to Arrive, 11 CARDOZO L. REV. at 324-333.

<sup>61</sup> *Id.* at 315.

of trade to take quick institutional measures to eliminate the puzzles that give such delight to lawyers. The thick institutional framework that Lisa Bernstein found in the diamond market in New York City is replicated in the English setting.<sup>62</sup> The critical market development was the final report of a specialized commission, adopted in June, 1863, that explicitly incorporated customary practices, and required arbitration of all disputes in light thereof "by two respectable brokers."<sup>63</sup> The attendant evolution in standard contract terms, moreover, did not stem from one wayward case, but from voluntary action in response to the improvement in sailing vessels and their navigational aids.<sup>64</sup> Greater control over sailing vessels made it possible to key contracts not to departure, but to the anticipated date of arrival, which has far greater commercial significance in planning for resale or use.<sup>65</sup> These arrival contracts in turn lay at the foundation of the emergence of a systematic market in cotton futures in Liverpool by the mid-1870s, a development that Simpson carefully chronicles.<sup>66</sup> How odd it is to look to the small points of contract law when futures markets are a fixture of all modern economies.

Contracts at a Distance. Long before laissez-faire, legal systems had to fashion rules for contracts made at a distance. Justinian's Institutes begins its discussion of the consensual contracts (sale, hire, partnership and mandate, (or

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<sup>62</sup> Lisa Bernstein, Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. LEGAL STUD. 115 (1992).

<sup>63</sup> Id. at 312.

<sup>64</sup> Simpson, Contracts for Cotton to Arrive, 11 CARDOZO L. REV. at 313.

<sup>65</sup> Id at 313.

<sup>66</sup> A.W. B. Simpson, The Origins of Futures Trading in the Liverpool Cotton Market, in ESSAYS FOR PATRICK ATIYAH 179 (Peter Cane & Jane Stapleton eds. 1991).

agency)) with the observation that "[p]arties who are not present together, therefore, can form these contracts by letter, for instance, or by messenger; . . ."67 But the Institutes do not elaborate the rules of offer and acceptance, for the Romans took the sensible view that agreement was the ultimate issue, which the trier of fact could find for whatever reason seemed sensible– e.g. the joint acceptance of an offer posed by a neutral third party– which does not quite fit into the offer and acceptance model.

The problem of contracting at a distance also lay at the core of the dispute in which Brian, C.J., uttered his devilish aphorism. The plaintiff sued the defendant for trespass for the carrying away of goods. Plaintiff and defendant had bargained in London for the sale of corn, barley, and grass found in a distant field for the sum of 3s. 4d. per acre. Defendant went to the site, viewed the corn etc., and then gathered it for his own use. His defense to the trespass action interposed a contract that he claimed passed title to him, at the latest when he took possession. The plaintiff's objection was merely that the defendant had not communicated his acceptance to the plaintiff prior to taking the corn. Catesby, the defendant's lawyer, kept stressing that his client had unequivocally indicated his acceptance of the goods by taking them from the field, so that the right action should be for the price, as computed, and not for trespass. On his view, the transaction could be understood to be one in which return communication of an acceptance had been waived given the defendant's

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67 Justinian, INSTITUTES, 3, 22 (Moyle Ed. 1883). The full quotation reads:

"Obligations contracted by mere consent are exemplified by sale, hire, partnership and agency, which are called consensual contracts because no writing, nor the presence of the parties, nor any delivery is required to make the obligation actionable, but the consent of the parties is sufficient. Parties who are not present together, therefore, can form these contracts by letter, for instance, or by messenger. . . ."

unambiguous overt act, just as in the famous smoke ball case, where acceptance was found in using the smoke-ball as requested and not in the return communication.<sup>68</sup> So the real issue is who takes the risk of the slippage from delay brought on by physical separation. Why not side with the defendant who wants to expedite contract formation? From the ex ante perspective, the court could treat the London conversation as forming a binding contract, subject to a satisfactory field inspection. Alternatively, the case could be treated as akin to one where the offer leaves it open to the offeree to decide whether to accept by return promise or by performance.<sup>69</sup>

In fairness, Brian feared that hasty acceptance could influence the sequence of performance. The defendant could take now and pay later, and thereby leave plaintiff an unsecured creditor. But even that point is not decisive, for an acceptance by messenger also creates an unsecured obligation without leaving plaintiff the opportunity to bargain further. But the peculiarities of this transaction to one side, Brian was a stout defender of freedom of contract because he recognized that the parties could have initially stipulated that the defendant could have taken the corn if he liked it, subject only to a bare future obligation to pay. In other words, he was quite prepared to enforce fully executory agreements without security, just like the Romans. His only reluctance was to presume that this agreement took that form. So understood this case is not about the philosophical importance of external appearances. It is

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<sup>68</sup> Carlill v. Carbolic Smoke Ball Co., [ 1893] 1 Q.B. 256.

<sup>69</sup> Restatement (Second) Contracts, § 32 (Invitation of Promise or Performance). The precedent is not precise because the taking of the corn and grain is not tantamount to providing the benefit to its owner, as would be the case if the stubble were to be carted away at a price.

about default rules for the order of performance, an issue that retains its salience to this day.

At this point it is instructive to contrast Brian's aphorism with Bowen L.J.'s equally famous bon: "The state of a man's mind is as much of a fact as the state of his digestion."<sup>70</sup> This clash of maxims is driven by context, not by any fundamental disagreement in world view. Bowen's comment was made in a fraud case, where human ignorance, if taken seriously, would block any chance of recovery in all fraud cases. The correct approach treats the question of intention as one of fact, difficult but not impossible to prove. Here again we can detect no transformation of attitudes that hinges on the rise or fall of laissez-faire. It is simply a matter of exercising good common sense on matters of proof. Neither defenders nor opponents of laissez-faire hold any brief for fraud.

Unlike Brian's case, in most contract-by-correspondence, the offers to buy and sell contemplate an acceptance by mail to set up a future bilateral transaction. The crucial matter—when is the contract formed?—cannot be resolved simply by finding that single moment in time when the subjective intentions of both parties converge. Adopt the mailbox rule, so that the acceptance is binding when posted, and the offeror is bound even if he changed his mind in the interim. But if the return acceptance must reach the original offeror, then, conversely, the offeree is bound even though he changes his mind before the offeror receives, or reads, the reply. So which rule is preferable when both present reciprocal risks?<sup>71</sup>

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<sup>70</sup> Edgington v. Fitzmaurice, 29 Ch. 459, 483 (1885).

<sup>71</sup> For a parallel discussion, see Charles Fried, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* 49-54 (1981), inclining toward the mailbox rule.



The first cue comes from freedom of contract: the offeror, as master of his offer, can stipulate that his personal receipt is required, even in the teeth of his own negligence (as by misstating the return address). The offeree who bristles at this condition need not respond at all. That risk in turn should induce the offeror to sweeten the deal by allowing acceptance at some earlier moment. He may take a greater legal risk to increase his chances of landing a desirable deal. Let offerors adopt different strategies, and the courts should respect a divergence that they may not quite understand.

Empirically, however most litigated cases contain no special provision on offer and acceptance: cases with specific clauses may just have washed out of the system. But so long as explicit terms govern, then all legal rules assume the status of default provisions. The task is finding the rule that gives the best fit in the routine case and thus reduces the need for contracting out. An observed lack of contractual activity, however, should not be treated as strong evidence that the common law has gravitated to an efficient rule. The risk of miscarried mail could be so small that neither side finds it worth dealing resolving specifically.

What then are those default rules? One situation involves negligence by offeror or offeree, but hopefully not both. The celebrated case of Adams v. Lindsell<sup>72</sup> involved a misdirected and delayed offer followed by a prompt acceptance. (Notwithstanding technical changes, the nineteenth century English post office seemed to outperform its twentieth century American rival.) The case thus pits a negligent offeror seeking to escape liability from responsible offeree who in the interim resold the goods to a third party. On one reading Adams just assigns the risk of an avoidable loss to the party best able to avoid it. It thus sidesteps the trickier "strict liability" cases when the transmission failure is

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<sup>72</sup> 1 B. & Ald. 681, 106 Eng. Rep. 250 (K.B. 1818).

attributable either to bad weather or post office error. Who bears the risk of third-party misconduct or natural events?

A second reading of Adams, however, downplays the admitted negligence of the defendant-offeror and adopts in its stead a general proposition that contracts are formed when the offeree posts an acceptance. Its short opinion deduces the conclusion philosophically by claiming the defendant's position invites a reductio ad absurdum: "no contract could ever be completed by the post. For if the defendant-offeror were not bound by his offer when accepted by the plaintiff till the answer was received, then the plaintiff ought not to be bound by the acceptance until they had received the notification that the defendants had received their answer and assented to it. And so it might go on ad infinitum."<sup>73</sup> Adams thus smacks of unsound deductive formalism so why lay its sins in the lap of laissez-faire? The sensible response for contracts by correspondence is to choose that rule of contract formation that minimizes, as best we can, the costs of error to both parties. That view allows us to still side with the offeree even if the offeror had not been negligent: the risk of error lies with the party who makes the mistake, period.

Nonetheless Adams's confused exposition gave birth to two divergent interpretations. Langdell strenuously opposed the mailbox rule on the dubious ground that the acceptance should be treated as a counteroffer which was presumed accepted when it reached the offeror.<sup>74</sup> But he never explains why it is wise to recast what was meant as an acceptance into something else.

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<sup>73</sup> Id. at 683, 106 Eng. Rep. at 251.

<sup>74</sup> See Langdell, SUMMARY at 18-19, criticized in Fried, CONTRACT AS PROMISE, at 51, stressing the ability of an offeror to condition an offer on receipt of the acceptance.

Even so, Langdell showed one flash of insight that, contrary to Gilmore's unflattering portrait, develops an hesitant error cost analysis of the alternative rules. Langdell does not warm to his subject graciously, but begins with an apology for his functional musings. "The true answer to this argument is, that it is irrelevant; . . ." <sup>75</sup> But like a shrewd lawyer, Langdell hedged his bets by asserting that if convenience did count, then the balance of advantage still did not lie with *Adams v. Lindsell*. Hardship in one direction or another is inevitable, so what are the choices?

Adopting one view, the hardship consists in making one liable on a contract which he is ignorant of having made; adopting the other view, it consists in depriving one of the benefit of a contract which he supposes he has made. Between these two evils the choice would seem to be clear: the former is positive, the latter merely negative; the former imposes a liability to which no limit can be placed; the latter leaves everything in statu quo. As to making provision for the contingency of the miscarriage of a letter, this is easy for the person who sends it, while it is practically impossible for the person to whom it is sent.<sup>76</sup>

This passage transforms Langdell into an unwitting precursor of the law and economics movement. He urges that the error costs are greater from enforcing the contract than letting it pass. He may be wrong in thinking that the language of "positive" and "negative" losses clinches the idea that the offeree's uncompensated loss from losing the action will be smaller than the amount of damages, especially when Hadley v. Baxendale limits recovery. Nor does this

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<sup>75</sup> Langdell, SUMMARY at 21.

<sup>76</sup> Id. at 21, quoted in Friedrich Kessler & Grant Gilmore, CASES AND MATERIALS ON CONTRACTS, 287-288 (2d ed. 1970).

proposition easily mesh with Langdell's repeated invocation of the Roman maxim, *ut res magis valeat quam pereat*— it is better that the affair be valid than perish.<sup>77</sup> The relevance of error costs, apart from knowledge of their frequency, magnitude and direction, is not decisive either way. But his second point, that the original offeror has the capacity to shape the rule to his own advantage, retains its persuasive power even today.

This last point led Baron Bramwell to inveigh against the mail-box interpretation of *Adams v. Lindsell* in *British & American Telegraph Co. v. Colson*,<sup>78</sup> which Cheshire and Fifoot chastise for its regrettable tendency "to champion the cause of 'real' consent,"<sup>79</sup> in opposition to the sounder view that finds the mark of contract in external appearances. But we can disagree with Bramwell's preferred rule without questioning his devotion to *laissez-faire*. *Colson* arose when the post office delivered plaintiff's acceptance of an allotment of shares to the wrong address. The defendant, when thereafter pressed, refused to take up the subscription and offered a catalogue of reasons why the misdelivery occurred: someone else with the same name lived on the same street; the numbers had just been changed; extensive construction was going on nearby to add to the confusion; and a number of his other letters have been similarly misdirected. Bramwell first noted that this case lacked the offeror's negligence found in *Adams v. Lindsell*. He then argued in effect that the offeree is the cheaper cost avoider, so that liability should be postponed until the acceptance is received.

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<sup>77</sup> Langdell, SUMMARY at 40, 45.

<sup>78</sup> 6 Ex. 108 (1871).

<sup>79</sup> Cheshire & Fifoot, CONTRACTS, at 21.

The sender of the letter [of acceptance] need not use the public post. If he does, he may guard against mistake by sending two letters, or requesting an answer and sending another on a non-receipt of an answer, or by taking other steps to ascertain the arrival or non-arrival of the letter, and to remedy the mischief of the latter event. But the person to whom it is addressed can do absolutely nothing; for by the hypothesis he does not know it has been sent.<sup>80</sup>

This functional argument hardly shows any excessive devotion to some ideal of real, let alone, mystical consent. But however sensible his basic orientation, Bramwell's oversight lies in his claim that the original sender can do nothing, which implicitly places the capacity to avoid harm on one party only. Although the original offeror can do nothing after the offeree receives his letter, he could have protected himself earlier in the process by stating that he will only distribute the shares if confirmation reaches him by a fixed date. The defendant had no reason to couch his solicitation as an offer instead of the so-called "invitation to treat" that becomes binding only when accepted by the solicitor. So in the abstract we really can't decide who is the cheaper cost avoider after all, or even who is an offeror, and who an offeree

These difficulties explain the lack of convergence on a single default rule. The correct choice remains problematic even today when scholars have identified the relevant variables. But it is a mistake to tarry too much in the search for optimal solutions, for the twisted history of contracts by correspondence should be taken as yet another illustration of the same institutional truth found in Raffles. Once the obviously unsatisfactory rules are eliminated, any variation in the choice of default rules is akin to shifting water

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<sup>80</sup> British & American Telegraph, 6 Ex. at 118.

from one shoulder to the other. The water is heavy no matter where it comes to rest. The surviving competitors are so evenly balanced that the water weighs about the same no matter which shoulder bears the brunt of the load. The central business mission therefore is to reduce the total risk, not to shift its incidence from one shoulder, or one side, to the other. Phones, faxes and express services have closed the temporal gap between offer and acceptance that contract by correspondence cases have much reduced salience in the twentieth century. Indeed when the question does pop up, the context to do with the risk of loss from any gap in communication. It is just as likely to be directed to a jurisdictional or choice of law issues, asking whose law governs an admitted agreement.<sup>81</sup>

More generally, the prolonged battle over offer and acceptance has little to do the rights and wrongs of laissez-faire. Any legal order has to search for the right rule on formation of contracts at a distance in order to promote the security of exchange. Getting that rule right, however, has no direct bearing on the more contentious issue of freedom of contract. As with slips of tongue and pen, the rejection of the doctrines of laissez-faire does not require us to reconsider the mailbox rule or its alternative. No matter how the class of valid contracts is defined, why follow an inefficient rule when only security of exchange is in issue? A modernist need not oppose a rule of offer and acceptance just because Bramwell or Langdell favored it. Parallel conclusions apply to the doctrine of consideration to which we now turn.

Consideration. The doctrine of consideration occupies a large, if somewhat undeserved, place in the history of Anglo-American contract law.

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<sup>81</sup> See, e.g., General Time Corp. v. Eye Encounter, Inc., 50 N.C. App. 467, 274 S.E.2d 391 (1981)(contract formed where acceptance faxed); Entores Ltd. v. Miles Far East Corp., [1955] 2 Q.B. 327. (contract formed when fax received).

The traditional legal rule held first that mere, or "bare," promises unenforceable. This rule in turn requires an account of what acts or forms so clothe a promise as to render it enforceable. Consideration is said to supply the needed raiments. Early on, the term consideration seemed to suggest a diffuse meaning of "cause," that allowed enforcement promises made for good reason whether or not they formed the part of some bargain.<sup>82</sup> Debates swirled around the enforcement of a promise made in consideration of a future marriage<sup>83</sup>; which were on occasion allowed, or a promise to pay for the receipt of some past unrequested service, for which relief was generally denied.<sup>84</sup>

The tension between the moral obligation to perform these promises and the legal right to ignore them has generated extensive commentary.<sup>85</sup> Perhaps the best explanation is that, in the context of family transactions, these promises will usually be performed except where some change in family circumstances, or some hidden form of familial pressure justifies nonperformance. The overbroad rule remains in effect because its error costs are low: promisors want to perform

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<sup>82</sup> For an exhaustive account of the early history of the doctrine, see A.W.B. Simpson, *A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT* (1975). His chapter 6 in Part II traces its evolution from the doctrines of "causa" in the canon law. Chapter 7 deals with its evolution of consideration in connection with assumpsit.

<sup>83</sup> See, e.g., *Dutton v. Poole*, Sir. T. Raymond 302, 84 Eng. Rep. 1168 (1677). The facts revealed a clear bargain between the plaintiff's father and the defendant. The plaintiff's father had agreed to refrain from cutting down certain timbers if the defendant would pay his daughter Grizil £1,000, which he refused to do. "The apparent consideration of natural affection" between father and daughter, allowed here to sue on the promise made to her father, in effect, as a third-party beneficiary. See Simpson, *HISTORY*, at 418-421.

<sup>84</sup> Simpson, *HISTORY*, at 414

<sup>85</sup> See, e.g., Lon L. Fuller, *Consideration and Form*, 41 *COLUM. L. REV.* 799 (1941); Melvin Eisenberg, *Donative Promises*, 47 *U. CHI. L. REV.* 1 (1979); Andrew Kull, *Reconsidering Gratuitous Promises*, 21 *J. LEGAL STUD.* 39 (1992).

promises borne of natural love and affection, and typically balk where circumstances are fishy. Since the law cannot improve the background practice, it steers clear of the field. The social sanctions work well even, perhaps because, the legal sanctions are put to one side. But there is always a hitch: the promisor may die and the executor of the estate may not perform the decedent's promise under pressure from the estate's beneficiaries.

By degrees consideration became less tied to "good reasons" and more tied to the idea of bargain or exchange: the promise was enforceable because it was supported by some return promise or act. At this point the doctrine of consideration was no longer so closely tied to family arrangements. Rather, consideration became a general principle of promissory enforcement. Langdell, for example, used that principle to justify enforcement of promises to perform pre-existing duties.<sup>86</sup> In his view, making a second promise does impose real constraints on the promisor "by giving another person the right to compel him to do it, or the right to recover damages against him for not doing it."

The analysis of the preexisting duty controversy in turn raises the larger issue of why allow the executory enforcement of any promises at all. On this question, Langdell has been roundly attacked for being both logically incoherent and necessarily circular.<sup>87</sup> The logical circularity lies in the fact that one has to assume that A's promise is enforceable (for it to be a detriment) in order for B's promise to be enforceable. But A's promise is not enforceable unless by parity of

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<sup>86</sup> See, Langdell, SUMMARY, at 104-105 "Thus, mutual promises will be binding, though the promise on one side be merely to do a thing which the promisee is already bound to a third person to do, and the actual doing of which would not, therefore, be a sufficient consideration."

<sup>87</sup> For a summary of the extensive literature on which I have relied, see Richard Bronaugh, A Secret Paradox of the Common Law, 23 J. LAW & PHIL. 193 (1983).



reasoning B's promise is enforceable as well. So the enforcement of each promise is said to presume the validity of the other; hence the validity of neither is established.

This formal objection is a poor way to undercut Langdell's commercial judgment, just as it a bad way to critique his position on contracts by correspondence. A better approach asks what views of bargains between A and B promotes overall social convenience. One solution is to say that neither promise is enforceable, eliminating all gains from future trades, to no one's benefit. A second alternative is to hold that the promise of either A or B , but not both, is enforceable. At this point either A or B, and perhaps both, will steer away from transactions that could promise them all pain and no gain, once again frustrating the emergence of trade.

So it hardly takes a shrewd and determined utilitarian to realize that the fourth solution, which Langdell embraced, is best. Where two promises are meant to be part of an integrated transaction, enforcing both preserves the gains from trade, a result that is consistent with laissez-faire and with any other political system that wants to nurture an exchange economy. Langdell's mistake was not in outcome, but in tying it to some transcendent legal principle. The wise court thus makes itself the servant of the parties. Since they can be (accurately) presumed to desire enforcement of these bargains, then enforce them, unless there is some strong reason of public policy to do otherwise. If the parties believe that courts are dangerous places to resolve commercial disagreements, then they can specify arbitration, or deny any intention to create legal relations in what otherwise looks to be a standard commercial context.<sup>88</sup> In

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<sup>88</sup> See Rose & Frank Co. v. Crompton Bros., [1923] 2 K.B. 261, aff'd [1925 A.C. 445 (HLE)]. which gave full effect to a gentlemen's agreement, although it enforced specific contracts of sale entered pursuant to its terms. The earlier

the end legal enforcement should not depend on meeting some external norm, but should reflect what the parties want. Legal enforcement of bargains becomes a powerful default rule, to which exceptions should be clearly manifested.

Frederick Pollock was alert to the ostensible circularity of consideration, which he called "the secret paradox of the common law." But Pollock also rued the proposition that "in fact there is no conclusive reason other than the convenience of so holding."<sup>89</sup> But why is social convenience the mark of a feeble legal theory? Joint convenience supplies ample reason for aligning law to social practice. And the logical objections to the rule have never led anyone to alter or abandon the rule of executory enforcement. The real difficulty lies with placing consideration at the center of the commercial system. A test that examines the intention to create legal relations in commercial contexts is freed of the logical conundrums. And it well tracks the commercial expectations of the parties to most agreements.

To be sure, enforcing executory promises does not settle all doctrinal issues. Our moral instincts become far shakier (as the utilitarian consequences become far less clear) when the debate shifts from the enforcement of promises to the sequence of performance. Must A and B perform simultaneously? Should A perform first? If he must, then what are B's options when A's performance is only partial and not complete. In principle each variation is a node on some perfect decision tree. But relying on decision trees untended by the parties is a

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decision in Balfour v. Balfour, [1919] 2 K.B. 751, contains Atkin, L.J.'s beautifully written but wrong-headed decision. The informal separation was more akin to a business arrangement than to an invitation of hospitality. The background norm should have been for enforcement. Indeed the specific result in the case was reversed by the Matrimonial Act of 195X. **(it's mentioned in the earlier editions of Cheshire & Fifoot).**

<sup>89</sup> See Pollock, PRINCIPLES OF CONTRACTS, 191 (8th ed.).

risky enterprise at best. It invites default rules to specify how B may respond to A's imperfect performance: is B excused from performance, or must B perform as well and settle for a reduction in price, or an action in damages?

Answering these questions takes time and patience. It raises certain questions to which the phrase "sanctity of contract" gives only a partial answer.<sup>90</sup> But for our purposes the basic point is again simple: no political philosophy would consciously set its face against the parties preference for the enforcement of fully executory promises. Use explicit substantive prohibitions against those contracts— gambling, prostitution, child labor, drinking were nineteenth century favorites— disliked for substantive reasons. But don't impair contractual efficiency where freedom of contract is preserved. Enforcing executory exchanges supported by consideration advances the security of exchange, which should be prized in every legal system, regardless of its attitude toward freedom of contract.

Consideration also has its "bad," or at least troublesome side: the refusal to enforce promises not supported by consideration. This nineteenth century defect has been trumpeted first by Gilmore,<sup>91</sup> and then, in expanded fashion, by Atiyah.<sup>92</sup> Both insist that the limitations of the classical theory of contract have been overrun on two sides. First, on the detriment side, promissory estoppel today allows for the enforcement of a promise on which the promisee has justly relied. Second, on the benefit side, conferring a benefit on the defendant for which the defendant then promises to pay, creates an enforceable obligation.

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<sup>90</sup> For some discussion, see the law of conditions *infra*.

<sup>91</sup> Gilmore, *THE DEATH OF CONTRACT* at 57-76.

<sup>92</sup> Atiyah, *RISE AND FALL* at 716 "There has thus, as we shall see, been a decline in promise-based liabilities and a growth in benefit-based and reliance-based liabilities."

The point holds even where the law of restitution do not permit a plaintiff to recover for the benefit conferred in the absence of the subsequent promise to pay. In tandem these two doctrines have been hailed as a sea-change from the narrow theories of responsibility championed by Holmes and Williston to the more enlightened theories of Corbin and Cardozo.<sup>93</sup> What should be made of this shift?

Very little, in the grand scheme of things. First, adding two novel heads of liability does nothing to compromise the enforcement of fully executory bargains. We simply have more routes to promissory liability. Put more baldly, the emergence of promissory estoppel was not suppressed until the 1930s debates over Section 90 of the Restatement. Rather, Corbin insisted that he worked to codify the earlier judicial acceptance of promissory estoppel. Second, these two new theories of liability have scant importance relative to commercial bargains which cover sales, leases, mortgages, partnerships, hire, and countless other collaborative arrangements for mutual gain through voluntary cooperation. Executory enforcement allows both sides to rely on the security of a promise in their committing resources to some common venture, expanding the scope of trade by reducing the likelihood of breach. This universe offers very few occasions to enforce promises under theories of promissory estoppel or, especially, prior benefit. Third, from the vantage of laissez-faire, why place limit on the class of enforceable promises. Lord Mansfield favored enforcing all serious commercial promises (perhaps subject to a writing requirement) wholly

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<sup>93</sup> See his decisions in De Cicco v. Schweizer, 221 N.Y. 431, 117 N.E. 807 (1917); Allegheny College v. National Chautauqua County Bank, 246 N.Y. 369, 159 N.E. 173 (1927).

without regard to the presence or absence of consideration.<sup>94</sup> The nineteenth century English reaction notwithstanding,<sup>95</sup> why was Lord Mansfield wrong in theory?

The key question asks why freedom of contract requires any doctrine of consideration at all. Kessler and Gilmore sensed the tension when they wrote: "Freedom of contract, even during the period when laissez-faire had its greatest triumphs, never succeeded in overcoming a deep-rooted suspicion on the part of the common law against the social desirability of enforcing one-sided or gratuitous promises, as contrasted with reciprocal bargains. . . ." <sup>96</sup> But why so, at least in the commercial context? The point hardly squares with any basic philosophical commitment to contractual self-determination. Even in the absence of consideration, the defendant must first consent to be bound, and thus can be stripped of his primary means of self-protection: don't make promises that you do not intend to keep. And the practical questions of proof are better handled by a writing both for sales and nonbargain transactions. So why oppose any expansion of the class of enforceable promises in the name of freedom of contract?

One reason for this caution is indirect: bare promises commonly fall prey to coercion and manipulation. But although this point has force in family contexts, it hardly follows that the routine informal adjustments in commercial

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<sup>94</sup> See, e.g., Pillans v. Van Mierop, 3 Bur. 1663, \_\_\_ **Eng. Rep.** \_\_\_ (K.B. 1765): "In commercial cases among merchants the want of consideration is not an objection."

<sup>95</sup> Rann v. Hughes, 4 Brown P.C. 27; 7 Times Rep. 350; **XX** Eng. Rep. **XX** (1778), taking the view that "the law of nature" required keeping serious engagements, but the law of England required proof of consideration. Eastwood v. Kenyon, 11 Ad. & El. 438. **XX** Eng. Rep. **XXX** (1840).

<sup>96</sup> Kessler & Gilmore, *CONTRACTS* at 37.

settings should be invalidated on a wholesale basis. The problems run in both directions. Consideration allows some transactions that should be cut down, and cuts down other transactions that should survive. On the first side, it is quite easy to "hold-up" a trading partner in renegotiation without running afoul of the consideration requirement, whose adequacy is, in the tradition of Hobbes, not a judicial issue. The aggressive holdout can happily agree to perform some small additional obligation as the price for extracting some very large payment. Thus even with doctrine of consideration firmly entrenched, we still need some account of economic duress to deal with cases where the threat to breach a promise is used to secure renegotiation of an existing agreement. All defenders of freedom of contract should be sensitive to this risk.

On the other hand, many so-called bare promises carry no whiff of coercion. In The Death of Contract, Gilmore discusses at length the famous renegotiation in Stilk v. Myrick,<sup>97</sup> where a portion of the crew had deserted the ship when moored in Cronstadt, a Russian port. In response the captain offered to divide the salary of the deserters among the crew who remained to guide the ship back home. It is doubtful that the desertion of some crew members released others from their obligation. Accordingly, the remaining crew did not extend fresh consideration since they were already bound to provide additional services. Yet it was good business for the captain to promise additional wages to improve the chances of a safe voyage home. The fact that the captain's total wage bill did not increase under the revised agreement negates risk any rent extraction. Indeed, whenever the increase in payment offered is proportionate to the increased costs imposed on the original performers, the renegotiation looks

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<sup>97</sup> Stilk v. Myrick, 6 Esp. 129, 170 Eng. Rep. 851; 2 Camp. 317, 170 Eng. Rep. 1168 (1809). Gilmore relies on both reports, Gilmore, THE DEATH OF CONTRACT at 22-28.

as though it helps, not hinders business efficacy. The want of consideration is a poor proxy for holdout behavior, just as presence of consideration is a weak proxy for the absence of holdout behavior. In both cases the task is to trace the pattern of negotiation in relation to the perceived risks. Although occasional errors mar that inquiry, the cases have generally done well.<sup>98</sup> Consideration does not have a bedrock role to play in responding to coercion during contract modification.

We can now put both detriment-based and benefit-based doctrines in perspective. Promissory estoppel allows enforcement of a few stray promises after the plaintiff has performed or changed position. Stated otherwise, courts often suspend the requirement of "mutuality" : no longer is the promisor free because the promisee was not bound. Even though mutuality often captures commercial intentions in a world of self-interested behavior, it is only a first approximation, not a sine qua non for rational behavior. Often hopes for indirect benefit and the creation of good generate a desire to create free options in other individuals. A firm offer left open for a definite period of time is one such example. The nature of the interaction generates a level of protection for both sides. The offeror can limit the time that the offer remains open (or the time that goods will be kept "on hold" for a particular customer. Even so, he runs some risk that offer will be rejected, while another sale was foreclosed. So a merchant or trader is likely to make a firm offer only to those someone likely to consider it seriously. The additional legal risk yield an increased probability of acceptance. On the other side, an offeree that takes up idle offers spends resources that offer no return. So firm offers are not costless to those who

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<sup>98</sup> Lingenfelder v. Wainwright Brewing Co., 103 Mo. 578, 15 S.W. 844 (1891)(knocking out an extractive promise for want of consideration). The cases are collected in E. Allan Farnsworth, *CONTRACTS* §§ 4.21-4.22 (2d. ed. 1990).

receive them. The process is thus bounded by powerful institutional constraints, so why preclude anyone from making that offer binding unless they receive consideration in exchange? All in all, this expansion of liability should be regarded as compatible with the doctrines of freedom of contract, not as its enemy. The Corbinized world gives a greater scope to promissory liability than the Williston vision, and is in every particular consistent with robust markets. The parties who don't want to be party to unilateral arrangements don't have to make them.

The overall analysis does not change with benefit-based liability. This boomlet is intimately connected with the well known case of Webb v. McGowin,<sup>99</sup> where the decedent promised a small pension to the plaintiff who quite literally put himself in the path of injury to prevent still greater harm to the employer. The promise was serious when made, and honored by the promisor until his death. When his executor, perhaps subject to the familiar family pressures, sought to renege, he was forced to honor the testator's promise. A new Restatement provision, section 89A, was drafted to celebrate the occasion.<sup>100</sup> But this mini-revolution does not deserve to be trumpeted in any larger debate over the role of contract in social affairs. First, the liability in question is promissory: the act of rescue did not generate in and of itself a claim for restitution. Second, the relevant class of cases is so small that it hardly alters the fundamental balance of contract law. Nothing about laissez-faire blocks this expansion of promissory liability, so long as the usual excusing conditions are allowed for this as for other promises.

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<sup>99</sup> Webb v. McGowin, 27 Ala. App. 82 , 168 So. 196 (1935). See also Restatement (Second) of Contracts, § 89A, Illustration 7 (1936).

<sup>100</sup> Restatement of Contracts, 89A, & Illus. 7.



So once the dust settles it is clear that the developments here bear little relationship to the "death" in "The Death of Contract" or to the "fall" in "The Rise and Fall of Freedom of Contract." Both of these volumes may cheer the decline of laissez-faire, but only by adopting the odd position that its demise rests in the expansion of promissory liability. Laissez-faire writers focused their fire on rules and regulation that restricted the enforcement of promises, and which allowed states to determine the shape of markets and to set prices and wages for goods and services. The nineteenth century corn laws, which restricted the entry of grain into Great Britain, were one notable target. To my knowledge, not one of them cared about legal developments that were small in magnitude and favorable in direction. To find any challenge to the traditional laissez-faire doctrines, we have to look to cases that challenge the sanctity of contract. That is the topic of the next section.

III. The Sanctity of Contract The previous sections have shown how the security of exchange is a paramount objective for all legal systems, whether or not they embrace laissez-faire. It also examined the extent to which traditional doctrines of offer and acceptance, and consideration, fit into that overall framework. The more distinctive portions of laissez-faire, however, relate to two additional doctrines, one the sanctity of contract, and the second, its broader and distinctive claim of freedom of contract.

Sanctity of contract is best analyzed in two separate parts. The first examines the set of excuses a defendant may interpose for the nonperformance of a contractual undertaking. The second asks how far a party is entitled to deviate unilaterally (i.e. without the consent of the other party) from a contractual undertaking while still claiming the benefits under that contract. Does laissez-faire require a narrow set of contractual excuses, and exact performance of contractual undertakings?

Necessity and Impossibility. The scope of permissible excuses is a topic of major importance not only in contract law but also in torts. As early as 1616, Weaver v. Ward<sup>101</sup> allowed some form of inevitable accident, narrowly construed, to excuse a defendant from tort liability: the defendant who had to cause harm no matter what he did was excused from the harm in question.<sup>102</sup> In contrast, however the legal response to promissory obligations has long been somewhat different. In 1647 Paradine v. Jane,<sup>103</sup> contrasted the tort defendant with the contract defendant:

where the law creates a duty or charge, and the party is disabled to perform it without any default in him, and hath no remedy over, there the law will excuse him . . . but when the 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. And therefore if the lessee covenant to repair a house, though it be burnt by lightening or thrown down by enemies, yet he ought to repair it.<sup>104</sup>

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<sup>101</sup> Hobart 134, 80 Eng. Rep. 284 (K.B. 1616).

<sup>102</sup> For a comprehensive view of the defense, which concludes that it excuses only defendants who have taken extraordinary care, see Stephen Gilles, Inevitable Accident in Classical English Tort Law, 43 EMORY L.J. 575 (1994); for my views favoring a still more literal reading of inevitable, see Richard A. Epstein, Cases and Materials on Torts, 101-103 (6th ed. 1995).

<sup>103</sup> Aley 26, 82 Eng. Rep. 897 (K.B. 1647).

<sup>104</sup> Id at 27, 82 Eng. Rep. at 897. The one phrase that is somewhat discordant in this passage is "if he may" which I do not take to undo the basic thought of the section, that impossibility is no defense, but only to stress that specific performance is the preferred remedy, and damages the backstop, on which more infra at .

Public duty and private agreement each have their separate excuses. The law allows excuses, albeit very narrow ones, for public duties (such as guarding prisoners in time of war) on the ground that the law cannot demand any individual to perform the impossible.<sup>105</sup> Indeed when Paradine speaks of the law creating a duty or charge, it is uncertain whether it refers to tort obligations to compensate for harms caused, or, as seems more likely, public obligations to protect against certain forms of harm in some official capacity or role. But this ambiguity does not carry over to contractual duties, where the promisor possesses the right denied to persons burdened with public duties, namely, to bargain on his own behalf.

Even that view has not been consistently followed. For example, the Roman law held those obligations which were truly impossible to perform—such as touching the sky with one's finger—were void ab initio.<sup>106</sup> That legal response has no bite if it only blocks a decree of specific performance, which could not be discharged even if ordered. Rather, its novelty lies in the denial of damages to the promisee, even though the unwise promisor could have protected himself by agreement. That view of objective, or literal, impossibility carried over into the English law before *laissez-faire*, and is clearly expressed in

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<sup>105</sup> In truth the allowable excuses on the public side are still narrower: not only must the defendant not be in default, but he must also have no remedy against third parties. In these cases the English tradition seems to have made it clear that if the defendant has the remedy over, then he can be bound, notwithstanding the fact that practically speaking the remedy is worthless. See Tithes Case, Y.B. Trin., 21 Hen. 7, f. 26, 27, 28, pl. 5 (1506), and for discussion, Richard A. Epstein, Holdouts, Externalities and The Single Owner: Another Tribute to Ronald Coase, 36 J. LAW & ECON. 553, 579-581 (1993).

<sup>106</sup> See Gaius, INSTITUTES 3, 97-99. Justinian, INSTITUTES, 3, 19, 1, 2, 11 (?).

Powell's 1790 treatise on contractual obligations.<sup>107</sup> The sanctity of contract never required some remedy for the nonperformance of the impossible.

But this conceptual curiosity should not be allowed to conceal the main point. Who would bother to undertake the sterile obligation to touch the sky if he were certain to breach it? Alternatively, who could ever sensibly rely on its promised performance? So it hardly matters whether we enforce a set of promises that are never made, or refuse to enforce them on the ground that they are wholly idle. Either way, the level of observed transactions will be zero. The matter will forever be one of speculation and never of litigation.

In the commercially relevant cases, however, both the Roman and English traditions enforced promises capable of performance, even if it were impossible for this defendant to perform it: the usual example was a promise to convey land in fact owned by another.<sup>108</sup> Now the promise gives information about capability not apparent from the general nature of things. So all the legal bite comes from treating these promises as categorically enforceable. Wherein lies the attractiveness of so doing? To stress that the promisor could have stipulated for some excuse does not supply the needed philosophical foundations for the rule. Why shouldn't promises for the performance of some particular event be subject to an implied condition of defeasance? These conditions are implicit in many ordinary understandings: who thinks in 1800 or today that physicians guarantee cure instead of making a promise of due care?<sup>109</sup> If these conditions

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<sup>107</sup> See 1 Powell, *ESSAY ON CONTRACTS*, at 160-162 (1790).

<sup>108</sup> *Id.* See Flureau v. Thornhill, 2 W. Bl. 1078, 96 Eng. Rep. 624 (CP. 1776) (allowing return of deposit, but no expectation damages for "the fancied goodness of the bargain").

<sup>109</sup> See Slater v. Baker, 2 Wilson 359, 24 Eng. Rep. 860, 861 (K.B. 1767), allowing contract action but using gross negligence standard. For modern

are implicit in some contexts, then why not require the promisee to ask for the ironclad assurances that the Crown, or state, does not extract from its subjects or citizens? So understood the default rule of no excuses loses much of its formal appeal, even though it has been numbly repeated countless times since Paradine.

But what rule should take its place? The basic truth is that default rules never raise fundamental philosophical issues about the institution of promising: filling gaps or divining intention when the parties are silent is at best a second-order affair. Indeed so long as the topic is inevitable necessity, the background presumption is not that critical. The correct choice is hard to determine, and any choice may be freely varied by contract. The tort debate between negligence and strict liability has been so closely divided because of the genuine uncertainty as to whether the residual risk in a stranger case should fall on the injurer or injured party, when the defendant has exercised the same level of care that he would take in his own affairs.

With contracts, however, the contexts are much more richly variegated. Even philosophical skeptics of absolute promissory obligations are usually unwilling to discharge many contractual obligations whenever the defendant exercised all reasonable care: the default rule for medical services does not carry over to the payment of money, the delivery of goods, or the construction of a waterproof roof. Usually some higher standard of liability is invoked, even if it is not clear exactly what that standard should be. But the range of permissible variation makes it hard to treat the sanctity of a promise as a necessary precondition for the success of markets, or even as an accurate rendition of the ordinary commercial understandings. Contexts matter. How might these be broken down? One approach is to break down the obstacle to contractual

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skeptical view on contracts for cure, see Sullivan v. O'Connor, 363 Mass. 579, 296 N.E.2d 183 (1973).

performance into three separate classes: problems whose source lies with the defendant; with the plaintiff; and in a third-party or in some Act of God. What presumption should be set for each case?

For the first class of cases the usual view saddles the defendant with the risk of nonperformance. He has the greatest knowledge and control of his capabilities and resources, and it seems odd that he could shift the risk of his nonperformance on the plaintiff who has neither. But some exceptions to this general rule may make sense. If the defendant contracts to draw the plaintiff's portrait, and is killed or disabled thereafter in a road accident, the usual view discharges the basic obligation completely. Who would choose death or serious disability in order to escape a promise which, in the general case, he wants to make and keep?<sup>110</sup> Nor does a release in this context give the promisor an opportunity to enter into some new lucrative engagement. Nor is it likely that an executor or caretaker could paint as well as the original promisor. The release of the obligation thus eliminates some nettlesome litigation and costly damages calculations, without undermining the basic obligation to perform. So the discharge clearly makes sense, whether or not one believes in *laissez-faire*.

The companion question is whether the death of the paying party also terminates the contract. Here, of course, the ability to pay money is never rendered literally impossible, so the buyer's estate should be able to require the painting a landscape. But if the contract were for a portrait of the deceased, and the arrangement were executory, then perhaps the deal should be called off—unless the portrait could be painted from photographs or other sources. Of course some compensation might be owing for any reimbursable expenses that

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<sup>110</sup> See, Restatement of Contracts, § 459 & Illustration 11.

the painter incurred in good faith prior to the subject's death, as in Roman law.<sup>111</sup> Perhaps my instinct on some of these variations is wrong, but in the grand questions at hand it hardly matters. We are lost in the sea of implied contracts, as in The Moorcock, with an eye toward the business efficacy of the entire arrangement.<sup>112</sup> As the variations become more complex, the intuitions become less robust, which is as it should be when so little is at stake. It is a happy concordance that intuitions on default are strongest in the most frequent cases: and most difficult to resolve in the suits that are selected for litigation.

In the second case, the difficulty is attributable to the default, or at least the conduct, of the plaintiff. Take, for example, a construction contract that calls for the builder to erect a structure on the buyer-owner's lot, which is unbuildable because of some latent defect in the soil. The nineteenth century cases often denied the builder any portion of the contract price from the landowner if the promised building was not completed,<sup>113</sup> even though some cases that reiterated the Paradine theme only demanded strict performance "unless prevented by the act of God, the law, or the other party to the contract."<sup>114</sup> The builder had to firm up the foundations on the owner's site at his own cost.

This approach clearly seems to be wrong. Typically, the landowner has greater knowledge and control over the site, and hence should, in the absence of a stipulation to the contrary, take the risk that it will not support his proposed building. That position would allow the builder to recover, if not the full

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<sup>111</sup> As under the contract of mandate, see Gaius, INSTITUTES, III,

<sup>112</sup> See supra at note .

<sup>113</sup> See, e.g., School Trustees of Trenton v. Bennett, 27 N.J.L. 513 (1859).

<sup>114</sup> See Stees v. Leonard, 20 Minn. 448 (1874), which continued "No hardship, no unforeseen hindrance, no difficulty short of absolute impossibility, will excuse him from doing what he has expressly agreed to do." Id. at 451.

contract price, his actual expenditures plus lost profits until the project is called to a halt. The modern builders' contract is typically written in this fashion unless the builder is charged with the preliminary site investigation. Invoking the maxim that the builder could have protected himself by contract rings hollow; ditto for the owner. But either way, little is at stake for the principle of laissez-faire when a stroke of the pen can reverse an unwise nineteenth century presumption.

When performance is rendered impossible by the conduct of some third party or an act of God, the analysis becomes more uncertain: the contingency is not within the obvious control of either party; nor is it easy to determine who can predict its occurrence with greater accuracy, or for that matter insure against the risk. Indeed capacities could be split: one party can better insure against the risk that the other is better able to prevent. So what should be done?

For starters, Paradine, a case of third-party risk, was correctly decided. The lease transferred possession of land for a limited period of time. The landlord did not owe the tenant any service obligations. Hence the term of years becomes, as an estate in land, the thing sold, . Normally the owner of a thing takes the risk of its destruction— res perit domino. The lease creates two owners, the tenant for his term, and the landlord for the reversion. The tenant would surely bear the risk of loss for the term if he made a lump-sum purchase of the term. What difference is there if the payments are called rent and staggered over the duration of the lease? The purchaser of the fee simple takes the risk of loss even on an installment sale. Why not follow the same rule for leases? The situation would be different if the landlord had service obligations that were discharged by the destruction of the property for then the best default rule reduces the rent by the amount of the services paid or discharges the lease



entirely. But Paradine raises service issues, so the decision seems right, wholly apart from any question of impossibility.

It is an open question whether the same result carries over to the controversial case of Hall v. Wright,<sup>115</sup> where the court refused to release the defendant from his contract to marry the plaintiff even though he could only consummate the marriage at great risk to his own health. Who believes that this condition does not excuse? Do we think that a defendant will fake death or illness to avoid marriage? And why damages if the plaintiff is free to marry another? Baron Pollock, no opponent of freedom of contract dissented, protesting the false assimilation of personal into commercial contracts.<sup>116</sup> The twentieth century view to the contrary hardly shakes laissez-faire to its foundations,<sup>117</sup> but turns a sensible dissenting opinion into law.

Even in its own time, Hall v. Wright did not establish any blanket prohibition against recognizing implied conditions. Taylor v. Caldwell,<sup>118</sup> decided in 1863, invoked an implied condition to defeat the otherwise categorical obligation to pay rent on premises accidentally destroyed before the plaintiff's planned gala. Here the possession of a Music Hall remained with the landlord; the obligations in question were for a short term— four days of grand concerts and festivities— that look service intensive. The rule of joint discharge makes each side lick its wounds. But it also gives both sides the strongest incentives to mitigate losses after destruction, and the rule reduces the

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<sup>115</sup> El. Bl. & El. 746, 120 Eng. Rep. 688 (Q.B. 1858).

<sup>116</sup> See his views on the perfect tender rule, *infra* at .

<sup>117</sup> See, Restatement of Contracts, § 459, & illustration 8. If the inability to marry is the result of voluntary misconduct, the result is otherwise, to control against moral hazard. *Id.* at illustration 9.

<sup>118</sup> 3 B & S. 826, 122 Eng. Rep. 310 (Q.B. 1863).

administrative costs by simplifying the accounting on discharge. Holding that the destruction of the premises be without fault of the defendant guards against the risk of moral hazard, although truth be known, the negligence condition here does not have much bite: what defendant would destroy his own premises to escape a profitable four-day engagement? Any explicit ex ante bargain could easily stipulate that both two parties go their separate ways which also happens when a building is destroyed before the defendant can begin repairs.<sup>119</sup> In any recurrent institutional setting, once bitten, twice shy. In future cases this remote risk will be allocated by contractual terms that either affirm or reject the excusing condition. But no public policy limitations surface. The choice of default provision may provide fertile grist for legal argument, but it has little if any relevance to the grand structure of laissez-faire.

*Unilateral alteration of terms.* Sanctity of contract raises a more urgent theme when a party seeks, not discharge, but unilateral variation from the initial contractual terms. Of course, it is well understood that circumstances may make it impossible to perform a specific undertaking: property may be destroyed before it is conveyed; workers may quit before their discharge their appointed tasks; ships may encounter bad weather. In those cases where the breach is against the will of the promisor, then damages must be substituted for performance. In many cases the parties might seek to protect the expectation of the promisee by setting damages that in theory (but rarely in fact) leave the jilted promisee indifferent between performance and breach. But in principle the parties should be able to decide what happens if performance is blocked or made more costly for reasons beyond the promisor's control.

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<sup>119</sup> See, e.g., Butterfield v. Byron, 153 Mass. 517, 27 N.E. 667 (1891).

It is at this juncture that some of the most difficult questions of contract law arise. Thus suppose that the defendant can deliver goods that deviate from the contract stipulation by some small degree. No. 2 cotton is substituted for No. 3 cotton. Promised goods are one day late, or must be shipped by rail instead of boat. One obvious response is to use cash allowances to offset the difference, if any, between the performance promised and the performance delivered. Yet to confer this option as of right to the party in breach carries with it this oddity: the party in breach can force the innocent party to take goods or services on new terms to which it never consented— such is the effect of a cash reduction against the late delivery of goods. A belief in the sanctity of contract gives all the cards to the innocent party. Once the defendant does not perform just as promised, the plaintiff as the innocent party has the election to take expectation damages or to throw off the bargain altogether. The familiar refrain is this: "Where parties have made an agreement for themselves, the courts ought not to make another one for them."<sup>120</sup> Doubly so, at the insistence of the party in breach.

Will promisee typically exercise this new-found right of rejection? Truth is, usually, he won't. In most cases getting goods late is better than getting no goods at all, so this breach is often waived for just that reason. Where it is not, then a "just in time inventory policy" will set out stringent conditions for suppliers. But every strategy is vulnerable to unfortunate outcomes in at least some cases. Perhaps the market price has broken between promise and delivery, so that the fortuitous opportunity to reject goods allows the plaintiff to insulate himself from the adverse price shifts that would have been his lot if sound goods

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<sup>120</sup> Hoare v. Rennie, 5 H & N. 19, 157 Eng. Rep. 1083 (18XX).

had been delivered on time,<sup>121</sup> or had been shipped in the stipulated way.<sup>122</sup> Recall that Raffles v. Wichelhaus was such a case. The "perfect tender" rule developed in the nineteenth century cases allowed the plaintiff to ditch the losing contract for reasons that had little or nothing to do with the defect in the timing or quality of the goods. By giving the innocent party an undeserved "out," does this rule undermine the security of exchange in the guise of protecting it?

Stated otherwise why does the perfect tender rule become the default position? Here the choice is close, but some strong argument supports the hard-line position on perfect tender. The first point to note is that our intuitive reaction varies between two extreme cases: in the first, the tendered performance is identical in all relevant respects to the promised performance, notwithstanding some formal deviation in contract terms. That was what happened, for example, in Jacobs & Young v. Kent,<sup>123</sup> where Judge Cardozo allowed the defendant to wiggle out of his breach because of the precise equivalence between the Cohoes and the Reading Pipe. At the other extreme the

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<sup>121</sup> See, e.g., Norrington v. Wright, 115 U.S. 188 (1885), upholding the perfect tender rule in a case where the time of shipment did not appear to go to the essence of the agreement. See the account of the case background in Kessler & Gilmore, *CONTRACTS*, at 831. The decision was in conformity with English precedent, see Hoare v. Rennie supra and Bowes v. Shand, 2 A.C. 455 (HLE 1877).

<sup>122</sup> Filley v. Pope, 115 U.S. 213 (1885).

<sup>123</sup> 230 N.Y. 239, 129 N.E. 889 (1921). In understanding this case, there is much to be said for Richard Danzig's suggestion that the specification of Reading pipe was used to insure that wrought iron pipe, and not inferior pipe (i.e. with steel scrap) was used in construction. So the name was a substitute for a standard that was met. See Richard Danzig, *THE CAPABILITY PROBLEM IN CONTRACT LAW* 120-123 (1978). Why not therefore treat the name as the source of latent ambiguity and allow parole evidence in on the point, as was done in Raffles.

market price remains dead level, so that any deviation in quality forces the innocent to accept a compromise with the promised goods. Just how much of an offset should be made in these cases if the formica comes in yellow instead of brown? If aesthetic beams are discolored in some public hall?<sup>124</sup> Here the willingness to hold the defendant to the precise terms of the bargain reduces the likelihood of breach in the first place. And the risk that the promisee will take the larger damages (cost of completion, not diminution in market value) and pocket them, could be blocked by having the promisor make the corrections instead of paying over the cash, or by making payment of the cash conditional on the use of the funds to secure corrections. Where the substitute performance is identical to that bargained for, the cases will be few and far between where the defendant will reject the performance, even to avoid the last installment on the construction price. The modern efficiency analysis of these outlying cases is inconclusive in the outcome.<sup>125</sup> Taken in the round, it seems that the legal rules should be tailored for the typical situation, stable markets, and not for the atypical volatile ones. The parties are already sensitive to risks of gamesmanship when prices shift rapidly, as they did the cotton markets in Liverpool. But for that ill, some institutional response is needed, not some doctrinal refinement. So on balance the nineteenth century rule seems correct

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<sup>124</sup> Where replacement cost was allowed in City School District of the City of Elmira v. McLane Construction Co., 85 A.D. 2d 749, 445 N.Y. S. 2d 258 (1981).

<sup>125</sup> Varouj A. Aivazian, Michael Trebilcock & Michael Penny, The Law of Contract Modifications: The Uncertain Quest for a Benchmark of Enforceability, 22 OSGOODE HALL L. J. 173 (1984). The trade off is difficult because enforcing the contract modification usually allow short-term mutual gains from trade. But it also increases the probability that one side will hold up the other. See the good discussion in Angel v. Murray, 113 R.I. 482, 322 A.2d 630 (1974), noting the risk of the "hold-up game" but accepting the modification when facts made it clear that it was in line with the increased costs of the promisor for circumstances beyond his control.

after all. But either way, commerce can adapt in ways to overcome any mistakes stemming from the initial use of the wrong presumption.

Deliberate Breach Sanctity of contract becomes a far more tenacious principle whenever the defendant plans a deliberate breach to take advantage of some better contractual opportunity elsewhere. In this context, the widespread scorn has been heaped on Justice Holmes's famous aphorism: "The only universal consequence of a legally binding promise is, that the law makes the promisor pay damages if the promised event does not come to pass. In every case it leaves him free from interference until the time for fulfillment has gone by, and therefore free to break his contract if he chooses."<sup>126</sup> Stated in this fashion the party in breach, not the innocent party, enjoys all the options. How could nineteenth century law do so strong an about-face after its endorsement of the perfect tender rule? The answer is that it did not.

The weakness of Holmes's position is evident from the recurrent nineteenth century disputes over the wage contracts for hired hands, an issue which Holmes nowhere addresses in The Common Law. A farmer hires a worker for an entire year for room and board, and a salary of \$10 per month. After ten months the hired hand quits and demands payment of \$100 for the time already worked. The farmer is usually held not to owe anything, even for the benefit previously received, because the obligation is "entire," and thus need be paid only at the end of the year, much like the modern "bonus." As early as 1470, Choke, J. denied an action in debt to a priest who chanted for the soul of the departed for only six months, after having promised to do so for a year. "This duty is entire, and he must serve for a year or otherwise he will have no

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<sup>126</sup> Oliver Wendell Holmes, Jr., THE COMMON LAW 301 (1881).

salary; and he cannot have his salary until he has served his term."<sup>127</sup> That rule remained in tact until the nineteenth century. Then some cases, most notably Britton v. Turner,<sup>128</sup> allowed the action in quantum meruit for the time worked, subject to a deduction for the farmer's additional costs in hiring substitute labor, no small matter for workers who leave just at harvest time when spot wages were highest. Most cases denied recovery to the worker as a plaintiff in breach: but none ever required him to refund the value of room and board received during his stay).<sup>129</sup>

Gilmore, for one, treats the entire contract as a sign of the misguided nineteenth century synthesis, and much prefers the rule that allows for quasi-contractual relief.<sup>130</sup> Why?<sup>131</sup> Typically, these are not cases of impossibility or anything close to that. The standard doctrine did allow the worker to recover his wages if the farmer's misconduct chased him from his job before the end of service, and thereby sought to control employer abuse.<sup>132</sup> But the greater risk

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<sup>127</sup> Veer v. York, Y.B. Hen VI (1470) (reproduced in Fifoot, Sources at 251.

<sup>128</sup> Britton v. Turner, 6 N.H. 481 (1834).

<sup>129</sup> See, e.g., Stark v. Parker, 19 Mass. 267 (1824). Smith v. Brady, 17 N.Y. 173 (1859).

<sup>130</sup> Gilmore, THE DEATH OF CONTRACT at 81.

<sup>131</sup> For a fuller consideration of these cases, see Richard A. Epstein, The Problem of Forfeiture in the Welfare State, 14 (no. 2) SOC. PHIL. & POL. 256 (1997).

<sup>132</sup> "Any apprehension that this rule may be abused to the purposes of oppression, by holding out an inducement to the employer, by unkind treatment near the close of a term of service, to drive the laborer from his engagement, to the sacrifice of his wages, is wholly groundless. It is only in cases where the desertion is voluntary and without cause on the part of the laborer, or fault or consent on the part of the employer, that the principle applies." Stark at 275.

lay in workers leaving for a short term gain,<sup>133</sup> and in these cases, the customary practice supports the view that only workers who worked out their term could collect the cash bonus.<sup>134</sup> "The plaintiff might as well claim his wages by the month as by the year, by the week as by the month, and by the day or hour as by either."<sup>135</sup> Indeed it is a mistake to import restitution into contract when the parties have allocated the risk of loss by contract.<sup>136</sup> Restitution works best for the return of money paid under mistake, or the reimbursement of expenditures made in conditions of necessity for the benefit of the defendant. But it should not override contracts whose provisions govern the contingency. The option to negotiate a lower salary for an early departure remains available to workers anxious to try their luck elsewhere. Once again, the courts neither make contracts for the parties, nor allow one party to remake a contract in its own image.

A second offshoot of the famous Holmes dictum is the now storied doctrine of "efficient breach." The doctrine praises defendants who deliberately breach contracts so long as they pay plaintiff full expectation damages and come

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<sup>133</sup> Id. at 273-274,

<sup>134</sup> "[T]he usages of the country and common opinion upon subjects of this description are especially to be regarded, and we are bound judicially to take notice of which no one is in fact ignorant. It may be safe to affirm that in no case has a contract in the terms of the one under consideration, been construed by practical men to give a right to demand the agreed compensation, before the performance of the labor, and that the employer and the employed alike universally so understand it." Stark v. Parker, 19 Mass. 267, 274 (1824).

<sup>135</sup> Id. at 273

<sup>136</sup> Andrew Kull, Restitution as a Remedy for Breach of Contract, 67 SO. CAL. L. REV. 1465 (1994).



away with a net profit to themselves.<sup>137</sup> This idealized argument rests upon a conception of economic efficiency which has the breaching party better off in consequence of its action, and the innocent party, given compensation, as no worse off. The doctrine is in obvious tension with nineteenth century thought, which for all its affinities to laissez-faire strongly condemned the Holmes dictum because it allowed the wrongdoer to profit from his own wrong.

That nineteenth-century position is correct both for moral and economic reasons. The wheels of commerce work best when social pressures support the faithful performance of promises with a minimum of legal compulsion and interference. To adopt a rule that invites breach on payment gives rise to the obvious question, how much should be paid, and when? The rule also allows promisors to be the arbiter of when they perform and when they pay, sharply contrary to the global expectations in standard commercial transactions. Theory aside, contract damages, as administered, often fail to bring the plaintiff to the position he would have enjoyed if the transaction were completed. Administrative costs often block suit even for an ironclad case. The contract measure of damages often excludes certain real losses that are not in the joint contemplation of the parties. The experience and contacts gained from one job often provide the gateway to the second, and these indirect gains are lost if expectation damages are calibrated to the discrete transaction.

It is therefore easy to imagine situations where the following inequalities hold: plaintiff's recovery is smaller than the defendant's gain, so the defendant will breach. But defendant's gain in turn is smaller than plaintiff's (uncompensated) losses, so that the breach is inefficient. It should surely give

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<sup>137</sup> See for its exposition, Richard A. Posner, The Economic Analysis of Law 119-120 (4th ed. 1992). For criticism, Daniel Friedmann, The Efficient Breach Fallacy, 18 J. Legal Stud. 1 (1989). **ADD CRASWELL PAPER USC**

champions of the efficient breach some pause that Lisa Bernstein reports that in trade (in her case through the National Feed and Grain Association) the only breaches that are tolerated are those which are done when the defendant has no prospect of gain, but is, for example, unable to obtain needed supplies.<sup>138</sup> With unavoidable breaches, the relationship is preserved, and damages, as determined in arbitration, are used for an offset of loss. But deliberate ones, succumbing to the temptation to breach for gain when performance is possible so disturbs the social fabric within the trading community, and creates dislocations up and down the line, that the group response is to drum the opportunist out of the trade. This bifurcated legal response here thus captures the deserved ambiguities that shroud the term "opportunity." To take advantage of opportunities is an unalloyed good. But to be an opportunist (that is to act in breach of a norm) carries with it the kinds of negative connotations that should never be overlooked.

The doctrine of efficient breach may be faulted on other grounds. By allowing easy exit from contractual undertakings, it may induce people to enter casually into arrangements taken seriously by the other side. As applied, it also allocates all the gains from breach to the party in breach, even if for some reason it gives full compensation. The doctrine encourages individuals to profit from their own wrong, and thus clashes with the moral view of laissez-faire which aspires to create a commercial atmosphere that reduces the reliance on legal mechanisms by an appeal to a common commercial morality. To fortify those instincts, the expectation measure is often bolstered by specific performance and injunctions. Holmes had acknowledged the role of the former, but dismissed its moral significance by noting that it was available only in select cases, while

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<sup>138</sup> Bernstein, Merchant Law in a Merchant Court, 144 U. Pa. L. Rev. at 1801-1802.

damages were the universal remedy.<sup>139</sup> The better explanation is that specific performance is out when parties settle up in cash at the end of the day, as in security markets. Unfortunately, Holmes never discussed the ability to obtain injunctions against employees who wish to work elsewhere or damages for inducement of breach of contract, even though both received judicial support a generation before The Common Law.<sup>140</sup>

In sum, laissez-faire may well be a doctrine of individualism and enterprise. But its own strong moral component precluded any ready affirmation of the Holmes dictum. The commercial morality that allows individuals to make contracts of their own choosing cannot allow people to breach those contracts free of moral stain, with only limited legal consequences.

IV. The Freedom of Contract. At long last we come to the central battle over freedom of contract, where laissez-faire has its greatest bite. The reach of this principle is measured by the ease with which individual contracts were invalidated on grounds of public policy. Here Sir George Jessel, Master of the Rolls, gave voice to the nineteenth century view in a dispute that arose out of the assignment of patent rights. The sentence usually quoted reads as follows:

It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than another [any other?] public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred

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<sup>139</sup> Holmes, THE COMMON LAW at 300-301.

<sup>140</sup> See, Lumley v. Gye, 2 El. & Bl. 216, 118 Eng. Rep. 749 (Ex. 1853) (allowing the tort action); Lumley v. Wagner, 1 De G. M. & G. 604, 42 Eng. Rep. 687 (Ch. 1852).

and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider– that you are not lightly to interfere with this freedom of contract.<sup>141</sup>

The passage that immediately follows, while less quoted, should not be forgotten either:

Now, there is no doubt public policy may say that a contract to commit a crime, or a contract to give a reward to another to commit a crime, is necessarily void. The decisions have gone further, and contracts to commit an immoral offence, or to give money or reward to another to commit an immoral offence, or to induce another to do something against the general rules of morality, though far more indefinite than the previous class, have always been held to be void. I should be very sorry to extend the doctrine much further.<sup>142</sup>

Exactly what, if anything, is wrong with this statement? Initially, it gets the right balance by defending freedom of contract in the name of public policy, and for good reason. Any contract that improves the lot of both sides will normally improve the position of third parties as well, by offering them expanded business opportunities with individuals of greater wealth. These positive externalities from mutually beneficial exchange are often neglected. Even though contracting parties cannot sue to recover these benefits conferred, any social evaluation of the overall practice must reckon with their impact. So the basic challenge raised under Jessel's framework asks what considerations could overcome the presumption in favor of freedom of contract. Jessel notes

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<sup>141</sup> Printing and Numerical Registering Co. v. Sampson, 19 Ch. 462, 465 (1875).

<sup>142</sup> Id.

right off the bat that the doctrine applies only "to men of full age and competent understanding," for sitting in a court of equity he could not categorically insist that contracts are never set aside for undue influence. Jessel also understood the obvious mischief in enforcing contracts that threaten criminal actions against third parties, or even immoral behavior. His one weakness is his failure to confront directly the dangers of monopoly power, against which the common law had already devised some protections, as with common carriers.

Nor does Jessel's defense of freedom of contract depend on incantation devoid of analysis. Indeed his treatment of the underlying transaction in Sampson reveals that he understood fully the subtleties of the matter. The defendant for £48,750 had assigned his patent rights in a new invention (for numbering and printing tickets consecutively) to the plaintiff. As part of the deal, he also agreed "to enter into a covenant with the said company to assign, as and when required by the company or their directors, all future patent rights, or in the nature of patent rights, which they or any of them may hereafter acquire with respect to the aforesaid inventions, or any of them, or any of a like nature in the United Kingdom, or any part thereof, the Channel Islands, the Isle of Man, or all or any part of the continent of Europe."<sup>143</sup>

Jessel held that the quoted covenant did not violate public policy, but only after a detailed discussion of the incentive effects of the covenant. He was fully aware of the relevant trade-offs. While this covenant acted as a deterrent to future invention, it was also necessary to prevent the patent from becoming worthless to the buyers if the sellers could retain control of some follow-on venture that "exposed them to the instantaneous, or almost instead, competition

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<sup>143</sup> Id. at 462.

of the inventor with the benefit of his previous experience."<sup>144</sup> The two forces do cut in opposite directions, but that is hardly a new phenomenon in the law, especially with intellectual property. The creation of the patent monopoly itself involves just such a tension, for in order to induce the creation of the invention in the first place the law blocks its free usage for a stated period of time. Jessel's point was that the parties were best able to consider their combined impact, and he could find no dislocation massive enough to upset a part of the bargain that secured the initial purchase. And he denied that "a man who has obtained money for the future products of his brain will not be ready to produce those products."<sup>145</sup> The defender of freedom of contract was quite prepared to believe that other noneconomic motivations could induce production, or that other contractual arrangements were able to secure it. He was therefore right to recognize both the advantages and shortcomings of this long-term arrangement, without striking down one of its essential components.

The genius and importance of the general maxim is that it offers guidance to judges less skillful than Jessel to decide cases in which discrete analysis is likely to be cloudy. But by the same token, it does not dispense with efforts to understand both the uses and limitations of that maxim. The key issue that was nowhere addressed in Jessel's argument was that of the role of monopoly in limited freedom of contract. That is surely the dominant social question, and on it, it is possible here to make only a few concluding remarks on a matter that has been canvassed far more thoroughly elsewhere. First, most businesses do not possess monopoly power, and for them the choice of trading partners in the indispensable feature in a system of competition and voluntary exchange, as the

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<sup>144</sup> Id. at 464.

<sup>145</sup> Id. at 465.

nineteenth century theorists understood. "A party has the right to select and determine with whom he will contract, and cannot have another person thrust upon him without his consent."<sup>146</sup>

Yet the system is not closed. Introduce monopoly power and the presumptions change. And again the legal system responded. The important class of monopolies facing the law were probably those that rose with common carriers and public utilities, areas that underwent explosive growth toward the end of the nineteenth century. On these matters the common lawyers stuck pretty much to their guns and insisted that these contracts were "affected by the public interest" not in some woolly sense of being important, but in a far more specific sense that special rules had to limit the freedom of contract when a single provider sat astride an essential commodity. Yet once again the response to these cases did not originate with laissez-faire but predated it. Sir Matthew Hale surely understood the point when he spoke of the dangers of maritime monopoly.<sup>147</sup> Lord Ellenborough had the same basic insights with respect to customs monopolies. "There is no doubt that the general principle is favored in both law and justice, that every man may fix what price he pleases upon his own property or the use of it; but if, for a particular purpose, the public have a right to resort to his premises and make use of them, and he have a monopoly in them

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<sup>146</sup> Boston Ice Co. v. Potter, 123 Mass. 28, 30 (1877); McDonald v. Massachusetts, 120 Mass. 432 (1876), making the same point for charitable hospitals. United States v. Colgate, 250 U.S. 300, 307 (1919): "In the absence of any purpose to create or maintain a monopoly, the Sherman act does not restrict the long recognized right of a trader or manufacturer . . . freely to exercise his own independent discretion as to the parties with whom he will deal." Great Atlantic & Pacific Tea Co. v. Cream of Wheat Co., 227 F. 46 (2d Cir. 1915) (antitrust laws do not influence general common law rule except in restraint of trade cases).

<sup>147</sup> Matthew Hale, DE PORTIBUS MARI (Of Carriage at Sea), quoted in Allnut v. Inglis, 12 East 525, **XX**, 104 Eng. Rep. 206, **XX** (K.B. 1810).

for that purpose, if he will take the benefit of the monopoly, he must as an equivalent perform the duty attached to it on reasonable terms."<sup>148</sup> The entire institutional framework is key if only because it rebuts the charge that laissez-faire was so doctrinaire that it was blind to the dominant social realities of its time.

The issue is surely more closely matched on the question of whether the dangers of monopoly in other sectors of the economy were tolerated under laissez-faire. Michael Trebilcock finds that trend under the English cases that let many horizontal arrangements pass freely by.<sup>149</sup> I am far less sure about his conclusions, thinking that some of these devices had some efficiency justifications, such as the efficient management of divided territories.<sup>150</sup> But for these purposes we can put these disputes to one side. Even though the most urgent issues under laissez-faire concerned the response to various manifestations of market power, one point remains true: the efforts to undermine laissez-faire by looking to the doctrinal or conceptual foundations of contract law, traditionally understood, should be rejected. When Atiyah, Fifoot, Friedman, Gilmore and Kessler look into the belly of the beast, they take after Bramwell or Langdell, and they see the insidious remains of an insensitive legal regime out of touch with the social realities. Yet a closer examination of the relevant issues suggests that they frequently fastened on to a sideshow of much doctrinal fascination, and of some importance in deciding cases that make it up

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<sup>148</sup> Allnut v. Inglis, 12 East 525, 538, 104 Eng. Rep. 206 (K.B. 1810).

<sup>149</sup> Michael Trebilcock, THE COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS (1986); see also, William Letwin, The English Common Law Concerning Monopolies, 21 U CHI. L. REV. 355 (1954)

<sup>150</sup> For a discussion, see Richard A. Epstein, Principles for a Free Society: Reconciling Individual Liberty with the Common Good, ch. 2 (forthcoming 1998)



the appellate ladder. There are no great conceptual riddles that cannot be solved by traditional techniques. There are no great gaffes that bring the system to its knees. Too much focus on the oddities of legal doctrine leads to a misguided political focus. The great political systems stand or fall on the way in which they respond to grand social problems– the trusts, the utilities. Ironically Langdell understood this. When he denounced the Supreme Court for its decision in the North Pacific Case, he did more than appeal to classical principles of equitable jurisdiction. Rather he argued, and with considerable force, that a system of rate regulation for common carriers was clearly superior to breaking up a large and complex operation under the antitrust law.<sup>151</sup> Here he was on to something big, a dispute that continues to rage in dealing with telecommunications regulation to this day. But that is just the main point. Contracts big and contracts little have some overlap, but greater divergence. The true political struggles are the large questions of freedom of contract, not with the smaller task of fine-tuning the mechanism of voluntary exchange.

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<sup>151</sup> Christopher Columbus Langdell, The Northern Securities Case and the Sherman Anti-Trust Act, 16 HARV. L REV. 539 (1903). He wrote "there was no call for such an act respecting them; that the only way in which railways can do an injury to the general public is by charging unreasonable rates for services which they render, and that for such an injury the state already had an incomparably better remedy than any which the Sherman Ant-Trust Act can furnish, in its unquestioned power to regulate and control railway rates; . . ." Id. at 553.