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ARTICLES

Offer, Acceptance, and Efficient Reliance

Richard Craswell*

In this article, Professor Craswell explores efficient reliance as an implicit economic rationale underlying courts' decisions in contract formation cases. Contracting parties often fail to express their intentions clearly and courts must later decide what the parties would have wanted ex ante. When negotiations fail, one party (S) may deny ever making a commitment, while the other party (B) may claim to have relied on the first party's statements or conduct. Professor Craswell observes that courts often find a binding commitment by S when reliance by B would have been efficient. After explaining when reliance is efficient, and why the nonrelying party might prefer it, Professor Craswell shows that courts appear to apply an efficient reliance rationale under a variety of common law doctrines. But because the question of whether B's reliance was efficient is highly fact specific, Professor Craswell concludes that bright line rules would not, as a general matter, guarantee a more efficient result.

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The problem is a familiar one. Two parties negotiate with an eye to a potential transaction. Discussions are held; documents are exchanged; perhaps a preliminary agreement is reached; perhaps one party even starts performing. Then something happens: The market turns, a better offer comes along, or someone simply has a change of heart. At any rate, one party announces that he or she is no longer interested in the transaction. The other party responds irately, claiming that "we had a deal," and that the time for free withdrawal from the transaction has long since passed. The legal question is whether the first party is indeed free to walk away, or whether the disappointed party is instead entitled to compensation.

While the question is straightforward enough, contract law attempts to answer it with a bewildering array of doctrines. The outcome of the case may turn on whether either party did or said anything the law will interpret as an "offer," and, if so, whether the other party did or said anything the law will interpret as an "acceptance." The law will also ask whether the "acceptance" took the proper form, and whether it came at a proper time (had the offer already been withdrawn? had it lapsed?). Liability may also turn on whether the party now attempting to withdraw said anything the law will interpret as a

"promise" on which the other party "reasonably" relied, or whether the disappointed party's preparations conferred any benefits on the other party for which he or she might be liable in restitution.

As scholars have pointed out for at least fifty years, the legal doctrines governing these issues are largely conclusory and question-begging.¹ The law interprets a communication as an "offer" if it is "so made as to *justify* another person in understanding that his assent to that bargain . . . will conclude it."² An offer of unspecified duration lapses if it is not accepted within a *reasonable* time, where what is reasonable depends "on all the circumstances existing when the offer and attempted acceptance are made."³ An offer also expires if the offeree responds by making a counteroffer—unless the purported counteroffer is really a "mere inquiry" or a "qualified acceptance."⁴ If an offer has not expired, the offeree's reliance on it may make the offer irrevocable—but only if the offeror should *reasonably* have expected to induce such reliance.⁵ Even then, the offer is irrevocable only "to the extent necessary to avoid injustice."⁶ And so on.

A long line of contracts scholarship, running from Arthur Corbin⁷ and Karl Llewellyn⁸ to Melvin Eisenberg,⁹ has argued that courts should not simply apply mechanical or formalistic rules to contract formation cases, but should instead decide them to give effect to the parties' most likely intentions. The wisdom of this approach is, of course, contestable,¹⁰ and I consider some of the possible alternatives in Part V. The article's main focus, however, is on how we might implement this approach, assuming that we accept its validity. In Parts I through IV, I argue that if we are to carry out the Corbin/Llewellyn recommendation, we need some way of figuring out what the parties most likely intended, and (in particular) some understanding of why someone would ever want to form a contract. That is, why would a party ever want to commit to a transaction in advance, rather than reserve the right to withdraw until the moment the transaction is consummated?

While there are several possible reasons why such a commitment might be in a party's interest, I focus on the effect of an enforceable commitment on the other party's incentive to rely on the proposed transaction. As Charles Goetz and Robert Scott pointed out in 1980, a legally enforceable commitment may sometimes be the only way to induce the other party to choose an efficient level

1. E.g., K. N. Llewellyn, *On Our Case-Law of Contract: Offer and Acceptance* (pts. 1 & 2), 48 YALE L.J. 1, 14-28 (1938), 48 YALE L.J. 779, 782-83 (1939).

2. RESTATEMENT (SECOND) OF CONTRACTS § 24 (1979) (emphasis added).

3. *Id.* § 41.

4. *Id.* § 39 cmt. b.

5. *Id.* § 87(2) (emphasis added).

6. *Id.*

7. Arthur L. Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L.J. 169 (1917).

8. Llewellyn, *supra* note 1.

9. Melvin Aron Eisenberg, *Expression Rules in Contract Law and Problems of Offer and Acceptance*, 82 CAL. L. REV. 1127 (1994).

10. See, e.g., text accompanying notes 74-75 *infra* (discussing penalty default rules).

of reliance.¹¹ Building on their insight, I suggest that the legal doctrines governing offer and acceptance can be interpreted to prevent one party from withdrawing in just those cases where an enforceable commitment would have been necessary to induce an efficient level of reliance by the other party. In those cases, I argue, even the party who now seeks to withdraw would have wanted to be committed (if he or she had been asked that question at the time the other party had to rely), precisely in order to induce efficient reliance.

Parts I through III develop this theoretical argument in more detail, explaining when reliance on a proposed transaction is efficient, and showing why a nonrelying party might want to be committed in order to induce efficient reliance. Part IV then surveys the reported cases to show that many decisions can be understood by reference to the efficiency (or inefficiency) of each party's reliance. That is, I show that in cases where the party now seeking to withdraw had a reason to be committed (in order to induce efficient reliance by the other party), courts have been quite willing to find both an offer and quite willing to find a valid acceptance, and quite willing to resolve every other legal issue in favor of an enforceable obligation. I do not claim that courts have *consistently* decided cases according to this principle: Exceptions and counterexamples are easy to find. But I do claim that considering the efficiency of the other party's reliance provides a principled method of applying these vague and conclusory legal doctrines, in a way that the doctrines themselves cannot.

Finally, Part V asks whether courts should even engage in this inquiry, if doing so requires them to assess the efficiency of one side's reliance on a case-by-case basis. The alternative to case-by-case analysis is increased judicial use of bright line rules. In theory, bright line rules could encourage the parties to decide for themselves when a commitment would induce efficient reliance, and to signal their decision more clearly to the courts and to each other. A bright line strategy could thus free courts from the burden of deciding when one party's reliance would have been efficient. As discussed in Part V, however, a bright line strategy also has drawbacks, which may explain why courts so often revert to case-by-case analysis.

I. WHY A LEGAL RULE?

For convenience, I will refer to a paradigmatic case where a seller, *S*, and a buyer, *B*, are considering a possible transaction. In most of my examples, *B* will be the party who relies on the proposed deal, while *S* will be the party who eventually tries to withdraw—though nothing turns on this, and the roles could easily be reversed. The legal question is whether *S* can withdraw with no liability to *B*, or whether *S* has incurred some obligation to compensate *B* if she withdraws.¹²

11. Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

12. For convenience in the use of pronouns, all of my examples involve a female seller *S* and a male buyer *B*.

A. *Voluntary vs. Involuntary Obligations*

I assume throughout this article that if *S* explicitly specifies that she has made a legal commitment to *B*, the law will respect that specification and will hold *S* to her commitment. I also assume that if *S* explicitly specifies that she is *not* committed to *B*, the law will respect that choice as well. In other words, my premise is that the parties are free to specify any degree of commitment they desire.¹³

If this premise is accepted, the difficult cases are those where *S* has not clearly stated whether she means to be legally committed to *B*. In any such case, the law must choose between: (a) treating *S* as legally uncommitted, thus forcing any *S* who wants to make a commitment to do so explicitly; or (b) treating *S* as legally committed to *B*, thus forcing any *S* who wants to remain uncommitted to say so explicitly. In other words, the law must pick some presumption or default rule to govern cases where *S* has remained silent or ambiguous. The default rule could be a very simple one—e.g., “a silent *S* is always presumed not to have given a legal commitment, whatever the other facts of the case”—or it could be minutely “tailored,” creating a presumption in favor of commitment in some situations and a presumption against commitment in others. But some default rule is needed, because courts must somehow reach a decision in cases where *S* has not indicated a preference either way.

At this point, some readers may feel that the presumption or default rule in cases of silence should unquestionably be a rule of “no commitment.” After all (the argument might run), if *S* wants to make a commitment to *B* she is always free to assume one explicitly. Why, then, should the law impose such a commitment on *S* if she has not freely assumed one?

This intuition runs aground, however, on the symmetry of the default rule problem. Consider the following symmetric but opposite argument: “The default rule, in cases of silence, should undoubtedly be a rule of implied *commitment*. After all, if *S* wants to avoid any commitment to *B*, she is always free to disclaim the commitment explicitly. Why, then, should the law impose an uncommitted relationship on *S* if she has not freely chosen to remain uncommitted?” This argument, like the one before it, asserts that if *S* has not chosen some particular legal relationship, the law should not impose that relationship on her. But arguments of this form do not help whenever a default rule is needed because, in these cases, *S* has not explicitly chosen *any* legal relationship. In cases requiring a default rule, any relationship the law recognized would be equally imposed on *S*.¹⁴

The confusion arising from this point may stem from an ambiguity in what it means for a legal relationship to be “imposed.” In one sense, a default rule of implied commitment represents a greater “imposition” than a default rule of

13. Arguments that courts should sometimes set aside explicit statements of commitment or noncommitment are thus beyond the scope of this article.

14. Similar problems arise when using “voluntariness,” or concern for liberty and personal autonomy, to select default rules in other parts of contract law, such as implied warranties, implied excuses, or remedies for breach. I discuss these issues at more length in Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989).

noncommitment, since an implied commitment can lead to judicially enforceable damages while an implied noncommitment cannot. However, neither rule is "imposed" in the sense of forcing *S* to accept a legal relationship against her will, since each is merely a default rule which allows her to specify a different relationship whenever she chooses. For this reason, the intuition that legal relationships should not be "imposed" on a party cannot, by itself, provide a reason for selecting one default rule over the other.

A related intuition, often associated with Grant Gilmore's *The Death of Contract*, links liability for reliance damages to tort law and other involuntary obligations, such as the obligation not to cause harm to others.¹⁵ Under this view, if *S*'s liability is tied to *B*'s reliance in any way, *S*'s liability might seem less voluntary. But this conclusion is misplaced if *S*'s liability rests on a mere default rule. As long as *S* is free to disclaim liability, any liability that attaches when she fails to disclaim is no more "involuntary" than is the absence of liability that would result if *S* failed to explicitly assume liability under the opposite default rule. Once again, the principle that legal relationships should be voluntary cannot provide a basis for selecting one default rule over another.¹⁶

There may be, of course, other reasons for preferring a default rule of "no commitment" over a default rule of "commitment," either in general or in particular situations. Ideally, though, those reasons should be defended as the *result* of economic analysis, not asserted as preanalytic premises. Indeed, one aim of this article is to identify some of the economic reasons that might favor a default rule of noncommitment or its opposite. To do so, I must briefly sketch two economic approaches to selecting default rules, which will be used throughout the remainder of the article.

B. *Economic Bases for Selecting Default Rules*

Economic analysis distinguishes between two strategies lawmakers might use in choosing a default rule. First, they can select the rule which, if the parties do not contract around it, will maximize the expected value of the transaction. In many contexts, this approach is equivalent to selecting the rule that most parties would have agreed to had they discussed the matter explicitly, since most parties will normally benefit by maximizing the transaction's expected value.¹⁷ Following this strategy, the case for a default rule of noncom-

15. GRANT GILMORE, *THE DEATH OF CONTRACT* 87-89 (1974). For a similar argument, see P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 1-7 (1979).

16. For a different (though less significant) sense in which Gilmore's thesis might still be valid, see text accompanying note 250 *infra*.

17. Ayres and Gertner refer to this rule as a "majoritarian" default rule. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87, 93 (1989). For an early defense of this approach, see Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 *J. LEGAL STUD.* 83, 89 (1977).

Default rules selected on this "majoritarian" basis could also be defended using normative theories of hypothetical consent. However, this defense is controversial, for using hypothetical consent in this way may add little (if anything) to a straightforwardly utilitarian efficiency argument. For varying perspectives on this issue, see, e.g., Randy E. Barnett, *The Sound of Silence: Default Rules and Contract*

mitment would require a showing that the expected value of a transaction would be maximized if *S* were not under any enforceable obligation to *B*. Conversely, a default rule of implied commitment could be defended whenever the expected value of the transaction would be maximized if *S* were under an enforceable commitment.

A second strategy, however, attempts to spare lawmakers the task of trying to determine which rule would maximize the expected value of a transaction. Under this approach, lawmakers should select a bright line rule that is predictable and easy to administer. As long as the rule is predictable, any parties whose expected values would not be maximized under the rule would have an incentive to contract around it, replacing the law's default rule with whatever rule *would* maximize the value of their transaction. To be sure, this approach may increase the parties' transaction costs, for the parties would have to figure out what rule they prefer and incur the expense of writing it into their contract. But if it is cheaper for the parties to determine the efficient rule than for courts or legislators to do so, overall efficiency may be increased.¹⁸

Part V will examine this bright line approach to defining default rules. In the next three Parts, however, I assume that courts are following the first approach and are attempting to determine, on a case-by-case basis, whether an enforceable commitment would increase the expected value of a transaction. Parts II and III identify the conditions under which an enforceable commitment would increase the expected value of a transaction. Part IV then interprets the case law as an example of this strategy.

II. WHY A COMMITMENT?

Why would one party ever want to make an enforceable commitment to the other? Or, to put the question in economic terms, under what circumstances will the expected value of a transaction be maximized if one party is committed to the other? While this question is fundamental, it is not often discussed in the literature on contract law, and its answers are far from obvious.

It might be argued that enforceable commitments give parties increased certainty. For example, if *B* can convince *S* to commit to sell him widgets three months from now at a price of \$100, *B* will be protected against any future increase in the price of widgets. This explanation, however, is incomplete. True, an advance commitment protects *B* against any loss he might suffer from a rise in widget prices. But if the commitment binds *B* as well, *B* also gives up

tual Consent, 78 VA. L. REV. 821 (1992); David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991); Jules L. Coleman, Douglas D. Heckathorn & Steven M. Maser, *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J.L. & PUB. POL'Y 639 (1989); Richard Craswell, *Efficiency and Rational Bargaining in Contractual Settings*, 15 HARV. J. LAW & PUB. POL'Y 805 (1992). The equation of "most efficient" with "what the parties would have agreed to" becomes particularly problematic if a single, untailored default rule must govern a class of heterogeneous contracting pairs, some of whom would have preferred one rule and some of whom would have preferred another. See Craswell, *supra*, at 815-20.

18. Ayres and Gertner refer to such rules as "penalty defaults." Ayres & Gertner, *supra* note 17, at 91.

any chance of benefiting from a fall in widget prices, so we need some further explanation to show why this tradeoff is *on balance* advantageous to *B*. Any further explanation must also consider the fact that locking in a price of \$100 does not actually eliminate the risk of market fluctuations. Instead, locking in the price merely shifts that risk from *B* to *S*, and *S* may well demand compensation for bearing an additional risk. Once again, we need something more to explain why or when the net benefit to *B* will exceed the increased compensation *S* is likely to demand.

In this Part, I discuss two reasons why an advance commitment might be attractive to the parties on balance. The first explanation, which I discuss only briefly, applies when the two parties differ in either their attitudes toward risks or their estimates of the likelihood of those risks. The second explanation, which is more central to this article, applies when an advance commitment would induce a more efficient level of reliance.

A. *Differential Attitudes to Risk*

If *B* is risk averse, he might prefer to lock in a price of \$100 in advance of the actual delivery. To be sure, if the price of widgets is just as likely to go up as to go down, then locking in a price of \$100 confers no greater expected benefits on *B* than would a strategy of forgoing an advance commitment, and simply waiting and buying at the eventual market price at the time of delivery. However, the label "risk averse" means that *B*, for whatever reason, prefers a sure thing over a more uncertain prospect with the same expected value. Since the strategy of waiting for the eventual market price is more uncertain—it could result in either a gain or a loss—a risk averse *B* would prefer the certainty of a guaranteed price of \$100. And if *S* is less "risk averse" than *B*, the minimum *S* must be paid to take the risk of a market fluctuation on herself will be less than the maximum *B* will willingly pay to be relieved of the risk. Thus, differences in risk aversion provide one reason why an advance commitment might increase the joint gains from the transaction.¹⁹

Even without any differences in risk aversion, a similar analysis could apply if *S* and *B* differed in their beliefs about which way the market was likely to move. If *B* thinks the price of widgets is more likely to rise than to fall, then locking in a price of \$100 will have a greater expected value to *B* (given *B*'s view of the odds) than will the strategy of forgoing any commitment and waiting instead to purchase at whatever the market price turns out to be. If *S*, on the other hand, thinks the price of widgets is more likely to fall, then locking in a price of \$100 will have a greater expected value to *S* (given her view of the odds) than will the strategy of forgoing any commitment and waiting to sell at the eventual market price. This is the essence of any commodities speculation: Different beliefs about the future give rise to mutual expected gains from trade.

19. For a more extended discussion of this motive for contractual commitments, and its implications for the most efficient damage rule, see A. Mitchell Polinsky, *Risk Sharing Through Breach of Contract Remedies*, 12 J. LEGAL STUD. 427 (1983).

Indeed, many offer-and-acceptance cases may involve just this motive for commitment. If the parties are negotiating the sale of a business, for example, there may be no established market price which fluctuates as commodities prices do. But the "market" price, in this context, is simply the highest price that any buyer will pay for the business, and the parties may be unsure how high a price other buyers are willing to pay. *S* may hope that other buyers will come forward who value her business even more than *B* does. She may also hope that a change in economic conditions or a change in the available data (e.g., a highly profitable quarterly statement) will make her business seem more valuable to buyers. But *S* must balance this hope against the possibility that changes in the opposite direction will lower the perceived value of her business. Whenever *S* judges that *B*'s optimism is as high as it is likely to get (relative to her own pessimism), that is the point at which *S* would like to lock in a commitment from *B*. The same, in reverse, is true of *B*: *B* would like to lock in a price when *S*'s pessimism about the value of her business seems as low as it is likely to get relative to *B*'s own optimism. In these cases, then, the parties' differences in opinion about the likelihood of future events are what determine the optimal time for a binding commitment.

Unfortunately, neither differences in risk preference nor differences in beliefs about the market have any obvious implications for the law's choice of default rules. To choose default rules that imply a commitment in exactly those cases where most parties would want to be committed, the law would have to identify the point in the negotiations at which the parties' risk aversion, or estimates of future values, differed by the greatest amount. Each of these determinations seems hard for courts to make. To be sure, there may be some situations where differences in the parties' risk aversion are easy to identify, as in contracts between insurance companies and applicants for insurance.²⁰ In this article, however, I will not pursue that avenue of inquiry.

B. *Mutually Beneficial Reliance*

Instead, my focus in this article is on the effect of an advance commitment on the parties' incentives to choose an efficient level of reliance. This was the central insight of Goetz and Scott's 1980 article, which introduced the concept of efficient reliance into the law review literature.²¹ This Part describes the

20. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 107 (4th ed. 1992) (suggesting that differences in risk aversion between insurance companies and their insureds might justify some aspects of the "reasonable expectations" doctrine as applied to insurance contracts).

21. Goetz & Scott, *supra* note 11. For more technical economic analyses, see Tai-Yeong Chung, *Incomplete Contracts, Specific Investments, and Risk Sharing*, 58 REV. ECON. STUD. 1031 (1991); Lewis A. Kornhauser, *Reliance, Reputation, and Breach of Contract*, 26 J.L. & ECON. 691 (1983); William P. Rogerson, *Efficient Reliance and Damage Measures for Breach of Contract*, 15 RAND J. ECON. 39 (1984); Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466 (1980); Aaron S. Edlin & Stefan Reichelstein, *Holdups, Standard Breach Remedies, and Optimal Investment*, 86 AM. ECON. REV. (forthcoming 1996). For less technical treatments, see Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 11-19 (1985); Lewis A. Kornhauser, *An Introduction to the Economic Analysis of Contract Remedies*, 57 U. COLO. L. REV. 683, 700-02 (1986).

concept of efficient reliance and explains its implications for contract formation.

1. *Efficient reliance.*

Reliance is a form of "relationship-specific investment." More specifically, it is any choice, be it action or inaction, which will (1) make *S*'s performance more valuable to *B* if *S* does in fact perform, but (2) make *B* worse off than if he had not relied if *S* fails to perform. The second element of this definition means that reliance always involves some risk to the relying party.

A simple example of reliance involves an investment in specialized equipment. If *B* plans to buy widgets from *S*, he may also want to buy a special widget-processing machine in order to make the best use of *S*'s widgets. *B*'s investment in such a machine *may* qualify as reliance under this definition, depending on the other facts of the case. For example, if *B* would lose nothing by waiting until *S*'s performance is more certain before buying the machine, then buying the machine now would not qualify as reliance. In that case, buying the machine now would not increase the expected value of the transaction to *B* (compared to waiting and buying the machine later), and thus would not satisfy the first element of the definition given above.²²

In other circumstances, *B*'s investment in the machine may not satisfy the second element of the definition because the investment will not be less valuable to *B* if *S* fails to perform. If *B* can resell the widget-processing machine for the price he paid for it, he clearly faces no risk, and the second element would not be satisfied. Even if the processing machine has no resale value, *B* still faces no risk if he is sure of being able to buy replacement widgets from somebody else if *S* fails to perform. In either of these two examples, the processing machine will still be used for its intended purpose (either by *B*, or by whomever buys it from *B*), so *B*'s investment in the machine will not diminish in value if *S* fails to perform.

B's investment in the machine would qualify as reliance, however, if (1) *B* must decide whether to purchase the machine before it is certain whether *S* will perform; (2) the machine will have little resale value; and (3) the machine will not be as productive when used on widgets made by anybody but *S*. In this case, *B*'s investment in the machine would satisfy every element of the definition of reliance. If *S* delivers her widgets, the contract will be more valuable to *B* because the customized machine will allow him to process the widgets more efficiently. If *S* does not deliver the widgets, *B*'s investment will be wasted, and *B* will be worse off than if he had not purchased the machine. This is a paradigmatic case of risky but potentially valuable reliance.

While investment in customized assets represents the clearest case of reliance, reliance can also take the form of inaction. For example, in *Hadley v.*

22. For a formal model analyzing the optimal timing of a reliance decision, see Avery Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 YALE L.J. (forthcoming 1996).

Baxendale,²³ the mill-owners' failure to keep a spare shaft was a form of reliance on the transport company's promise to deliver the repaired shaft in a timely manner. Turning down alternative offers can also be a form of reliance. For example, if *B* turns down a chance to buy widgets from some other seller, this rejection will make the transaction with *S* more valuable to *B* (assuming that *B* would have no use for two sets of widgets). However, if *S* fails to perform, and if the other offer is no longer available, *B* will then regret having turned down the other offer. In effect, the value to *B* of the offer that he turned down is a relationship-specific opportunity cost.

Since reliance involves both potential losses and potential gains, the efficient level of reliance—that is, the level of reliance that will maximize the total expected value of the proposed transaction—can be defined by the balance of the potential gains and losses. More specifically, the efficient level of reliance depends on (1) the potential upside from the reliance, or the amount by which the reliance will increase *B*'s gains if *S* does perform; (2) the potential downside from the reliance, or the amount by which the reliance increases *B*'s losses if *S* fails to perform; and (3) the probability of each of these two outcomes (i.e., the probability that *S* will or will not perform). Thus, the efficient level of reliance is determined by a sort of cost-benefit analysis, analogous to the "Learned Hand" test for defining the efficient level of precautions in a negligence case.²⁴ Ideally, *B* should rely whenever the potential benefits of reliance (weighted by the probability that *S* will in fact perform) exceed the potential losses from reliance (weighted by the probability that *S* will not perform).

2. Incentives to choose efficient reliance.

How is efficient reliance relevant to the decision to enter into a binding commitment? If *S* is not legally committed to *B*, *B* may have an incentive to choose too low a level of reliance. This is because, if there is no legally enforceable commitment, reliance will make *B* more vulnerable to renegotiation by *S*.²⁵

23. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

24. The Learned Hand rule appears in *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947). Cooter uses a similar cost-benefit analysis to define the socially efficient level of reliance. Cooter, *supra* note 21, at 13.

Some argue that any definition of "reasonable" reliance must be circular, since the reasonableness of relying on a promise depends on whether the law treats the promise as binding. *E.g.*, Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 275 (1986); L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 85 (1936). This circularity disappears, however, once efficient reliance is defined in terms of the total costs and benefits of relying on a promise, not just the private costs and benefits to the promisee (which will indeed depend on the promise's enforceability). For a more extended discussion of this "circularity" critique, and its relationship to efficient reliance, see Jim Leitzel, *Reliance and Contract Breach*, 52 LAW & CONTEMP. PROBS., Winter 1989, at 87.

25. See note 21 *supra*. For recent discussions of this distortion of *B*'s incentives with particular reference to the law of contract formation, see Juliet P. Kostritsky, *Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 HASTINGS L.J. 621, 663-66 (1993); G. Richard Shell, *Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action*, 44 VAND. L. REV. 221, 239-40 (1991); Wouter P. J. Wils, *Who Should Bear the*

From the definition of reliance, any reliance by *B* must make consummation of the deal more important to him, since reliance increases the difference between the benefit *B* receives if *S* performs, and the loss *B* suffers if *S* fails to perform. But once consummation of the deal becomes more important to *B*, *S* can exploit this by threatening not to perform unless *B* agrees to pay her a higher price. To be sure, *S*'s threat would be an empty one if she would be liable for damages if she refused to perform. But if *S* is free to walk away from the deal without paying damages—in other words, if *S* is not legally committed to *B*—then *S* can credibly hold out for a larger share of *B*'s profits.

S's ability to hold out for a share of *B*'s profits is what distorts *B*'s reliance incentives in the absence of a binding commitment. *B* must still bear all the downside risks of his reliance, for if it becomes inefficient for *S* to perform, then she will walk away from the deal without paying anything. But if *B*'s reliance becomes worthwhile—that is, if it becomes efficient for *S* to perform—then *B* will not capture all of the gains from his reliance because *S* may extract some of those gains by holding out for a higher price. In short, unless *B* can induce *S* to commit, *B* will bear all of the costs of unsuccessful reliance but will not capture all of the benefits of successful reliance. This asymmetry will often lead *B* to choose too little reliance, relative to the efficient level.²⁶

This efficient reliance argument can be viewed as a more general form of an older account of contractual commitments: an account which dates back at least as far as Hobbes.²⁷ According to this account, advance commitments might be unnecessary when the exchange of goods or services is simultaneous, but an advance commitment is crucial when one party must perform before the other. When performance is sequential, the party who performs first takes a huge risk if he or she does so without some assurance that the other party will provide the agreed-on return performance.

The efficient reliance literature generalizes the Hobbesian argument by showing that enforceable commitments may also be useful in protecting other forms of reliance, not just reliance that takes the form of advance performance. For example, even if the proposed exchange is to occur simultaneously, one party may need to invest in specialized equipment, or may turn down alternatives that will be unavailable later. In either of these situations, an enforceable commitment will give the first party the security he needs to rely, just as in

Costs of Failed Negotiations? A Functional Inquiry into Precontractual Liability, 4 JOURNAL DES ÉCONOMISTES ET DES ÉTUDES HUMAINES 93 (1993).

26. This distortion would disappear if *S* and *B* could not communicate, or if some other transaction cost prevented *S* from renegotiating with *B*. See Shavell, *supra* note 21, at 470, 480-81 (showing that, when *S* cannot renegotiate with *B*, a rule of zero damages will optimize *B*'s reliance incentives). Cooter argues that efficient reliance incentives could also be created by any other rule fixing damages at any level which did not vary with respect to *B*'s reliance, such as a liquidated damage clause. Cooter, *supra* note 21, at 14-15. However, Cooter's conclusion also depends on the assumption that *S* cannot renegotiate for a higher price after *B* has relied. As parties engaged in precontractual dealings almost always are in communication with each other, and therefore usually are able to renegotiate, I will not consider conclusions based on contrary assumptions.

27. THOMAS HOBBS, LEVIATHAN 84-85 (Edwin Curley ed., Hackett Publishing Co. 1994) (1668). For a more modern version of this account, see POSNER, *supra* note 20, at 89-90.

Hobbes's scenario an enforceable commitment gives the first party the security he needs to begin performing.

On the other hand, an enforceable commitment is not always necessary to induce efficient reliance. In some settings—for example, if the probability of successful consummation is extremely low—the efficient level of reliance might be zero, so an enforceable commitment would be unnecessary. In other cases, some discrete level of reliance might be efficient, but that reliance might be so valuable to *B* that he would rely even without any enforceable commitment.²⁸ In either case, *S* would have no reliance-related motive for committing herself in advance. An advance commitment could also be unnecessary in any setting where nonlegal forces check *S*'s ability to exploit *B*'s reliance by demanding a higher price once *B* has relied. For example, in some cases *S* may be concerned about her reputation: She may want to induce *B* (or others like him) to enter into similar contracts in the future. In other contexts, where *S* and *B* are family members or belong to another close-knit group, nonlegal sanctions may prevent this kind of exploitation.²⁹

The distortion of *B*'s reliance incentives could also be prevented by a legal rule that permitted *S* to withdraw whenever circumstances made consummation of the transaction inefficient, but which forbade *S* from withdrawing (or threatening to withdraw) whenever consummation was efficient and she was merely trying to negotiate a better price. This rule would eliminate the potential for a hold-up, thus removing the distortion which gives *B* an incentive to underrely. But because *B* would still be required to bear the risk that consummation of the deal might become inefficient, this rule could give *B* an incentive to rely too heavily.³⁰ In effect, this rule would be the precontractual analog of the modern preexisting duty rule, which does not normally apply until after *S* and *B* have signed a contract, but which then prevents *S* from renegotiating the price solely to take advantage of *B*'s change of position.³¹

28. In technical terms, if *B*'s reliance is not a continuous variable, the bias in *B*'s incentives that would normally be introduced by the absence of an enforceable commitment will not always be large enough to move *B* to too low a level of reliance. For an apparent example, see *Wright v. United States Rubber Co.*, 280 F. Supp. 616 (D. Or. 1967) (discussed at note 228 *infra* and accompanying text).

29. On the role of informal sanctions generally, see ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373 (1990). In part for this reason, in this article I will not discuss any of the contract formation cases involving reliance by family members.

30. For a discussion of possible incentives to overrely, see notes 33-34 *infra* and accompanying text.

31. RESTATEMENT (SECOND) OF CONTRACTS §§ 73 cmt. c, illus. 4, 89 cmt. b, illus. 5 (1979); U.C.C. § 2-209 (1989). Of course, this rule raises a number of difficulties in application, even when it is limited to *S*'s attempts to renegotiate after an enforceable contract has been created. As those complexities require detailed analysis of their own, I will not consider this issue here. For discussions of these complexities, see, e.g., Varouj A. Aivazian, Michael J. Trebilcock & Michael Penny, *The Law of Contract Modifications: The Uncertain Quest for a Bench Mark of Enforceability*, 22 OSGOOD HALL L.J. 173 (1984); Jason Scott Johnston, *Default Rules/Mandatory Principles: A Game Theoretic Analysis of Good Faith and the Contract Modification Problem*, 3 S. CAL. INTERDISCIPLINARY L.J. 335 (1993). For discussions of the possibility that the doctrine of impracticability might be used to optimize *B*'s reliance incentives, see Alan O. Sykes, *The Doctrine of Commercial Impracticability in a Second-Best World*, 19 J. LEGAL STUD. 43, 60-63 (1990) (expressing skepticism about courts' ability to use the doctrine appro-

Finally, *B*'s reliance incentives may also remain undistorted if *S* cannot find out what effect *B*'s reliance has had on the value of the transaction to *B*. For example, *B*'s reliance might take the form of gathering information about the profitability of the proposed transaction. If *S* cannot find out what *B*'s information revealed, she may not know whether *B* now believes the transaction to be any more valuable, and thus may have no reason to try to negotiate a higher price.³² Here too, an enforceable commitment would be unnecessary to create an incentive for efficient reliance.

3. *Incentives to rely excessively.*

In some cases, an enforceable commitment on the part of *S* may create the opposite problem by inducing *B* to choose *more* than the efficient level of reliance.³³ This distortion occurs because an enforceable commitment entitles *B* to collect some measure of damages if *S* fails to perform. The distortion is most easily seen if *B* is allowed to collect expectation damages, although similar distortions can arise under other damage measures. If *S* is liable for *B*'s expectation damages, *B* can collect enough in damages to leave him just as well off as if *S* had performed the contract. Thus, *B* need no longer worry about the possibility that *S* will not perform, and need not consider the possibility that his reliance will be wasted. In other words, expectation damages allow *B* to capture all of the upside potential of his reliance without making him bear any of the downside potential. This gives *B* an incentive to rely too heavily, relative to the efficient level of reliance.

In the remainder of this article, however, I will say little about this overreliance problem, for two reasons. First, even if an enforceable commitment would give *B* an incentive to overrely, there should still be some cases where the loss from this overreliance is less than the loss from the underreliance if *S* were not legally committed. That is, if the law must choose between one rule which leads *B* to overrely and another which leads *B* to underrely, there will surely be some cases where the best outcome is unattainable and the second-best outcome involves overreliance. In these cases, a binding commitment will be more efficient than the absence of a commitment.

Second, and more important, it is sometimes possible to achieve the first-best outcome, efficient reliance. This can be achieved if courts can evaluate *B*'s reliance decision and refuse to infer a commitment, whenever *B* has chosen an inefficiently high level of reliance, thereby giving *B* an incentive not to overrely. As Goetz and Scott pointed out, such a rule would be similar to a contributory negligence standard in tort law, by scrutinizing the behavior of the

priately); Gerhard Wagner, *In Defense of the Impossibility Defense*, 27 *LOV. U. CHI. L.J.* 55 (1995) (similar, but less skeptical about the effect of those doctrines).

32. For a formal economic model with this property, see Jason Scott Johnston, *Cheap Talk, Sunk Costs, and Contractual Liability in Preliminary Negotiation* (April, 1994) (unpublished manuscript, on file with the *Stanford Law Review*).

33. See note 21 *supra*.

plaintiff (*B*, in this case) to see whether he has behaved "reasonably."³⁴ Such a rule would of course increase the informational demands on courts, by requiring them to decide in each case whether *B*'s reliance was efficient. Still, the decisions in many of the cases I discuss in Part IV can be understood as resting on just such an evaluation of *B*'s reliance.

C. *The Benefit to the Nonrelying Party*

The preceding subsection of this Part showed how an advance commitment by *S* can lead to a more efficient level of reliance by *B*. In most of those cases, it would also be in *S*'s interest to agree to such a commitment. This is because if *B* is induced to rely in a way that increases the expected value of the total transaction, that should increase the expected benefit to *S*.

This benefit to *S* is easiest to see if *B*'s reliance takes the form of turning down other offers. If *B* does not rely—that is, if he instead accepts one of the other offers—then *S* will lose the chance to make a sale. In such a case, *S* clearly benefits if *B* is induced to rely.

The benefit to *S* can also take other forms. For example, in *Hoffman v. Red Owl Stores*,³⁵ the proposed transaction involved the award of a grocery store franchise. Hoffman relied on receiving the hoped-for franchise in several ways, including selling his bakery and buying a separate grocery store "in order that he gain experience in the grocery business."³⁶ If this experience would have enabled Hoffman to run a more profitable franchise, the experience would have benefitted the franchisor, Red Owl, as well as Hoffman. A profitable franchise could make the chain attractive to other potential franchisees; also, most franchise agreements give the franchisor a share of the profits made by each local store, in which case Red Owl would benefit directly from Hoffman's profitability.

Indeed, even when *B*'s reliance does not benefit *S* in any of these direct ways, *S* should still be able to share in the benefits of efficient reliance by charging a higher price. That is, whenever a commitment by *S* would increase the expected value of the transaction, *S* should be able to adjust the underlying price to a level that leaves both *S* and *B* better off as a result of the commitment. This is simply an instance of the general proposition that whenever a given rule would increase the total size of the "pie" (i.e., the expected value of the transaction), both parties would benefit by adopting that rule.³⁷

34. Goetz & Scott, *supra* note 11, at 1280; see also Cooter, *supra* note 21, at 15 ("It is but a short step to argue that reliance that is excessive in efficiency terms is also unforeseeable."). Limits on the damages *B* is allowed to recover could also check *B*'s incentives to overrely, if those limits were themselves tied to the efficient level of reliance. *Id.* at 16; see also Richard Craswell, *Performance, Reliance, and One-Sided Information*, 18 J. LEGAL STUD. 365, 377-78 (1989) (describing various damage measures that could restrain *B*'s incentives to overrely).

35. 133 N.W.2d 267 (Wis. 1965).

36. *Id.* at 269.

37. For discussions of this general principle see, e.g., A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 7, 27-38 (2d ed. 1989); Lucian A. Bebchuk, *The Pursuit of a Bigger Pie: Can Everyone Expect a Bigger Slice?*, 8 HOFSTRA L. REV. 671, 676 (1980); Richard Craswell, *Passing On*

To be sure, if the transaction is not eventually consummated, *S* will not collect any price at all (and could even be liable for damages). But so long as the probability of consummation is sufficiently high to make *B*'s reliance efficient, *S* should still be compensated (in expected value terms) by the *probability* that she will be able to collect a higher price on the underlying transaction. If *S* is a repeat player, for example, she should make enough in those cases where the transaction is consummated to compensate for her losses in those cases where she withdraws from the deal and must pay damages. The very definition of efficient reliance—reliance that increases the expected value of the transaction—implies that *S* can charge enough to compensate for her potential losses and still come out ahead.

Indeed, it could be in *S*'s interests to commit to several potential *B*'s, even if she knows that she will eventually contract with only one of them. Economists refer to such a situation as a winner-take-all "tournament." One frequently-analyzed example is the patent race, in which a number of firms invest in research and development (R&D) (a form of reliance) even though only one will receive the patent. Having many firms invest in R&D can be optimal if there is no way to know in advance which firm is most likely to succeed. And while this incentive structure could lead to excessive R&D expenditures (a form of excessive reliance), the result could still be more efficient than if no reward were offered at all, or if a reward was offered but the offering body retained the right to withdraw the reward or renegotiate after the firms had relied.³⁸ To be sure, if *S* can decide which *B* she wants to contract with before the time for reliance arrives, there is no reason to allow more than one of the *B*'s to rely. But if the *B*'s must make their reliance decision before it is clear which *B* is the best trading partner for *S*, the "tournament" analogy shows that it could be efficient for all of the potential *B*'s to begin relying. Of course, the optimal level of reliance for any single *B* will be lower when there are many possible *B*'s, for the probability that *S* will consummate the deal with any given *B* will necessarily be less. However, it could still be efficient for each of the *B*'s to begin relying, if doing so would increase the expected value of the transaction even after accounting for the cost of all the wasted reliance. If so, it should be in the interests of all parties (including *S*) to have *S* legally committed to each of the *B*'s in advance.

A more general concern is that the benefit to *S*, in each of these cases, will depend on *S*'s ability to set a price that compensates her for the risk of the occasional failed transaction. Moreover, if a commitment is implied at a time when the parties have not yet specified the price (or other key terms), *S*'s benefit will depend critically on how the courts fill in the resulting gaps. For exam-

the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships, 43 STAN. L. REV. 361 (1991).

38. For formal models of this tradeoff, with citations to the extensive economic literature, see Trond E. Olsen, *Regulation of Multiagent Research and Development*, 24 RAND J. ECON. 529 (1993); Brian D. Wright, *The Economics of Invention Incentives: Patents, Prizes, and Research Contracts*, 73 AM. ECON. REV. 691 (1983); see also Dale T. Mortensen, *Property Rights and Efficiency in Mating, Racing, and Related Games*, 72 AM. ECON. REV. 968 (1982) (deriving a similar conclusion for "racing games" where firms race to make similar discoveries).

ple, if courts systematically set the price too low, or fill the other gaps with terms extremely unfavorable to *S*, *S* would no longer have any guarantee of benefiting from the implied commitment, even in cases where such a commitment would induce more efficient reliance by *B*. The risk of this sort of judicial error is one of the principal arguments in favor of the bright line or penalty default approach,³⁹ to which I return in Part V.

For now, I simply note that in many cases courts infer commitments after the parties have filled in all the terms, so this issue does not arise. Moreover, even when the parties have not filled in all the terms, there is often no reason to expect courts to err systematically by filling gaps with terms unduly harsh to *S*. In these cases, it remains true that even *S* can benefit from being legally committed to *B* before the transaction is consummated, if such a commitment would induce a more efficient level of reliance by *B*. Moreover, as the following subsection will show, *S* can benefit in this situation even if she is committed and *B* is not.

1. *One-sided commitments.*

The analysis so far has identified the circumstances where both *S* and *B* would benefit if *S* were legally committed to a transaction in advance. Significantly, nothing in that analysis required a reciprocal obligation that would also prevent *B* from withdrawing from the transaction. That is, the argument that even *S* would benefit from being legally committed to *B* (when such a commitment would induce more efficient reliance) did not depend in any way on *B* also being legally committed to *S*. Thus, when the motive for commitment is to induce an efficient level of reliance, the commitment need not be mutual.

Now, the preceding analysis *did* assume that *B* was the only party with any opportunity to rely on the proposed transaction. In many situations, this assumption may not be valid, as both *S* and *B* may be able to increase the expected value of the transaction by relying. For example, while *B* may need to prepare to receive widgets from *S*, *S* may also have to make relationship-specific investments in order to produce the widgets, or she may have to turn down other offers. If *S*, too, faces a decision about how heavily to rely, *S*'s reliance will not be efficient unless *B* is under a legal commitment to *S*. In other words, when each party has a reliance decision to make, it may be that only a mutually binding commitment will optimize both parties' reliance decisions simultaneously.

Still, there are situations where only one party (*B*) has any occasion to rely, so efficiency requires that only *the other* party (*S*) be committed. As a result, the inquiry into whether a commitment by *S* would be efficient (to encourage reliance by *B*) can proceed independently of any inquiry into whether a commitment by *B* would also be efficient (to encourage reliance by *S*). In other words, mutuality in the legal sense of a *logically required* link between a com-

39. See text accompanying note 18 *supra*.

mitment by *S* and a commitment by *B* is simply unnecessary when the rationale for commitment is to encourage more efficient reliance.⁴⁰

If this conclusion seems counterintuitive, consider that we regularly observe people making commitments that are explicitly one-sided. Option contracts, for example, bind the seller to remain ready to transact on the offered terms, but do not bind the buyer at all. Sometimes the buyer pays for this option, but sometimes the seller grants the option for a token payment or for nothing at all. In these cases, the seller's motive can only be her hope of profiting by inducing the buyer to do something he would be unwilling to do without the binding commitment. Perhaps the buyer needs to invest in specialized machinery, or needs to spend money investigating some aspect of the seller's product, and perhaps the buyer would be unwilling to make that expenditure if the seller could then withdraw her offer or raise her price. In such a case, the seller clearly believes that the potential upside from her commitment—the increased probability that the underlying transaction will be consummated at a favorable price to her—outweighs its potential downside.⁴¹ If *S* has calculated correctly, she should commit when and only when such a commitment is necessary to induce *B* to engage in efficient reliance.

I emphasize the profitability of a one-sided commitment to *S*, as well as to *B*, because common law courts have often viewed such commitments with suspicion. The unenforceability of option contracts at common law is well known,⁴² but a similar suspicion seems sometimes to have affected courts' views on other contract formation issues. For example, in *James Baird Co. v. Gimbel Bros.*,⁴³ the court considered whether a subcontractor could be bound to the terms of a bid submitted to a general contractor, even though the general contractor (who relied on the subcontractors bid in calculating his own bid) was not bound to employ that particular subcontractor. Judge Learned Hand ruled that there was no implied obligation, apparently in the belief that no subcontractor could ever be benefitted by a purely unilateral commitment. As Judge Hand saw it, "[t]here is not the least reason to suppose that the defendant meant to subject itself to such a one-sided obligation."⁴⁴

This skepticism about one-sided commitments would be perfectly appropriate if all commitments were motivated by differences in risk aversion, or by

40. For a recent analysis of unilateral commitments that locates them in the broader context of speech act theory, and criticizes courts for their reluctance to recognize the logical possibility of unilateral commitments, see Peter Meijes Tiersma, *Reassessing Unilateral Contracts: The Role of Offer, Acceptance and Promise*, 26 U.C. DAVIS L. REV. 1 (1992).

41. For a nontechnical discussion of this motive, see Melvin Aron Eisenberg, *The Principles of Consideration*, 67 CORNELL L. REV. 640, 649–56 (1982). For a formal model of the seller's incentive to give the buyer an irrevocable offer, see Steven Shavell, *A Model of Open Versus Temporary Offers* (Sept. 9, 1990) (unpublished manuscript, on file with the *Stanford Law Review*).

42. *E.g.*, *Dickinson v. Dodds*, [1876] 2 Ch. D. 463 (Eng. C.A.). Modern courts are somewhat more willing to enforce option contracts, even when not supported by actual consideration. See RESTATEMENT (SECOND) OF CONTRACTS § 87(1) (1979); U.C.C. § 2-205 (1989).

43. 64 F.2d 344 (2d Cir. 1933).

44. *Id.* at 346. For another possible interpretation of Judge Hand's argument, see text accompanying notes 254–256 *infra*.

different beliefs about the future.⁴⁵ In commodities speculation and in insurance contracts, for example, neither party could afford to be committed if the other party remained free to wait and see how things turned out, for such a contract could never result in a gain for the committed party. In cases where the motive for a commitment is to induce more efficient reliance, however, this skepticism about one-sided commitments is unwarranted.⁴⁶ As I demonstrated earlier, a more efficient level of reliance increases the expected value of the transaction, and can therefore benefit both parties, even if the other party makes no commitment in return.⁴⁷

Of course, sellers will not *always* benefit from being unilaterally committed to their buyers. Even in cases where a commitment by *S* would induce efficient reliance by *B*, *S* might still prefer not to be committed if her risk aversion is large enough (relative to *B*'s) to outweigh any efficiency gains from *B*'s reliance.⁴⁸ Moreover, in many cases reliance by *B* simply will be inefficient, so there will be no reason for *S* to assume a commitment. For example, the probability of consummating the deal may be too low for reliance to be efficient; too many unresolved details may remain, or too many contingencies may intervene. In other situations, there may be no need for *B* to rely quite so soon. Perhaps nothing would be lost if *B* delayed the reliance decision until some of the contingencies have been resolved. In these examples, reliance by *B* would be inefficient, so *S* would have no reliance-based reason for wanting to be committed.

2. *The measure of damages.*

Some commentators have assumed that if an obligation is based on another party's reliance, the proper measure of damages is the relying party's reliance losses.⁴⁹ From an economic standpoint, however, there is little reason to privilege reliance damages over expectation damages, or over any other possible remedy. Indeed, if we are concerned with inducing *B* to choose an efficient level of reliance, reliance damages may actually be worse than expectation damages. While most remedies give *B* an incentive to choose more than the efficient level of reliance, the reliance measure is often the worst of all in this respect.⁵⁰

Instead, the damage remedy should be chosen giving consideration to its possible effects on all the relevant economic factors. If the parties have differ-

45. See text accompanying notes 19-20 *supra*.

46. For an early recognition that not all offer-and-acceptance problems involve speculation against commodity prices, see Ian R. Macneil, *Time of Acceptance: Too Many Problems for a Single Rule*, 112 U. PA. L. REV. 947, 960-62 (1964).

47. See text accompanying notes 22-24 *supra*.

48. Polinsky, *supra* note 19, at 430-33. See also note 176 *infra* (discussing a possible real-world example).

49. The *locus classicus* is Fuller & Perdue, *supra* note 24. For some recent critiques of this assumption, see Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J. LEGAL STUD. 105, 107-08 (1989); W. David Slawson, *The Role of Reliance in Contract Damages*, 76 CORNELL L. REV. 197, 219-20 (1990).

50. Shavell, *supra* note 21, at 479-80.

ing attitudes toward risk, for example, the damage remedy may affect their riskbearing costs.⁵¹ The damage remedy may also affect the extensiveness of the search for contracting partners,⁵² and the choice from among the available partners;⁵³ or it may affect the parties' incentives to gather other information about the profitability of the proposed transaction.⁵⁴ The damage remedy may also affect the incentives of the party in *B*'s position: his incentive to mitigate losses after a breach by *S*,⁵⁵ for example, or his incentive to try to provoke a breach on *S*'s part.⁵⁶ The damage measure may also affect the relative prices paid by parties who bring different degrees of risk to the transaction, thus generating pooling or cross-subsidization effects.⁵⁷ These effects have all been extensively analyzed in the prior literature, and they are equally relevant here.

The reliance measure's intuitive attraction (to many commentators) probably rests on a different basis. When *S*'s motive for committing herself is to induce efficient reliance by *B*, the reliance measure is the *minimum* measure to which *S* would have to commit herself in order to induce *B* to rely. A commitment to pay a larger measure (such as expectation damages) would be unnecessary, for as long as *B* is guaranteed that his reliance losses will be fully compensated, *B* no longer puts himself at risk by relying on the proposed transaction. If one is not positive that *S* would want to be committed at all, caution might seem to dictate that *S* should not be held liable for any measure of damages beyond the absolute minimum.⁵⁸

The flaw in this intuition, however, lies in its assumption that *S* would not want to commit herself to any liability beyond what is absolutely necessary. If *S* were more risk averse than *B*, *S* might indeed want to commit to no more than the lowest damage measure necessary to induce efficient reliance.⁵⁹ But if some larger damage measure would be more efficient for other reasons—say, if *S* was not very risk averse compared to *B*, and if the larger measure of damages

51. Polinsky, *supra* note 19, at 433-37.

52. Peter A. Diamond & Eric Maskin, *An Equilibrium Analysis of Search and Breach of Contract, I: Steady States*, 10 BELL J. ECON. 282 (1979); P. A. Diamond & Eric Maskin, *An Equilibrium Analysis of Search and Breach of Contract, II: A Non-Steady State Example*, 25 J. ECON. THEORY 165 (1981); see Mortensen, *supra* note 38, at 973-75.

53. Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 630, 650-66 (1988).

54. Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. LEGAL STUD. 401 (1988). For an analysis of some contract formation doctrines from this standpoint, see Mark P. Gergen, *Liability for Mistake in Contract Formation*, 64 S. CAL. L. REV. 1, 19-20 (1990).

55. *E.g.*, Cooter, *supra* note 21, at 11-19; Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967 (1983).

56. Kenneth W. Clarkson, Roger LeRoy Miller & Timothy J. Muris, *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351, 368-72.

57. Ayres & Gertner, *supra* note 17, at 108-18; Gwyn D. Quillen, *Contract Damages and Cross-Subsidization*, 61 S. CAL. L. REV. 1125 (1988). As these articles discuss, this concern may justify limits on unusual or "unforeseeable" damages under the rule of *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854).

58. Obviously, I abstract here from possible measurement problems that might make expectation damages superior even as an estimate of *B*'s likely reliance losses. As many commentators have pointed out, in perfectly competitive markets the reliance and expectation measures (when properly calculated) should be equal. Fuller & Perdue, *supra* note 24, at 62-63.

59. Polinsky, *supra* note 19, at 437-41.

would create more efficient incentives in other respects—then a commitment by *S* to pay that larger damage measure would increase the expected value of the transaction to *S* even more. In such a case, even *S* should have an interest in committing to pay the larger damage measure (making up for her increased exposure to damages by raising the price). As discussed earlier, whenever any legal rule would increase the expected value of a transaction, there should be some price at which both parties would be better off adopting that rule.⁶⁰

For the remainder of the article, therefore, I will largely ignore the question of what remedy should be used when an enforceable commitment is found. Instead, I will concentrate on the more basic question: When will courts find an enforceable commitment of any sort (i.e., a commitment backed up by any remedy at all)? The following section discusses the factors courts would have to consider to determine whether *B*'s reliance would be efficient in any given case.

III. ASSESSING THE EFFICIENCY OF RELIANCE

The preceding section suggested that *S* might prefer to be committed whenever a commitment on her part is necessary to induce efficient reliance by *B*. To implement a default rule that tracks *S*'s likely preferences, therefore, courts must have some way to assess the efficiency of *B*'s reliance in any given case. Unfortunately, this assessment will not always be very easy for the courts. Moreover, even if the courts can make this assessment correctly, *B* will not respond correctly to the resulting incentives unless *B*, too, can figure out what level of reliance is efficient. Each of these problems is discussed below.

A. *Limits on the Information Available to Courts*

It is not always easy for a court to judge the efficiency of *B*'s reliance. As discussed earlier, the efficiency of *B*'s reliance in any actual case will turn on: (1) the extent to which *B*'s reliance would have increased the value of the transaction, if the transaction had been consummated; (2) the extent to which *B*'s reliance increased his losses, if the transaction was not consummated; and (3) the estimated probability, at the time that *B* had to rely, that the transaction would or would not be unconsummated. While factor (2) may be easy for a court to judge after the fact, factors (1) and (3) are likely to be much harder to assess.

Indeed, much of the economic literature on reliance assumes that the expected costs and benefits of a party's reliance are completely inaccessible to the courts, thus making it impossible for courts to implement any legal rule conditioned on the efficiency of *B*'s reliance.⁶¹ This assumption is primarily a heuristic device, though, to let analysts focus on alternative methods of optimizing the parties' reliance incentives. As a description of the real world, the assump-

60. See text accompanying note 37 *supra*.

61. See, e.g., Chung, *supra* note 21. For a less technical discussion (and defense) of this "nonverifiability" assumption, see Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. CAL. INTERDISCIPLINARY L.J. 389, 394-95, 404-06 (1993).

tion is false on its face, because no factual issue is ever *completely* inaccessible to courts. Even if they have no other information to go on, courts can always guess about whether *B*'s reliance was efficient. The accuracy of these guesses will vary, of course, depending on the difficulty of the task and the quality of whatever information the courts have. However, even inaccurate guesses will still affect the parties' incentives, as the parties anticipate recovery with some degree of error. Moreover, even guesses with a high chance of being inaccurate can still produce incentives more desirable than those produced by any alternative regime, in which courts refuse to make such guesses at all.⁶² Ultimately, the desirability of each regime is an empirical question (and a rather difficult one, at that). This empirical question cannot even be addressed by any model that simply posits that the efficiency of *B*'s reliance is "completely" beyond the ability of courts to measure.

Moreover, there are at least two reasons to expect that courts' decisions about the efficiency of *B*'s reliance may not be completely inaccurate. First, I noted earlier that assessing the efficiency of a party's reliance is similar to assessing the efficiency of precautions against accidents under the Learned Hand test.⁶³ That is, relying on a proposed transaction is like taking fewer precautions against an accident: Reliance may turn out to be a wise decision, if nothing goes wrong and the transaction is consummated, but it will turn out to be unwise if something prevents the deal from going through. To be sure, the ability of courts to determine the efficient level of precautions in accident cases has often been questioned.⁶⁴ Still, there is no consensus that assessing the efficiency of precautions in accident cases is entirely beyond courts' abilities, and certainly no consensus that courts should not even attempt such assessments.⁶⁵ If case-by-case assessments of efficiency are at least roughly workable in accident cases, they should be equally workable in cases involving contract formation.

Second, the courts usually do not have to evaluate *all* the possible ways in which *B* might have relied, in order to determine which level of reliance would have been the most efficient. Rather, cases reach the courts only after the fact—that is, only after *B* has chosen some particular form of reliance—so

62. See Gillian Hadfield's recent consideration of the circumstances under which judicial review of franchise termination cases could still improve franchisor and franchisee incentives, even if the courts' decisions reflect a high probability of error. Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159, 164, 171-83 (1994). For similar analyses of the effect of inaccurate determinations on parties' incentives in tort cases, see STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 79-82 (1987); Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279, 285-87 (1986). For a less technical discussion, see John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 966-67 (1984).

63. See text accompanying note 24 *supra*.

64. For representative criticisms, see Richard A. Epstein, *The Risks of Risk/Utility*, 48 OHIO ST. L.J. 469 (1987); James A. Henderson, Jr., *Judicial Review of Manufacturers' Conscious Design Choices: The Limits of Adjudication*, 73 COLUM. L. REV. 1531 (1973).

65. Cf. Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 32-36 (1972) (suggesting that courts, even when they do not explicitly measure the costs and benefits in negligence cases, may be roughly or intuitively balancing those costs and benefits and thus reaching an approximately efficient result).

usually courts will only need to assess the efficiency of the reliance *B* actually chose.⁶⁶ Moreover, there will surely be some cases where this evaluation is not difficult at all. In some cases, it may be obvious that *B* began to rely too soon; in others, it may be obvious that it was entirely appropriate for *B* to rely as he did. In these cases, at least, a default rule that imputes a commitment when *B*'s reliance was efficient should not be too difficult for courts to administer.

B. *Limits on the Information Available to the Parties*

Even if courts, deciding cases after the fact, could perfectly tell whether *B*'s reliance has been efficient, there would still be problems if *B* himself was unable to judge the efficiency of his reliance at the time that he needed to act. If *B* didn't know the probability that the transaction would be consummated, for example, or if he didn't know all the potential benefits of some form of reliance, he would not be able to decide whether it was efficient for him to rely.

Of course, even when *B*'s information about the efficiency of reliance is imperfect, it may still be as good as (or better than) the information that anybody else possesses at the time *B* has to act. If so, *B* should base his reliance decision on his best estimate of the relevant costs and benefits, for this is the most efficient decision the law could hope to induce, given the limited information available at that time.⁶⁷ One way to protect *B* in this situation is to have courts judge the efficiency of *B*'s reliance based on the facts *as they appeared to B* at the time he had to act. This standard is the most natural interpretation of any legal test referring to "reasonable" reliance.⁶⁸ Under such a test, even if *B* probably should not have relied (because the courts, with the benefit of perfect hindsight, can now see that the transaction was doomed to fail), the courts should still treat *B*'s reliance as reasonable, and should still infer that *S* would have wanted to be committed in order to induce *B* to rely.

In other cases, though, *B*'s information about the relevant probabilities may be worse than the information *S* already possesses. For instance, *S* might have better information about the various pitfalls that could prevent consummation of the transaction, or she might have better information about how much a particular act of reliance would add to the parties' joint gains if and when the deal is consummated. Even in these cases, however, a rule that judges the efficiency of *B*'s reliance based on the information available to *B* may still be desirable. I have shown elsewhere that if *S*'s information is superior to *B*'s, and

66. In negligence cases, an analogous simplification permits courts to consider the efficiency of a single untaken precaution, rather than trying to assess the entire range of possible precautions. For a discussion of this aspect of negligence law, see Mark F. Grady, *Proximate Cause and the Law of Negligence*, 69 IOWA L. REV. 363, 376-78 (1984).

67. I assume here that *B* does not have the option of waiting until he has more information before deciding whether to rely. As discussed earlier, see note 22 *supra* and accompanying text, in any case where *B* would lose nothing by delaying his reliance until some of the uncertainties had been resolved, it would be inefficient for *B* to begin relying at any earlier time so *S* would have no reason to want to commit herself.

68. For a discussion of the analogous issues in tort law—i.e., whether a party's negligence or contributory negligence should be judged on the basis of what that party could have known at the time it acted, or what is known later when the case is eventually tried—see Guido Calabresi & Alvin K. Klevorick, *Four Tests for Liability in Torts*, 14 J. LEGAL STUD. 585, 587-92 (1985).

if *S* can easily communicate her information to *B*, such a rule gives *S* an incentive to share her information with *B*, thereby improving *B*'s information and enabling him to choose a more efficient level of reliance.⁶⁹

To illustrate this incentive, suppose that *S* knows (while *B* does not) that the probability of consummating a given transaction is extremely low—so low that it would not be efficient for *B* to rely on the transaction in any way. If courts were to infer a commitment based on whether reliance by *B* was *in fact* efficient, *S* would have an incentive to say nothing and allow *B* to rely. By saying nothing, *S* could share in the benefits of *B*'s reliance if the transaction were successful, while still avoiding any liability (on the ground that *B*'s reliance was not, in fact, efficient) if the transaction fell apart. But if courts were to judge the situation based on what *B* knew at the time, *S* would then face liability in such a case (on the ground that *B*'s reliance appeared to him to be efficient). *S* would then have an incentive to correct *B*'s misinformation in order to discourage him from relying in an inefficient way. In effect, *S*'s potential liability in such a case forces her to internalize both the expected benefits and the expected costs of *B*'s actions, thereby giving her an incentive to ensure that *B* knows enough to act efficiently.⁷⁰

1. *When one party recommends reliance.*

Of course, even if the courts judge the efficiency of *B*'s reliance on the basis of the facts *B* knows at the time he had to act, *B* still may have difficulty evaluating those facts to determine whether it is efficient for him to rely. Similarly, the court may have difficulty processing those facts afterward, to determine whether *B* was justified in relying in light of the facts known to him. There is one subset of cases, however, where it is easy both for *B* and for the court to determine what level of reliance appeared efficient at the time that *B* had to act. This subset is the class of cases where *S* has superior information about the level of reliance likely to be efficient, and *S* urges *B* to rely in a particular way. In these cases, *S*'s recommendation can be interpreted as an assertion that the steps she recommended would in fact be efficient, increasing the expected value of the transaction. If *B* takes the recommended steps, courts should treat *B* as having relied efficiently, based on the information available to him at the time (which includes *S*'s recommendation). A rule that inferred a binding commitment in such a case would then give *S* an incentive to use her superior information to recommend only efficient reliance.

The *Red Owl* case⁷¹ is probably the most striking example of this fact pattern. In that case, the representatives of a grocery store chain almost surely had the best information about the probability that they would award a franchise,

69. Richard Craswell, *Performance, Reliance, and One-Sided Information*, 18 J. LEGAL STUD. 365 (1989).

70. *Id.* at 378-85, 390-94. As the discussion there shows, the exact effect on *S*'s incentives depends in part on the measure of damages for which *S* is held liable, and on the extent to which legal rules can check what might otherwise be an incentive on *B*'s part to overrely.

71. *Hoffman v. Red Owl Stores*, 133 N.W.2d 267 (Wis. 1965). For further discussion of *Red Owl*, see text accompanying notes 35-36 *supra*.

and they recommended each of the steps that the would-be franchisee took in reliance on that prospect. Thus, even if a court found that the franchisee's reliance in that case was in fact inefficient, it might nevertheless be appropriate to infer a commitment by *S*. Such a rule would induce *S* either to correct *B*'s misinformation or to disclaim any commitment entirely ("We'd like you to rely, but you should understand that we're not promising anything, so you'll be relying at your own risk.").

Implying a commitment on this basis—that is, implying a commitment whenever *S* has superior knowledge and has recommended a particular level of reliance—is not the same as holding *S* liable for misrepresentation. A misrepresentation theory holds *S* liable whenever she "knows (or should know) that [her] promise will appear to be more reliable than it is."⁷² But even when *S* recommends a particular level of reliance, thereby implying that consummation of the transaction is likely, she is not implying that consummation of the transaction is absolutely certain. As a result, any subsequent failure to consummate the transaction would not by itself be sufficient to establish that *S*'s earlier recommendation had *overstated* the true probability of a successful consummation.⁷³ Instead, the only way to tell if *S*'s recommendation implicitly overstated that probability is to compare (1) the probability of consummation implicitly presupposed by *S*'s recommendation (i.e., the probability that would be necessary to make *S*'s recommendation sensible), with (2) the true probability of consummation. Unfortunately, each of these probabilities is likely to be difficult to discern. Indeed, a court cannot identify the probability of consummation presupposed by *S*'s recommendation without knowing the potential costs and benefits of the reliance that *S* recommended. If a court knows all of these facts, it would also know enough to determine the efficient level of reliance, so this application of a misrepresentation theory would do nothing to reduce the informational demands on the courts.

By contrast the rule under consideration here is closer to a form of strict liability. Under this rule, *S* would be deemed committed to *B* (unless she has explicitly disclaimed a commitment) whenever (1) she is better informed than *B* about the efficient level of reliance; and (2) she recommends a particular level of reliance, which *B* proceeds to carry out. Moreover, this commitment would attach regardless of whether her recommendation implied anything false about any of the underlying probabilities. This test thus does not require the court to determine the true probability of consummation, or the true value of any other factors bearing on the efficiency of *B*'s reliance.

72. Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations*, 15 HOFSTRA L. REV. 443, 491 (1987).

73. Cf. Wils, *supra* note 25 (discussing *Red Owl* and other promissory estoppel cases as cases in which the defendant had painted a "rosy picture" of the likelihood of consummation). Wils simply assumes, without any justification, that the pictures the defendants painted were sufficiently rosy to be false. For another criticism of the use of misrepresentation doctrine in contract formation cases, see Gergen, *supra* note 54, at 34-46 (arguing that liability should attach only when the misrepresentation is in some way negligent).

A default rule of this type is one instance of what Ian Ayres and Robert Gertner have labeled a "penalty default" rule.⁷⁴ That is, under this rule the courts would not attempt to determine whether a commitment would *in fact* have been efficient, or whether a commitment would have been agreed to by fully informed parties. Instead, the courts would infer a commitment in a way that is slanted against the better informed party (*S*), to give that party an incentive to share her information with the other side. When one party has superior information—and especially when that party recommends a particular form of reliance—such a rule should be relatively easy for courts to apply.

2. *When one party has superior information.*

It might be argued that courts should infer a commitment (as a form of penalty default) *whenever B* has relied and *S* is better informed than *B*, even when *S* has not affirmatively recommended any particular level of reliance. The rationale for this rule would be similar to the one just discussed: The rule would give *S* an incentive to share her information with *B*, to avoid an implied commitment whenever reliance by *B* would be inefficient. The difference is that this rule would encourage such information-sharing in *any* case where it is inefficient for *B* to rely, not merely in those cases where *S* has expressly recommended a specific level of reliance.⁷⁵

While much can be said in favor of this sort of penalty default, the rule also has drawbacks. Such a rule would achieve its desired effect only when (1) the cost of passing information between *S* and *B* is sufficiently low to make such information sharing worthwhile,⁷⁶ and when (2) it is easy to tell when *S* has shared "enough" information with *B* to avoid the operation of this default rule. The costs of passing information will normally be low when *S* is already in communication with *B*, as when she is recommending particular forms of reliance. However, the costs of passing information may be higher if the parties are not in direct communication, or if the necessary information is highly technical and cannot easily be conveyed. In the latter situation, it may also be difficult to tell when *S* has disclosed enough information to *B* to satisfy the burden. For example, if *S* says that she will "probably" perform, should this

74. Ayres & Gertner, *supra* note 17, at 95-107.

75. This rationale seems to be behind the suggestion made recently by Juliet P. Kostritsky. Kostritsky proposed that the law recognize an implied term under which a promisor would assume liability "for the reasonable value of *whatever* actions you [the promisee] take in furtherance of our proposed transaction prior to my warning you that my willingness to make the projected promise has changed." Kostritsky, *supra* note 25, at 672 (emphasis added). Kostritsky does not appear to limit her rule to cases where *B*'s actions in reliance on the proposed transaction are efficient (unless "in furtherance of" the proposed transaction is interpreted as "efficiently in furtherance of"). To the contrary, the proposal as written would seem to attach liability whenever any *B* relied on any *S*—even if *B*'s reliance was completely unjustified in terms of its potential costs and benefits, and (apparently) even if *B* knew that his reliance was inefficient. This can only be justified if we assume that *S*'s information is superior to or at least as good as *B*'s, and that *S* should therefore bear the responsibility for warning *B* off if reliance by *B* would be inefficient.

76. Cf. Lucian Ayre Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORG. 284, 287-92 (1991) (describing the circumstances under which the costs of communicating information about one party's possible consequential damages could make such information-sharing not cost-effective).

assertion count as an adequate warning if the actual probability of performance is only 51 percent? Perhaps not, if *S* could have given *B* the exact 51 percent figure. But what if even *S* does not know the exact numerical odds of performance, and instead knows only the highly technical facts from which an expert might form a rough estimate of the odds? The difficulty courts face in deciding analogous questions under products liability law, when warnings about product safety are at issue, suggests that this sort of standard would not be very easy to administer.⁷⁷

By contrast, neither of these problems arises if *S* is already in direct communication with *B*, and if *S* recommends a specific form of reliance. Thus, we can at least say that the case for this sort of penalty default is strongest when *S* explicitly recommends a particular form of reliance to *B*. As the following section will demonstrate, many of the cases inferring a commitment by *S* fall into exactly this category.

IV. RELIANCE IN THE CASES

The following survey of the case law does not seek to test a "hypothesis" that courts are systematically more inclined to find a commitment when *B* has relied efficiently. As discussed in Part II, there are several factors other than the efficiency of *B*'s reliance that can affect the desirability of a commitment. Perhaps as a result, courts sometimes find an enforceable commitment even though *B* has not relied at all, and sometimes refuse to find a commitment even though *B*'s reliance may have been efficient. Many (perhaps most) contract formation opinions do not even say whether *B* relied on the proposed transaction, thus making it impossible to tell whether a commitment might have been justified on that ground.

As a result, the following survey has several more modest aims. First, it attempts to isolate one factor—the efficiency of *B*'s reliance—which *often* seems to play a role in courts' decisions. These cases provide precedential support for the proposition that courts are entitled to consider the efficiency of *B*'s reliance as one factor that is relevant in applying the various contract formation doctrines.

Second, the cases discussed below also show how the efficiency of *B*'s reliance can provide a principled basis for *justifying* a court's application of these contract formation doctrines. This principle is significant because the legal doctrines themselves generally do not provide any such principled basis for justifying a decision. As I discuss at more length below, most of the legal doctrines are so vague, or have so many exceptions, that decisions for or against an enforceable commitment could be justified with almost equal ease.

77. For a criticism of the products liability decisions, see James A. Henderson, Jr. & Aaron D. Twerski, *Doctrinal Collapse in Products Liability: The Empty Shell of Failure to Warn*, 65 N.Y.U. L. REV. 265, 296-303 (1990) (arguing that juries are generally incapable of accurately measuring the marginal costs and benefits of adding new warnings). Kostritsky, *supra* note 25, at 673 n.213, recognizes the uncertainties and administrative difficulties that might be created by her proposal, but defers discussion of these difficulties to a future article.

Third, and finally, the cases surveyed below shed light on whether courts *ought* to be trying to judge the efficiency of *B*'s reliance on a case-by-case basis. This question turns, in part, on how difficult it is for courts to tell whether *B*'s reliance was efficient in any given case, and the cases discussed below provide plenty of examples of those difficulties. But the cases discussed below also demonstrate the range of issues that would have to be addressed by any alternative to a case-by-case analysis, including any regime of bright line rules.

A. *Finding an Offer*

It is standard hornbook law that if *S* has made an offer to *B*, *B* can bind *S* simply by accepting the offer. By contrast, if *S*'s statements are not interpreted as an offer—for example, if they are instead interpreted as “mere inquiries”—*B* has no power to bind *S*, so *S* remains free to withdraw at any time. A court's decision to interpret *S*'s statements as an offer will thus affect the extent to which *S* is committed to *B*, and the extent to which *B*'s reliance on the proposed transaction will be protected.

In cases where *S* has not clearly stated whether her communication is intended as an offer, there are no hard-and-fast rules for interpreting her statement. The *Restatement (Second)* adopts a test which simply begs the question: A communication is an offer if it is “so made as to *justify* another person in understanding that his assent to that bargain is invited and will conclude it.”⁷⁸ Whether and when the other party would be justified in so concluding is left for decision on a case-by-case basis. Sometimes courts mention the definiteness or completeness of the communication as a relevant factor: Communications leaving open many of the terms of the deal are less likely to be interpreted as legal offers. But it is not hard to find cases where courts find that relatively indefinite communications are offers, or that relatively definite communications are not offers.⁷⁹

My claim is that courts (sometimes) decide whether to interpret a communication as an offer based on the effect an offer would have on *B*'s reliance incentives. Under this approach, a court would interpret a communication as an offer whenever an offer would be likely to induce a more efficient level of reliance than a “mere inquiry” would. If an offer would indeed induce a more efficient level of reliance, then (for the reasons given earlier⁸⁰) it should be in *S*'s interest to give *B* the higher level of commitment represented by a legal offer. These are the cases where it would make sense to interpret *S* as having made a legal offer rather than a “mere inquiry.”

78. RESTATEMENT (SECOND) OF CONTRACTS § 24 (1979) (emphasis added).

79. Compare, e.g., *Moulton v. Kershaw*, 18 N.W. 172 (Wis. 1884) (no offer) with *Fairmount Glass Works v. Crunden-Martin Woodenware Co.*, 51 S.W. 196 (Ky. 1899) (offer). See generally JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 34 (3d ed. 1990) (criticizing the definiteness test for offers as failing to accurately reflect the case law). For a discussion of “definiteness” (or completeness) as an independent requirement for an enforceable contract, rather than merely as a test for what constitutes an offer, see note 229 *infra* and accompanying text.

80. See text accompanying notes 35-39 *supra*.

To be sure, the effect of an offer on *B*'s reliance incentives is complicated, because an offer by *S* does not guarantee that *B*'s reliance will be protected. If *B* relies without first accepting the offer, *S* may still revoke her offer (depending, of course, on the rules governing revocability, and also on the rules defining what counts as an acceptance).⁸¹ Still, a ruling that *S* has made an offer does at least give *B* a better *chance* at protection than he would have under a ruling that *S*'s statements were not an offer at all. This increased chance of protection should reduce the risk to *B* of relying on the transaction, thus giving *B* an incentive to choose a higher level of reliance.

Notice, too, that from *S*'s point of view, an offer entails some risk that she might later change her mind but be unable to withdraw from the proposed transaction. As Corbin noted long ago, even offers which are *legally* revocable may be irrevocable in practice, if the offeror is unable to give notice of her revocation before the offeree accepts.⁸² In this respect, every "offer" has effects that are similar (though perhaps lesser in degree) to any other one-sided commitment. If we really believed, as Judge Learned Hand seemed to,⁸³ that one would rarely accept a risk of being bound without receiving either a payment or a legally enforceable commitment in return, we should almost never observe anyone making a legal offer.

In fact, we frequently observe parties making legal offers. In at least some cases, then, the risk that an offer places on *S* must be outweighed by the benefits she expects from giving *B* the increased protection of a legal offer. Perhaps *B* must decide whether to rely on the proposed transaction with *S* (say, by turning down other offers), and perhaps *B* would be unwilling to take that step unless he has the prospect of protecting himself by accepting *S*'s offer. If *B*'s relying in this way would be efficient—that is, if the likelihood that *B* and *S* will eventually consummate their deal is sufficiently high that it makes sense for *B* to turn down the other offers—then even *S* will benefit from giving *B* the increased certainty that he needs in order to rely in this way. If *B*'s reliance would be inefficient, however, there would then be no reason for *S* to make a legal offer unless and until *B* *does* need some form of increased protection in order to rely.

1. *Offers in general.*

This reasoning at least occasionally influences courts' willingness to interpret a communication as an offer. For example, in *Motel Services, Inc. v. Central Maine Power Co.*,⁸⁴ an electric power company announced a rebate to builders of houses heated by electricity. A construction company under contract to a local housing authority persuaded the authority to alter the contract to allow electric heating, in order to take advantage of the rebate. Not only was

81. The rules governing revocability are discussed in the text accompanying notes 182-228 *infra*. The rules governing acceptance are discussed in the text accompanying notes 117-181 *infra*.

82. Corbin, *supra* note 7, at 187.

83. See *James Baird Co. v. Gimbel Bros.*, 64 F.2d 344, 346 (2d Cir. 1933). For further discussion of this case, see text accompanying note 43 *supra*.

84. 394 A.2d 786 (Me. 1978).

this action exactly the kind of reliance the rebate was intended to induce, it also seems unlikely that the construction company would have relied in this way if it had thought the power company could have withdrawn the rebate at any time. Not surprisingly, the court held that the advertised rebate was indeed an offer, and that the construction company had accepted the offer by building the houses with electric heat.⁸⁵

In another case, a buyer of corporate bonds advertised a stated price, and asked interested sellers to deliver their bonds to a New York bank.⁸⁶ One seller did so, only to have the buyer attempt to back out of the deal after the market price fell. It is hard to tell from the opinion how much expense was incurred in delivering the bonds to New York, or whether the prospective seller would have been willing to rely in this way without the security of a legal offer. But the court seemed to treat these reliance factors as important, rejecting the buyer's claim that his advertisement was a mere solicitation of offers to sell. As the court stated:

We cannot believe that the ordinary business man could be expected to read the advertisement as an invitation to send bonds from wherever he might be to New York on the *chance* that when they got there the advertiser would accept his offer to enter into negotiations for the purchase of bonds.⁸⁷

On the other hand, in cases where there is no need for *B* to rely, or where reliance by *B* would not be efficient, courts are sometimes less inclined to treat *S*'s communication as an offer. For example, in *Lonergan v. Scolnick*,⁸⁸ a seller in California sent a form letter to a potential buyer in New York describing some land the seller had for sale. After further correspondence, the buyer wrote back purporting to accept the seller's "offer," but by this time the seller had already sold the land to another buyer. The court held that the seller's letter was not an offer, so no contract was formed when the buyer attempted to accept. In this case, the buyer did take some steps in reliance on the transaction (he opened an escrow account and deposited \$100), but reliance at that time probably was not efficient. Nothing indicated that it was important to set up the escrow so early rather than wait until the seller confirmed the deal. Indeed, the seller had told the buyer that there were other potential purchasers sched-

85. This holding was to some extent dicta, since the power company never attempted to withdraw the offered rebate. The actual dispute was between the construction company and the local housing authority, and the precise issue was whether the rebate should go to the construction company (on the ground that it had earned the rebate before it transferred the houses to the local authority) or to the local authority. Still, the court's ruling implies that the power company had no right to withdraw the offered rebate once the construction company had accepted. While such extrapolations should always be treated with care, I have no reason to believe the court would have ruled differently if the power company had attempted to withdraw.

86. *R.E. Crummer & Co. v. Nuveen*, 147 F.2d 3, 4 (7th Cir. 1945).

87. *Id.* at 6 (emphasis added); see also *Jaybe Constr. Co. v. Beco, Inc.*, 216 A.2d 208, 211 (Conn. Cir. Ct. 1965) (emphasizing the general contractor's foreseeable reliance before holding that the subcontractor's price quotation constituted a legal offer); *Maryland Supreme Corp. v. Blake Co.*, 369 A.2d 1017, 1023-25 (Md. 1977) (finding that subcontractor's bid reasonably induced reliance and constituted a definite and certain offer); *Coffman Indus. v. Gorman-Taber Co.*, 521 S.W.2d 763, 772 (Mo. Ct. App. 1975) (holding that promise of payment, which induced reasonable reliance, warranted the application of the rule of promissory estoppel).

88. 276 P.2d 8, 9 (Cal. Ct. App. 1954).

uled to view the land, so the buyer knew enough to realize that the probability of consummating the transaction was relatively small. In short, this is a case where *B*'s actions did nothing to increase the expected value of the transaction. Consequently, there was no reason for *S* to want to give *B* the protection provided by a legal offer, and the court found no legal offer.

2. *Mass advertisements as offers.*

Peter Klik has applied a similar analysis to the question of whether courts should interpret public advertisements as offers.⁸⁹ A consumer acts in reliance on a published advertisement when choosing to travel to the advertiser's store. The trip has the upside potential associated with any reliance investment, since a trip to the store is usually a prerequisite to consummation of the purchase. But traveling to the store also has a downside potential, so consumers may be less willing to take this step if the seller can withdraw the advertisement at any time. Not only does traveling to the store have direct costs of its own, but—perhaps more important—once the consumer has incurred the cost of travel, the store's salespeople may try to raise the price or steer the consumer to some more expensive product (the so-called "bait and switch" technique). If stores are free to engage in such tactics, consumers will be less willing to rely on published advertisements by visiting the advertisers' stores. Thus, even advertisers would sometimes benefit from having their ads interpreted as legal offers, to give consumers the assurance they need to rely efficiently.

Of course, in any given case some or all of the conditions just described may not hold. For example, the probability of successful consummation may be so low that it would be inefficient for most consumers to rely by driving to the store (e.g., the store might have an extremely limited supply). In that case, it would also be less efficient for the store to try to induce its customers to rely, so there would be less reason to interpret the store's advertisement as a legal offer. But these possibilities simply confirm my methodological point. Understanding the incentives for efficient reliance can provide a basis for deciding how to interpret the parties' communications, whenever those communications do not themselves settle the issue.

Admittedly, it is hard to say how often such concerns influence courts in cases involving mass advertisements. Consumer advertisements rarely give rise to appellate cases; the results of those that do are rather mixed;⁹⁰ and the textbook favorite for showing that advertisements can be offers did not involve any desired reliance by the particular consumer who brought the suit.⁹¹ Still, at least some of the cases treating consumer advertisements as offers have emphasized the seller's apparent desire to induce consumers to visit the seller's show-

89. Peter Klik, *Mass Media and Offers to the Public: An Economic Analysis of Dutch Civil Law and American Common Law*, 36 AM. J. COMP. L. 235 (1988).

90. For citations to cases on each side of the "advertisement as offer" question, see 1 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 4:7 (Richard A. Lord ed., 4th ed. 1990).

91. *Lefkowitz v. Great Minneapolis Surplus Store, Inc.*, 86 N.W.2d 689 (Minn. 1957).

room, and have sometimes expressed concern about the possibility of "bait and switch" tactics.⁹²

The pattern seems even stronger in cases where the consumer's reliance goes beyond a visit to the dealer's showroom or store. For example, when an auto dealer's advertisement for end-of-the-year 1954 cars announced that any purchaser would be allowed to trade his purchase "even" for a 1955 car when the new models arrived, a court treated this advertisement as an offer, and held the dealer bound to a consumer who bought a 1954 model with the belief that he would be able to exchange it.⁹³ The classic case of *Carlill v. Carbolic Smoke Ball Co.*,⁹⁴ where the seller advertised a £100 reward to anyone who used its product for two weeks but still contracted influenza, also fits into this category. In each case, the party in *S*'s position wanted to induce reliance by *B*, and probably would not have been able to induce that reliance if it had reserved the right to withdraw at any time.

B. *The Duration of the Power of Acceptance*

As noted earlier, a ruling that *S* has made an offer does not guarantee that *B*'s reliance will be protected. In order to lock in the deal, *B* must accept the offer in a proper manner, and within a proper period of time—that is, before *S* has revoked the offer, and before the offer has terminated for some other reason. The standard rule holds that, even if *S* never revoked her offer,⁹⁵ *B*'s power of acceptance ends if he does not accept the offer within a "reasonable time." What is "reasonable," however, depends "on all the circumstances existing when the offer and attempted acceptance are made."⁹⁶ *B*'s power of acceptance also ends if *B* rejects the offer or makes a counteroffer,⁹⁷ or if *S* dies or becomes legally incompetent.⁹⁸

The duration of *B*'s power of acceptance can be viewed as a choice of appropriate default rules. In some cases, *S*'s offer will specify just how long it will remain open. If *S*'s offer is silent on this point, however, the courts will have to fill the gap themselves. One way to do so is to adopt some arbitrary,

92. *E.g.*, *Izadi v. Machado (Gus) Ford, Inc.*, 550 So. 2d 1135, 1139-40 (Fla. Dist. Ct. App. 1989) (finding a dealer's advertisement to be part of its bait and switch strategy). *See also Harris v. Time, Inc.*, 237 Cal. Rptr. 584 (Ct. App. 1987) (involving a sweepstakes envelope designed to mislead the recipient into thinking he had won, thereby inducing him to open the advertiser's envelope). As the *Harris* court stated, "At a time when our homes are bombarded daily by direct mail advertisements and solicitations, the name of the game for the advertiser or solicitor is to get the recipient to open the envelope." *Id.* at 588. The court ruled that the invitation on the outside of the envelope did constitute a legal offer, but ultimately dismissed the recipient's claim, partly on the ground that the reliance involved in opening the envelope was too small to justify legal relief under the maxim *de minimis non curat lex*. *Id.* at 589.

93. *Johnson v. Capital City Ford Co.*, 85 So. 2d 75, 79 (La. Ct. App. 1955). The bond-purchasing case, *R.E. Crummer & Co. v. Nuveen*, 147 F.2d 3, 4 (7th Cir. 1945), *see text* accompanying notes 86-87 *supra*, also involved an advertisement that was held to be an offer.

94. [1893] 1 Q.B. 256 (Eng. C.A. 1892).

95. Doctrines limiting *S*'s ability to revoke her offer are discussed in Parts IV.C and IV.D.

96. RESTATEMENT (SECOND) OF CONTRACTS § 41(2) (1979). For a discussion of how courts have interpreted "reasonable time," *see text* accompanying notes 101-104 *infra*.

97. *Id.* §§ 39, 59. For a discussion of counteroffers, *see texts* accompanying notes 112-116, 137-143 *infra*.

98. *Id.* § 48.

bright line rule—for example, a rule that all offers expire after exactly three days, or the often quoted “rule” that offers made in face-to-face conversation last no longer than the conversation itself.⁹⁹ This bright line approach would encourage the parties to contract around the arbitrary rule, whenever the time for acceptance stated in the rule was inefficient.¹⁰⁰

Another approach to filling this gap, however—the approach I consider here—is to ask how long a party in *S*’s position would have wanted her offer to remain open. If we take this approach, we encounter issues very similar to those discussed in the preceding subsection of this Part. The longer an offer remains open, the greater the risk of an undesirable outcome for *S*, because there is always a chance that *B* will accept the offer at the same time that something happens to change *S*’s mind about the deal, thus leaving *S* bound to a contract she would prefer to avoid. If we really believed that no party would voluntarily accept such a risk without being paid for it, or without receiving some legal commitment from *B* in return, we would have to conclude that any *S* who has not been paid would never want her offer to stay open beyond the shortest possible time. Indeed, as the preceding subsection discussed, we would have to conclude that any *S* who has not been paid would never want to make an offer at all.

The counterargument, of course, is that *S* has an interest in accepting this risk if doing so would give *B* more security, and if increased security would induce *B* to rely in some way that will increase the expected value of the transaction. Thus, if courts are trying to determine the duration of an offer in a way that matches what the parties themselves would prefer, they should let the offer remain open whenever reliance by *B* would be efficient. I now consider the extent to which courts have employed this case-by-case approach.

1. *Lapse after a “reasonable time.”*

Most opinions deciding what counts as a reasonable time are conclusory: They describe what happened, then baldly conclude that the amount of time which elapsed between *S*’s offer and *B*’s acceptance was or was not reasonable. Further, those opinions that do discuss the issue in any depth usually focus on the risk or hardship to the *offeror*, and not on the relative importance of the offeree’s reliance incentives. For example, when the offer concerns a commodity whose price fluctuates rapidly, courts sometimes say that the duration of the offer should be short, because otherwise the offeror might be bound to a price that was no longer favorable to her.¹⁰¹

99. *Id.* § 41 cmt. d, illus. 4 (1979). As Melvin Eisenberg has pointed out, this so-called “rule” rests on a very small number of cases, many of which could be explained on other grounds. Eisenberg, *supra* note 9, at 1153-55; see also *Ganley v. G&W Ltd. Partnership*, 409 A.2d 761 (Md. Ct. Spec. App. 1980) (treating the offeree’s failure to accept or reject the offer before the end of the conversation as acceptance by silence).

100. I will discuss the merits and demerits of this bright-line approach in Part V.

101. See, e.g., *Minnesota Linseed Oil Co. v. Collier White Lead Co.*, 17 F. Cas. 447, 449 (C.C.D. Minn. 1876) (No. 9635) (focusing on the probability of sudden and great fluctuations in the market in deciding which rule to apply); *Piland Corp. v. REA Constr. Co.*, 672 F. Supp. 244, 247 (E.D. Va. 1987); *Coleman v. Davies*, 235 P.2d 199, 202-03 (Wash. 1951).

This rationale for adopting a shorter reasonable time may be sound, as far as it goes. Even in a market where prices fluctuate rapidly, however, an offeror might still be willing to commit to a certain price in advance if doing so were the only way she could induce the offeree to rely, thereby increasing the expected value of the transaction. After all, if the offeree incurs expense in reliance on the offer, there is less danger that the offeree will pull out of the deal simply to take advantage of a small price swing. From this standpoint, it seems significant that most of the cases citing the fluctuating market rationale and adopting a short reasonable time do not appear to have involved any substantial reliance by the offeree.

More important, the argument that risk of hardship to the offeror justifies a relatively short "reasonable time" fails to explain why the courts should ever adopt a *longer* reasonable time. Even if a commodity's price does not fluctuate suddenly and rapidly, it is still somewhat risky for *S* to leave the offer open for *any* length of time. Thus, there must be something on the other side of the balance that prevents the reasonable time from being reduced to zero. The other side of the balance might be the recognition that almost every offer is intended to induce *some* degree of reliance, for merely spending time thinking about an offer is one form of relationship-specific investment. As a result, perhaps most *S*'s who are willing to make an offer would be willing to give *B* at least some time to think the offer over.¹⁰² But this rationale would often justify only a relatively short period of time, and courts often hold offers open for longer than that.

Significantly, in at least some cases where courts have held the offer open for a period longer than the bare minimum necessary for the offeree to think it over, the offeror wanted to induce more substantial reliance by the offeree. For example, in one case an employee of a state's social services department wanted to take a leave of absence and return to school for a master's degree. Rather than grant a leave, which would have required the department to keep his position vacant, the department instead asked the employee to resign, promising to reappoint him when he returned if there was a vacancy.¹⁰³ The employee resigned, took one year to get his master's degree, spent nine or ten months working at two veterans' hospitals to receive further training, and then asked for his old job back. When the department refused to reinstate the employee, in spite of available vacancies, the court held that the ten-month delay was not long enough to cause the department's offer to lapse. Significantly, there was evidence that the department originally made their offer because they wanted to encourage the employee to continue his education, as that would

102. In this regard, consider *Brown v. Noland Co.*, 403 S.W.2d 33 (Ky. 1966), where an insurance company made an offer to settle litigation against one of its insureds, and urged the recipients of its offer to "take their time and consider the offer and advise whether it was accepted or rejected at their convenience . . ." *Id.* at 35 (emphasis added). The recipients did not accept the settlement offer until after (unbeknownst to them) the statute of limitations on their original claim expired. The court held that a jury could decide whether the recipients had accepted the offer within a reasonable time.

103. *Becker v. Missouri Dept. of Social Servs.*, 689 F.2d 763, 765 (8th Cir. 1982) ("[W]e will be willing to go on record to allow you a choice of any position available at your rank with the agency at the time you desire to return.").

make him a more effective employee on his return. This suggests that the department (a) believed the employee's reliance to be efficient, and (b) believed the employee would not have relied in this way without a binding commitment.

In another case, a surety company told a subcontractor that it would pay the subcontractor's claim (the general contractor having defaulted) as soon as the subcontractor settled a dispute with one of its suppliers. The surety made this offer just two months before the statute of limitations would expire, which would bar the subcontractor from suing the surety. On the strength of the surety's offer, the subcontractor refrained from filing suit and instead tried to settle the dispute with its supplier. Even though these settlement negotiations lasted two and a half years, the court held that the subcontractor could still accept the surety's offer.¹⁰⁴ If the surety made the offer to induce the subcontractor to refrain from filing suit at once (as the court assumed), then the surety would have wanted the subcontractor to know that the offer would still be open after the statute of limitations expired. Otherwise, the offer would not have induced the desired reliance.

2. *Lapse after the offeror's death.*

A similar analysis can be applied to the rule that an offer instantaneously lapses when the offeror dies or becomes legally incompetent. This rule, too, is merely a default rule, since the offer can always provide that it terminates earlier or later. Since this default rule is framed in absolute terms, it does not give courts much discretion to decide whether any particular offer should stay open longer in order to promote efficient reliance. Still, the automatic lapse rule has often been criticized,¹⁰⁵ and when courts have refused to adopt or extend it, they have usually employed reliance-based arguments very similar to those considered here.

The case against the automatic lapse rule is as follows. It is true that the automatic lapse rule reduces the potential risk to the offeror, since it eliminates the possibility that her estate will be bound to a deal in which she no longer has any interest. If we thought that no offeror would ever accept such a risk (without being paid), we would have to conclude that no offeror would ever want her offer to survive beyond her death. As I have argued in preceding sections, however, an offeror who limits her exposure in this way may not induce the offeree to rely, even where such reliance would increase the expected value of the transaction to both parties. In such a case, a rational offeror would want to give the offeree the security of an offer that would not automatically expire upon the offeror's death.

Significantly, these arguments have persuaded some courts not to adopt or extend the automatic lapse rule. For example, the Connecticut Supreme Court

104. *Coffman Indus. v. Gorman-Taber Co.*, 521 S.W.2d 763, 771 (Mo. Ct. App. 1975). The court also rejected the surety's argument that its conversation with the subcontractor should not be interpreted as a legal offer, *id.* at 770, as might be expected, given the analysis earlier in this article. The court also held that the subcontractor's settlement negotiations barred the surety from revoking its offer, *id.* at 772-73, for reasons discussed in Part IV.D.

105. For an early critique, see Corbin, *supra* note 7, at 198-99.

refused to apply the rule to a case where shareholders of a corporation had given a bank a continuing personal guaranty of any loans made by the bank to the corporation.¹⁰⁶ A continuing guaranty is usually treated as a continuing offer for a series of unilateral contracts, with the offer being accepted each time the lender makes a loan. Obviously, the guarantor hopes to induce the lender to continue to make such loans (i.e., to induce the lender to rely on the guaranty). In this case, the court ruled that the death of one of the guarantors did *not* automatically revoke the continuing offer. Rather, the offer was revoked only when the lender learned of the death (and, even then, only with respect to any subsequent loans the lender made). As the court put it, a contrary rule

would impose upon the guarantee the burden of knowing at all times whether or not the guarantors are in life. There could be no safety in relying upon the credit of the guarantor, unless at the moment of reliance the guarantee knew the guarantor to be in life. The practical difficulties in the way of a guaranty so construed would prevent credit being given upon it, and curtail a useful method of commercial business.¹⁰⁷

Similar concerns led a New Jersey court to refuse to apply the automatic lapse rule to a guarantor who became mentally incompetent, at least until the guarantee received notice of the incompetence.¹⁰⁸ The court stressed that the guarantee was given "[t]o induce plaintiff to sell provisions"¹⁰⁹ to the guarantor's business, and that without the security provided by the guaranty, the plaintiff "would not have taken on the business risk of selling to the corporation."¹¹⁰ By contrast, in many of the cases that have followed the automatic lapse rule, the offeree did not appear to have relied in any way.¹¹¹

3. *Lapse after rejection by the offeree.*

Even if a reasonable time has not yet expired, and the offeror is still alive, an offer is also said to lapse once the offeree rejects it.¹¹² Thus, if *B* rejects an offer on day one, he may not change his mind and accept it on day two or three,

106. *Gay v. Ward*, 34 A. 1025 (Conn. 1895).

107. *Id.* at 1026.

108. *Swift & Co. v. Smigel*, 279 A.2d 895, 896 (N.J. Super. Ct. App. Div. 1971), *aff'd per curiam* 289 A.2d 793 (N.J. 1972).

109. *Id.* at 896.

110. *Id.* at 899. The court also reasoned that the scope of the guarantor's intended commitment should be judged by the parties' reasonable expectations at the time the guaranty was given. Since the guarantor was perfectly competent at that time, his subsequent incompetence was deemed irrelevant. *Id.*

111. See, e.g., *New Headley Tobacco Warehouse Co. v. Gentry's Ex'r*, 212 S.W.2d 325 (Ky. 1948) (applying automatic lapse rule where no reliance occurred); *Tucker v. Rucker*, 73 So. 2d 269 (Miss. 1954) (applying automatic lapse rule without commenting on any offeree reliance). In *Beall v. Beall*, 434 A.2d 1015 (Md. 1981), the court applied the automatic lapse rule to terminate an option in spite of the offeree's alleged reliance. However, the court also noted that the offeree's claimed reliance—failure to exercise the option while the offeror was still alive—was equivocal.

112. RESTATEMENT (SECOND) OF CONTRACTS § 38 (1979). A contrary rule may apply if *S* originally stated that her offer would remain open for a certain period of time. See *id.* § 37 (stating that rejection of an option contract does not terminate offeree's power of acceptance "unless the requirements are met for the discharge of a contractual duty"); *Ryder v. Westcoat*, 535 S.W.2d 269 (Mo. Ct. App. 1976) (same). For a critique of this rule, see Michael J. Cozzillo, *The Option Contract: Irrevocable Not Irrejectable*, 39 CATH. U. L. REV. 491 (1990).

even if three days would otherwise have been a reasonable time within which to accept the offer. This rule might be justified on the ground that, once *B* rejects the proposed transaction, it is unlikely that *B* will rely on that transaction in any way, thus leaving no reason for *S* to remain committed to *B* beyond that point. The counterargument, though, is that there is always some chance that *B* might change his mind about rejecting the offer, in which case *B*'s incentive to rely would again become important. Since the only risk to *S* from holding her offer open is the risk that *she* might change her mind, the balance could easily tip in either direction in any given case.

Although the rule that a rejection terminates *S*'s offer appears inflexible, it actually gives courts a good deal of case-by-case discretion, for courts must first determine whether *B* has in fact rejected the offer. Depending on the circumstances, a response by *B* which is not an unqualified acceptance of *S*'s offer could be interpreted as either (1) a rejection of *S*'s offer; (2) an acceptance of *S*'s offer, coupled with a proposal to modify the contract just formed; or (3) a mere "inquiry," which neither accepts nor rejects *S*'s offer (thus leaving that offer open until a reasonable time expires), coupled with a new offer from *B* to *S*.¹¹³ If, as usual, *B* does not explicitly state which result he intends, courts must decide what effect to give to *B*'s response, taking their pick from among the various default rules.

As Melvin Eisenberg has pointed out, if courts were really concerned with interpreting *B*'s likely intentions they would almost always have to choose either interpretation (2) or (3).¹¹⁴ If *B* wants to lock in the deal, even at the price of being stuck with *S*'s original terms, he would clearly prefer interpretation (2) over interpretation (1). And if *B* does not want to lock in the deal at once, either because he is not sure he likes the deal or because he wants to preserve bargaining leverage while negotiating for even better terms, *B* would prefer interpretation (3) over interpretation (1). Even if *B* thought it highly unlikely that he would ever accept *S*'s original terms, there is no reason for him to prefer interpretation (1) as long as there is even the slightest chance that he might some day change his mind.¹¹⁵

If a court's choice of interpretation (1) is defensible, then, it must be by reference to the likely intent of *S*, on the theory that *S* would prefer that her offer not survive *B*'s initial, equivocal response. If *S*'s only interest were to limit her potential exposure as much as possible, this interpretation might make sense. But, as discussed above, there are some cases where *S* would prefer to make a more solid commitment, to induce efficient reliance by *B*. In these cases, even *S* might prefer that her offer remain on the table after *B*'s initial response.

113. RESTATEMENT (SECOND) OF CONTRACTS § 39 cmt. b (1979). In contracts for the sale of goods, the *Uniform Commercial Code* introduces additional complexities (which will not be discussed here) in determining the terms of the resulting contract where *B*'s response is interpreted as an acceptance. U.C.C. § 2-207 (1989).

114. Eisenberg, *supra* note 9, at 1160.

115. *Id.*; cf. Cozzillio, *supra* note 112 ("There is no reason for [the offeree] to announce an early decision knowing that he might recant at a later time.").

This argument suggests that courts might be particularly inclined to interpret *B*'s response as something other than a rejection in those cases where *S* did in fact want to induce efficient reliance by *B*. I will argue below that this is indeed what courts do.¹¹⁶ Because courts most often achieve this result by choosing interpretation (2), which involves finding an acceptance by *B*, these cases are best discussed in combination with the other rules governing acceptance, to which I now turn.

C. *Finding a Valid Acceptance*

An acceptance by *B* locks both parties into the proposed transaction. This means that *S* and *B* can be on either side of the acceptance issue, depending on the posture of the case. If *S* is trying to withdraw from the transaction (as I have assumed throughout), *B* will be the one arguing that he already made a valid acceptance; if *B* is trying to withdraw, *S* will be the one arguing that *B* already accepted. In the latter case, the roles I have assumed must be reversed, and the desirability of binding *B* will depend on whether leaving *B* free to withdraw would distort *S*'s incentive to rely.¹¹⁷ Because cases where *B* tries to withdraw seem to arise less frequently, however, I will only occasionally refer to those cases here.¹¹⁸

Instead, in this article I focus on the apparently more common case where *S* is the party who is trying to withdraw, while *B* is trying to block her withdrawal by claiming that he had already accepted her offer. The rules defining what counts as an acceptance are merely default rules, of course. *S*, as "master of the offer," is generally free to specify just what *B* must do in order to accept. If *S* has not stated her intentions clearly, though, courts must fill that gap. Courts that are quick to find that *B* has accepted give *B* more security, and thus encourage greater reliance. On the other hand, courts that are less quick to find that *B* has accepted produce the opposite effect.

As a consequence, courts' application of the acceptance rules raises issues very similar to those discussed earlier. Significantly, the pattern of decisions is also very similar. As I show below, courts (sometimes) seem particularly willing to find a valid acceptance in cases where reliance by *B* would increase the expected value of the transaction. In these cases, even *S* has an interest (if

116. See text accompanying notes 137-143 *infra*.

117. Cf. *McTernan v. LeTendre*, 351 N.E.2d 566 (Mass. App. Ct. 1976), where a buyer posted his acceptance before his option to buy expired, but the acceptance did not reach the seller until after the option expired. The seller received the buyer's acceptance and relied on it. The buyer then tried to withdraw from the deal, claiming that his acceptance was too late to be effective. The court bound the buyer by treating the option as providing that the acceptance would take effect when posted, even if a different rule might otherwise apply to acceptance of option contracts. The rules governing the timing of acceptance of an option contract are discussed in the text accompanying notes 129-136 *infra*.

118. I also omit consideration of the many other issues which might be affected by the rules governing *B*'s acceptance. For instance, the timing of *B*'s acceptance may determine the location where the contract is deemed concluded. This conclusion may determine which jurisdiction's law will govern the transaction. For a survey of the various issues affected by the rules governing *B*'s acceptance, see Ian R. Macneil, *Time of Acceptance: Too Many Problems for a Single Rule*, 112 U. Pa. L. Rev. 947 (1964).

asked *ex ante*) in giving *B* the security afforded by an expansive concept of acceptance.

1. *Acceptance by correspondence.*

The "mailbox rule" holds that *B*'s acceptance takes effect as soon as *B* puts his acceptance into the mail (or dispatches it by any other appropriate method), regardless of when *S* actually receives it.¹¹⁹ Where the rule is in force, its practical effect is to increase the effective duration of *S*'s offer. For example, if *S*'s offer would normally remain open for ten days, the mailbox rule gives *B* a full ten days to consider the offer. In contrast, without the rule *B* would have to decide after seven or eight days (to allow time for his acceptance to reach *S*). For the same reason, the mailbox rule effectively increases *S*'s exposure by requiring her to remain ready to perform for ten days *plus* the number of days it takes to find out whether *B* posted an acceptance in time. If the mailbox rule also applies when *B*'s acceptance is lost in the mail and never reaches *S*, then *S*'s additional exposure could last for quite a long time.

To be sure, if *S* can telephone *B* to find out whether he accepted, the duration of *S*'s additional exposure may be quite short. But while the availability of faster means of communication has obviously reduced the practical importance of the mailbox rule, the number of cases that still arise under that rule shows that many people still accept contracts by mail, and many offerors still wait to receive their mail to find out whether an acceptance has been posted. In these cases, the mailbox rule clearly increases the time during which *S* is potentially committed to *B*.

As a consequence, the desirability of the mailbox rule turns on issues very similar to those discussed in connection with the duration of *S*'s offer.¹²⁰ The extent to which *S* can afford to wait for a long period of time is one obviously relevant factor.¹²¹ But even if *S* has no immediate need to know where she stands, we need some further explanation of why *S* would *ever* be willing to extend the period of her exposure (to extend it, that is, beyond the exposure she would have if she reversed the mailbox rule and provided that acceptances would only take effect when she received them). After all, those *S*'s who leave the mailbox rule in effect do not normally receive any payment for doing so. Thus, commentators who insist on mutuality must conclude that any *S* who has not received payment for her offer would never want to grant *B* any additional

119. RESTATEMENT (SECOND) OF CONTRACTS § 63(a) (1979).

120. See text accompanying notes 95-116 *supra*.

121. See *Maloney v. Atlantique Condominium Complex, Inc.*, 399 So. 2d 1111 (Fla. Dist. Ct. App. 1981)

Delay and uncertainty impair marketability and are very important and undesirable If the owner-offeror was required to assume the risk of the delays and miscarriages of the mail he would never know how long he had to wait, particularly where, as here, the option is subject to acceptance by any of many persons living anywhere they choose.

Id. at 1113-14; cf. note 101 *supra* and accompanying text (discussing offers of shorter duration).

time to respond.¹²² The error in this reasoning, however, is that whenever *B*'s reliance would increase the expected value of the transaction, *S* will normally want *B* to rely. In such cases, then, *S* has reason to give *B* the additional security represented by the mailbox rule, even if she is not compensated directly for that concession. *S* will be indirectly compensated by an increase in the expected value of the transaction whenever it is efficient for *B* to rely.

This concern for *B*'s reliance makes itself felt in the mailbox rule cases. While it might seem that the mailbox rule gives courts little discretion to adjust *B*'s protection on a case-by-case basis, the rule contains a number of exceptions that permit just this kind of flexibility. For one thing, the mailbox rule applies only when *B* sends his acceptance by a "reasonable" medium of communication. What is "reasonable" normally depends on the facts of each case. For example, in a case where *S* does not seem to have wanted to induce *B*'s reliance, the court held that it was unreasonable for *B* to post his acceptance by mail, thus depriving *B* of the benefit of the mailbox rule and permitting *S* to withdraw.¹²³

More important, the mailbox rule applies only if *S* does not provide otherwise in her offer, and deciding whether *S* has provided otherwise often gives courts a great deal of flexibility. For example, in one case the offer stated, "[I]f I do not hear from you [by a certain date] . . . I shall conclude 'No.' " The court interpreted this offer as reversing the mailbox rule, and requiring that *S* actually receive *B*'s offer in order to be bound.¹²⁴ In another case, the offer stated, "As soon as [your acceptance is] received, we shall send amongst the farmers and secure the first lots . . ."—but this court ruled that the offer did *not* reverse the mailbox rule, thus permitting *B*'s acceptance to take effect when mailed.¹²⁵ Offers requiring that *B* "notify" or "give notice" to *S* have also received mixed treatment. Some courts have interpreted this language to mean that *S* must actually receive *B*'s notice of acceptance.¹²⁶ Other courts have required only that *B* put his notice in the mail.¹²⁷ Not surprisingly, some courts have regarded the phrase as ambiguous.¹²⁸

122. See, e.g., Beth A. Eisler, *Default Rules for Contract Formation By Promise and the Need for Revision of the Mailbox Rule*, 79 Ky. L.J. 557, 573 (1990-91) (criticizing the mailbox rule as giving the offeree an "unbargained for" advantage).

123. *Elkhorn-Hazard Coal Co. v. Kentucky River Coal Corp.*, 20 F.2d 67, 69 (6th Cir. 1927). The court also rested its decision on the alternate ground that *S* did not intend to be bound until a further, more formal agreement was drawn up. This implies that *S* was unwilling to give *B* the power to close the deal even if *B* delivered his acceptance in person. The question of whether the parties should be bound when a more formal agreement is contemplated is taken up in Part IV.E.

124. *Lewis v. Browning*, 130 Mass. 173, 176 (1881).

125. *Vassar v. Camp*, 11 N.Y. 441, 447 (1854).

126. E.g., *Livesey v. Copps Corp.*, 280 N.W.2d 339, 342-43 (Wis. Ct. App. 1979); cf. *Romain v. A. Howard Wholesale Co.*, 506 N.E.2d 1124 (Ind. Ct. App. 1987). In *Romain*, where the offer provided that an option could be exercised either by delivering or mailing written notice, but the exercise of the option required *B* to make a down payment of \$5000, the term "paying" was deemed to require that *S* actually receive the payment.

127. E.g., *Palo Alto Town & Country Village, Inc. v. BBTC Co.*, 521 P.2d 1097, 1099-1100 (Cal. 1974).

128. E.g., *Aguillard's Enter. v. Smith*, 439 So. 2d 1158, 1160 (La. Ct. App. 1983), *cert. denied*, 444 So. 2d 1224 (La. 1984).

Courts have also had difficulty deciding whether option contracts, in which *S* agrees (and is paid) to hold her offer open for a stated time, should be interpreted as reversing the mailbox rule. Some courts have argued that the very nature of the option agreement entails a reversal of the mailbox rule, because extending the time during which *S* is potentially bound exposes her to more risk than she was paid to assume.¹²⁹ But this argument is circular: If *S* knows that her option requires only that *B* post his acceptance within the option period, then she can adjust the price of the option accordingly (to reflect her increased exposure). Refusing to apply the mailbox rule would then expose *S* to *less* risk than she was paid to assume. The general problem is that arguments of the form, "*S* (or *B*) should not be held to more risk than she has assumed" can only justify enforcing whatever level of risk we decide *S* (or *B*) has assumed. Such arguments cannot tell us anything about how much risk *S* (or *B*) should be deemed to have assumed in the first place. This is the question that we must address to evaluate the mailbox rule.¹³⁰

If we look past the courts' stated rationales, however, and focus instead on the outcomes of the cases, those outcomes are often consistent with the analysis presented here. In many of the cases following the "majority" rule (acceptance must actually be received within the option period), there is no indication that *B* had to rely in any way, especially not in any way that would have increased the expected value of the transaction.¹³¹ By contrast, the leading case adopting the opposite rule (acceptance of an option takes effect upon dispatch) involved just such reliance by *B*.¹³² The case involved a five-year lease at a residential shopping center, with an option to renew for two additional five-year terms. One reason landlords agree to such long-term leases is to give tenants the security they need to develop their businesses, or to make long-term improvements to the premises, without fear that the lease would then be withdrawn or renegotiated. In this case, the option to renew had to be exercised by June 31. On June 5, the tenant put his renewal notice in the mail, then proceeded to make various improvements on the premises.¹³³ The renewal notice never reached the landlord, and so eight months later the landlord tried to cancel the lease. The court ruled that the option contract did not require actual receipt, thus placing the risk of nondelivery on the landlord rather than on the tenant.¹³⁴

To be sure, the court in this case announced its decision as an across-the-board rule: Acceptances under option contracts *always* take effect upon dis-

129. See, e.g., *Romain*, 506 N.E.2d at 1127 (stating that option contract gives a definite time for acceptance, the expiration date, and that the option holder has received full agreed value at expiration); *Salminen v. Frankson*, 245 N.W.2d 839, 840 (Minn. 1976).

130. Cf. *Worms v. Burgess*, 620 P.2d 455, 458 (Okla. Ct. App. 1980) (describing such arguments as "conclusory").

131. E.g., *Dynamics Corp. v. United States*, 389 F.2d 424 (Ct. Cl. 1968); *Maloney v. Atlantique Condominium Complex, Inc.*, 399 So. 2d 1111 (Fla. Dist. Ct. App. 1981); *Cities Serv. Oil Co. v. National Shawmut Bank*, 172 N.E.2d 104 (Mass. 1961). Many of the cases interpreting "notice" or "notify" to require actual receipt of the notice also fit into this category. See note 126 *supra*.

132. *Palo Alto Town & Country Village, Inc. v. BBTC Co.*, 521 P.2d 1097 (Cal. 1974).

133. *Id.* at 1098.

134. *Id.* at 1100-03.

patch.¹³⁵ As later cases made clear, though, this "rule" too can be overcome by finding that any given option was not intended to grant the offeree this much security. As one court put it,

[T]he issue is one of construction. No doubt can be raised that if the parties wanted to require receipt of the notice of intent to exercise the option they could have done so. Consequently, while the issue of contract construction is for the court, the matter is not one as to which a fixed rule of law will be found.¹³⁶

2. *Counteroffers and equivocal acceptances.*

The validity of *B*'s acceptance may also become an issue if *B*'s response to *S*'s offer is equivocal, or mentions terms which differ from the terms of the offer. As discussed earlier,¹³⁷ the traditional rule is that if *B*'s response is a rejection or a counteroffer, *S*'s offer expires at once. If *B*'s response is a "mere inquiry," *S* is still free to revoke her offer at any time until *B* properly accepts. Thus, *B* is fully protected against any subsequent withdrawal by *S* only if *B*'s response is interpreted as an acceptance, since only a valid acceptance makes *S*'s offer irrevocable.

Here, too, *S* is free to specify in her offer what effect various kinds of responses will have on her right to withdraw. In many cases, though, *S* has not addressed this issue explicitly, so the courts must decide what kind of response by *B* will suffice to lock *S* in. While there is no clear pattern in these cases either,¹³⁸ at least some of the cases seem to reflect the same concern as that described in previous sections. That is, when *B* has relied in a way that seems to have increased the expected value of the transaction, courts are (at least sometimes) more willing to treat *B*'s response as an acceptance, thus ending *S*'s power to withdraw. When *B* has not relied in such a way, or when it appears that *B*'s reliance was not efficient, the courts are less willing to interpret *B*'s response in this way.

135. *Id.* at 1101 (relying in part on a California statute which codified the common law mailbox rule).

136. *Worms v. Burgess*, 620 P.2d 455, 456 (Okla. Ct. App. 1980) (following *Palo Alto Town & Country Village*, in part due to a similar Oklahoma statute). See also *Jameson v. Foster*, 646 P.2d 955, 958 (Colo. Ct. App. 1982) (interpreting the language of an option as allowing the acceptance to take effect when mailed); *McTernan v. LeTendre*, 351 N.E.2d 566, 567 (Mass. Ct. App. 1976) (same). The decision in *McTernan* was aided by the fact that the optioner had already relied on the optionee's posted acceptance, and the optionee was the party attempting to withdraw. See note 117 *supra*.

For other ways to adjust, on a case-by-case basis, the offeree's protection under an option contract, see *Simons v. Young*, 155 Cal. Rptr. 460, 469-70 (Ct. App. 1979) (finding that acceptance of option to renew lease was untimely, but allowing lessee to recover in restitution for value of improvements made to the property); *Ritchie v. Cordray*, 461 N.E.2d 325, 328 (Ohio Ct. App. 1983) (holding that optionor's failure to object to late receipt may constitute waiver of requirement that acceptance be received before expiration); *Southern Region Indus. Realty v. Chattanooga Warehouse & Cold Storage Co.*, 612 S.W.2d 162, 165 (Tenn. Ct. App. 1980) (ruling that acceptance of option contract must be received to take effect, but equity will protect the optionee against forfeiture when the optionor has not been injured by the delay). The court in *Palo Alto Town & Country Village* might have reached its result by one of these doctrinal routes as well.

137. See text accompanying notes 112-116 *supra*.

138. *Eisenberg*, *supra* note 9, at 1158-63.

For example, in one case a tenant offered to pay the landlord a stated amount to terminate a commercial lease. The landlord searched for and signed a contract with a replacement tenant, then sent the first tenant a letter purporting to accept that tenant's buyout offer. The landlord's "acceptance" letter raised a new issue, though: "At the time I talked with [the first tenant's agent], I was not aware that an outside broker was involved in procuring the tenant who is to take the space. The broker fee should be shared Your share of this cost is \$1,432.80."¹³⁹ This letter asked for \$1,432.80 *in addition* to the amount the first tenant had originally offered to terminate the lease. In many contexts, this discrepancy between offer and acceptance might be enough to prevent the landlord's response from counting as a valid acceptance.

In this case, though, the court ruled otherwise. The case arose when the first tenant realized that the landlord had found another tenant, then tried to use the discrepancy in terms to withdraw from its original buyout offer. The first tenant claimed that it was now released from the original lease (as the replacement tenant was already occupying the premises), and that it therefore owed the landlord nothing at all. Yet it seems unlikely that the landlord would have signed a replacement tenant if he had known the original tenant would then be free to withdraw its buyout proposal. Moreover, the landlord's acts of searching for and signing a replacement tenant were presumably the kind of reliance that the first tenant wanted to encourage, for the landlord's willingness to accept the buyout offer would turn on whether he could find a replacement. Thus, it is hardly surprising that the court treated the landlord's letter as a valid acceptance in spite of the discrepancy in terms. According to the court, the landlord's language about sharing the brokerage fee was a mere "request" or "suggestion."¹⁴⁰

In another case, the roles were reversed as *B* argued that his "acceptance" was ineffective after the offeror, *S*, relied in just the way the offeree wanted. The offeror, a seller, proposed to deliver timber to a government agency at a rate of two "schedules" (a unit of quantity) per month.¹⁴¹ The government agency responded by telegram saying that the seller could "proceed to make arrangements," and that the "documents" for the transaction were being sent by mail. The documents provided for delivery of twenty schedules of timber "at the rate, if possible, of 4 schedules per month."¹⁴² The seller proceeded at once to spend "large sums of money in securing and proving additional necessary machinery, materials and labor for performing said contract."¹⁴³ For some reason, the agency later changed its mind and attempted to withdraw from the transaction, claiming that it was free to withdraw because its "acceptance" had

139. *Alpha Venture/Vantage Properties v. Creative Carton Corp.*, 370 N.W.2d 649, 651 (Minn. Ct. App. 1985).

140. *Id.* at 652. The court also noted that, even if the landlord's response were not a valid acceptance, it could hold the tenant liable on a promissory estoppel theory. *Id.* at 653. For a discussion of other promissory estoppel cases, see text accompanying notes 182-212 *infra*.

141. *Eichberg v. United States Shipping Bd. Emergency Fleet Corp.*, 273 F. 886, 888 (D.C. Cir. 1921).

142. *Id.* (emphasis added).

143. *Id.*

impermissibly varied the terms of the seller's offer. Again not surprisingly, the court upheld a finding that the agency's acceptance was valid in spite of the discrepancy in terms. Since the government agency had apparently wanted a faster rate of output, the seller's rapid reliance was presumably exactly what the agency wanted to induce.

3. *Acceptance by silence.*

Another interpretive problem arises when an offeree neither accepts nor rejects an offer, but simply remains silent. The parties are of course free to agree in advance that such silence will count as an acceptance, as is common in mail order book and record clubs. The parties are also free to agree that silence will *not* count as acceptance. The difficult cases—here, as elsewhere—are those where the parties have not agreed either way.

The common law default rule is that, absent a prior agreement to the contrary, silence does not count as acceptance. However, there are several exceptions. According to the *Restatement (Second)*, if *B* silently accepts goods or services from *S* when *B* has "reason to know" that *S* expects compensation (and when *B* had a "reasonable opportunity" to reject the goods or services), *B* has accepted *S*'s implicit offer and will be liable to pay for what he has received.¹⁴⁴ *B* is also bound if, "because of prior dealings or otherwise," it is "reasonable" that *B* should notify *S* if he does not mean to accept her offer.¹⁴⁵

The interpretation of these vague standards will affect *B*'s reliance incentives. Just as in the other contexts discussed earlier, a liberal approach to finding a valid acceptance will encourage *B* to rely, by making it harder for *S* to threaten to withdraw. If *B*'s reliance would be efficient, even *S* might want to give *B* this form of security. Perhaps as a result, at least some cases involving a purported silent acceptance, the courts seem concerned with protecting efficient reliance by *B*.

144. RESTATEMENT (SECOND) OF CONTRACTS § 69(1)(a) (1979).

145. *Id.* § 69(1)(c) (emphasis added). A third exception binds *S* when she has given *B* reason to understand that his silence or inaction will count as acceptance, and when *B* in fact intends to accept. *Id.* § 69(1)(b).

Avery Katz has shown that the rules governing acceptance by silence can have efficiency consequences even if neither party has any occasion to rely on the proposed transaction. Counting silence as acceptance reduces the number of communications necessary to form a contract, but increases the number of communications required to avoid forming a contract. Thus, depending on the likelihood that the parties will want to contract, the rules governing acceptance by silence could either reduce or increase total communication costs. Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 MICH. L. REV. 215, 249-72 (1990); Avery Katz, *Transaction Costs and the Legal Mechanics of Exchange: When Should Silence in the Face of an Offer Be Construed as Acceptance?*, 9 J.L. ECON. & ORG. 77 (1993) [hereinafter Katz, *Transaction Costs*]. Katz also shows that a rule permitting silent acceptance can have distributional effects: If *B* must incur transaction costs in order to reject *S*'s offer, *S* will be able to charge a higher price. Moreover, if *S* is a monopolist and cannot perfectly price-discriminate, this distributional effect may itself have consequences for allocative efficiency, by altering the number of contracts that are formed. Katz, *Transaction Costs*, *supra*, at 90-93. If the cost of a single communication is low, however, the effect on net communication costs is unlikely to be very significant. Moreover, as Katz points out, the conditions under which courts actually treat silence as an acceptance do not seem to correspond very closely to this communication-cost rationale. *Id.*

Silence in response to insurance applications. For example, many (though not all) states hold an insurance company bound to provide insurance coverage if it fails to reject an insurance application within a reasonable time.¹⁴⁶ Typically, the applicant relies on the prospect of getting insurance by not pursuing alternative possibilities (e.g., by not applying to other companies).¹⁴⁷ It is probably efficient for the applicant to rely in this way, as long as it is sufficiently likely that the first company will approve his application. Moreover, the first company will often *want* the applicant to rely in this way—again, as long as it is sufficiently likely that it will approve his application—since such reliance increases the probability that it will ultimately sell the applicant his insurance.

Not only is this general doctrine consistent with encouraging efficient reliance, but many of the specific contours of the doctrine seem shaped by this concern as well. For example, it might be inefficient for some applicants to rely on an anticipated policy from the first insurance company if there were only a low likelihood that the company would want to insure their risks—and in such a case, the first company would not want to commit itself because it would not want to encourage these applicants to rely. Perhaps as a result, courts have been most inclined to recognize this cause of action when the likelihood that the policy would be granted was quite high, either because the applicant had already been examined and approved by the company's experts,¹⁴⁸ or because the company did not require a prior examination (as in many group insurance policies).¹⁴⁹ Some courts have also refused to recognize this cause of action in cases where the applicant made no showing that he would have sought insurance elsewhere if he had known the first company would delay this long;¹⁵⁰ or where the applicant's risk was one that no insurance company would have been willing to insure, so that the applicant in fact risked nothing by waiting for the first company to respond.¹⁵¹

Silence and prior courses of dealing. A concern for the offeror's reliance has also played a role in decisions about whether the parties' prior course of

146. *E.g.*, *Duffie v. Bankers' Life Ass'n*, 139 N.W. 1087, 1089 (Iowa 1913); *Robinson v. United States Benevolent Soc'y*, 94 N.W. 211, 212 (Mich. 1903); *Kukuska v. Home-Mutual Hail-Tornado Ins. Co.*, 235 N.W. 403, 404 (Wis. 1931). In some states, the insurance company is held liable not in contract but in tort, based on the company's "negligent" delay. *Id.* See generally Annotation, *Rights and Remedies Arising Out of Delay in Passing Upon Application for Insurance*, 32 A.L.R.2d 487 (1953) (describing tort and contract remedies for untimely decisions on insurance applications). In a few cases, this doctrine has also been applied to banks that fail to make a timely response to a loan application. *E.g.*, *Jacques v. First Nat'l Bank*, 515 A.2d 756, 762 (Md. 1986).

147. In a few cases, the applicant has relied in an even more significant way. In *Freimuth v. Glens Falls Ins. Co.*, 314 P.2d 468 (Wash. 1957), for example, the plaintiff left on a yacht trip believing the vessel was insured because the insurance company's inspector had approved the yacht and the trip plan.

148. *E.g.*, *Bellak v. United Home Life Ins. Co.*, 211 F.2d 280, 283 (6th Cir. 1954); *Huberman v. John Hancock Mut. Life Ins. Co.*, 492 So. 2d 416, 416-417 (Fla. Dist. Ct. App. 1986); *Freimuth*, 314 P.2d at 469-70.

149. *E.g.*, *Gorham v. Peerless Life Ins. Co.*, 118 N.W.2d 306, 307 (Mich. 1962); *North Am. Accident Ins. Co. v. Ralls*, 288 P.2d 1097, 1098 (Okla. 1955).

150. *E.g.*, *Thomas v. Life Ins. Co. of Ga.*, 55 So. 2d 705, 707 (La. 1951).

151. *E.g.*, *Antoine v. Sentry Life Ins. Co.*, 352 So. 2d 768, 770-71 (La. Ct. App. 1977).

dealings imposed a duty on the offeree to speak up if he meant to reject the offer. For example, in one case a landowner had used a real estate broker several times in the past, and the broker had often been willing to lower his commission in order to facilitate a sale.¹⁵² In the transaction at issue, the landowner had an immediate opportunity to sell a particular parcel, and told the broker he would make the sale only if the broker reduced his commission from 10 percent to 4 percent. The broker apparently remained silent, and the landowner proceeded to sell the property in the belief that the broker had agreed to the reduced commission. When the broker then sued to collect his usual 10 percent commission, the court held that the broker's silence counted as an acceptance of the landowner's offer of a reduced commission. The landowner clearly relied on the broker's silence by consummating the sale, and the broker "knew that the circumstances required [the landowner] to act expeditiously and that their decision was conditioned upon his acceptance [of the reduced commission]."¹⁵³ Moreover, the broker had reason to want the landowner to rely in this way, for otherwise there would have been no sale and he would have earned no commission at all.

By contrast, in another case an insurance agent sent a customer a notice to renew his insurance policy, with instructions to return the policy if he did not want to renew.¹⁵⁴ The agent had sent a similar notice on a previous occasion when another policy was due for renewal, and on that occasion the customer had remained silent and accepted the automatic renewal. On this occasion, the customer also remained silent, but in fact purchased insurance from another company (without notifying the original agent). In this case, though, the original agent apparently did not have to take any action in reliance on the customer's renewal or nonrenewal of the original policy. Perhaps as a result, the court refused to treat the parties' prior dealings as imposing on the customer a duty to speak up if he wanted to reject the renewal offer.¹⁵⁵

4. *Acceptance by performance.*

The validity of *B*'s acceptance also becomes an issue if *B* simply begins performing the contract, without promising *S* that he will perform. Traditional doctrine held that *B* could only accept by performance if *S*'s offer was for a "unilateral contract," or (as the *Restatement (Second)* now puts it) if *S*'s offer was one that invited acceptance by performance.¹⁵⁶ Even then, the traditional rule was that *B*'s acceptance did not take effect, and *S* could still revoke her offer, until *B* completely finished performing the contract. Today, however, courts tend to say that *B*'s acceptance is fully effective (or, at least, that *S*'s

152. *Ganley v. G & W Ltd. Partnership*, 409 A.2d 761, 765 (Md. Ct. Spec. App. 1980).

153. *Id.* at 766. The court made no mention of the "rule" that offers made in a face-to-face conversation expire if not accepted prior to the end of that conversation. See note 99 *supra*.

154. *Roberts v. Buske*, 298 N.E.2d 795, 796 (Ill. App. Ct. 1973).

155. *Id.* at 797.

156. *RESTATEMENT (SECOND) OF CONTRACTS* § 30 (1979); see also *id.* § 1 cmt. f (rejecting the unilateral/bilateral terminology).

right to revoke her offer comes to an end) once *B* begins to perform, if performance is a permissible means of acceptance.¹⁵⁷

In its modern form, the doctrine of acceptance by performance has an obvious connection with efficient reliance. Performance by *B* often involves reliance in the form of a relationship-specific investment, and *S* (at the time she makes her offer) will often want *B* to rely in this way. In many cases, of course, *S* will not have explicitly stated whether she wanted her commitment to become irrevocable once *B* began to perform, so the courts will have to decide whether to interpret her offer as permitting that method of acceptance. But it is easy to find cases where courts seem to interpret *S*'s offer as irrevocable when *B* begins to perform precisely because *B*'s reliance is the sort that *S* would have wanted to induce.

For example, in one early case, some residents of a community pledged to pay part of a railroad's expenses if the railroad built a line to their community. The railroad bought a franchise from the city council, and had begun building the line, when the residents announced that they would withdraw their pledge. The court held that the pledge became irrevocable once the railroad had purchased the franchise from the city.¹⁵⁸ In this case, the railroad made an investment which seemed (at the time) to increase the expected value of the parties' relationship, but left the railroad company vulnerable to exploitation if the residents could demand better terms once the investment had begun. This is precisely the sort of reliance that an offeree will be reluctant to engage in if the offeror retains the right to withdraw at any time. As a consequence, even the residents in this case might have explicitly agreed (if they had addressed the matter) to be bound once the railroad began to rely.

A similar rationale might be applied to the growing number of cases that treat commissions offered to real estate brokers as unilateral contracts that become irrevocable once the broker begins expending time and effort to find a buyer.¹⁵⁹ A broker's effort to sell a particular house is largely a relationship-specific investment, thus exposing brokers to the risk that the owner might later demand that the broker accept a lower commission or lose his fee entirely. This risk could distort brokers' level of reliance, by reducing their incentives to invest time and resources in finding a buyer. Since most owners presumably

157. See RESTATEMENT (SECOND) OF CONTRACTS § 62 (1979) (counting the beginning of performance as acceptance when the offer allows acceptance either by performance or by a promise to perform); *id.* § 45 (counting the beginning of performance as making the offer irrevocable when the offer allows acceptance only by performance and the offeree begins to perform). As the distinction between these two rules is important only when the roles are reversed and *B* withdraws from the deal (after he has begun performance). I will say little about that distinction in this article.

158. *Los Angeles Traction Co. v. Wilshire*, 67 P. 1086, 1088 (Cal. 1902).

159. *E.g.*, *Baumgartner v. Meek*, 272 P.2d 552, 555 (Cal. Dist. Ct. App. 1954); *Hutchinson v. Dobson-Bainbridge Realty Co.*, 217 S.W.2d 6, 10 (Tenn. Ct. App. 1946); *see also* *Real Estate Listing Serv., Inc. v. Connecticut Real Estate Comm'n*, 425 A.2d 581, 585 (Conn. 1979) (treating broker's beginning performance as acceptance of bilateral contract under which homeowner promises to pay commission and broker promises to use best efforts to find buyer); *Mark Realty, Inc. v. Rogness*, 418 So. 2d 373, 376 (Fla. Dist. Ct. App. 1982) (same).

want brokers to rely in this way, most owners may actually prefer to bind themselves in advance.¹⁶⁰

Another example of this concern with efficient reliance involved a wholesale broker of frozen seafood.¹⁶¹ The seafood company gave the broker responsibility for an exclusive territory, in part to encourage him to stimulate demand for the seafood among customers there, free from the worry that other seafood brokers could capitalize on his efforts after sufficient demand had been stimulated.¹⁶² The broker did in fact generate demand for the company's products (or so the jury could have found), including a new market for large blocks of frozen fish to be made into the newly popular "fish sticks."¹⁶³ The company encouraged him in these efforts, but once the broker had created the demand, the company terminated the brokerage relationship, allegedly to avoid paying a commission on his sales.¹⁶⁴ In this case, the court did not protect the broker by treating his efforts as acceptance of a unilateral offer—but it reached much the same result by allowing the broker to recover on a theory of bad faith termination.

Because the doctrine of acceptance by performance explicitly focuses the court's attention on *B*'s actions, and because *S* will normally want *B* to rely by beginning to perform, this doctrine easily protects *B* in cases where his reliance ought to be protected. Thus, the real challenge associated with this doctrine is not to explain its use in protecting efficient reliance, but to explain how to avoid its application in cases where *B*'s reliance is not efficient. There are, however, several limiting rules which permit courts to apply this doctrine flexibly on a case-by-case basis.

Performing vs. preparing to perform. Even when an offer permits acceptance by performance, courts distinguish between the start of "actual performance" and mere "preparations to perform": only the first makes *S*'s offer irrevocable.¹⁶⁵ Sometimes this distinction can be used to weed out cases where *B* has not really relied in any relationship-specific way. The textbook case of

160. *But cf.* notes 172-177 *infra* (listing cases where courts refuse to protect brokers who begin performing, especially when the listing contract is not exclusive).

161. *Malloy v. Coldwater Seafood Corp.*, 156 N.E.2d 61 (Mass. 1959).

162. For a discussion of this rationale for offering exclusive territories, see RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 160 (1976).

163. *Malloy*, 156 N.E.2d at 63, 64-65.

164. *Id.* at 65-66. In an analogous group of cases, employers have offered pension plans and other benefits to employees, in order to attract new employees or induce existing employees to stay on the job, only to withdraw their offers later. For a review of these cases, see Mark Pettit, Jr., *Modern Unilateral Contracts*, 63 B.U. L. REV. 551, 560-67 (1983). I discuss some of the employment cases at note 196 *infra*, in connection with the doctrine of promissory estoppel.

A number of the cases discussed in earlier sections also had to permit acceptance by performance in order to protect *B*'s reliance. See, e.g., *Motel Servs., Inc. v. Central Me. Power Co.*, 394 A.2d 786, 788 (Me. 1978) (building houses to be heated by electricity was a valid acceptance of an electric company's rebate offer to any builder who constructed such houses), see text accompanying note 84 *supra*; *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256, 262 (Eng. C.A. 1892) (use of advertiser's product was a valid acceptance of advertiser's offer to pay anyone who used the product and contracted influenza), see text accompanying note 94 *supra*; *Becker v. Missouri Dep't of Social Servs.*, 689 F.2d 763, 769 (8th Cir. 1982) (employee's resignation to return to school for a degree was a valid acceptance of employer's offer to rehire him if a vacancy was available), see note 103 *supra* and accompanying text.

165. RESTATEMENT (SECOND) OF CONTRACTS § 62 cmt. d (1979).

*White v. Corlies*¹⁶⁶—and, in particular, the facts of that case that are emphasized in the *Restatement (Second)*'s treatment of it¹⁶⁷—can serve as an example. Apparently, a series of negotiations led to an offer to hire a builder to install paneling and other woodwork in some offices, whereupon the builder at once bought lumber and began to work. The hiring party revoked its offer the very next day, after the builder had begun work, but before his work had customized the lumber in any way that would make it unfit for any other job. This fact suggests that the builder risked little by relying in this way, since even if this job offer were withdrawn, the lumber could still be used on the next job. If so, there was no need for the hiring party to be committed at this stage. The authors of the *Restatement (Second)* contrast this case with a second example where *S* orders goods from *B*, and *B* "crates them and loads them on a truck at substantial expense."¹⁶⁸ Loading the truck is a relationship-specific investment, for the expense of loading is wasted if *S* backs out of the transaction. Thus, according to the *Restatement (Second)*, loading the truck counts as the beginning of actual performance (unlike the carpenter's "mere preparations"), and therefore creates a binding contract.¹⁶⁹

Interpreting the offer to preclude acceptance by partial performance. Another limiting rule holds that *B*'s acceptance by performance binds *S* only if the court decides that *S*'s offer permits acceptance in this manner. Since *S* is the master of her offer, she is normally free to specify any method of acceptance she wants. The difficult cases, again, are those where *S* has not clearly indicated her intentions either way. To be sure, the *Restatement (Second)* suggests a presumption which allows acceptance in any "case of doubt" by whatever method *B* chooses.¹⁷⁰ Nevertheless, one can still find cases where *S*'s offer has not explicitly addressed the proper mode of acceptance, but courts do *not* treat *B*'s beginning performance as a valid acceptance.¹⁷¹

This proposition is best illustrated by the cases allowing a property owner to withdraw from a real estate listing agreement after the real estate agent has begun looking for a buyer. Courts generally protect brokers who begin performing under an exclusive agency contract, but do not protect brokers who begin to perform under a nonexclusive agency contract, and some courts have

166. 46 N.Y. 467 (1871).

167. RESTATEMENT (SECOND) OF CONTRACTS § 62 illus. 1 (1979).

168. *Id.* illus. 2 (based on *Ever-Tite Roofing Corp. v. Green*, 83 So. 2d 449 (La. Ct. App. 1955)).

169. *Id.*

170. RESTATEMENT (SECOND) OF CONTRACTS § 32 (1979). This rule altered the presumption endorsed by the original RESTATEMENT OF CONTRACTS § 31 (1932), which stated that ambiguous offers could be accepted only by a return promise. The *Restatement (Second)*'s change reflects the significant number of cases that treated *B*'s start of performance as an acceptance, thus blocking *S* from withdrawing after *B* had relied.

171. *E.g.*, *First Home Savings Bank, FSB v. Nernberg*, 648 A.2d 9, 14-15 (Pa. Super. Ct. 1994) (applying the older rule that a unilateral contract is unenforceable until the offeree completes performance, and holding that offeree's partial performance constituted counteroffer terminating offeror's unilateral contract); *Smith v. Sabine Royalty Corp.*, 556 S.W.2d 365, 367-68 (Tex. Civ. App. 1977) (holding that initial communication merely constituted invitation to further negotiations and thus could not constitute a binding offer, although plaintiff had commenced "performance").

adopted this distinction as a hard-and-fast rule.¹⁷² Nevertheless, exceptions can be found in both directions: Brokers who begin performance under a nonexclusive agency are sometimes protected,¹⁷³ while brokers who begin performance under an exclusive agency are sometimes not protected.¹⁷⁴ The decisions that do not protect a relying broker have had no doctrinal difficulty in deciding that the listing agreement did not permit acceptance by performance, or that it did not permit acceptance except by complete performance (i.e., finding a willing buyer).

Admittedly, it is not clear that the mixed pattern in brokerage cases can be explained by the efficient-reliance argument. As discussed earlier, property owners generally want their agents to rely by taking steps to find buyers for the property. To be sure, a nonexclusive listing creates a "tournament,"¹⁷⁵ so the optimal level of reliance by any one agent will normally be lower in this setting than it would be in an exclusive listing. But it could be efficient for the owner to be irrevocably committed even in a tournament setting, so this argument might not justify any hard-and-fast distinction between exclusive and nonexclusive listings. The use of revocable, nonexclusive listings thus presents something of a puzzle, for which no economic rationale has yet been identified.¹⁷⁶

Nevertheless, some of the cases involving brokers do seem to incorporate efficiency concerns. In those cases where courts have *not* protected a broker who began performing, they have at least sometimes rested on the belief that a commitment by *S* would not have been needed to induce the broker to rely. As one court put it, "Brokerage contracts, . . . by their very nature, entail a high risk of noncompensation. . . . There is no basis for assuming that [the broker] would not have taken exactly the same steps . . . in the hope of earning a substantial commission."¹⁷⁷ If the court was correct in this assessment, enforcing the contract would not have encouraged efficient reliance.

Exclusive vs. optional modes of acceptance. Finally, even when *S*'s offer has explicitly addressed the proper mode of acceptance, courts may still have to interpret *S*'s language. For example, a number of cases involve offers stating that only a signature of an officer at *B*'s headquarters will constitute an acceptance. Although the language appears in *S*'s offer, it is usually drafted by *B*, and invoked by him to justify withdrawing from the transaction if the offer has not

172. *E.g.*, *Tetrick v. Sloan*, 339 P.2d 613, 616-17 (Cal. Dist. Ct. App. 1959). For a discussion of cases where courts protected brokers who began performing under an exclusive listing agreement, see note 159 *supra* and accompanying text.

173. *Marchiondo v. Scheck*, 432 P.2d 405, 407-08 (N.M. 1967).

174. *Bartlett v. Keith*, 90 N.E.2d 308, 309-10 (Mass. 1950).

175. See note 38 *supra* and accompanying text.

176. *Cf.* Saul Levmore, *Commitments and Conflicts in Agency Arrangements: Lawyers, Real Estate Brokers, Underwriters, and other Agents' Rewards*, 36 J.L. & ECON. 503, 517 (1993) (arguing that sellers should never want to use a tournament among real estate agents). One possible argument in favor of revocability is that irrevocable listings could induce excessive reliance by the broker. Another possible justification might lie in the parties' relative risk aversion: Disappointed brokers can usually spread their losses over a number of real estate transactions, while an individual seller may participate in a smaller number of transactions and thus be more risk averse. While each of these explanations seems possible, neither seems obviously correct.

177. *Bump v. Robbins*, 509 N.E.2d 12, 19 (Mass. App. Ct. 1987) (citations omitted). The court also refused to find an acceptance by silence of the broker's proposed terms. *Id.*

yet been signed. In these cases, then, the usual roles are reversed: *B* is the party claiming the right to withdraw at any time, while *S* is the party claiming that the deal should have been regarded as settled.

In many of these cases, courts have refused to count beginning performance by *B* as an acceptance of the offer, on the ground that the offer explicitly required acceptance by *B*'s signature.¹⁷⁸ Significantly, though, in many of the cases adopting this interpretation *S* had no need to rely on *B*'s apparent acceptance, so there was no efficiency-based reason not to let *B* withdraw at any time. On the other hand, in cases where *S* did need to rely on *B*'s apparent acceptance, courts have been more inclined to interpret the quoted language as providing for a permissible *but nonexclusive* method of acceptance,¹⁷⁹ and have prevented *B* from withdrawing by finding an acceptance by some other means.

For example, in one case the party in *B*'s position (i.e., the offeree on whose apparent acceptance *S* was induced to rely), was the seller of bowling alley equipment. *B* never formally accepted by signing *S*'s offer, but did draw up plans to help *S* remodel her bowling alley to utilize the new equipment, and actually supervised *S*'s remodeling.¹⁸⁰ When *B* then claimed that he was still free to withdraw, the court ruled that signing the offer was not the only permissible method of acceptance, and that *B*'s conduct could be interpreted as accepting the offer. In a similar case, *B* never accepted by signing the required documents, but *B* did indicate to *S* that her order had been "approved," and urged *S* to install \$12,000 worth of electrical equipment needed to install *B*'s product. In that case, too, the court ruled that *B* could have properly accepted by virtue of his conduct.¹⁸¹ In each of these cases, it is unlikely that *S* would have relied in the way she did if *B* had retained the right to withdraw at any time. Thus, *B* might not have wanted the offer interpreted to give him an unlimited right of withdrawal, if he had been asked that question at the time that *S* relied.

D. *Irrevocability by Estoppel*

The various rules governing performance as a permissible means of acceptance became less important when courts held that reliance on an offer could make the offer irrevocable.¹⁸² The doctrine of estoppel allows *B*'s reliance to bind *S* regardless of whether *S*'s offer permitted acceptance by performance, or whether *B*'s actions in reliance were "beginning performance" or merely "preparing to perform." In addition, the roughly parallel doctrine of promissory estoppel can, in certain cases, bind *S* if she has made a *promise* rather than an

178. *E.g.*, *Beard Implement Co. v. Krusa*, 567 N.E.2d 345, 350 (Ill. App. Ct. 1991); *Kuzmeskus v. Pickup Motor Co.*, 115 N.E.2d 461, 464 (Mass. 1953).

179. *See* RESTATEMENT (SECOND) OF CONTRACTS § 60 (1979) ("If an offer merely suggests a permitted place, time or manner of acceptance, another method of acceptance is not precluded.").

180. *Calo, Inc. v. AMF Pinspotters, Inc.*, 176 N.E.2d 1, 3 (Ill. App. Ct. 1961).

181. *Empire Mach. Co. v. Litton Business Tel. Sys., Inc.*, 566 P.2d 1044, 1049 (Ariz. Ct. App. 1977); *see also Lomas & Nettleton Co. v. United States*, 1 Cl. Ct. 641, 645-46 (1982) (refusing to grant summary judgment where mandatory mode of acceptance had not been followed but a triable issue of fact existed as to whether that requirement had been waived or altered by custom).

182. RESTATEMENT (SECOND) OF CONTRACTS § 87(2) (1979).

offer, and *B* relies on that promise.¹⁸³ As this doctrine binds *S* when she has not made a offer, the legal definition of an offer also is now less important than it once was.

However, these reliance-based doctrines contain limits of their own. For example, reliance on *S*'s offer (or on *S*'s promise) binds *S* only if the offer or promise is one which *S* should "reasonably expect" to induce *B*'s reliance.¹⁸⁴ Even then, *S* is bound only "to the extent necessary to avoid injustice."¹⁸⁵ Admittedly, the inquiries required by these tests are phrased differently from the inquiries required under the doctrines discussed earlier, but the new inquiries are just as vague, and leave just as much scope for case-by-case discretion. Consequently, it should not be surprising that many of the cases applying the two estoppel doctrines follow the same pattern seen in previous sections involving offer and acceptance: Courts seem more inclined to treat *B*'s reliance as binding if his reliance appeared to increase the expected value of the transaction, so that even *S* would have wanted to be committed.

For example, in the leading case of *Drennan v. Star Paving Co.*,¹⁸⁶ a subcontractor submitted a bid to a general contractor who used the subcontractor's bid to calculate its own bid for a construction contract. After the general contractor won the contract and released the other subcontractors, the subcontractor whose bid had been used refused to perform at the original bid price and demanded more money from the general contractor. In holding that the subcontractor was bound by the general contractor's reliance on the subcontractor's bid, the court emphasized not only that the general contractor had relied, but also that the general contractor's reliance had benefitted the subcontractor as well, at least in expected value terms. That is, the general contractor probably would not have relied in this way if it had known the subcontractor could subsequently demand to renegotiate. Moreover, the subcontractor, at the time it submitted the bid, clearly wanted the general contractor to rely in this way. As the court noted, the subcontractor "had reason not only to expect [the general contractor] to rely on its bid *but to want him to*."¹⁸⁷ Most other cases involving subcontractors and general contractors have reached identical results.¹⁸⁸

Courts are more mixed on whether or when the general contractor is bound to the subcontractor after using the subcontractor's bid. The majority view

183. *Id.* § 90(1).

184. *Id.* §§ 87(2), 90(1).

185. *Id.* §§ 89(2), 90(1). In the case of reliance on an offer, § 87(2) adds the additional requirement that *B*'s reliance be "substantial."

186. 333 P.2d 757, 758 (Cal. 1958).

187. *Id.* at 760 (emphasis added); see also *Montgomery Indus. Int'l v. Thomas Constr. Co.*, 620 F.2d 91, 96 (5th Cir. 1980) ("To accept [the subcontractor's] position, that [the general contractor] should not have relied on their bid, would defeat the entire purpose of such bids as they are used in the commercial world."). For suggestions that this result at least roughly corresponds with what many general contractors and subcontractors expect, see Franklin M. Schultz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. CHI. L. REV. 237, 260-61, 267-68 (1952) (reporting survey that most general contractors and subcontractors felt bound to perform their agreed duties after main contract awarded); Note, *Another Look at Construction Bidding and Contracts at Formation*, 53 VA. L. REV. 1720, 1734, 1740 (1967) (same).

188. E.g., *Debron Corp. v. National Homes Constr. Corp.*, 493 F.2d 352, 356-57 (8th Cir. 1974); *Crook v. Mortenson-Neal*, 727 P.2d 297, 303-04 (Alaska 1986).

seems to be that the general contractor is not bound simply by using the subcontractor's bid,¹⁸⁹ but contradictory cases are not hard to find.¹⁹⁰ On the view taken here, i.e., that the nonrelying party would prefer to be committed ex ante if committing would increase the expected value of the transaction, the key question is whether the general contractor (the party in *B*'s position) needs to be committed in order to induce efficient reliance by the subcontractor (the party in *S*'s position). Consistent with this article's analysis, in many of the cases adopting the "majority" rule, the subcontractor did not have to rely in any way.¹⁹¹ By contrast, in several of the cases holding the general contractor bound, the subcontractor had in fact relied on the general contractor's use of her bid, by turning down other jobs.¹⁹² This action seems like exactly the kind of reliance by the subcontractor that the general contractor would have wanted to induce.

Another set of cases involves franchisors who encourage prospective franchisees to rely on a potential transaction, only to attempt later to withdraw or renegotiate. In these cases, too, reliance is in the franchisor's interest as well as the franchisee's, thus suggesting that the franchisor might well want to be committed in order to induce efficient reliance. The *Red Owl* case, which introduced this use of promissory estoppel has already been discussed.¹⁹³ In other cases, gasoline companies have been held liable after they encouraged a prospective franchisee to acquire land and make improvements on it,¹⁹⁴ or after they assured the applicant that the deal was "all set" and that he should not sell his land to a competing oil company.¹⁹⁵ There are also cases holding an employer liable after offering a job to a prospective employee, urging the employee to move to a new city or resign from his old job, then later trying to withdraw the offer.¹⁹⁶

189. E.g., *Merritt-Chapman & Scott Corp. v. Gunderson Bros. Eng'g*, 305 F.2d 659, 663-64 (9th Cir. 1962) (ruling that general contractor's use of subcontractor's bid does not count as an acceptance); *Holman Erection Co. v. Orville E. Madsen & Sons, Inc.* 330 N.W.2d 693, 699 (Minn. 1983) (same); *Milone & Tucci, Inc. v. Bona Fide Builders*, 301 P.2d 759, 763 (Wash. 1956) (same).

190. E.g., *Industrial Elect.-Seattle, Inc. v. Bosko*, 410 P.2d 10, 17-18 (Wash. 1966) (admitting evidence of custom to show that use of subcontractor's bid did count as acceptance); *AROK Constr. Co. v. Indian Constr. Serv.*, 848 P.2d 870, 875 (Ariz. Ct. App. 1993) (holding that general contractor was bound when it explicitly promised to use subcontractor's bid, in exchange for subcontractor's reduction of its bid); *Southern Cal. Acoustics Co. v. C. V. Holder, Inc.*, 456 P.2d 975, 978-81 (Cal. 1969) (ruling that general contractor's use of subcontractor's bid does not count as acceptance under common law, but general contractor was bound under a state statute which the court interpreted as altering the common law rule).

191. E.g., *Holman Erection*, 330 N.W.2d at 697.

192. *Southern Cal. Acoustics*, 456 P.2d at 979; cf. *AROK Constr.*, 848 P.2d at 878 (finding that subcontractor relied by spending eight to ten hours revising bid). In *Southern California Acoustics*, 456 P.2d at 981 n.9, the court also noted that the subcontractor spent \$500 preparing to perform the contract (after learning that the general contractor had been awarded the primary contract), and allowed the subcontractor to recover for those expenses as well.

193. *Hoffman v. Red Owl Stores*, 133 N.W.2d 267 (Wis. 1965). See texts accompanying notes 35, 71 *supra*.

194. *Walters v. Marathon Oil Co.*, 642 F.2d 1098 (7th Cir. 1981).

195. *Cellucci v. Sun Oil Co.*, 320 N.E.2d 919, 921-22, 926 (Mass. App. Ct. 1974), *aff'd*, 331 N.E.2d 813 (Mass. 1975).

196. E.g., *Sheppard v. Morgan Keegan & Co.*, 266 Cal. Rptr. 784, 785-86 (Ct. App. 1990); *Hunter v. Hayes*, 533 P.2d 952, 953 (Colo. Ct. App. 1975); *Grouse v. Group Health Plan, Inc.*, 306

Indeed, many other cases applying this doctrine involve similar instances of reliance that appear to have been mutually beneficial at the time of the reliance. For example, in one case a loan applicant had not heard whether his loan to purchase land had been approved, even though he had reached the point in the growing season when he had to decide whether to plant crops on that land. When he asked the bank what he should do, the bank told him that there was no problem with the loan and that he should "go ahead and farm the property." The court held that these statements were sufficient to bind the bank, on either an express contract or a promissory estoppel theory.¹⁹⁷ In another case, a producer negotiated with the singer Aretha Franklin to appear in a musical production. Once the parties reached a tentative agreement, the producer contracted with costume and lighting designers and reserved dates in theaters, all of which needed to be done well in advance of the actual production. The court held that Franklin was bound, even though she had not yet signed the final contract documents, because she "could not possibly have assumed" that the producer would have taken such steps without a binding commitment on her part.¹⁹⁸ In still another example, a court held the Xerox Corporation bound after Xerox began negotiating a supply contract, encouraged the potential supplier to lease a production facility and begin manufacturing the supplies, and then subsequently tried to withdraw.¹⁹⁹

In each of these cases, the reliance seemed (at the time the relying party had to act) desirable even to the other party to the transaction. Thus, these cases, too, can be viewed as an attempt to fill a gap in the parties' dealings by asking whether a paradigmatic *S* had any reason to want to be bound in order to induce efficient reliance by a paradigmatic *B*. Indeed, given the similarity between these cases and those decided under the other doctrines discussed earlier, it is unclear why the estoppel doctrines are so often viewed as an infringement on private autonomy or freedom of contract.²⁰⁰ To be sure, the black letter tests of the estoppel doctrines do not explicitly ask whether *S* intended to be bound—but the same is true of the more traditional black letter tests for how long an offer remains open, or for whether an acceptance takes effect when posted or when received. Moreover, the black letter tests used by the estoppel doctrines do ask whether *S* has made an *offer* (or, in the case of promissory estoppel,

N.W.2d 114, 115-16 (Minn. 1981). For a similar interpretation of these employment offer cases, see Barnett & Becker, *supra* note 72, at 478-80.

197. Bixler v. First Nat'l Bank of Or., 619 P.2d 895, 898 (Or. Ct. App. 1980); see also First Nat'l Bank of Logansport v. Logan Mfg. Co., 577 N.E.2d 949, 955-56 (Ind. 1991) (holding bank liable when the bank's officer encouraged businessmen to buy a company and move it to bank's city, even though the final loan documents were never approved).

198. Elvin Assocs. v. Franklin, 735 F. Supp. 1177, 1183 (S.D.N.Y. 1990).

199. Werner v. Xerox Corp., 732 F.2d 580 (7th Cir. 1984).

200. E.g., E. ALLAN FARNSWORTH, CONTRACTS § 3.26, at 208 (2d ed. 1990) ("[T]he [Red Owl] decision may fit better into that field of liability for blameworthy conduct that we know as tort, instead of that field of liability based on obligations voluntarily assumed that we call contract."); Comment, *Once More into the Breach: Promissory Estoppel and Traditional Damage Doctrine*, 37 U. CHI. L. REV. 559, 575 (1970) ("[S]ince action-in-reliance designates a promise enforceable at some point prior to the moment of normal contract formation, it impliedly represents a departure from the notion that private autonomy determines what promises will be enforced.") (footnote omitted).

whether she has made a *promise*), and these tests certainly invite inquiry into *S*'s likely intentions at the time she spoke.²⁰¹ And there can be little doubt that if *S* is sufficiently explicit in disclaiming any intention to be bound, neither estoppel doctrine will apply.²⁰² For example, the Red Owl representatives could have told Hoffman, "We think you are likely to be awarded a franchise—but we can't be 100 percent positive, and we aren't willing to commit our company just yet, so if you start relying now you'll be doing so at your own risk." Instead, the Red Owl representatives remained silent (or sent conflicting signals) on the question of whether Red Owl meant to be legally committed, thus leaving it to the court to resolve that ambiguity as best it could.²⁰³

Indeed, one should not forget that many cases resolve this ambiguity by holding *S* is *not* bound by *B*'s reliance, even when *S* has not disclaimed responsibility as explicitly as in the preceding paragraph. Significantly, courts reach this outcome most often when *B*'s reliance did not increase the expected value of the transaction, or when *B* had no reason to begin relying quite so soon. For example, one court refused to protect a party who was negotiating an oil lease and who began drilling before waiting for the other party's final approval—even though the drilling party's reliance (by drilling the well) was quite substantial.²⁰⁴ In another case, a laundry service began negotiating with a hospital for a three-year contract. During the negotiations, the laundry expanded its facilities (having been encouraged to do so by hospital officials) in the hope of being awarded the contract. The court refused to hold the hospital liable, partly because much of the reliance came before the laundry had received any encouragement from hospital officials, and partly because the court found the expansion of facilities was not relationship specific.²⁰⁵ In several other cases, courts have ruled that the parties did not intend to commit until final contract docu-

201. The importance of the court's decision as to whether a promise was made has often been remarked in connection with the other uses of promissory estoppel—for example, its use as a substitute for consideration to make donative promises and charitable pledges enforceable. *E.g.*, Daniel A. Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake"*, 52 U. CHI. L. REV. 903, 907, 937 (1985); Edward Yorio & Steve Thel, *The Promissory Basis of Section 90*, 101 YALE L.J. 111, 153-66 (1991). Farber & Matheson, *supra* at 922-24, suggest that, in this context too, courts often decide this issue by looking to whether the promisor had any reason to want to induce the promisee to rely. *See also* Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 713-16 (1984) (analysing promisor's "reason to know" as the connecting link between promise and promisee's reliance). On the use of promissory estoppel to avoid other technical requirements, such as the Statute of Frauds, see Barnett & Becker, *supra* note 72, at 470-78.

202. *E.g.*, McKee v. First Nat'l Bank of Brighton, 581 N.E.2d 340, 341-42 (Ill. App. Ct. 1991) (denying recovery to franchisees who relied on a loan arrangement that was still subject to an unfulfilled condition, when the lending bank had warned them they were relying at their own risk). *See also* Werner, 732 F.2d at 583, where the court held Xerox liable for Werner's reliance on Xerox's assurances that Werner would be selected as Xerox's supplier. The court refused, however, to let Werner recover for that part of its reliance that occurred after another Xerox official had warned Werner that its selection as Xerox's supplier was not likely. *Id.* at 583. For further discussion of Werner, see note 199 *supra* and accompanying text.

203. For further discussion of Red Owl, see texts accompanying notes 35, 73, 193 *supra*.

204. Smith v. Sabine Royalty Corp., 556 S.W.2d 365, 367, 371-72 (Tex. Civ. App. 1977); *see also* American Handkerchief Corp. v. Frannat Realty Co., 109 A.2d 793, 796 (N.J. 1954) (holding that landlord was not bound because there was no reason for the tenant to rely (by finding a sublessee) before learning if landlord would approve the subtenant).

205. Lavoie v. Safecare Health Serv., Inc. 840 P.2d 239, 250-51 (Wyo. 1992).

ments were prepared, and that anyone who relied before that time relied at his own risk.²⁰⁶

The fundamental similarity between the estoppel doctrines and the other rules of contract formation is underscored by the large number of cases that rest their decisions on more than one doctrinal ground. When courts feel that the party in *S*'s position ought to be bound—as, for example, in the general contractor/subcontractor disputes discussed earlier—they are reluctant to release the subcontractors under any of the other doctrines discussed in this article. Thus, courts have usually rejected arguments that the subcontractor's bid was not really an offer,²⁰⁷ or that the subcontractor's offer had lapsed because a reasonable time had expired,²⁰⁸ or that an equivocal response by the general contractor was not really an acceptance,²⁰⁹ or that the contract was too indefinite to be enforced,²¹⁰ or that the parties did not intend to be bound until a formal contract was prepared.²¹¹ In other cases, when the courts feel that the party in *S*'s position should *not* be bound, they not only refuse to hold her bound under the estoppel doctrines, but also rule that her communications did not constitute an offer, or that *B* did not use the proper method of acceptance, or that *S*'s offer had lapsed by the passage of a reasonable time.²¹² This high degree of overlap suggests that the estoppel cases reflect the parties' likely intentions to exactly the same extent—no more and no less—as do cases applying the traditional rules of offer and acceptance.

E. Preliminary Agreements

The estoppel doctrines are closely related to another doctrine that courts use to determine when an enforceable commitment begins. Often, negotiating parties reach a preliminary agreement (which may even be in writing), but they

206. *E.g.*, *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 264-65 (2d Cir.), *cert. denied* 469 U.S. 828 (1984); *Wright v. United States Rubber Co.*, 280 F. Supp. 616, 620 (D. Or. 1967); *Smith v. Boise Kenworth Sales, Inc.* 625 P.2d 417 (Idaho 1981); *Werner v. Norwest Bank S.D.*, 499 N.W.2d 138, 142 (S.D. 1993); *cf. Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 817 (7th Cir. 1987) (holding that parties did not intend to be bound to entire contract until final documents were signed, but remanding case to decide whether *S* should nevertheless be liable for *B*'s losses from giving up a particular opportunity at *S*'s request). The possible bases for deciding that parties do not intend to be fully committed until the final documents are signed are discussed in text accompanying notes 213-228 *infra*.

207. *E.g.*, *Maryland Supreme Corp. v. Blake Co.*, 369 A.2d 1017, 1023-25 (Md. 1977).

208. *E.g.*, *Loranger Constr. Corp. v. E.F. Hauserman Co.*, 374 N.E.2d 306, 310 (Mass. App. Ct.), *aff'd*, 384 N.E.2d 176 (Mass. 1978).

209. *E.g.*, *Debron Corp. v. National Homes Constr. Corp.*, 493 F.2d 352 (8th Cir. 1974); *see also Alpha Venture/Vantage Properties v. Creative Carton Corp.*, 370 N.W.2d 649, 652-53 (Minn. Ct. App. 1985) (resting enforcement alternatively on promissory estoppel or on an acceptance that was valid despite its introduction of new terms). For further discussion of *Alpha Venture*, see notes 139-140 *supra* and accompanying text.

210. *E.g.*, *Saliba-Kringlen Corp. v. Allen Eng'g Co.*, 92 Cal. Rptr. 799 (Ct. App. 1971); *Ingrassia Constr. Co. v. Walsh*, 486 A.2d 478 (Pa. Super. Ct. 1984).

211. *E.g.*, *Jaybe Constr. Co. v. Beco, Inc.*, 216 A.2d 208, 211 (Conn. Cir. Ct. 1965).

212. *E.g.*, *Smith v. Sabine Royalty Corp.*, 556 S.W.2d 365, 368-69 (Tex. Civ. App. 1977) (relying on all of these doctrines as alternative bases for its decision); *Lavoie v. Safecare Health Serv., Inc.*, 840 P.2d 239, 250 (Wyo. 1992) (rejecting a promissory estoppel argument, and also refusing to find either a bilateral or a unilateral contract). For further discussion of *Sabine* and *Lavoie*, see notes 204-205 *supra* and accompanying text.

also agree to draw up a more formal contract.²¹³ Such preliminary agreements frequently occur in negotiations over the sale of a business or in other complex deals in which one group of negotiators conducts the discussions leading to the preliminary agreement, but lawyers then prepare and review the final documents. If the parties are unable to agree on the final documents, or if one side simply changes its mind before those documents are executed, the courts must decide whether the parties remained free to withdraw while the final documents were being prepared or whether they instead became bound as soon as the preliminary agreement was reached.

The courts seem to agree that the issue in these cases is whether the parties intended to be bound, keeping in mind that intentions must be interpreted objectively and that secret intentions undisclosed by one party are irrelevant.²¹⁴ As one court put it, "The point of these rules is to give parties the power to contract as they please, so that they may, if they like, bind themselves orally or by informal letters, or that they may maintain 'complete immunity from all obligation' until a written agreement is executed."²¹⁵ The difficulty, of course, lies in deciding how the parties' intentions should be interpreted. Echoing earlier criticisms, Allan Farnsworth concluded, "It would be difficult to find a less predictable area of contract law."²¹⁶

Part of the difficulty may be that, in many of these cases, each party's motive for being committed (or not) has little to do with the desire to induce efficient reliance. Especially in complex negotiations over the sale of a business, the parties' motives may be more influenced by the dynamics of negotiations ("If we commit to this much now, will we be more or less likely to win favorable concessions on other parts of the deal?") or by changes in their estimates about the future value of the business ("If we remain uncommitted for a little longer, maybe economic conditions will improve or another buyer will make us a better offer"). While a full understanding of these factors might make it possible to say something about the precise point at which it becomes efficient for one or both parties to be bound,²¹⁷ at present it is very difficult to generalize.

That said, a number of these cases *do* involve reliance by one party or the other, and in those cases the incentives to rely, or to induce reliance, often play the same role they have played under the other doctrines discussed above. For example, in one case Borg-Warner negotiated to acquire a smaller corporation, Anchor Coupling.²¹⁸ The parties agreed on the price of the sale (subject to Borg-Warner's inspection of the company's assets), but had not yet agreed on other terms, including a provision guaranteeing the continued employment of

213. For a good description of the form that preliminary agreements can take, see E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 249-63, 287-94 (1987).

214. *E.g.*, *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 814-15 (7th Cir. 1987).

215. *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74 (2d Cir. 1984) (quoting 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 30, at 98 (1963)).

216. Farnsworth, *supra* note 213, at 259-60.

217. See text accompanying notes 19-20 *supra*.

218. *Borg-Warner Corp. v. Anchor Coupling Co.*, 156 N.E.2d 513 (Ill. 1958).

one of Anchor's principal officers and the retention of lower-level personnel. Borg-Warner was reluctant to incur the expense of inspecting the company's assets without a complete agreement or a binding option, but the sellers assured Borg-Warner that the quoted price was "in effect an option," and that the provisions concerning continued employment did not prevent the offer from being capable of acceptance.²¹⁹ Borg-Warner proceeded to inspect the company's assets, but the sellers later tried to withdraw from the deal, arguing that no agreement had been reached on what they regarded as key terms. In rejecting this argument, the court observed that:

The fact that plaintiff spent large sums of money in conducting a survey of Anchor's business certainly tends to indicate that it believed a mere acceptance of defendant's offer would be sufficient to form a contract. If plaintiff had believed that employment contracts had first to be agreed upon, one would seriously question whether it would expend such large sums without attempting to negotiate such contracts.²²⁰

To be sure, reliance on a preliminary agreement is somewhat less likely to be efficient (all else equal) than reliance after the terms of the agreement have all been settled. The efficient level of reliance depends in part on the probability that the deal will eventually be consummated, and the more terms on which the parties have not reached agreement, the greater the chance that something will intervene to prevent consummation. Nevertheless, in cases where it appears that it was indeed efficient for one party to begin relying at the preliminary agreement stage—and especially where the other party appears to have wanted the first party to rely, as in the *Borg-Warner* case—courts have often concluded that the preliminary agreement was meant to create a binding commitment.

Indeed, if we look beyond the cases involving corporate acquisitions, illustrations of this tendency are abundant. In one case, a company planning to drill for oil (on property whose mineral rights it had leased) offered another company a half-share in the costs and profits. The parties' preliminary exchanges expressly contemplated a formal joint venture agreement, but they proceeded to drill the well and share the costs without preparing a formal document. When the well proved profitable, the company that held the lease of the mineral rights denied that it was bound to grant the other party a half-share in the profits, arguing that the contemplated formal documents had never been executed. In rejecting this argument, the court used language very similar to that in the *Borg-Warner* case. As this court put it, "One party does not agree to bear one-half of the costs of, and actually pour more than \$100,000 into, a wildcat venture, the fruition of which leaves the reaping of all, or mostly all, the benefits to the party paying the other half."²²¹ That is, the court took into account the fact that the project would never have gotten underway without the reliance the preliminary agreement had induced.

219. *Id.* at 515.

220. *Id.* at 517.

221. *Franco W. Oil Co. v. Fariss*, 66 Cal. Rptr. 458, 471 (Ct. App. 1968).

In another case, a buyer of construction services repeatedly delayed signing the final documents, but nonetheless encouraged the construction firm to prepare drawings, reserve time in its production schedule, and so on. This court, too, had little difficulty ruling that these parties had meant to be bound even before they signed the final documents.²²² A similar result was reached when the owner of a house repeatedly refused to sign a written contract, but urged the builder to begin repairing the dwelling's fire-damaged roof immediately ("The roof ought to be fixed, so get on it.").²²³ In yet another case, an airline seeking housing for its flight crews refused to sign any final documents, but urged the owner of a planned apartment building to finish the building soon, and encouraged him to modify the building's construction to meet the airline's needs. Again, the court ruled that the parties could have intended to be bound at the time of the preliminary agreement.²²⁴

By contrast, there are cases where the party in *S*'s position used language that was every bit as encouraging, but there was no immediate need for the party in *B*'s position to rely on those assurances. In those cases, the courts have usually refused to infer an intent to be bound at the stage of the preliminary agreement. For example, in one case the officials of a franchise chain assured a local applicant that it would be awarded a franchise, using expressions such as: "It's official," and "you 'should have no problems, . . . [the Carowinds franchise] is yours.'"²²⁵ These assurances are strikingly similar to the ones found to constitute a binding promise in *Hoffman v. Red Owl Stores*.²²⁶ In *Red Owl*, however, the applicant for the franchise had an immediate opportunity to rely, and the franchisor wanted to encourage that reliance. In *Blanton Enterprises*, by contrast, the applicant had no immediate occasion to rely on the franchisor's assurances, and therefore the franchisor had no reason to want to be committed at this stage. Not surprisingly, the court refused to find that the preliminary agreement was meant to be binding.

Indeed, even in cases where the party in *B*'s position did rely on *S*'s assurances, if *S* had no reason to induce that reliance, courts have usually treated the preliminary agreement as nonbinding.²²⁷ One court reached the same result where *B*'s reliance did have some (potential) value to *S*, but *B* would have

222. *Steeltech Bldg. Prods., Inc. v. Edward Sutt Assocs.*, 559 A.2d 228 (Conn. App. Ct. 1989).

223. *Moore v. Kuehn*, 602 S.W.2d 713, 715 (Mo. Ct. App. 1980).

224. *Zeman v. Lufthansa German Airlines*, 699 P.2d 1274 (Alaska 1985); see also *OA Corp. v. United States*, 17 Cl. Ct. 91 (1989) (holding government bound to implied-in-fact contract to pay for supplier's start-up expenses, when government urged supplier to begin performing before all contract terms were officially approved); *Quake Constr., Inc. v. American Airlines, Inc.*, 537 N.E.2d 863 (Ill. App. Ct. 1989) (holding buyer bound when it encouraged builder to make expenditures in preparation for project).

225. *Blanton Enters., Inc. v. Burger King Corp.*, 680 F. Supp. 753, 776 (D.S.C. 1988) (alteration in original).

226. 133 N.W.2d 267 (Wis. 1965). See notes 35-36, 71 *supra* and accompanying texts; see also *Cellucci v. Sun Oil Co.*, 320 N.E.2d 919 (Mass. App. Ct. 1974) (resting liability on similar assurances by the franchisor's representatives).

227. See, e.g., *Smith v. Sabine Royalty Corp.*, 556 S.W.2d 365 (Tex. Civ. App. 1977); *Elkhorn-Hazard Coal Co. v. Kentucky River Coal Corp.*, 20 F.2d 67 (6th Cir. 1927); *Lavoie v. Safecare Health Serv., Inc.*, 840 P.2d 239 (Wyo. 1992). For further discussion of these cases, see notes 204, 123, & 205 *supra* and accompanying texts.

chosen the same level of reliance even without any commitment from *S*, thus removing the reason for making such a commitment.²²⁸ In short, the strength or weakness of *S*'s desire to induce additional reliance often plays a key role in the court's interpretation of a preliminary agreement.

F. Indefinite Agreements

Similar issues arise when *S* argues that she should not be held to an alleged contract because the contract leaves open too many terms, and thus is too indefinite to be enforceable. This issue often comes up in cases involving preliminary agreements, which (almost by definition) usually leave at least some aspects of the deal unresolved. Doctrinally, however, the two issues are distinct. An agreement could be too indefinite to be enforced even if the parties have no intention of drafting any further, more formal contract. Conversely, a preliminary agreement could be unenforceable if the parties did not intend it to be binding, even if it included enough terms to pass all the normal tests of definiteness.

While these doctrinal issues are distinct, the underlying policy concerns are similar. The more terms left open, the less likely that it will be efficient for *B* to begin relying on the proposed transaction, since the risk of disagreement over the remaining terms reduces the probability that the deal will ever be consummated (just as in the case of preliminary agreements). In addition, contracts that leave open a large number of terms increase the risk of judicial error, by increasing the chance the court will fill gaps with terms that one or both parties would not have wanted. As a result, some courts interpret the "definiteness" requirement as a penalty default, designed to force the parties to fill the gaps themselves if they want their contract to be enforceable.²²⁹

However, a larger number of cases reject this penalty-default interpretation of the indefiniteness requirement. The risk of judicial error in filling in the missing terms is of course a matter of degree (as are the costs the parties would face in filling in those terms themselves), so this risk hardly implies that no *S* would ever want to be bound to an indefinite agreement. The penalty-default approach would make *S*'s likely intentions irrelevant, for that approach directs courts to deny enforceability *in spite of S's intentions* in order to force *S* to be

228. See *Wright v. United States Rubber Co.*, 280 F. Supp. 616, 620 (D. Or. 1967). The court remarked,

Like the gambler who is already over-committed to the pot, Wright felt he had no alternative. He went ahead, not in reliance on promises made by defendant, but in complete desperation on finding no other alternative. If I found myself in the same position, I probably would feel there was nothing more to be lost and take the same chance.

The court also rejected Wright's promissory estoppel argument, for the same reason. *Id.*

229. See, e.g., *Goldstick v. ICM Realty*, 788 F.2d 456 (7th Cir. 1986).

If people want the courts to enforce their contracts they have to take the time to fix the terms with reasonable definiteness so that the courts are not put to an undue burden of figuring out what the parties would have agreed to had they completed their negotiations. The parties have the comparative advantage over the court in deciding on what terms a voluntary transaction is value-maximizing; that is a premise of a free-enterprise system.

Id. at 461. Interestingly, the *Goldstick* court upheld a promissory estoppel cause of action, despite the indefiniteness of the alleged promise. *Id.* at 462; see note 275 *infra*.

more explicit in the future. But most courts instead profess a desire to respect the parties' likely intentions, and have adopted a test for definiteness that treats the number of terms left open merely as evidence of the parties' likely intent. As one court put it, the test is whether "the parties themselves meant to make a 'contract' and to bind themselves to render a future performance,"²³⁰ or whether the parties instead had no intention to be bound.

The difficult cases, of course, are those in which the parties have not expressed their intention with unmistakable clarity. In these cases, if courts are really trying to respect the parties' likely wishes regarding enforceability, they must address issues very similar to those discussed in connection with preliminary agreements. For example, is there any reason to think that *S* would have benefited by binding herself even before all the terms had been worked out, or would *S* have been better off remaining uncommitted? Once the questions are framed in this way, it is hard to avoid considering the effect of *S*'s commitment (or noncommitment) on *B*'s incentive to rely on the proposed transaction. As a result, it should not be surprising that *B*'s incentives to rely play an important role in many cases arising under this doctrine as well.

As an example, consider *Williams v. Jones*,²³¹ where some venture capitalists agreed in principle to refinance an engineer's consulting operations. Afterwards, they all adjourned to a nearby country club for a celebratory lunch. The engineer then proceeded with the actions the financiers had requested, including liquidating his old company and going to work for a new one. Presumably, the financiers wanted the engineer to embark on these steps; presumably, too, the engineer would not have taken these steps if he thought the financiers were still free to withdraw from the arrangement. Thus, when the financiers later tried to withdraw, the court held them bound, despite the fact that many key terms had not yet been specified.²³²

In yet another case, a manufacturer expected its shipping needs to increase and apparently agreed (in somewhat vague terms) to hire a particular trucking company to handle the increased shipping. The manufacturer urged the trucking company to expand its fleet of trucks and helped it obtain financing to do so. Later, when the manufacturer's shipping needs failed to increase as expected, the manufacturer tried to cancel the relationship. Because the manufacturer clearly had wanted the shipping company to rely in this way, the court found that the parties had intended to create an enforceable commitment and upheld the trucking company's action for breach of contract.²³³ By contrast, in other cases where the party in *B*'s position did not appear to have had any

230. *Lee v. Joseph E. Seagram & Sons, Inc.*, 552 F.2d 447, 453 (2d Cir. 1977) (quoting CORBIN, *supra* note 215, § 97, at 424-26).

231. 366 S.E.2d 433 (N.C. 1988).

232. *Id.* at 438. Indefiniteness has also usually been rejected as a bar to enforcement in the general contractor versus subcontractor disputes discussed earlier, at least when the general contractor has relied on the subcontractor's bid. See text accompanying note 210 *supra*.

233. *Knauf Fiber Glass, GmbH v. Stein*, 615 N.E.2d 115, 119-23 (Ind. Ct. App. 1993). The court also upheld the trucking company's cause of action based on promissory estoppel. *Id.* at 123.

immediate need to rely, courts have been perfectly willing to deny enforcement.²³⁴

G. *Liability in Restitution*

Finally, in cases where *B* has conferred some form of benefit on *S*, courts may be able to bind *S* by letting *B* sue in restitution.²³⁵ Since restitution is an obligation implied by law, which does not require the formation of an enforceable contract, it might seem to stand on a different footing from the other doctrines discussed above. But the net result is the same: If an action in restitution is permitted, *B* will be allowed to recover money from *S* if *S* refuses to go forward with the deal. As a consequence, the restitution cases often show a similar concern for *B*'s reliance incentives.

For example, in cases where it does not appear that the parties meant to be bound, courts are quick to deny recovery on the ground that *B* was a mere volunteer who, if he conferred any benefits on *S*, did so at his own risk.²³⁶ But when the actions of *B* which conferred the benefit on *S* appear to have been in both parties' interests (when viewed at the time *B* had to act), the courts are less quick to treat *B* as acting at his own risk, and more inclined to let *B* recover in restitution. In one case, for example, an architect was hired to draw plans for a new development, and he began drawing the plans (at the owner's request) even though his employment contract still omitted a number of key terms. When the owner later tried to cancel the arrangement, the court ruled that the employment contract might have been too indefinite to be enforceable in its own right, but allowed the architect to recover the reasonable value of his plans in restitution.²³⁷

It might seem that an action in restitution would not always be available to protect *B*'s reliance. Normally, restitution protects only those forms of reliance that actually confer a benefit on the party in *S*'s position, and the measure of recovery is generally limited to the value of the benefit conferred. However,

234. See, e.g., *Bare v. Kansas City Fed'n of Musicians Local 34-627*, 755 S.W.2d 442, 445 (Mo. Ct. App. 1988) (finding insufficient evidence that *B* had relied); *Bethlehem Steel Corp. v. Litton Indus. Inc.* 488 A.2d 581, 589 (Pa. 1985) (same). The *Bare* case also rejected *B*'s claim of promissory estoppel.

235. For general discussion of the law of restitution (as applied to contract formation cases), see Farnsworth, *supra* note 213, at 229-33; Gareth Jones, *Claims Arising Out of Anticipated Contracts Which Do Not Materialize*, 18 U. W. ONT. L. REV. 447 (1980).

236. E.g., *Songbird Jet Ltd. v. Amax Inc.*, 581 F. Supp. 912, 926 (S.D.N.Y. 1984) ("Every businessman faces the risk that the substantial transaction costs necessary to bring about a mutually beneficial contract will be lost if the negotiations fail to yield a satisfactory agreement.") (quoting *Gruen Indus. v. Biller*, 608 F.2d 274, 282 (7th Cir. 1979)); *Rutledge v. Housing Auth. of E. St. Louis*, 411 N.E.2d 82, 86 (Ill. App. Ct. 1980) ("Where preliminary services are conferred for business reasons, . . . quasi-contractual relief is unwarranted."); see also *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 263 (2d Cir.), *cert. denied*, 469 U.S. 828 (1984) (rejecting argument that benefits provided during preliminary negotiations had unjustly enriched the other party and refusing to find that any benefits had in fact been provided).

237. *Bodmer v. Turnage*, 233 P.2d 157 (Cal. Dist. Ct. App. 1951); see also *Hill v. Waxberg*, 237 F.2d 936 (9th Cir. 1956) (permitting an action in restitution on similar facts, and rejecting the argument that the developer could not have meant to incur any enforceable obligation until all the documents were finalized).

courts have shown some flexibility in this area, both in finding a benefit and in measuring the value of that benefit. In the case just described, for example, the proposed development was never built, so the architect's plans never really benefitted the owner. Still, the court ruled that there had been enough of a benefit (or a potential benefit) to permit the action in restitution.²³⁸ In another case, while a seller and buyer were negotiating over the sale of a building, the seller made some alterations to the building at the buyer's request. When the negotiations subsequently broke down, the court allowed the seller to recover the reasonable value of those alterations—even though the buyer never purchased the property, and thus never really benefitted from the alterations.²³⁹

In another, even more striking case, a developer negotiated with a builder to build a trailer park on two adjacent parcels of land. The developer already owned one parcel and planned to acquire the other. The developer's building permit was due to expire if construction was not begun by a certain date, so the developer asked the builder to begin construction even though the details of the construction contract had not yet been fully worked out. The builder went ahead and erected structures on both parcels of land, but the developer then encountered financial problems and abandoned the project without ever signing a construction contract or acquiring the second parcel of land. Nevertheless, the court allowed the builder to recover in restitution—and not only for the building on the land that the developer owned, but also for the building on the adjacent parcel that the developer never acquired.²⁴⁰ While it was clearly a fiction to say that the second building ever "enriched" the developer, the court expressed its "determination to protect 'justifiable reliance,'"²⁴¹ and ruled that the builder had reasonably relied on the belief that the developer would pay for the construction.²⁴²

While these decisions are difficult to square with traditional principles of restitution, they are entirely consistent with the other doctrines discussed here.²⁴³ In each case, *B* relied in a way that *S* thought would increase the expected value of the proposed transaction, and *B* probably would not have been willing to rely if *S* had remained free to withdraw at any time. These are exactly the cases where it is plausible to suppose that most parties in *S*'s position would have wanted to place themselves under an enforceable obligation, in order to induce this efficient level of reliance.

238. *Bodmer*, 233 P.2d at 159.

239. *Kearns v. Andree*, 139 A. 695 (Conn. 1928); see also *Abrams v. Fin. Serv. Co.*, 374 P.2d 309 (Utah 1962) (allowing the seller to recover in restitution for alterations requested by the buyer after signing a conditional sales contract, when the condition was never fulfilled and so the sale was never consummated).

240. *Earhart v. William Low Co.*, 600 P.2d 1344, 1352 (Cal. 1979).

241. *Id.* at 1351.

242. *Id.* at 1352.

243. Cf. *Farnsworth*, *supra* note 213, at 232 (noting that "a claimant who can show a request for its services can often make out a claim based on a contract implied-in-fact"). For an argument that many other uses of restitutionary remedies in contract law have more to do with contract principles than with any core notion of restitution, see Andrew Kull, *Rationalizing Restitution*, 83 CAL. L. REV. 1191 (1995).

V. ALTERNATIVES TO A CASE-BY-CASE ANALYSIS

Many of the cases just described might be criticized as judicial "manipulation" of legal doctrines or "result-oriented" jurisprudence. But this criticism must be phrased with care: If the "result" that contract law aims at is carrying out the parties' apparent intentions, "manipulation" of the legal doctrines to reach that result may be entirely justifiable. As a number of commentators have noted, contracting parties' are much more likely to frame their intentions in terms of the ultimate issue in the case ("Do I have a commitment?") than to frame them in terms of the law's doctrinal categories ("If I do have a commitment, would it result from a unilateral or a bilateral contract?").²⁴⁴ If the analysis presented in this article is correct, courts that "manipulate" the doctrinal categories may actually be more faithful to the parties' intentions, by implying a commitment just when most parties would want to be committed.

A different, though probably sounder criticism is that courts' attempts to gauge the parties' likely intentions on a case-by-case basis are apt to produce unpredictable and/or erroneous results. The analysis presented here implies that, in order to tell whether *S* would want to be committed to *B*, the courts must decide on a case-by-case basis whether *B*'s reliance increased the expected value of the transaction at the time he relied. As Part III pointed out, this decision will not always be easy. And if courts are not very good at making such decisions, their attempts to identify the parties' intentions on a case-by-case basis could have the perverse effect of making it *less* likely that the parties' actual intentions would be realized in any given case.

This concern is probably what underlies the fear, expressed by both courts and commentators, that rules permitting courts to find implied commitments at an early stage of negotiations could make parties more reluctant to begin negotiations in the first place.²⁴⁵ If courts never made errors, and imputed such commitments only when an enforceable commitment would increase the welfare of both parties, negotiations would not be discouraged since the parties could be confident that they would be committed only when it was in their own interest. But if there is some chance that courts will err, by ruling that *S* is committed when she would actually prefer not to be, the effect may well be to discourage some *S*'s from ever beginning negotiations.

Indeed, this concern suggests a different interpretation of the intuition that contract rules basing liability on one party's reliance result in "involuntary" or "tort-like" obligations.²⁴⁶ If the essence of contract law lies in its formal predictability, or in the parties' ability to determine what responsibilities they have assumed without having to speculate about how a court might later view the case,²⁴⁷ obligations based on an assessment of the efficiency of *B*'s reliance do

244. See generally Corbin, *supra* note 7 (defining legal relations resulting from acts of offer and acceptance); Llewellyn, *supra* note 1 (discussing case law doctrine of contracts).

245. See, e.g., Farnsworth, *supra* note 213, at 243. For an economic model of this effect, see Johnston, *supra* note 32.

246. See text accompanying notes 13-16 *supra*.

247. Cf. JAMES BRADLEY THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 428-29 (1896) (describing, skeptically, "that lawyer's Paradise where all words have a fixed, precisely

indeed depart from an ideally predictable regime. Of course, the same could be said of nearly all rules of contract law—not just the rules of offer and acceptance, but also the default rules governing implied excuses (when does a contract implicitly allocate the risk of a sudden increase in costs?²⁴⁸) or the remedies for breach (when it is appropriate to award the full cost of fixing some defect in performance?²⁴⁹). On this view, virtually all of contract law would be “tort-like” or “involuntary,”—thus confirming Grant Gilmore’s thesis about the death of contract,²⁵⁰ but only in an uninteresting way.

The question, then, is whether there is any superior alternative to attempting to assess the efficiency of *B*’s reliance on a case-by-case basis. While many such alternatives are no doubt possible, the alternatives I consider in this Part eschew case-by-case analysis in favor of bright line rules. On the question of how long an offer ought to stay open, for example, the law could adopt some rule such as, “all offers will remain open indefinitely, unless a specific time of termination is stated in the offer.” The rationale for such a rule would not be that most offerors want their offers to remain open indefinitely—that would clearly be false—but rather that this rule would give offerors an incentive to state their offers’ intended duration more clearly, to avoid being subject to the “indefinite duration” rule. If such a rule did induce offerors to state their preferred duration explicitly, courts would not need to make their own assessment of how long any particular *S* might have wanted her offer to stay open.

Although Ayres and Gertner use the term “penalty default” to describe these rules,²⁵¹ this terminology is somewhat misleading. The rule considered in Part III.B (inferring a commitment whenever a better-informed *S* recommends a particular level of reliance) was a “penalty” because it was slanted against the better-informed party, giving her an incentive to share her information with the other party. By contrast, default rules designed to encourage parties to make their agreements more explicit are not necessarily slanted against either party: they do not have to be “penalties” in that sense of the term. For example, the benefits described in the preceding paragraph could also be obtained from a bright line rule stating that “all offers will remain open for exactly two days, unless some other time of termination is stated in the offer.” Under this rule, all offerors who preferred a longer or shorter period would

ascertained meaning; where men may express their purposes, not only with accuracy, but with fulness; and where, if the writer has been careful, a lawyer, having a document referred to him, may sit in his chair, inspect the text, and answer all questions without raising his eyes”).

248. Compare, e.g., Posner & Rosenfield, *supra* note 17 (discussing the economic factors relevant to this decision), with Andrew Kull, *Mistake, Frustration, and the Windfall Principle of Contract Remedies*, 43 HASTINGS L.J. 1, 42-52 (1991); see also Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 284-90 (1992) (criticizing such analyses as inevitably unpredictable); Alan O. Sykes, *The Doctrine of Commercial Impracticability in a Second-Best World*, 19 J. LEGAL STUD. 43, 93-94 n.154 (1990) (questioning courts’ ability to apply the impracticability doctrine in an efficient manner a predictable way, but recognizing the difficulty of designing alternative rules that would be any more predictable).

249. See, e.g., Timothy J. Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379 (1983) (discussing the economic considerations that might inform courts’ judgments on this issue).

250. See GILMORE, *supra* note 15.

251. Ayres & Gertner, *supra* note 17, at 95-100.

have an incentive to say so in their offer, while those who were happy with a two-day duration would remain silent.

Indeed, the benefits of predictability can usually be obtained even from a rule drafted to reflect what *most* parties want, thus producing a rule that is not a "penalty" at all under Ayres and Gertner's terminology. For example, if surveys showed that most offerors wanted their offers to remain open for exactly 1.7 days, that duration could be adopted as the bright line default rule.²⁵² Those who preferred longer or shorter times would still have an incentive to specify otherwise, while those who preferred 1.7 days could remain silent. In short, all that is needed to achieve predictability is a line that is truly bright: one that does not require difficult case-by-case analysis for courts to apply. Following Lon Fuller, I will refer to these bright line rules as "formalities."²⁵³

It is possible that some traditional contract formation doctrines could be defended as attempts to create a formality. For example, Allan Farnsworth describes traditional contract law as adopting an "aleatory" view, which holds that no liability will attach until there has been a valid offer and a valid acceptance. Under this view, anyone who relies on a proposed transaction before that point is deemed to be relying at his or her own risk.²⁵⁴ While some decisions, such as the Learned Hand opinion quoted earlier,²⁵⁵ suggest that this approach rested on a belief that no party in *S*'s position would ever want to assume liability at an earlier stage, a better rationale might be that it is just too hard for courts to tell whether or when *S* would want to assume liability.²⁵⁶ On this view, traditional contract law attempted to shift that determination to *S* by adopting a simpler bright line rule, such as never inferring any commitment unless *S* has explicitly said that she wants to be committed. If all *S*'s responded by explicitly assuming a commitment whenever a commitment would improve *B*'s reliance incentives, we would then have the best of both worlds, by inducing efficient reliance without ever requiring courts to make a case-by-case assessment of the efficiency of *B*'s actions.

252. In Ayres and Gertner's terminology, this rule would be an untailored "majoritarian" default rule. Ayres & Gertner, *supra* note 17, at 93-95; see also Ian Ayres, *Preliminary Thoughts on Optimal Tailoring of Contractual Rules*, 3 S. CAL. INTERDISCIPLINARY L.J. 1 (1993) (discussing the choice between tailored and untailored default rules).

253. Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 799-806 (1941). Ayres and Gertner recognize the similarity between some of their analysis and Fuller's earlier work. Ayres & Gertner, *supra* note 17, at 123-25. Other useful discussions of formalities in connection with contract formation issues include: Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1697-1701 (1976), and Douglas G. Baird & Robert Weisberg, *Rules, Standards, and the Battle of the Forms: A Reassessment of § 2-207*, 68 VA. L. REV. 1217 (1982).

254. Farnsworth, *supra* note 213, at 221. Of course, the common law also contained a number of exceptions to this principle, so the "aleatory view" may not have really described the law at any actual time. See *id.* at 229-39.

255. See text accompanying note 44 *supra*.

256. Cf. *United States v. Braunstein*, 75 F. Supp. 137 (S.D.N.Y. 1947).

Greater precision of expression may be required, and less help from the court given, when the parties are merely at the threshold of a contract. If a court should undertake to resolve ambiguities in the negotiations between parties, . . . it is hard to see where the line of demarcation could be drawn and the general effect would inevitably be a condition of chaos and uncertainty.

Id. at 139-40.

Similar arguments could no doubt be made on behalf of other, more specific rules of contract law—for example, the rule that offers expire whenever the offeree makes a counteroffer, or that offers made in face-to-face conversations expire at the end of the conversation. These rules probably do not reflect the intentions of all, or even most, contracting parties.²⁵⁷ But if these rules succeeded in inducing all parties who preferred something else to state their preferences more explicitly, then parties would achieve the goal of effectuating their preferences without requiring the courts to guess what those preferences might be.

In sum, formalities or bright line rules have obvious attractions. Nevertheless, as the discussion of the cases in Part IV demonstrates, courts have not confined themselves to bright line rules. Instead, courts have been quite willing to assess, on a case-by-case basis, the likelihood that any particular *S* would have wanted to commit herself in order to induce reliance by *B*. In the remainder of this Part, I survey some of the drawbacks associated with bright line rules to suggest reasons why courts have been unwilling to pursue this strategy. While many of these reasons have already been noted in the literature on legal formalities, some have special significance to the rules of contract formation.

A. *Private Transaction Costs*

One disadvantage of formalities is that, while they ease the burden on courts, they do so by increasing the burden on the contracting parties. That is, formalities relieve the courts from assessing what the parties intended, but shift that task to the parties by requiring them to make more explicit agreements. To be sure, that task may be more easily borne by the parties than the courts; this, after all, is the usual justification for a formality. But if the transaction costs the parties must incur are sufficiently large—and “transaction costs” should include the risks of not knowing or forgetting about the legal rule, as well as the more obvious costs of negotiating and drafting the agreement—the formality will not have its desired effect. Even if the cost to the parties is less than the cost to the courts, the cost to the parties may still be more than they are willing to incur, in which case they will leave the law’s default rule in force whether they prefer it or not. In such situations, the formality will not succeed in inducing the parties to select the most efficient rule.

Of course, this difficulty will usually be less significant when the parties are commercially sophisticated. For example, in negotiations over the sale of a business, where teams of lawyers are involved on both sides,²⁵⁸ it should be relatively easy for the parties to specify the point at which they intend to be committed. Perhaps as a result, these are the cases where one most often finds judicial testimony to the virtue of formal rules. As one court put it,

The ability to fix the consequences with certainty is especially important in commercial transactions that are planned with care in advance. A merger or the acquisition of assets will create many potential difficulties, and the parties

257. For a criticism of these (and other) rules from this perspective, see Eisenberg, *supra* note 9.

258. See notes 213-228 *supra* and accompanying text.

should be able to choose with precision the point at which they can no longer back out. . . . A rule of law that could bind the parties to a deal in the midst of resolving these uncertainties—perhaps worst of all, inject the random element of a jury's determination about subjective intent—would make transactions riskier.²⁵⁹

However, even sophisticated parties often fail to hammer out a written agreement on every aspect of their proposed transaction, as evidenced by the large number of cases involving a "battle of the forms."²⁶⁰ Of course, there may be feedback effects here, if uncertain legal doctrines make it difficult for even sophisticated parties to know what aspects of the transaction must be in writing, or whether it is worth spending the time to hammer out the terms.²⁶¹ Still, for better or worse, most courts have not been willing to stick to bright line rules in contract formation cases, even in cases involving large commercial transactions. In the decision just quoted, for example, the court rejected *B*'s claim that a preliminary agreement was intended to bind *S*, resting its decision in part on the need for certainty in commercial transactions. But the court remanded the case for trial to determine whether *S* could nevertheless be bound on a theory of promissory estoppel—with no reference, in this portion of the opinion, to the importance of certainty in commercial transactions.²⁶²

Other opinions display a similar inconsistency. In another case, the court began by announcing that "[i]t is important to commerce that the law make clear what force will be given to various expressions of intent, for otherwise parties could never be assured that they were, in fact, channeling their negotiations toward an oral contract or toward a written one."²⁶³ But the force of this argument was undercut (to say the least) by the court's very next sentence: "Hard and fast requirements of form are out of place, of course."²⁶⁴ The rest of the opinion proceeded to assess whether the parties in that particular case actually intended their preliminary agreement to be binding.

B. *Selecting a Bright Line Rule*

Another difficulty concerns the problem of just *which* bright line rule to use as a default rule. If all that matters is that the line be bright, then several possible rules will work more or less equally well. As a consequence, it may be hard for courts—especially courts in a decentralized, common law system—to coordinate on any single rule.

259. *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 815 (7th Cir. 1987).

260. See generally JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* § 1-3 (3d ed. 1988) (discussing the "battle of the forms" under U.C.C. § 2-207).

261. See, e.g., Mark P. Gergen, *The Texaco-Pennzoil Affair and the Economic Analysis of Remedies for Mistakes in Contract Formation*, 9 REV. LITIG. 441, 465-71 (1990) (discussing the Texaco-Pennzoil litigation from this standpoint).

262. *Skycom Corp.*, 813 F.2d at 817; cf. note 206 *supra* (citing cases where courts held that anyone who relies on preliminary agreements that were not intended to be binding does so at his own risk, so that there is no injustice in allowing the other party to withdraw).

263. *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74-75 (2d Cir. 1984).

264. *Id.* at 75.

The mailbox rule illustrates the problem nicely. This rule could be seen as a formality designed to force any offeror who doesn't want to be bound when an acceptance is dispatched to say so in her offer. On the other hand, the opposite rule (acceptances take effect only upon receipt) could be equally effective as a formality, for that rule would force any offeror who wanted the mailbox rule to say so in *her* offer. Predictably, then, it is not hard to find judicial opinions making the same formality-style argument for each of these possible rules. According to one court, application of the mailbox rule was justified because "[t]he defendant, had it desired to do so, could have limited the time of the reinstatement of the policies to the actual receipt by it . . . of the letter and check, but this it did not do."²⁶⁵ But according to another court, the opposite rule should apply because "[i]f it is intended that the requirements of notice are to be satisfied by mailing . . . the contract should say so."²⁶⁶

A related problem concerns the difficulty of selecting a rule that is suitably bright—that is, a rule that can be applied without detailed case-by-case analysis. This is the standard realist critique of legal formalities. As Duncan Kennedy points out, "a great deal of legal scholarship between the First and Second World Wars went into showing that legal directives that looked general and formally realizable were in fact indeterminate."²⁶⁷

Here, too, examples are easy to find in the law of contract formation. In one case, involving the issue of how long an offer remains open if no time limit is expressly stated, an insurance company made an offer to settle a disputed claim.²⁶⁸ The offerees waited two months to accept the offer. In the meantime, the statute of limitations on the underlying claim had expired, thus insulating the insurance company from suit. When the offerees then tried to accept the earlier settlement offer, the insurance company argued that it was obvious they could not have wanted their offer to stay open any longer than their exposure to suit on the underlying claim. The court rejected the insurance company's contention on the ground that courts should not have to assess what the parties probably wanted:

If an offering defendant wishes to limit the duration of his offer to a certain time, whether a date two years from the accident or otherwise, he need only so state in the offer itself. He is the master of his offer. There is no need for us to provide such a term where, as here, the defendant has not done so.²⁶⁹

The rule the court actually applied, however, did nothing to eliminate the courts' need to "provide" a term where the parties had failed to do so, or to eliminate the need for case-by-case assessments of the parties' likely intentions. In fact, the rule the court applied was simply the normal rule that, in the absence of an explicit statement otherwise, an offer is deemed to stay open for a *reasonable* time, where what is "reasonable" depends on an assessment of all

265. *Pennsylvania Lumberman's Mut. Fire Ins. Co. v. Meyer*, 126 F. 352, 354 (2d Cir. 1903).

266. *Livesey v. Copps Corp.*, 280 N.W.2d 339, 343 (Wis. Ct. App. 1979) (quoting *E.M. Boerke, Inc. v. Williams*, 137 N.W.2d 489, 494 (Wis. 1965)).

267. Kennedy, *supra* note 253, at 1700.

268. *Vaskie v. West Am. Ins. Co.*, 556 A.2d 436 (Pa. Super. Ct. 1989).

269. *Id.* at 439.

the relevant facts and circumstances.²⁷⁰ Accordingly, the court remanded the case for trial on this highly fact-specific question, and noted that the expiration of the statute of limitations was one factor the trial court could consider in deciding what time was reasonable.²⁷¹ This conclusion hardly created a bright and easy to follow rule.

Indeed, many of the other rules of contract formation are equally fuzzy. For example, the rule that a communication is an offer if it is reasonable to interpret it as giving the other party the power to accept²⁷² is not at all definite or bright. Neither is the rule that a counteroffer terminates the offeree's power of acceptance, while a "mere inquiry" does not;²⁷³ or the rule that indefinite agreements are unenforceable if they are "too" indefinite to be enforced.²⁷⁴ Thus, the courts have not found it very easy to develop bright line rules that could fulfill the promise of freeing them from the need for case-by-case assessment of *B*'s reliance.

C. *Controlling Interactions Among Doctrines*

A related, but more subtle problem, is that it may do little good to adopt a bright line rule to deal with one legal issue if there are six other ways of imputing liability that still require case-by-case analysis. This problem is particularly acute in the law of contract formation, where (as Part IV pointed out) so many legal doctrines overlap.

For example, it would be entirely possible to adopt a bright line default rule that an acceptance always takes effect when it is mailed, regardless of what any particular *S* or *B* might have intended. But this rule would still leave a court with the task of figuring out (1) whether *S* made an offer in the first place; (2) whether *S*'s offer lapsed before the acceptance was dispatched, because a reasonable time had passed or because *B* made a counteroffer; and (3) whether the document *B* dispatched was in fact an acceptance, rather than a counteroffer or a mere inquiry. The court might also have to decide (4) whether the purported acceptance produced a contract that was sufficiently definite to be enforceable; and (5) whether the parties intended to execute a more formal document later, and if so, (6) whether they intended to be bound before that formal document was executed. If each of these decisions must be made on a case-by-case basis, any certainty produced by the "bright line" mailbox rule will be illusory.

Examples of this problem are easy to find. The decision quoted earlier, denying a preliminary agreement any binding effect while recognizing that *S* could still be bound under a promissory estoppel theory, is one example.²⁷⁵

270. See text accompanying notes 101-104 *supra*.

271. *Vaskie*, 556 A.2d at 439.

272. See text accompanying notes 78-79 *supra*.

273. See text accompanying notes 137-143 *supra*.

274. See text accompanying notes 229-234 *supra*.

275. *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810 (7th Cir. 1987). For other cases holding that *S* was not committed under any traditional contract theory, but could still be held liable on promissory estoppel see *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69 (2d Cir. 1989); *Goldstick v. ICM Realty*, 788 F.2d 456 (7th Cir. 1986), see note 229 *supra*; *Elvin Assocs. v. Franklin*, 735 F. Supp. 1177 (S.D.N.Y. 1990), see note 198 *supra*.

Other examples include cases allowing recovery in restitution, even when the disappointed party might have no right to recover on any contractual theory.²⁷⁶ More frequently, of course, the courts reach the *same* result under each of the various legal theories that apply in any given case.²⁷⁷ But this fact strongly suggests that no single legal doctrine was both necessary and sufficient to the outcome, thus confirming the proposition that replacing any single doctrine with a bright line formality would have no effect.

D. *Interpreting Agreements to Supplant the Rule*

Most important of all, if courts are to adopt a formality to encourage parties to signal their preferences explicitly, the courts must first develop some method of recognizing when parties have in fact done so. Though the literature on default rules does not often discuss this issue,²⁷⁸ it is of particular importance where contract formation is concerned.

Consider, again, the mailbox rule. Most of the cases discussed in Part IV.C.1 concerned not the question of what default rule to adopt, but the question of whether *S*'s offer should be interpreted as changing the default rule. For example, how should a court treat an offer that says that the offeror must be "notified" by a certain date?²⁷⁹ Or what about an offer that requires an option to be "exercised" by a certain date?²⁸⁰ The opinions discussing such questions do not sound notably different from those in cases where *S*'s offer said nothing at all about the timing of acceptance. In particular, both sets of opinions show similar attention to the efficiency of *B*'s reliance incentives.²⁸¹

The same is true of many of the other doctrines discussed in Part IV. For example, when *S*'s offer specifies a particular mode of acceptance, the courts have had to interpret that specification to decide whether the listed mode of acceptance was meant to be exclusive or not.²⁸² The same is true of the cases that have to interpret *B*'s response to *S*'s offer as a counteroffer or a mere inquiry.²⁸³ Indeed, even the cases deciding what counts as an offer²⁸⁴ must (in effect) decide whether *S* has changed the otherwise applicable bright line de-

276. *E.g.*, *Hill v. Waxberg*, 237 F.2d 936, 940 (9th Cir. 1956); *Coleman Eng'g Co. v. North Am. Aviation, Inc.*, 420 P.2d 713, 724-29 (Cal. 1967); see text accompanying notes 235-243 *supra*.

277. See text accompanying notes 207-212 *supra*.

278. See *Ayres & Gertner*, *supra* note 17, at 119 n.133 (noting that a complete theory of default rules requires a theory of contract formation to determine whether an otherwise applicable default rule has been supplanted); *Ayres*, *supra* note 252, at 15-17 (same).

279. Compare *Livesey v. Copps Corp.*, 280 N.W.2d 339, 341 (Wis. Ct. App. 1979) (treating such language as changing the default rule, and requiring that the acceptance actually arrive by the stated date) with *Worms v. Burgess*, 620 P.2d 455, 456-57 (Okla. 1980) (allowing an acceptance to take effect if mailed by the stated date).

280. *E.g.*, *Jameson v. Foster*, 646 P.2d 955, 958 (Colo. Ct. App. 1982) (treating an exercise requirement as "plain language" reversing the default rule that would otherwise apply, and allowing acceptance of an option contract to take effect when mailed); see also *McTernan v. LeTendre*, 351 N.E.2d 566, 567 (Mass. App. Ct. 1976) (treating language requiring that an option be "accepted" by a certain date similarly), see note 117 *supra*.

281. See texts accompanying notes 124-136 & 268-271 *supra*.

282. See text accompanying notes 178-181 *supra*.

283. See text accompanying notes 137-143 *supra*.

284. See text accompanying notes 78-94 *supra*.

fault rule (no commitment at all unless the parties explicitly agree to one) by her ambiguous communication. That is, the difficult issues involved in finding an offer usually involve interpreting actual language that might have altered the default rule, rather than deciding what consequences to impute to a party who has merely said nothing.

In short, even when courts start with a bright line default rule, they must often revert to an analysis of whether a commitment would be efficient in order to decide whether the parties have contracted around the bright line default. This conclusion should not be too surprising, for philosophers of language have long recognized that the interpretation of utterances often requires some understanding of what the speakers would be likely to want under the circumstances.²⁸⁵ But if courts, in deciding whether parties have contracted around a bright line default rule, must first assess what the parties are likely to have wanted, this interpretive exercise will almost inevitably resemble the case-by-case inquiry required in the absence of a formality. In either situation, courts will try to decide on a case-by-case basis just how plausible it is that *S* might have wanted to be legally committed to *B*.²⁸⁶

The only sure way to avoid this recursion is to create a method of contracting around the default rule that itself leaves no room for ambiguity or interpretation. That is, not only must the default rule itself consist of a bright line, but there must also be some bright line device for parties to signal when they want to change the default rule, as well as to signal exactly how they want to change it. One could imagine, for instance, a regime in which any offer under seal would be interpreted as adopting the mailbox rule. As long as the definition of a "seal" was itself free from ambiguity,²⁸⁷ courts could apply this rule without having to worry about whether the mailbox rule or its opposite were more efficient in any given case. In such a regime, however, the interactions with the other doctrines governing contract formation would quickly become unmanageable. We would need another kind of formality—say, a red seal and a green seal—to distinguish offers that could be accepted by performance from offers that required verbal acceptance. Still other kinds of seals would be needed to show how long the offer was intended to stay open, and to indicate whether the offer would survive the offeror's death, and to distinguish letters that were offers from letters that were not offers at all. Even if we created such

285. This is particularly true of what are called "pragmatic implications" or "conversational implicatures." PAUL GRICE, *Logic and Conversation*, in *STUDIES IN THE WAY OF WORDS* 1, 22-40 (1989). For an interesting application of this concept to contract formation issues, see Peter Meijes Tiersma, *The Language of Offer and Acceptance: Speech Acts and the Question of Intent*, 74 CAL. L. REV. 189, 206-12 (1986).

286. Cf. Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 290-91 (1985) (noting that courts are sometimes resistant to claims that the parties have contracted away from whatever default rule the court believes to be most efficient). Goetz and Scott seem to attribute this tendency to judicial stubbornness or ignorance. But if the parties have not spoken with unmistakable clarity, a policy of interpreting the parties' statements in light of what it would have been efficient for the parties to have wanted is not obviously incorrect.

287. For a discussion of the various problems created by the use of a seal as a legal formality, see Fuller, *supra* note 253, at 822-23; Eisenberg, *supra* note 41, at 659-61.

a complex collection of seals, the burden on parties to remember the proper use of each kind would almost surely be unworkable.

VI. CONCLUSION

In this article, I have examined just one of several reasons why parties might want to be legally committed. If one party can increase the expected value of a transaction by relying in a certain way, the other party may gain (in expected value terms) by submitting to an enforceable commitment, in order to give the first party the security he needs in order to rely. Only a subset of cases appears to involve this motive for a contractual commitment. Within that subset, however, this reliance incentive often seems to play an important role in determining the outcome of the case. Moreover, this role is equally prevalent whether the legal issue in the case concerns the interpretation of a purported offer, the proper mode or timing of a purported acceptance, the effect of reliance in estopping one party from denying a commitment, the effect given to a preliminary or indefinite agreement, or the circumstances under which one party will be allowed to recover in restitution. Whatever the legal issue, courts seem concerned with whether a commitment was needed to induce efficient reliance, and they seem to make that decision on a case-by-case basis.

Obviously, the considerations discussed in Part IV do not establish that case-by-case inquiries are inevitably superior to bright line formalities. The relative costs and benefits of the two approaches are, ultimately, empirical matters which cannot be resolved *a priori*. Moreover, it is possible for the law to follow different approaches in different cases—for example, by designing bright line rules that would efficiently deal with a particular set of cases, while leaving all others to a case-by-case inquiry. In some areas, for instance, it might be possible to design “safe harbors” that would guarantee a certain legal treatment for parties who used a particular legal formality, while still leaving all others to be decided case by case.

The only point that seems clear is that, for better or worse, courts generally have *not* used bright line formalities in cases involving contract formation. Thus, while there is undoubtedly room for further research into possible alternatives to the current case-by-case inquiry, we also need research to better inform the current inquiry. In particular, if the aim of the case-by-case inquiry is to identify the most likely intentions of the contracting parties, we need a better understanding of just why contracting parties would (or would not) want to be legally committed in any particular case. Efficient reliance provides one insight into that understanding.