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THE MEANS/ENDS DILEMMA IN CONTRACT INTERPRETATION: A RESPONSE TO PROFESSORS KRAUS AND SCOTT: HOW THE INTRACTABILITY OF EXPRESS LANGUAGE AND UNCERTAINTY AFFECTS LEGAL INTERVENTIONS IN CONTRACTS

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I. Introduction

When parties draft a contract, they reach agreement on terms that reflect the best means of achieving their individual goals. If a dispute arises about the meaning of the agreed on terms or if subsequent events cause one party to regret its obligations under the contract, one or both parties may seek a court’s assistance in enforcing the contract. The court’s enforcement role begins with ascertaining the parties’ intent as evidenced objectively by the language. In navigating its role in contract interpretation and enforcement, a court may need to decide whether a dispute should be resolved solely by reference to the contract’s express terms or whether courts should look outside the contract. If it looks outside the contract’s terms, a court might look to specific contractual

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1 This is the famous idea of the “regret contingency” discussed by Robert Scott and Charles Goetz. See Charles J. Goetz & Robert E. Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 YALE L.J. 1261, 1271 (1980).
2 The objective theory of contract interpretation is well accepted. E.A. FARNSWORTH, CONTRACTS § 3.5 (discussing prevalence of objective theory).
3 Those who advocate looking only at the contract are part of the new formalism school. See e.g. Robert E. Scott, The Case for Formalism in Relational Contract, 94 NW. U.L. REV. 847 (2000). For a contrary view suggesting that both formalistic and contextual approaches have a place in contract interpretation, with the preference for one or the other depending on a number of specific factors including risk averseness of the parties, transaction costs, the presence of transaction specific investments, and a number of other factors, see Avery Katz, The Economics of Form and Substance in Contract Interpretation, 104 COLUM. L. REV. 496 (2004).
objectives or ends held by the parties\(^4\) to use in determining parties’ obligations under a contract. Alternatively courts could look to overall goals of maximizing gains from trade while minimizing deadweight losses and transaction costs in deciding contract issues.\(^5\) This latter approach would ignore the specific contractual goals that one or both parties hoped to achieve in favor of the overall goal of maximizing joint surplus.

Premising contract interpretation on specific contractual objectives presents difficulties for courts. Since such objectives are often not part of an express contract, and parties may adopt “shadow” terms that are designed to achieve their objectives,\(^6\) one party may claim that while its counterparty wishes to achieve a particular objective, the claiming party is in fact indifferent as to whether that objective would actually be realized. If one party were to miscalculate and the shadow term were to give one party less than its contractual objective, that would not necessarily matter to the other party and so should not necessarily influence a court’s interpretation of a contract.

\(^4\)These objectives may or may not be expressly referred to in the contract. Interpreting contracts in light of the parties’ specific contractual objectives is a misguided strategy according to Jody Kraus and Robert E. Scott unless the parties have specifically directed courts to consider such objectives. See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent* [http://amlecon.org](http://amlecon.org) (ALEA 2008). All references are to the May, 2008, draft presented at ALEA. References to later draft will be inserted later.

\(^5\)Professor Kostritsky argues that courts in fact do take account of these broader contractual goals of maximizing joint surplus and minimizing transaction costs in the way that they apply the contract doctrine of interpretation to curb opportunistic behavior which would otherwise act as a drag on gains on trade. See Juliet P. Kostritsky, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 Ky. L.J. 43 (2007-2008).

\(^6\)The parties in the Kraus and Scott paradigm did not actually agree to a price term based on assuring the seller 3% above its costs; instead, the price term was a shadow term tied to an index designed to achieve the same result. See *infra*.  

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Despite agreement on express terms, parties thus share different assumptions and different predictions about the future. So, agreement on one or more terms does not necessarily mean that there is a specific joint intent or objective that a court could look to in resolving meanings, as each party may want a single clause for different reasons. A joint contractual intent or objective is really a superficial, perhaps misleading notion, since parties intend contract terms to serve different functions. Courts will therefore face a Sisyphean task of contract interpretation if they interpret terms using a joint contractual objective as a deciding factor.

Divergent views of how a term will actually function in reality, with each party’s predictions about the future inclining it to think that the clause will favor oneself rather than one’s opponent, suggest that courts should resolve contract disputes not by reference to joint objectives or to joint intent but solely by reference to the express terms. Such a strategy offers the perceived advantage of certainty since there is only one contract agreed to by both parties.

In their recent article on Contract Design and Intent, Professors Jody Kraus and Robert Scott offer a new justification for such a literal enforcement of the parties’ chosen terms and for ignoring contractual objectives. Their argument depends on a theory of how

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7 Parties reach agreement somewhere on the contract curve if there are gains from trade. Ronald J. Coffey. See discussion of Edgeworth Box.
8 Email from Peter M. Gerhart, Professor of Law, Case Western Reserve University School of Law to Juliet P. Kostritsky, Professor of Law Case Western Reserve University.
10 Much of current law and economics scholarship adopts this approach.
11 Kraus & Scott, supra note 4.
parties bargain and trade off front end and back end costs. Kraus and Scott posit that if parties have invested enough transaction costs to result in specific terms, and failed to delegate decision-making to a court through open-ended terms, they have a deliberately chosen to exclude courts. In such cases courts should rigorously adhere to the explicit contractual means chosen by the parties and spurn any judicial strategy that overrides the parties’ chosen means in order to secure the parties’ contractual objectives.

The key insight of Kraus and Scott that supports strict enforcement of the chosen terms is a portrait of contracting in which one infers that the adoption of specific terms and the absence of any vague terms denotes both large investment in up front costs in drafting (to determine the optimal term) as well as a decision to foreclose all judicial intervention and a deliberate opting into a rule-based approach non-contextualized approach to interpretation. It depends on a singular view of how parties negotiate contracts which ignores the impediments to complete contingent contracting and distorts the significance of specific terms in a contract. The Kraus/Scott view posits that parties have a choice about how much effort to devote to contract drafting and make certain dichotomous choices in contract design. If there is no express term on point and

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13 Id. at 5.
14 Id. at ______
15 Kraus & Scott, supra note 4, at 39. “When transactions are complex and performance obligations are verifiable, parties will rationally choose to enforce these obligations by relying on formal, legal enforcement.” Id. at
no express delegation to a court, the parties have necessarily decided *ex ante* to rely exclusively on informal enforcement to police behavior under the contract.\textsuperscript{17}

The Kraus and Scott argument about contract design and intent shares the same structure and logic as the arguments against the incorporation of trade usages into contracts.\textsuperscript{18} The formalists argue that parties who do not expressly incorporate trade usages into their contract intend for those usages to be enforced exclusively by informal means.\textsuperscript{19} In each instance, both when the parties choose specific terms and fail to adopt a vague term and when they fail to adopt an express directive to courts to incorporate trade usages, the contract should be regarded as conclusive evidence of an intention to bar judicial intervention in the parties’ contract. Courts should therefore refrain from supplying terms or obligations not expressly consented to by the parties.

The universal embrace of the chosen means and the rejection of judicial intervention in contracts, absent an express delegation, is premised on a distorted and exaggerated view of the deleterious effects of judicial intervention and an overly narrow view of when intervention is justified (only when the parties explicitly ask for it through an open-ended clause). The bifurcated framework of Kraus and Scott, in which parties (1) use open-ended terms to expressly delegate matters; or (2) use specific terms and in so doing intend no role for courts, fails to account for the full range of judicial interventions

\textsuperscript{17} Kraus & Scott, *supra* note 4, at 5, 29.

\textsuperscript{18} *Id.*

\textsuperscript{19} See *e.g.*,...
that exist and are widely embraced in contracts, even when there is no express delegation through an open-ended standard.\textsuperscript{20}

This Article disputes this account of contract formation in ways that call into question the conclusion that exclusive emphasis should be placed on the parties’ chosen means unless the parties have expressly signaled a desire for judicial intervention. It is not clear that a contract with specific terms and no vague term or open-ended term represents a deliberate choice to exclude all judicial intervention. The use of a term such as the term wife should not prevent a court from intervening by looking beyond the express terms even when the parties have not used an open-ended term.\textsuperscript{21} An unwavering rule that focuses exclusively on the means chosen may generate negative welfare effects.\textsuperscript{22} Moreover, the certainty promised by such a strategy\textsuperscript{23} might prove mythical.

Agreement on specific terms and a failure to expressly delegate authority to the courts through a vague term may result for a variety of different reasons, not all of which suggest that courts should refuse to intervene beyond the express terms. Agreement on such terms does not mean that parties intend courts to look exclusively at the parties’ chosen means and to refuse to interpret the term or to intervene in the contract nor does it necessarily mean that the parties have invested large front end costs in drafting. Parties could agree on a specific, rigid term because of uncertainties particularly uncertainties of

\textsuperscript{20} See infra
\textsuperscript{21} \textit{In re Soper’s Estate}, 264 N.W. 427 (Minn. 1935). Parties designing contracts wish to economize on the costs of contracting and to achieve their objectives at the least cost; this goal of welfare improvement is a shared goal.
\textsuperscript{22} See Kostritsky, \textit{supra} note 5 (questioning whether a unitary default rule of literal interpretation confined to the express terms is welfare enhancing across the board).
\textsuperscript{23} Kraus & Scott, \textit{supra} note 4, at 4.
a certain type where there are “information barriers that prevent parties from controlling moral hazard when the future states of the world depend on their own actions.” There parties could still count on a court to interpret the contract (or fill in gaps) to maximize joint surplus. Because of limits on cognition, they may not even realize that express language that they thought was clear would later turn out to be ambiguous. Moreover, the parties may fail to adopt an open-ended standard giving one party discretion because they might fear that the open-ended clause would facilitate moral hazard by the parties expressly delegated discretion. Maximizing joint surplus may sometimes best be achieved through judicial intervention in a contract, even without an express delegation. For example, even without an express directive to courts to interpret a term using trade usages, a judicially supplied default rule to interpret contract terms with trade usages may maximize gains from trade while minimizing transaction costs.

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24 Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration, forthcoming 109 COLUM. L. REV. (2009) draft p. 23. These contractual approaches are desired by parties who are attempting to deal with the fact that transaction costs prevent them from achieving a completely contingent contract which would achieve both ex ante and ex post efficiency. A second best alternative would be a deliberately incomplete contract that commits parties ex ante to fixed terms. Another device is the open-ended contract. Yet each of these contracted solutions presents other problems. The hard and fast contract may fail to achieve ex post efficiency in some states of the world. The open-ended contract may promote moral hazard in the party with discretion or present verifiability problems to a court attempting to apply such a vague standard.

Scott et al recognized the limits of this bifurcated structure when they suggested that parties may strive for other ways of curbing opportunism while maximizing ex ante and ex post efficiency. These include “a continuum of contracts that support collaborative reservation.” Scott et al, p. 4 draft.

25 Even sophisticated commercial parties might not be aware of how a complicated bond indenture would allocate priorities between different classes of bondholders even though they negotiated the terms. These could include private informal enforcement, other private strategies for controlling opportunistic behavior including hostage taking, bonding, etc.

26 Gilson, et al, supra note 24, at 25.

27 R.J. Coffey discussing legislatively supplied default rules as an alternative.

28 See Kostritsky, supra note 5.
Whether a court should intervene to interpret or to add terms to a contract or decline legal intervention and relegate the parties to informal sanctions should not depend solely on whether the parties have adopted a specific term (where non-intervention should prevail) or an open-ended vague term (where intervention should prevail). Instead, judicial intervention should depend on whether it will achieve the parties’ objective of maximizing gains from trade at a lower cost or more effectively than the alternatives.  

Will the welfare improvement be greater with judicial enforcement supplementing informal enforcement or with exclusive reliance on informal mechanisms? Since there is often no actual evidence of the parties’ thinking, the assumptions underlying the argument that parties would prefer informal enforcement whenever they use specific terms and omit any vague term must be carefully examined before accepting the conclusion that legal enforcement should always be restricted to the chosen means.

Part of the reason for Kraus and Scott’s insistence that courts should respect the parties’ chosen means to the exclusion of contractual objectives is that they build their theory on a paradigm case in the context of a particular fact pattern. In the fact pattern (based on the Alcoa case) two parties negotiate a deal for supplying a product. Although Kraus and Scott identified the parties’ goal is to “assure the seller of a three % profit,” the parties choose to enter a different contract in which the price term is “equal to three percent above a published industry price index.” Courts overlook the parties’ chosen means ex post and choose to override those terms in circumstances where the court “believes that the

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29 Parties designing contracts wish to economize on the costs of contracting and to achieve their objectives at the least cost; this goal of welfare improvement is a shared goal.
30 Kreitner, supra note x, at 439.
31 Kraus & Scott, supra note x, at 2.
published price index or some other similar term severely under-represents the seller’s actual costs.” Such intervention would be justified as necessary to advance the parties’ goal of a three % profit for the seller. This paradigm case and the difficulties with constructing a theory of contract design built on this particular example will be examined in depth in the article.

The difficulty with centering a theory of contract and design article on a misguided case, together with language in their article that might be broadly read to proscribe any intervention in contracts beyond the parties chosen means, is that it wrongly suggests that if the parties have not expressly chosen to delegate intervention to a court through an open-ended or vague term, a court should always refrain from intervening to achieve the parties’ goals. By privileging the parties’ written terms and imbuing them with a mythical certainty, the authors suggest that courts act improperly whenever they overlook specific express terms to achieve some larger goal, such as the avoidance of forfeiture. That approach would seem to exclude many judicially supplied default rules such as the effect of part performance in a unilateral contract, implied terms of good faith, reasonableness in contract interpretation, and the incorporation of trade usages into contracts. It would

\[32\text{ Id. at 2.}
\[33\text{ See infra.}
\[34\text{ Courts thus also act improperly when they treat express conditions as constructive conditions of exchange to avoid forfeitures.}
\[35\text{ See RESTATEMENT (SECOND) OF CONTRACTS §45.}
\[36\text{ Roy Kreitner suggests that the logic and conceptual framework of the new instrumentalists would exclude law-supplied default rules, contextualized interpretation, pre-contractual non-bargained for liability. Kreitner, supra note 9, at 433, 437. In their new article on Contract Intent and Design Kraus and Scott do not admit that they intend to reject all law-supplied rules, including such rules as the legal default rule incorporating trade usages that are not specifically negated, implied constructive conditions of exchange, the implied non-revocability of offers on which the offeree has begun part performance or the preference for interpreting ambiguous terms as creating duties not conditions. Nevertheless, by suggesting that parties who adopt specific}
also seem to preclude a variety of default rules, including a preference for construing ambiguous terms as promises rather than conditions\(^{38}\) since such interpretation would be premised on the parties’ presumed objectives and the parties may have not expressly delegated any authority to a court.

Debate the proper role for courts to take in contract disputes, how much primacy to afford the explicit terms, whether courts should interpret the contract in order to achieve the parties’ specific objectives\(^{39}\) or whether the court should resolve disputes over meaning by intervening in ways beyond the parties’ chosen means all involve the fundamental issue of when judicial intervention in contracts justified?\(^{40}\) In advocating adherence to the parties’ chosen terms, and in charting the alternative as one in which courts simply override those chosen means “whenever they believe that doing so is necessary to substantially correct the parties’ contract by realigning it with their contractual ends,” Kraus and Scott have posed the problem of judicial intervention in a way that suggests that if the courts would only

\(^{37}\) UCC 1-303.

\(^{38}\) Restatement Second §227.

\(^{39}\) Kraus and Scott seem to equate objectives of the parties’ with narrowly defined contractual objectives and it is not clear whether the contractual objectives refer to the parties’ joint goals. In contracts these joint goals would include the maximization of contractual surplus and minimization of transaction costs. In identifying contractual goals Kraus and Scott seem to refer to a very specific goal of only one party for whose benefit it was drafted. That lack of precision on whose objectives are intended or goals and how broadly those goals are conceived of complicates the analysis in ways that will be explored later. If Kraus and Scott intended to refer to the overall objective of welfare improvement, then the courts’ willingness to refer to the parties’ objectives in setting default rules or aggressively interpreting terms in contract would make sense. To the extent courts are using such objectives to override express terms, a different analysis might follow. When contracts are regarded as incomplete or when express terms are ambiguous, then it might be justifiable to consult welfare improvement as an overall goal. Kraus and Scott largely ignore the notion of incompleteness or ambiguity in meaning in their analysis.

\(^{40}\) See Kostritsky, supra note x.

\(^{41}\) Kraus & Scott, supra note 4, at 2. (draft ALEA).
“reliably enforce” the chosen means/terms, they would be serving the parties’ preferences. Parties’ preference for enforcing chosen means thus depends on a stylized view of intervention in which the only type of intervention are ones in which the court overrides the parties’ terms by invoking specific contractual objectives and does so in a case which necessarily involves it in making decisions that depend on unverifiable information.

Kraus and Scott’s proposed design for discovering contractual intent and for providing a structure for analyzing that intent depends on a number of specific assumptions which may not universally hold true.42 These assumptions limit the reach of the Kraus and Scott theory when such assumptions do not hold. The theory that it will be possible to identify with reasonable certainty what those terms are; otherwise the authors conclusion that courts could “reliably enforce” those terms would not make sense. If terms are not ambiguous or incomplete, then insistence on enforcing the chosen terms would be the preferred strategy because it would implement the terms chosen by the parties and “private information as to their contractual intent is systematically superior to a court.”43 The myth of the certainty of terms portrayed in the Kraus and Scott article makes judicial departures from those terms to achieve the parties’ contractual ends appear necessarily wrong. When courts intervene in contracts with certain terms, they do so by ignoring the parties chosen terms in ways that will require it to ascertain unverifiable data in order to achieve the parties’ goals.

42 See infra.
43 Kraus & Scott, supra note 4, at 2. See also FRIEDRICH A. HAYEK, LAW LEGISLATION AND LIBERTY VOL. 1 RULES AND ORDER (1983).
The focus on impossibly certain terms together with a focus on a set of outlier cases in contract adjudication and a picture of contract design and intent which postulates all contracts containing specific terms and no vague terms represent deliberate decisions to exclude judicial intervention offers a distorted view of the case law of bargaining and an incomplete view of the rules in Contracts. Once one admits that the terms themselves might be uncertain, then courts intervening are not necessarily overriding the parties’ terms but instead consulting overall goals of joint surplus maximization when the terms cannot simply be “enforced.” In excluding types of judicial intervention in contracts or rules of contract interpretation that do not necessarily depend on courts accessing private, unverifiable information that is likely to be needed to implement specific contractual objectives, including a variety of default rules and liability rules, Kraus and Scott have implied that all forms of judicial intervention are equally misguided.

This Article explores various examples of law-supplied default rules in Contracts which reflect judicial departures from, or additions to, the parties’ chosen means (assuming that chosen means are limited to mean the explicit terms of the contract). These are counter examples in which courts seem to ignore the Kraus and Scott injunction to courts to refuse to intervene in contracts unless explicitly requested to do so through a broad delegation. The examples suggest that there are limits inherent in the

44 The characteristics of such cases will be explored in depth. See infra.
45 I am assuming that Kraus and Scott equate the chosen means with the specific contract terms.
46 This is the specific opt in provision. One such example, that shows the limitation of the Kraus and Scott approach, is Section 45 of the RESTATEMENT 2d of Contracts, which governs unilateral contracts. If one were to literally apply the Kraus and Scott approach, the court should have no
Kraus/Scott critique which hampers its ability to resolve a broad range of contracts issues.

To determine whether intervention in a contract is justified in any particular case, this Article suggests that courts must make realistic assumptions about contracting behavior; such assumptions will permit a court to determine whether intervention in a contract is justified. Courts should consider the possibility that the parties’ chosen means or terms (1) are not completely unambiguous and self-defining; (2) can be economically incomplete or ambiguous; and (3) that specific terms do not necessarily signal an intent that courts should refuse to intervene. The threshold question is whether a court should add to, interpret or even override a term to achieve the parties’ broad goals of maximizing gains from trade (maximizing gains from trade while also minimizing transaction costs and the costs of opportunism). It should consider all possible types of intervention to see if they would be welfare improving and should be cautious about embracing interventions that will facilitate counter-opportunistic behavior by the other party.

This Article identifies a framework to use in determining if judicial intervention would be optimal, even absent an express delegation. It presents types of cases often involving a situation in which the chosen means are ambiguous, there are specific terms which nevertheless fail to place any limits on one party’s discretion or the parties have role to play because the parties had not signaled their desire, through the use of a vague term, that the court plays an active role.

47 See infra.
48 OLIVER WILLIAMSON, MECHANISMS OF GOVERNANCE (discussing contribution to surplus from efficient control of opportunism problem).
omitted a term or the contract is economically incomplete and the court can improve welfare by supplementing the parties’ chosen means. The absence of an open-ended term, should not and does not deter courts, for example, from deciding to imply a subsidiary promise not to revoke an offer once there is partial performance even if the party failed to adopt a vague term delegating authority to a court.

Courts should not determine whether or not to intervene in contracts solely on the basis of whether an express delegation exists through the use of a vague standard. That requirement would add to transaction costs and, in many cases, would -- by suggesting an invariant rule -- preclude courts from intervening even if such intervention were welfare improving. There is always a tradeoff involved in judicial intervention or interpretation questions. Courts should weigh the benefits of doing so (transaction costs saved, opportunism deterred) against the costs of doing so. The costs that might result from the Kraus and Scott approach include: reduced trade, increased transaction costs and increased opportunism. These costs might result from an approach that elevates contractual means over ends, fails to account for incompleteness or ambiguity in contracts and assumes that all forms of legal intervention to achieve the parties’ goals would uniformly be deleterious.

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50 This article reviews Section 45 cases in which courts were confronted with the question of what should be the effect, if any, of partial performance on the offeror’s power to revoke an offer. The contract itself, in these cases, contained express terms which provided for payment in return for an action.
51 Moreover, because the only way for a party to invoke judicial intervention in a contract seems to be through the adoption of an open-ended term, and in many cases parties might want an intervention that does not lend itself to a vague or open-ended term. In the case of the unilateral contract, it is not clear how the parties would help themselves or the court resolve the issue of the effect of part-performance through the use of a vague term.
53 See infra.
since it would always “require[] courts to make decisions based on information they are ill-suited to acquire. . . .”\textsuperscript{54}

A justificative framework for understanding how contracts are designed as well as the obstacles that parties face to unambiguous, complete drafting include the deadweight costs of uncertainty, bounded rationality and sunk costs which act as natural barriers to contracting.\textsuperscript{55} It recognizes the back end costs (including enforcement costs particularly if there are factors subject to manipulation by one party) that are central to the new instrumentalists while arguing that parties’ goals or objectives (broadly defined) must play a central part in any framework for analyzing whether judicial intervention in a contract is likely to improve welfare.

The court should adopt whatever strategy yields the greatest net benefits. This might take the form of drafting a default rule, such as filling in a price term in a sale of goods case when the parties have not agreed on a price,\textsuperscript{56} using trade usages to interpret express terms or employing a liability to govern precontractual negotiation to regulate the risk of hold-up on when strategic behavior.\textsuperscript{57} Assessing net benefits of intervention would of course require a court to assess whether there are particular governance mechanisms already in place which would curb the problem of opportunism.\textsuperscript{58} Presumably no net

\textsuperscript{54} Kraus & Scott, supra note 4, at 1.
\textsuperscript{55} R. J. Coffey
\textsuperscript{56} See 2-305.
\textsuperscript{58} See Gilson \textit{et al.} supra note 24.
benefits would obtain from judicial intervention where private governance mechanisms are already in place. The absence of such mechanism might suggest a role for courts.

Part II of this Article examines Kraus and Scott’s arguments against current trends in contract adjudication, including the allegation is that courts ignore parties’ chosen contractual means to promote their contractual goals. This section seeks to determine the nature of their objections. It examines the assumptions underlying the critique as a means of determining how conclusions about the proper approach to take to discerning contractual intent might be altered if those assumptions changed or proved too limited. Part III proposes an overall framework for judging intervention in contracts. Part IV looks at several doctrinal areas in contracts to see how judicial intervention can be justified using a normative framework. These include: plain meaning and contractual interpretation, promissory estoppel, trade usage and incorporation strategy, Section 45 and Conditions. In each of these doctrinal areas, the law departs from the limited language of the contract, the parties’ chosen means, and implies a liability rule or adds a default rule or a law-supplied term. These departures present a puzzle for lawmakers concerned with when it is permissible to go beyond the express agreement of the parties. This Article will show that these departures can be justified in welfare improvement (efficiency) terms.
II. Discerning Contractual Intent and What Weight to Give to the Parties’ Express Terms: The New Instrumentalism

It is tempting to think that parties can agree on terms that are clear and unambiguous and, in effect, self-defining.\(^\text{59}\) Were that so, problems of interpretation would never arise and contracts would be self-enforcing.\(^\text{60}\) However, because of uncertainty about future contingencies and future behavior, parties face large transaction costs that act as a barrier to detailed express arrangements.\(^\text{61}\) They could invest in \textit{ex ante} costs but some uncertainties will never be eliminated, even with investments \textit{ex ante} and there will be a “budget constraint” limiting investment to deal with or resolve the uncertainties.\(^\text{62}\) The parties could alternatively decide to expressly delegate all or some subset of matters to courts through an open-ended term when courts will have information \textit{ex post} that the parties lack \textit{ex ante}.

A. Kraus and Scott’s Argument in Favor of Enforcing the Chosen Means

Kraus and Scott argue that courts should give preference to the chosen means \textit{even if it defeats the parties’ overall contractual objectives}, except where the parties have explicitly delegated authority to the courts to broadly interpret the terms by using open-

\(^{59}\) Kostritsky, \textit{supra} note 5, at 119.
\(^{60}\) See Self-Enforcing Contracts.
\(^{61}\) See \textsc{Oliver E. Williamson, Economic Institutions of Capitalism: Firms, Markets, Relational Contracting} 45 (1985) (discussing bounded rationality).
\(^{62}\) Email from R. J. Coffey, Professor of Law Emeritus, Case Western Reserve University School of Law to Juliet P. Kostritsky, Professor of Law, Case Western Reserve University.
ended or vague terms such as “good faith.” Kraus and Scott posit that courts should ascertain the exact terms by “applying standard contract doctrine” to the explicit terms of the agreement. The terms the court would find using such standard doctrine would be “the standard contract terms.”

Kraus and Scott cite both autonomy and efficiency reasons for giving exclusive effect to the parties’ chosen means. Adhering to the parties’ chosen means upholds party autonomy because the chosen means reflect the parties’ actual agreement, rather than a court supplied attempt to discern the parties’ intentions. They also assume that even if the parties fail to abide by value maximizing behavior, since they have chosen to rely exclusively on informal sanctions to police such conduct, that choice should be implemented.

Kraus and Scott also posit that adhering to the parties’ chosen means enhances efficiency and reliability. This assumption of efficiency from non-intervention is premised on a particular type of legal intervention when a court chooses to override those chosen means to achieve the parties’ objectives. When the means and the contractual objectives conflict, it is an error to “equate” the means and ends. Their assumption is that

63 Id. at 1-2. Kraus & Scott, supra note 4, at 4.
64 Although the Kraus and Scott article does not put itself forward as a theory of contract interpretation, their theory would have implications for interpretation since it seems to foreclose courts from determining the content of the agreement by reference to matters outside the contract, such as contractual objectives.
65 Kraus & Scott, supra note 4, at 4.
66 Id. at 4-5.
67 Id. at 52 (discussing “judicial speculation”).
68 Id. at 4-5.
69 Id. at 1.
commercially sophisticated parties would prefer that courts apply strict or standard contract doctrine to the contractual language, even if doing so defeats the parties’ joint contractual objectives. Kraus and Scott’s advocacy of a literal interpretation of the chosen means to the exclusion of the parties’ contractual objectives stems from their assumption that judicial intervention would embroil the court in inquiries that they are ill equipped to make. The unspoken premise of this argument is that the application of standard contract doctrine to the explicit, chosen means will result in the court adhering to the explicit terms, a result consistent with a formalistic approach to contract interpretation and beneficial since such adherence would avoid the court making decisions with inadequate data. It would also coincide with the parties’ preferences since the judicial intervention envisioned would take a form that the parties implicitly rejected by not including a vague term because of its potential for opportunistic exploitation by one party—the moral hazard danger.

By adopting specific terms, the parties choose to invest in drafting costs \textit{ex ante} and to foreclose the back end costs of delegating decisions to the courts \textit{ex post}. If a court intervenes, the projected intervention takes the particular form of rewriting the parties’ terms to achieve their contractual objectives and by substituting those objectives for the

\begin{footnotesize}

70 Kraus & Scott suppose that the court will only depart from those terms if it looks outside the contract by considering the parties’ contractual objectives. In the example discussed, resort to those objectives results in a departure from the express terms while a contrary approach confined to applying standard contract doctrines will presumably result in the enforcement of the parties’ explicit terms.

71 \textit{Id.} at 1.

72 \textit{Id.} at 8.

73 Alternatively, by choosing vague terms when there is substantial uncertainty, parties avoid the costs of coming to an agreement on precise terms. \textit{Id.} at 8-9.

74 \textit{Id.} at \underline{\underline{______}}. \textit{See also} Williamson, supra note 48, at 47.

75 Kraus & Scott, \textit{supra} note 4, at 7-8.

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actual terms. Because the parties deliberately eschewed express incorporation of those objectives to avoid back end costs and moral hazard, the back end costs are projected to be quite high.

Ignoring the specific terms to achieve the parties’ objectives would ignore the parties’ choice for a rule-based approach, decrease reliability, and increase back end costs. Kraus and Scott argue that these are results which should be avoided in order to decrease costs, enhance efficiency and implement the parties’ intentions.

For these reasons, Kraus and Scott find the modern trend of courts overlooking the chosen means in order to promote the parties’ overall goals, to be a misguided one. To ensure efficiency, Kraus and Scott urge courts to reverse course and hew to the contractual means “even when doing so would defeat the very contractual ends they were designed to

76 Id. at 2.

77 The conclusion that parties intend for courts to use a rule-based system based on the fact that they have used a specific term rather than an open-ended one seems to rest on the conclusion that since parties know how to draft to delegate broad authority to courts through vague terms, that when they do not use such terms, they intend a rule-based approach. Yet, there is no necessary logic between the use of a specific term and the exclusion of broad judicial interpretation or interpretation that involves reference to contract objectives. In the trade usage area, courts conclude that if parties do not specifically negate trade usages, they are deemed incorporated into the contract. In that context at least courts do not draw the conclusion that if the parties used a specific term, such as one dozen, they necessarily foreclosed courts from implying those terms into the contract. The decision of the court to incorporate and to look beyond the precise terms must depend on a consideration of what approach would be value maximizing. The use of a precise term does not by itself contain any explicit indication that a strict or rule-based system of interpretation is intended.


79 Kraus & Scott, supra note x, at 2. I am assuming that the “chosen means” in a contract is synonymous with the explicit terms of the contract.
They argue that this more restricted approach to contract interpretation would be preferred by “commercially sophisticated parties.” Their argument, elevating the parties’ means over their goals, belongs to a recent intellectual movement embracing greater formalism in contract.

To determine whether the modern departures embracing the trend of overriding the parties’ chosen terms can be justified, Kraus and Scott examine a paradigm factual scenario closely associated with judicial departures from strict terms to discern the purported rationale for such judicial interventions in private contracts. They conclude that courts feel free to “override [contract terms] whenever they believe that doing so is necessary to substantially ‘correct’ the parties’ contract by realigning it with their contractual ends.” Kraus and Scott posit that the rationale used to justify such a departure is that the parties themselves would prefer it whenever courts have additional information ex post indicating that the means chosen will fail to achieve the parties’ initial goals. Courts intervene and override terms on the supposition that “had the parties known at the time of formation what the court knows at the time of adjudication, the parties themselves would have crafted different terms.”

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81 Id.
82 Id.
83 This intellectual movement has embraced plain meaning over contextualized interpretation. See Scholars embracing formalism argue that it saves parties from back end litigation and judicial enforcement costs, costs which have been ignored by the contextualists. See supra note x.
84 Kraus & Scott, supra note 4, at 2.
85 Id. at 3. However, as Scott and Kraus aptly point out, even if parties would have drafted a different contract had they had information not then available, they would not necessarily empower courts to revise the contract ex post to better align with contractual goals given the costs of judicial error and reduced reliability of terms. Id. at 4.
Kraus and Scott then criticize several judicial doctrines in current contract law which reflects the trend of overriding parties’ chosen means to achieve contractual goals. Based on examples from: (1) cases in which courts override express conditions or interpret terms as promises not conditions to avoid forfeiture,⁸⁶ (2) the parol evidence rule in which courts overlook the express contract to improperly admit oral evidence of conditions,⁸⁷ and (3) excuse doctrines exemplified by the ALCOA case,⁸⁸ they argue that courts improperly offer parties a default “insurance policy” by intervening whenever it turns out that the contractual terms no longer serve their overall contractual ends.⁸⁹ Courts should intervene, they argue, only if the parties have explicitly opted into such a system delegating such discretion to the court.⁹⁰

Yet, many contracts doctrines permit courts to supply a term or a default rule even if the parties have not agreed on it and even if they have not expressly delegated a decision to the courts. Good faith and best efforts⁹¹ constitute doctrinal examples in which courts imply terms or performance obligations into contracts. In other instances, courts intervene in contract adjudication by creating legal liability rules as, for example, when courts decide to make the promisor responsible for the promisee’s reliance costs in Section 90 cases, in effect supplying a liability rule. In still other instances the court may decide on an appropriate default rule, such as one in which trade usages are used to interpret terms in a

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⁸⁶ See Jacobs & Young v. Kent, 129 N.E. 889 (N.Y. 1921).
⁸⁷ See infra.
⁸⁸ Kraus & Scott discuss the ALCOA case at p.30.
⁸⁹ Id.
⁹⁰ Id. at 5. They are free to do so through the adoption of open-ended standards in the contract which delegate such discretion to the court.
⁹¹ Courts are willing to supply a best efforts term even if not agreed on expressly. See e.g. UCC 3-306.
contract unless specifically negated, and the effect of the default rule is to interpret the parties’ terms using trade usage even without any open-ended term directing a court to intervene. If the intervention in contracts is as flawed and costly as Kraus and Scott project, one wonders why parties fail to opt out of many standard contract default rules.

The next section will look at the limitations of Kraus and Scott’s arguments advocating exclusive reliance on the parties’ chosen means, absent an express delegation to the courts to determine what circumstances or factual contexts might call for a different approach. It will suggest an analytic framework and a taxonomy of heuristics to determine when legal intervention might be beneficial and when it should be proscribed because it is merely reallocating risks and giving one party an insurance policy that they did not pay for.\(^{92}\) It argues that a dichotomous approach which either enforces the contract’s express terms and proscribes all intervention absent an express delegation in the form of an open-ended term or intervenes beyond the parties’ chosen terms if an open-ended term exists is too narrowly conceived.

**B. Limitations of Kraus and Scott’s Argument**

Kraus and Scott’s argument, recommending a dichotomous approach that precludes all judicial resort to contractual objectives to resolve contractual disputes whenever the parties have not explicitly delegated such authority to the courts, is based on several assumptions which may lead to a faulty view of the negative effects of judicial intervention and fail to account for many cases in which intervention is justified. The first assumption

\(^{92}\) See Kraus & Scott, supra note 4.
is that if parties have used a specific contractual term in a contract they have negatively
resolved the question of whether or not judicial intervention would achieve welfare gains
for the parties. Merely because the parties have not explicitly delegated authority to the
courts through the adoption of a vague standard, such as best efforts, does not mean that the
court should not intervene when doing so would be optimal or welfare improving. The
second assumption is that if a court intervenes, intervention will take a particular form. A
court will override specific terms or the chosen means in order to achieve specific
contractual objectives particular to the transaction. By conceptualizing legal intervention
in that narrow a fashion, Kraus and Scott ignore other types of judicial intervention in
contract in which the justification is premised on the broader basis of maximizing joint
surplus.

If these assumptions are questioned, it is possible to envision a different view of
bargaining that goes beyond the dichotomous one of parties adopting specific terms to
exclude courts or vague terms to invite judicial intervention. There is a third alternative:
parties could adopt a contract that was incomplete in certain respects and then depend on a
court to interpret the contract or fill in the gaps. Parties might agree on a specific term but
fail to specify whether they meant the term to govern no matter what state of the world
materialized.93 They might agree on a performance obligation and impose no express
limits on the operation of the performance obligation. In this third category of cases, a
court will have to decide if judicial intervention would improve welfare even if parties
failed to adopt an open-ended term expressly delegating decision-making to a court. Parties

93 Steven Shavell, On the Writing and the Interpretation of Contracts, 22 J.L. ECON. & ORG. 289
(2006); see also Karen Eggleston, Eric A. Posner and Richard Zeckhauser, The Design and
might fail to see the need for an express open-ended term. They might fail to delegate expressly because they assume that the parties will adhere to the performance obligation in a way that restrains discretion and maximizes welfare. They may also assume that if the parties fail to abide by value maximizing behavior that informal sanctions may be available to police such conduct but they may also assume that legal enforcement to restrain such discretion will be available for cases in which informal sanctions are not effective.94

1. The Use of Specific Terms

The first problem with the argument against all judicial intervention absent an explicit authorization is that it mistakenly assumes that if the parties employ specific terms and do not employ a vague, open-ended standard, they intend to entirely foreclose judicial intervention on the back-end in all cases. If parties deliberately choose not to invest in front end costs, they will then expressly opt for the alternative strategy of delegating decision making to courts through an open-ended term. If parties adopt specific terms and fail to delegate to courts, then they have chosen to restrict legal enforcement to the specific terms and to relegate the parties to informal sanctions for any matters not specifically covered by the express terms. Had they intended there to be legal intervention, the argument posits, the parties would have adopted an express open-ended term delegating decisionmaking to a court.

94 This is the complementary theory of informal enforcement being supplemented by formal enforcement.
This divided world neglects certain cases in which there is a term that is specific and rigid not because the parties have invested large front end costs but because of the uncertainty about the future.\textsuperscript{95} Foreclosing contract interpretation by courts based on a stylized view of negotiation in which the presence of specific, non-vague terms signals a deliberate choice to invest in front end costs places too much meaning on the presence of specific terms and imbues those words with the choice of a single legal methodology. Once the barriers to contracting are accounted for there are reasons to conclude that legal intervention might be appropriate even if the parties use specific terms and fail to use a vague term. Parties may use specific terms even when they would prefer a court to interpret those terms. Contract design theory must account for and model transactions that are beset by uncertainty which may cause parties to agree on a rigid term that fails to deal with many possible contingencies.\textsuperscript{96} Parties may agree on a contract which gives authority to one party to act with specific terms of payment and hours, as to a children’s babysitter,\textsuperscript{97} or an agent, without specifying how the discretion or performance ought to be exercised.\textsuperscript{98} Or they may use a term that has both an ordinary, plain meaning and a trade usage meaning and assume that their trade meaning is the ordinary meaning.\textsuperscript{99} They may use an ordinary term such as the word “wife” but intend an idiosyncratic, non-ordinary meaning to prevail.\textsuperscript{100} In these types of cases, the parties have not expressly delegated authority to intervene through an open-ended term to a court. The parties have not employed a vague term.

\textsuperscript{95} See \textit{Shavell}, supra note 93, at 289; \textit{see also} Eggleston, supra note 93.
\textsuperscript{96} Pierpaolo Battigalli & Giovanni Maggi, \textit{Rigidity, Discretion and the Costs of Writing Contracts}, 92 AMER. ECON. REV. 799 (2002).
\textsuperscript{97} Id.
\textsuperscript{98} Avery Katz made this valuable point in reviewing Juliet Kostritsky, \textit{Plain Meaning vs. Broad Interpretation}.
\textsuperscript{100} Kostritsky, supra note 5.
term because they may not have anticipated the ways in which their specific contract term might itself be ambiguous. The term might be specific and rigid, because the parties did not think of how future contingencies might affect the term or require “interpretation.” Thus, they would not even think that there was a need to delegate to a court. Nor is there reason to suppose that even if the parties will have “private information as to their contractual intent”\textsuperscript{101} \textit{ex ante}, that will allow them to craft a highly detailed contract \textit{ex ante}, that such a highly detailed contract should foreclose all judicial supplementation. Even such highly detailed contracts may remain incomplete. The failure to expressly delegate to courts through a vague term may be due to the fact that contracts may remain incomplete in ways that will not be cured by delegating the job of filling in the terms \textit{ex post}. The incompleteness may not be of the kind that can be remedied by a court filling in an open term using the “benefit of hindsight”\textsuperscript{102} in light of objectively verifiable later events or developments. Instead, the court’s role would be one of simply policing the contract and of curbing opportunistic behavior, matters that parties might assume courts had inherent authority over, even without any express delegation.

While the parties have \textit{ex ante} private information superior to a court’s\textsuperscript{103} that allows them to determine whether there are gains from trade, they will inevitably lack information about future states of the world and about their counter party’s proclivities to behave opportunistically. Parties may settle on a specific term because of such uncertainties about the state of the world (present or future) or behavior (past or future). Once one recognizes that the use of specific terms might be due to uncertainty, of a type

\begin{footnotes}
\item[101] Kraus & Scott, \textit{supra} note 4, at 2.
\item[102] Id. at 3.
\item[103] See HAYEK, \textit{supra} note 43.
\end{footnotes}
that a party might not even recognize was there and resulted in the adoption of a rigid term without that party making a conscious decision to foreclose all interpretation of that term or that parties might assume that where there is a recurring pattern of behavior in which one party invests another with discretion and where the “heterodox terms of the implied bargain” will always be similar across a wide variety of factual situations, the parties may have thought that there was no need to bother to explicate a bargain since the terms are so obvious – namely an implied fiduciary-type obligation constraining the discretion of one party to prevent it from acting opportunistically. In these cases, there are reasons to suggest parties may have agreed on terms without simultaneously using vague terms without an intention to foreclose judicial interpretation.

In cases where parties _ex ante_ are not deliberately thinking that the passage of time will determine whether some event will materialize or not, they may not think in terms of an express delegation to a court. A party employing an agent or a party entering a contract knows that there is a potential “propensity to diverge problem.”¹⁰⁴ To control that risk _ex ante_ the parties could draft a very detailed contract but that would be very costly. They could extract a vague promise of the other party to refrain from acting opportunistically but that might not be believed or enforced by a court.¹⁰⁵ They could delegate expressly to a court the job of protecting one party against opportunistic behavior. The parties may not expressly delegate that job to a court because they assume that courts will police against such behavior as part of their authority and equitable jurisdiction, at least where there are greater net benefits from intervention than from non-intervention.

¹⁰⁴ Email from Ronald J. Coffey, Professor of Law Emeritus, Case Western Reserve University School of Law to Juliet P. Kostritsky, Professor of Law Case Western Reserve University.
¹⁰⁵ _WILLIAMSON, supra_ note 48, at 63.
Alternatively, parties may fail to see the need for delegation to a court if they have assumed that the particularized meaning that they ascribe to a term (such as trade meaning) will be used in interpreting a term that also has a plain, English meaning as they understand it. If so, they would not see the need for an express delegation to the court. Finally, both parties may ascribe an idiosyncratic meaning to a term of the contract. In these cases, there is reason to suppose that the contract is incomplete or ambiguous and thus less reason to simply enforce the chosen means and there is a plausible reason why the parties might not have seen the need to expressly delegate to courts.

The assumption that the use of a specific term represents a deliberate large front end investment in drafting assumption ignores, or at least minimizes, the multi-faceted problem of incompleteness in contracts. Incompleteness may be present in a contract even if the parties adopt a specific term (one dozen donuts) without an express delegation to the court. In many cases, parties will choose specific terms and whether or not the contract is deliberately or inadvertently incomplete or not must be a question a court must decide.

Recognition that the use of specific terms might be due to uncertainty, or to reasons that that parties may have agreed on a failure to apprehend the need to expressly delegate, means that the assertion by Kraus and Scott that the choice of a specific term, necessarily reflects a simultaneous choice of the parties to foreclose judicial resort to contractual objectives deserves scrutiny. To conclude that judicial authority was withdrawn simply because the parties used a precise term implies a judgment by the authors that intervention
in such cases is not warranted since there was no express intimation. That conclusion, however, must be justified using an analytical framework. Since the parties do not explicitly ban such intervention when they adopt specific terms, the assertion that the parties are choosing to foreclose broad judicial interpretation conceals a normative choice that Kraus and Scott themselves are making. That choice must be analyzed from a welfare improvement perspective.

One can imagine a term that is specific in nature, such as the term one dozen for example, where parties might still prefer that a court resort to trade usages to interpret that term to mean a baker’s dozen (thirteen), even though the parties did not expressly delegate to the courts the authority to invoke such usages. The adoption of a specific term should not automatically preclude legal intervention because “even a highly detailed term… typically omits explicit mention of a multitude of potentially relevant contingencies.”\textsuperscript{106} The parties may have adopted specific performance obligations without specifying the order of performance or whether tender of performance should be required as a precondition to the other party’s performance.\textsuperscript{107} The question is whether the legal intervention will be efficient and whether it can be justified as promoting welfare gains for the parties. Whether and when the use of chosen means should foreclose legal intervention in the form of implied terms or a default rule should depend on a complex analysis of when and if judicial intervention would lead to welfare improvement not merely an assertion that the parties intended to foreclose judicial intervention. The analysis should include an examination of why the terms or default rules were not expressly included, what private

\textsuperscript{106} Shavell, \textit{supra} note 93, at 292.
\textsuperscript{107} See \textit{infra}.
alternatives the parties had to expressly including the terms and whether judicial intervention would be optimal.

2. Judicial Intervention as Override

Another problem with the argument against all judicial intervention absent an explicit authorization is that it narrowly conceptualizes how courts can intervene and fails to tie the causes of incompleteness to the particular form of judicial intervention. It assumes that because courts improperly intervene in some cases, by overriding the parties’ chosen specific means without an analytical framework for justifying such intervention, it necessarily follows that judicial intervention is improper in all cases where the parties have agreed on specific terms and have not expressly delegated authority to courts to intervene. The authors present examples of the negative effects of judicial intervention that result when courts override specific terms to achieve defined contractual goals in certain factual scenarios. They then use those examples to foreclose judicial intervention across the board whenever the parties agree on specific terms and omit any vague terms even though judicial intervention in other contexts could be justified under a welfare improvement standard.

Specifically, Kraus and Scott rest their argument on an example, in which the parties agree to “a price [to the seller] equal to three percent above a published industry price index,”108 but the parties’ goal in agreeing on this particular price term is to “assure

108 Kraus & Scott, supra note 4, at 2.
the seller a three percent profit.”109 This term is referred to as the “chosen means” of the contract. Kraus and Scott use this paradigm case to urge that “sometimes the only way to maintain fidelity to the parties’ intended means is to enforce the standard contract terms to which they have agreed, even when doing so defeats their contractual ends.”110 The problem with overriding the chosen means to achieve the goal of assuring a 3% above costs price for the seller, according to the authors, is that it will hinder reliability of specific terms and involve the court in an expensive inquiry into the seller’s costs, an inquiry which the parties wished to avoid by adopting an index proxy for the seller’s costs.

In their example, Kraus and Scott hypothesize a situation in which the chosen contractual means fails to assure the contractual goal of assuring the seller 3% above his costs because the proxy index does not function well ex post and thus ends up assuring the seller less than the contractual goal of 3% above its costs. Kraus and Scott use this example to posit that courts, in such a situation, improperly assume “that had the parties known at the time of formation what the court knows at the time of adjudication, the parties would have crafted different terms. . . .”111 In the outlier examples courts intervening in contracts make the mistake of trying to take account of ex post events to realign the contracts’ terms with the original “joint” contractual goals in a way that requires the court to make decisions using unverifiable data. What follows from this assumption, according to the authors, is that the courts conclude that parties would “prefer courts to do for them in the course of adjudication what the parties would have (but could not) do for themselves at

109 Id. at 2.
110 Id. at 4 (emphasis supplied).
111 Id. at 3.
the time of formation."\textsuperscript{112} In such cases, they assert, courts wrongly suppose that they should depart from and override the specific contractual means chosen (the 3% above the index) in order to accomplish the contractual goal of assuring the seller 3% above his costs.

While Kraus and Scott raise valid concerns that cast doubt on certain types of intervention, especially when those interventions take the form of intervening to achieve contractual goals in a case where the parties deliberately avoided adopting an express term tied to those goals because of verifiability and moral hazard concerns, their criticisms extend to all types of judicial intervention if the parties did not signal their desire for judicial intervention through a vague term.

However, one problematic aspect of the intervention examined by Kraus and Scott is that the court intervened to assure that parties that they would achieve a particular contractual objective when the express term failed to secure that objective even when (1) is not clear such joint contractual objective existed or (2) if achieving such an objective would alone be a proper basis for judicial intervention.

Although Scott and Kraus assume that the parties’ joint goal is to assure the seller a 3% profit in the price term, it is not clear that both parties subscribed to that joint goal. It is possible that the seller may have hoped that the term would operate to guarantee such a profit while the buyer agreed to the term because that price term was on the contract curve. The second problem with this example is that it involves a court intervening \textit{ex post} on a rationale in which a court intervenes to achieve a specific contractual goal of permitting the

\textsuperscript{112} \textit{Id.} at 3.
seller to garner a 3% profit. However, the mere fact that one of the parties did not achieve its goals does not provide an adequate justification for a court intervening ex post to secure the seller a 3% profit. A court should intervene only if the benefits of judicial intervention outweigh the costs of intervention. Because of negative ex ante prospective effects on other contracts, such as the increase of moral hazard when a court has to ascertain what a seller’s true costs are and there no ways to verify that issue, a court might well decide that the costs of intervention outweigh the benefits of intervention even if the clause no longer achieves the seller’s original goal of a three percent profit. Thus, if a more robust justificative framework were used, intervention in the proposed case might be deemed inappropriate.

The parties agreed on the specific term because an alternative term such as a price term which gave the seller his “cost plus three percent” would be subject to manipulation.\footnote{Kraus & Scott, supra note 4, at 4.} A seller could claim high costs and unless that term were verifiable, the buyer would be subject to the seller’s inflated cost claims and therefore subject to opportunism. The case does not provide a solid foundation for their argument because it is an example of judicial overreaching built on a much criticized case.\footnote{Alcoa case. For insightful criticism of the case see VICTOR GOLDBERG, FRAMING CONTRACT LAW 348 (2006).} Because the form of the judicial intervention in the Kraus/Scott example would involve the court in ascertaining matters that are unverifiable and subject to manipulation by one of the parties, and because the parties specifically avoided adopting an express term that mimicked the seller’s objective that would permit a court to supply terms based on such data, it does not provide a sound foundation for analyzing the broader question of whether courts should look to the
parties’ overall objectives when interpreting incomplete contracts in a variety of different contexts, that might not involve the court in unverifiable matters.

If the example used by Kraus and Scott is reexamined, however, it is possible that the example does not counsel against judicial intervention in contract adjudication to achieve the parties’ overall contractual goals whenever parties have chosen specific means or terms. Instead, it suggests that judicial intervention must be based on a careful analytical framework and that the current approach to contracts issues, at least as it is described in the Kraus and Scott article, omits certain steps in the analysis that are needed to justify judicial intervention. It does not follow, however, that other instances of judicial intervention when parties have “chosen means” are similarly misguided.

In order to override a contract term, courts need a justification for doing so. It seems that the court in ALCOA may have engaged in a process of overriding a term without a complete normative framework. Merely because courts improperly intervened by invoking an incomplete framework to justify overriding a term of three % above a certain index with a substitute geared to seller’s costs should not serve as the basis for widely preferring a contrary strategy of non-intervention. The framework for judicial intervention must take account not only of the means chosen by the parties, as well as the possible judicial error costs of a judicial resort to an open-ended inquiry, but also a number of other factors, some of which might counsel against judicial intervention but only after a more extended analysis.
One of the factors that the framework for judicial intervention should take into account when determining whether or not a court should intervene is the risk that the buyer, by insisting on the courts adhering to express chosen means of the contract, is in fact seeking to shift a risk to the seller that the seller did not assume *ex ante*. In the example used by Kraus and Scott, one could surmise that the seller, who was guaranteed a price of three % above an index, was mitigating some of the risk by having a term that would move with inflation and other sources of upward pressure on prices and that the buyer was aware that the seller was insulating itself from some of the market risk through the agreed on terms.

At the same time, the means chosen were to afford the seller a price that moved with the market but that did not require the court to evaluate non-verifiable matters such as the seller’s costs. If the court were to depart from the express terms, because they no longer could achieve the goal of assuring the seller a price term equal to 3% above its costs, by inquiring into and substituting a price term based on the seller’s costs, the court would be subjecting the buyer to a risk of judicial error that the buyer might well not have agreed to even if it were later found that the agreed on chosen means no longer served to assure the seller a markup of 3% above its costs. Having the price term depend on the seller’s costs would permit the seller to capitalize on the unanticipated circumstances to subject the buyer to error costs in litigation that would add to its overall costs and perhaps subject it to seller’s opportunistic behavior (by inflating its costs).

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115 However, as Victor Goldberg points out the formula was flawed for many reasons. *Id.* at 351.
The hypothetical example demonstrates that there are risks and costs to both intervening and not intervening and any court must consider those costs. Before deciding which approach to take, certainly the court should determine whether there is another proxy index that would more closely track the seller’s costs and that could be used to establish a pricing term that more closely mirrored the parties’ objectives of assuring the seller a price term equal to 3% above its costs without subjecting the buyer to the risk of an open-ended inquiry into a manipulable element, such as the seller’s costs. Further, the court might require the parties to bargain in good faith towards a new pricing term if it were convinced that the costs would be observable to the parties though not verifiable to a court. Finally, the court might look to other objective indicia to determine whether there is any bad faith occurring. One such indicator would be the fact that one party is using the malfunctioning index to propel itself into the position of a reseller on the market. By enforcing the price term as it is, the parties’ chosen means, the court would allow one party to propel itself into a role as reseller, a form of conduct regarded as opportunistic in other contexts.

The paradigm example presents a situation in which one could argue that if the court were to intervene by “realigning the price term with the seller’s actual costs,” it would in fact defeat the parties’ contractual goals, if those goals are broadly conceived to mean welfare improvement. Although the parties intended to provide the seller with 3% above his costs, even in cases where the published index fails to achieve that goal, one should not necessarily jump to the conclusion that the parties would want the court to

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117 Kraus & Scott, supra note 4 at 4.
intervene with an *ex post* inquiry into the seller’s costs. Legal intervention should be justified only by projecting whether parties *ex ante* would think that judicial intervention would be optimal and efficient. The courts should craft legal rules and interventions using a justificative framework that finds that there are welfare gains from such intervention. If the court has to calculate the seller’s costs and such information is unverifiable, the parties may indeed prefer the court to decline to intervene when the initial price index fails. The costs of judicial error may outweigh any possible benefit from the court coming up with its own estimate of the seller’s costs including the benefit that an open-ended inquiry might curtail some opportunistic behavior and thus judicial intervention could not be justified using a cost/benefit analysis, even if the seller *ex post* might desire such an inquiry.

When deciding such cases, courts should consider such presumed goals including the likely incentive effects a rule or intervention will have as well as the effect on the overall goal of maximizing gains from trade or contractual surplus while minimizing transaction costs. Courts can intervene without engaging in an inquiry into an unverifiable factor that the parties deliberately excluded from their contract means.\(^{118}\) Courts should expand consideration of matters beyond the parties chosen means and beyond a specific contractual goal that was deliberately avoided by the chosen means and consider broader goals such as minimizing transaction costs, maximizing surplus, minimizing deadweight losses, and curbing opportunistic behavior making it possible to see that sometimes the court should move beyond the parties’ express terms, even absent an express delegation. It is difficult to see how courts can function effectively to choose optimal rules without

\(^{118}\) Of course, the deliberate decision to exclude a decision built on an unverifiable factor like costs rests on a long standing critique of judicial intervention in such cases. See Schwartz, *supra* note 16.
considering “what goals or objectives will be served or jeopardized by a response awarding (or withholding) a property right or imposing (or not imposing) liability in light of responses’ likely effect on those who will be affected by litigation or those who will be affected by litigation. . . .”

The paradigm example, however, is used by Kraus and Scott to bolster their broader argument that courts should refrain from judicial intervention to achieve the parties’ goals if doing so would override or undermine the specific terms that have been chosen by the parties. Moreover, because Kraus and Scott do not carefully distinguish between the parties’ contractual goals specific to individual transactions and broader economic goals of maximizing joint surplus which are present in every transaction, readers may mistakenly conflate the two. One consequence of the Kraus and Scott approach is, therefore, that it seems to suggest that even if a court could intervene in a contract in such a way that it could achieve the parties’ broader contractual goals of welfare maximization, it should refuse to do so unless the parties have specifically requested such intervention through vague terms. Their article is an extended argument for greater formalism in contract interpretation and for greater deference to the parties “chosen means” which are the parties’ explicit terms. The example based on the 3% above costs as well as many of the other examples chosen by Kraus and Scott seem to illustrate cases in which a court neglects the specific terms chosen to achieve a contractual goal that necessitates the court in such cases supplying unverifiable terms. Intervening with a term based on “costs terms” might in fact not be preferred by the majority of parties because of the negative effects on

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119 Ronald J. Coffey, Professor of Law Emeritus, Case Western Reserve University.
120 Id.
future parties who would anticipate the high back end costs of judicial intervention. These examples, however, rather than standing for the proposition that courts should not intervene when the parties have chosen precise terms, demonstrate the need for courts to engage in a careful justificative analysis in deciding whether or not to intervene, to determine whether or not there are welfare gains for the parties from such intervention.

In the case discussed by Kraus and Scott, courts look at events *ex post* and find there to be a “misalignment” between the agreed on terms of the contract and the parties’ objectives which are no longer achievable due to subsequent events. The suggested justification for judicial intervention takes the form of substituting terms is to allow the parties’ to achieve their original contractual goals. However, normally, courts should not intervene to achieve specific contractual goals, because those goals may diverge amongst the parties.121 Judicial intervention should not add to or override contractual language to achieve “joint” contractual goals, since the parties are likely to share different goals, with one party hoping that the term will achieve a goal such as 3% above the seller’s costs and the other party – the buyer – sharing no view on what the seller’s returns will be but hoping that events will make the contract profitable for it, regardless of what happens to the seller’s return or price term. In addition, even if an *ex post* realignment could be justified on “fairness” grounds, it might not be preferred by parties *ex ante* if such intervention would adversely affect parties’ incentives or lead to significant back end costs by requiring a court to craft terms based on unverifiable data input and so would not be preferred by parties *ex ante*, even if one of them would prefer the intervention *ex post*. Courts can and should intervene if doing so improves the parties’ welfare. In the example posited by Kraus

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121 See *supra* note 8.
and Scott the purported intervention seems self-evident since *ex post* events have resulted in the contract terms *ex post* not achieving a shared contractual goal. However, intervention should only take place *ex post* if the parties *ex ante* would both want the court to effectuate realignment in light of *ex post* events and that intervention would not have negative effects on investment and incentives. Their posited example would seem not to warrant intervention under a welfare improvement standard but that it does not suggest that all judicial intervention in contracts, absent express delegation, would have negative welfare effects.

**III. Suggested Framework**

In order to determine whether judicial intervention in a contract is justified, courts must recognize that the presence of a specific term by itself does not resolve whether a court should intervene. Courts must use an analytical framework to determine if intervention would improve welfare that would applicable to a wide range of cases that arise in Contracts. A framework for judicial intervention must move beyond outlier cases to ascertain when courts might play a useful role.

Courts must make realistic assumptions about why contracts may be incomplete. Contracts may be incomplete because of the enormous uncertainties that parties face. Parties employing agents might use very simple contracts in which they agree to employ an agent for a fixed wage, for example, because the parties may have great difficulty
specifying all the various choices as to actions that should be constrained. Very often the contract is silent on a matter and there is no term at all to govern an issue of how an agent with discretion (a babysitter) should behave when faced with certain choices.

Even if a contract is specific and employs a term, courts cannot necessarily assume that parties invested large front end costs to arrive at the optimal term and in doing so intended to foreclose all judicial intervention. Very often the parties settle on a specific term, that is rigid in nature, not because they necessarily intend it to apply across the board in all cases but because uncertainties about the future caused them to omit more complex terms that varied with the circumstances because those circumstances were unknowable (at any cost) \textit{ex ante}. The parties can also settle on specific terms assuming that they will be understood as the parties in the trade understand them without realizing that giving effect to the chosen means without further context evidence would preclude that outcome and might harm the parties’ overall welfare by requiring them to translate all of their trade terms into the language of others even when they assume that the meaning that they assign is the ordinary, English language meaning of the term.

Thus, one heuristic is for a court to determine if a secret code exists outside the four corners of the contract that could be easily incorporated by a court without great cost. That would require objective evidence of prevalent trade usages or trade meanings. As one author explained, a failure to give effect to context evidence in such cases would promote

\begin{itemize}
\item \textsuperscript{122} WILLIAMSON, supra note 48.
\item \textsuperscript{123} \textit{See} Pierpaolo Battigalli & Giovanni Maggi, Rigidity, \textit{Discretion, and the Costs of Writing Contracts}, 92 AMER. ECON. REV. 798 (2002).
\item \textsuperscript{124} R.J. Coffey
\end{itemize}
opportunistic behavior. If a court can interpret the term using trade usages to deter such opportunism at a low cost, it should consider doing so.

Matters of interpretation cannot be resolved simply by arguing that the parties who omit to use vague terms have chosen to foreclose judicial intervention of implication of terms. Since no express terms foreclose such interpretation, a court resolving the issue must decide whether the intervention is justified, using a normative structure that relies on a number of assumptions about behavior (propensity to act opportunistically) and limits on cognition. Heuristics may be helpful to courts in deciding if and how to intervene.

In deciding if there are net benefits to intervention, a court should consider whether intervention would promote the parties’ and society’s goals of maximizing welfare while minimizing transaction costs. In making determinations about intervention a court should downplay the importance of specific contractual goals unless there is evidence that those goals were shared by both parties and that the benefits of courts intervening to achieve those goals more than offset the costs of such intervention. A court must ask if it fails to intervene through the implication of trade usages, or a best efforts clause or active interpretation of a term, will that failure to intervene facilitate opportunistic behavior? If intervention by courts through a law supplied term will control opportunistic behavior at less cost than the alternative private strategies or informal enforcement mechanisms, then a court should consider intervening. A failure to remedy opportunistic behavior will result in deadweight losses which act as a drag on gains from trade.

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125 Kostritsky, supra note 5.
Instead of focusing on outlier cases where courts engage in *ex post* realignment that might be embraced by those who are concerned with *ex post* fairness\(^\text{126}\) rather than *ex ante* efficiency, and in which courts justify the results by reference to specific contractual goals (which might well diverge), courts and scholars should instead focus on when judicial intervention is likely to improve welfare and limit judicial intervention to those cases. If so, one can identify cases where courts should move beyond the parties’ chosen means, to promote efficiency. Often courts intervene in contracts not to seek realignment in light of later events to achieve specific goals but to craft rules, including default rules, that would be preferred by the parties *ex ante* for efficiency reasons. These examples of judicial intervention serve to underscore the importance of clarifying the framework and the particular fact patterns under which courts choose to intervene to determine the manner in which the court intervenes and whether and how those interventions will promote welfare improvement and which will not.

A court may have to decide whether to imply a term to govern the performance obligations of a party such as a babysitter\(^\text{127}\) or employee or agent (even if the parties have not used an open-ended term such as good faith or fiduciary obligation) or whether the court should confine its role to strict or literal interpretation of the terms. The court should determine whether a failure to intervene will likely result in a lack of control of a party’s discretion under the contract after analyzing whether 1) express contract controls exist and


\(^{127}\) See Battigalli & Maggi, *supra* note 97.
2) the potential for robust informal sanctioning mechanisms exist or other private governance strategies exists.¹²⁸

The problem of deadweight losses resulting from uncontrolled discretion if the court fails to intervene must be accounted for as a cost in assessing the costs and benefits of judicial intervention. That cost must then be compared to methods of control by judicial enforcement via a law supplied term and by informal enforcement. A court must first consider the costs of parties enforcing constraints on behavior or limiting opportunistic behavior or shirking by an agent by informal enforcement to police such behavior. A court must consider how robust the non-legal sanctions are, whether there is transparency and a means for parties and courts to judge whether opportunistic behavior has occurred. It should consider whether there are possibilities of repeat play that would make reputational sanctioning and tit for tat strategies effective. If repeat play is not possible or likely, does the experimental evidence suggest that norms of reciprocity would constrain such behavior? For those parties who choose not to be constrained by such norms, could the law play a helpful role by supplementing non-legal enforcement? Merely because parties have chosen not to address some matter or failed to condition some obligation on an uncertain event does not mean necessarily that they were relying exclusively on informal means of enforcement. The parties would prefer the courts to intervene if doing so would maximize gains from trade at a low cost.

IV. Doctrinal Areas Illustrating a Framework for Justification of Judicial Intervention

Courts can and do promote welfare improvement by intervening in contracts in a variety of ways even when the parties have not deliberately opted into back end arrangements that delegate matters to courts *ex post*. Kraus and Scott assume that courts should intervene only when the parties have explicitly signaled their intention to opt into judicial intervention through terms that are explicitly vague. Vague standards allow parties to delegate to courts who will have certain hindsight advantages *ex post* because facts or information will have been revealed.

This bifurcation by Scott and Kraus suggests that many doctrines in contract law such as Section 45, the Drennan rule of irrevocability, the good faith doctrine and the incorporation of trade usage doctrines are misguided since they sanction courts intervening with an implied term constraining discretion or broadly interpreting contracts by incorporating matters that were not expressly adverted to even without express authority. There are many areas in contract law when this bifurcated structure of Kraus and Scott appears too narrow to accommodate what courts are actually doing.

Courts seem to be comfortable implying duties in a variety of settings even when the parties have agreed on specific terms and failed to expressly delegate authority to a court through an open-ended term. Courts exercise such authority to restrain opportunistic behavior by incorporating terms or by implying duties or terms that were not agreed upon.
In deciding whether it should go beyond the parties’ chosen means, the court cannot assume that the choice of specific means without a vague term means that the parties have decided to exclude any form of legal intervention and intended for the court to follow a rule based approach. Every term presents the court with a possible interpretive question that cannot be resolved with a unitary rule which looks only at the chosen means and that also forbids the court from looking at contractual goals.

A. Oral Conditions and the Parol Evidence Rule

A case discussed by Kraus and Scott, to illustrate the means/ends conflict is presented by discussion of the Hunt v. Doliner case. In that case Kraus and Scott suggest that the court made a mistake in not looking exclusively at the parties’ chosen means, their words and looking beyond those words to a clearly stated goal articulated by the parties before the contract was signed. Kraus and Scott argue that when the contract lacks express contractual protection, then the parties intend to rely exclusively on informal means and a court oversteps its authority when it lends legal enforcement to terms or agreements not in the formal contract. A close examination of the case reveals that there are contrary arguments which would look beyond the written words to effectuate joint goals of restraining opportunistic behavior.

During negotiations for the purchase of the Doliner by Hunt Foods, Doliner requested a recess in the negotiations. To deter Doliner from using the recess to shop

130 Id.
the offer by Hunt Foods to other companies, Hunt Foods insisted on securing an option from Doliner to purchase Doliner as the price for acquiescing in the recess. During negotiations Hunt Foods allegedly orally assured Doliner that the option would not be exercised unless Doliner shopped the bid during the recess.\footnote{131}

The parties reconvened after the recess but failed to reach agreement.\footnote{132} Hunt Foods then sought to exercise the option and to enforce the option on a motion for summary judgment.\footnote{133} Doliner then sought to introduce evidence of the oral condition, arguing that because the condition had not been met, and Doliner had not shopped the bid, the option was not operative. Hunt Foods sought to exclude evidence of the oral condition on the ground that the parol evidence rule barred evidence of prior oral agreements.

The court allowed in evidence of the oral condition on the implicit assumption that the agreement was only partially integrated.\footnote{134} As a partially integrated agreement, extrinsic evidence would be admitted unless that evidence contradicted the written agreement; thus additional oral terms would be admissible. The court then adopted a test for contradiction that was very narrow: contradiction would occur only if the term negated an actual term in the writing.\footnote{135}

\footnote{131} Id.  
\footnote{132} Id.  
\footnote{133} Id.  
\footnote{134} Id.  
\footnote{135} 270 N.Y. S. 2d at ___
Kraus and Scott criticize the result in this case on a number of grounds but their bottom line conclusion is that “the court would have been wise to rule inadmissible the evidence of an oral condition on the option.” Kraus and Scott argue that “[i]f the parties intended the written option to be the final expression of the option term, and if it is clear that the proper interpretation of the option as written, is that it is unconditional, then allowing evidence that the option was conditional undermines the point of the parties’ agreement that the written option is a final expression.” The authors also criticize the court on the ground that the standard applied by the court ignored the basic “allocation of contractual benefits and burdens as reflected in the final and exclusive written terms of the agreement.”

Kraus and Scott assume that the court reached the wrong result in Hunt Foods because the court misguidedly tried to vindicate Doliner’s contractual intention to grant a conditional option while granting an expressly unconditional option. In their view, taking account of such contractual goals always led the court astray. It would have been preferable to adhere only to the written document which was unconditional and to ignore the parties’ intention to grant only a conditional option.

In suggesting that a contrary result would have been the preferred outcome, Kraus and Scott offer a means of understanding why Doliner would have agreed to grant an unconditional option after reaching a prior oral agreement that the option would only be exercised on bid shopping. The explanation is as follows: since Hunt Foods did not want

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136 Kraus & Scott, supra note 4, at 28.
137 Id. at 17.
138 Id. at 18.
to make the option conditional on bid shopping by Doliner due to the unverifiable nature
of the event, and Doliner agreed to the unconditional option, Doliner was choosing to rely
exclusively on non-legal means to informally sanction Hunt Foods if it exercised the
option without Doliner’s having bid shopped. Had Doliner intended to preserve an option
that was *legally* enforceable only if the bid shopping occurred, then Doliner would never
have agreed to the option without the condition. The implication is that the court should
strictly enforce the express option and deny evidence of the oral condition.

This line of reasoning ignores the possibility that Doliner might have agreed to
the option without any express condition on the assumption that a court might find the
option agreement to be “only partially integrated until the condition occurs.”\(^{139}\) Doliner
might have assumed that there was some probability that a court would let evidence of
the condition come in by finding that the (1) agreement was only partially integrated; and
then (2) by finding that there was no contradiction. In fact, that assumption might not be
far fetched; the *Restatement (Second) of Contracts* adopts this view and provides
that agreements are only partially integrated with respect to conditions.\(^{140}\) Evidence of an
oral condition should be routinely admissible despite the fact that the final written
agreement contains no condition so long as it does not contradict the writing. So, Doliner
might have signed the agreement believing that in litigation, a court might admit evidence
of the oral condition. Once that probability/possibility is admitted, then the conclusion
that Doliner did not expect the court to incorporate the oral condition into a legally
enforceable agreement becomes less plausible.

\(^{139}\) *Restatement Second* § 217.
\(^{140}\) *Restatement (Second) of Contracts* § 217 (1980). It is based on the earlier
*Restatement (First) of Contracts* § 241.
The Restatement (Second) of Contracts permits evidence of oral conditions to come in even when they are not included in the final written agreement, then the Kraus and Scott view that parties who omit oral conditions intend them to be enforceable exclusively through informal means is not logically compelled. The supposition might be that because the whole operation was not to take effect unless the option or bid shopped, case law would support evidence of such a condition since it would tend to show no contract existed. \(^{141}\)

Doliner might have expected that a court, with some probability, might enforce the oral condition even though it was not part of the express agreement. And any similarly situated party who agreed to an unconditional option only after an oral agreement stipulating that the option would not be enforced except on the occurrence of an event might have been informed by legal counsel that courts do admit evidence of oral conditions under certain circumstances despite a final written agreement. So one party’s agreement to an unconditional written agreement does not necessarily and conclusively establish that the party acceding to the exclusion of the oral condition had decided to rely exclusively on informal enforcement, \(^{142}\) it might have been counting, at least partially, on a formal enforcement via an exception to the parol evidence rule.

\(^{141}\) See Farnsworth, Contracts § 7.4 (4th ed. 2004)(discussion of the no contract existed rationale for admitting evidence of oral as an exception to conditions the parol evidence rule).

\(^{142}\) This is a suggestion or implication in the Kraus & Scott article. See Kraus & Scott, supra note 4, at 28. It is also supported by a statement by Doliner to his lawyer. See Trial Transcript.
Since the agreement by itself does not establish the parties’ intentions that a court should not interfere or admit evidence of the oral condition, a court would have to decide whether it was an appropriate case in which to admit evidence of a prior oral condition. There are two main theories under which evidence of an oral condition might come in: to show that no agreement existed until the condition occurred or to show that the agreement was only partially integrated; under the latter approach a court would still need to decide whether evidence of the oral condition contradicted the express agreement. In reaching its decision, it might be useful to reexamine the *Hunt Foods* case to see why a court might admit evidence of the oral condition to maximize joint gains. The discussion of this follows.

Once those considerations are present, one can see that a court’s determination to admit evidence of the oral condition might not appear as illogical or misguided as Kraus and Scott argue it was. *Hunt Foods* succeeded in getting an express option that did not include the agreement, an oral condition that it would be exercised only if Doliner bid shopped. Both parties faced the potential for opportunistic behavior. Doliner might seize on the recess in negotiations to shop *Hunt Foods*’ bid in an opportunistic fashion to secure a higher offer for its assets. At the same time if *Hunt Foods* acquiesced to making the option exerciseable only on proof of bid shopping to a court, a matter that is arguably non-verifiable and subject to manipulation,\(^\text{143}\) then Doliner could bid shop but opportunistically defend on the ground that there was no proof of that to a court and thus opportunistically deny *Hunt Foods* its option.

\(^{143}\) Both parties, Doliner and another potential bidder, would have an interest in keeping information about Doliner having shopped *Hunt*’s offer secret.
In deciding if a court should intervene in this case and go beyond the chosen means by admitting evidence of the oral agreement, as to the conditional nature of the option, a court might consider the following. The contract, as agreed to, allowed one party, Hunt Foods, the right to protect itself unilaterally in the event that the other party, Doliner, acted opportunistically. If it observed such bid shopping, Hunt Foods could exercise the express option without having to prove anything to a court.

However, the way that the express option was structured subjected Doliner to the risk of opportunism since Hunt Foods might unjustly claim that Doliner had bid shopped and then exercise the option even if there was no evidence of such conduct. The only protection offered to Doliner by Kraus and Scott for such conduct would be the reputational sanctions that Doliner could impose on Hunt Foods.

The court might have seen that one party, Hunt Foods, had adopted a private strategy, a contractual option, that gave it perfect protection against opportunistic behavior from Doliner. Doliner on the other hand, while subject to the risk of opportunistic behavior by Hunt Foods falsely claiming bid shopping, had no private contractual protection.

With this disparity in express protections against the risk of opportunistic behavior, with one party having a private strategy for protection and the other party lacking such a device, the court might conclude that in interpreting the contract, it would

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144 Kraus and Scott discuss this possibility. Kraus & Scott, supra note 4, at 28.
decide to find the agreement to be only partially integrated, thereby allowing evidence in
of the oral condition. If the court had instead relegated Doliner exclusively to reputational
sanctions, Doliner would face many of the same problems of verifiability that made Hunt
Foods reluctant to condition the option on bid shopping. Doliner would have to prove to
other parties that Hunt Foods had wrongfully exercised the option. Moreover, it might be
difficult to sanction Hunt Foods when Hunt Foods has already acquired Doliner. It might
be difficult for Doliner to exert reputational sanctions since there is the possibility that it
won’t be in existence as a company any longer.\footnote{Discuss corporate law issues and the acquisition.}

Reputational sanctions are certainly not uniformly effective, particularly where
the probability of proving the wrongful conduct at issue is not 100%, where the parties
are not homogenous with an effective means of efficiently transmitting information, and
where there may be reason to discount the information because it is offered by a
disgruntled target company.\footnote{That would be the case here.}

Where reputational sanctions may be ineffective, there may be reasons to look
beyond the chosen means to allow evidence of the oral condition to come in and there is a
risk of opportunistic behavior that is not controlled by contractual or other means. That
would allow one party the opportunity to rely on legal sanctions as one alternative.
Otherwise, the court would be subjecting one party to the risk of opportunistic behavior
(wrongful exercise of the option) and insisting that that party rely exclusively on informal
enforcement. That result might act as a drag on gains from trade.
B. Section 45: Constraining Discretion

The same risk of opportunism can occur in other contexts in Contracts. In some set of contracts one party hires another party to do an action. The offeror wants an acceptance by performance rather than in words. The terms are specific and contain no open-ended term delegating any authority to courts. Nonetheless, in these cases courts intervene through a doctrine that implies a subsidiary promise not to revoke an offer once the promisee has partially performed it. Yet, if one were to adhere to the Kraus and Scott approach, then the presence of specific terms without delegation would foreclose intervention by a court. Yet courts intervene even without express authority. They have developed a doctrine that constrains the discretion of the offeror to revoke offers once the offeree partially performed. The justification lies in the notion that even parties who do not anticipate all of the myriad ways in which their counterparty can act opportunistically and they may fail to devise specific constraints on that discretion. Yet without that constraint, the prospect of unremedied opportunism which would permit offerors full freedom to revoke until the act was fully performed, would act as a disincentive to parties to begin performance on future offers and that would act as a deadweight loss. The judicial implication of a law-supplied rule is done in circumstances where the parties had not expressly invited legal intervention but the benefits of such intervention can be seen in terms of a remedy to constrain unbridled opportunist behavior.
C. Trade Usage and Plain Meaning: Why a Unitary Approach Will Not Work

Courts may play a useful role even when the parties seem to have chosen specific means and have not expressly delegated decision making to a court through an open-ended term. Courts incorporate trade usages and customs used to interpret express terms. The use of a specific term in a contract often cannot resolve the normative question of whether and when courts should intervene with a law supplied default rule by: (1) interpreting specific terms of a contract using extrinsic evidence of trade usages or (2) by resorting to an objective standard of reasonableness to interpret express terms. Yet, if one were to adhere to the Kraus and Scott view that courts should stick with the parties’ chosen means unless they have specifically signaled to the court they wish to have the court intervene in the contract, many cases that currently allow for broad interpretation of contract terms, using trade usages, would be interpreted literally since the parties often fail to invoke the court’s authority through the use of a vague or open-ended term. This section will attempt to illustrate the beneficial functional effects of courts implying trade usages into the contractual agreement, including the control of opportunistic behavior. An approach hewing to the Kraus and Scott injunctions would lead to potential costs in terms of unremedied opportunism, that is unless the non-contractual means of policing against such opportunism were uniformly robust and effective.

Often the parties do not explicitly delegate to courts the direction to go beyond the chosen terms and yet the courts respond by incorporating trade usages if the parties have
not specifically negated the use of such trade usages.\footnote{U.C.C. Section 1-303.} Rather than assuming that the failure to expressly invoke the trade usages necessarily means in all cases that parties intend to exclude those usages from legal enforcement and rely strictly on informal enforcement, the courts seem to consider whether incorporation of the usage would help the parties achieve their overall goals, including the control of opportunistic behavior. Court should and do consider whether literalistic enforcement of the chosen terms without incorporation of trade usages would advance or hinder those instrumental goals. In addition, the courts weighing intervention in the form of a decision to invoke trade usages in interpretation issues, should consider the barriers or reasons that might have prevented express incorporation of those usages into every contract. Some of the reasons for omission might suggest that courts should be cautious about incorporation and in other instances those reasons might suggest intervention is appropriate. Finally, the court should consider whether there are structural conditions which would contribute to successful informal enforcement and whether even if such conditions exist, there might be self-interested pressures to deviate from commercial norms because of large gains, facilitating gains from trade from enforcing usages. As in other doctrines of contract, courts do not uniformly adhere to the parties’ chosen words or means. Instead, they demonstrate a willingness to go beyond the parties’ chosen means even when the parties have not expressly delegated expressly the authority to intervene in the parties’ contract, as for example expressly opting into the court incorporating trade usages. The circumstances in which they do so as well as the analytical structure used to justify their intervention are examined below.
Those decisions should be made using a taxonomy of factors or heuristics rather than assuming that a failure to expressly incorporate the usages signals an intent to rely exclusively on informal means of enforcement.

One component of analysis should include an analysis of why parties may have omitted to include a term expressly incorporating a trade usage or alternatively adopting a vague or open-ended term. In the context of trade usages, parties may agree on a specific term such as “one dozen” because they assume the trade meaning is the ordinary meaning. They may fail to see the need for an express open-ended term delegating authority to a court or to expressly incorporate such usages. Application of Kraus and Scott’s framework confining the court’s consideration to the express terms to a situation in which the parties agreed on the term “one dozen” would suggest that the parties thereby intended to foreclose any judicial intervention that would invoke the parties’ contractual objectives or goals. A court should give effect to the chosen terms/means, without interpreting the term according to prevailing trade usages. However, in reality it is likely that the court will interpret “one dozen” to mean a baker’s dozen. The decision by courts (and by legislatures via the UCC) to incorporate trade usages and other trade practices can be rationalized if one takes account of parties’ overall goals of maximizing joint surplus. The incorporation doctrine helps parties to achieve party goals such as the control of opportunistic behavior and other such hazards that might be difficult to control ex ante by express means.\textsuperscript{148}

\textsuperscript{148} This is Professor Aaron Edin’s example discussed in Kostritsky, \textit{supra} note 5, at 69-70.
Midwest Television,\textsuperscript{149} illustrates the benefits of incorporating trade usages into an agreement even absent express language invoking such usages into an agreement even absent express language invoking such usages. In Midwest Television the court had to decide whether an ad agency would be responsible for the cost of televised ads when the company which placed them went bankrupt. Because the ad agency disclosed the principal to the TV station, the ad agency said that it should not have to pay the fee under the normal rule is that disclosure of the principal resulted in a contract existed between the client and the TV station.

However, in deciding the liability issue, the court looked to the prevailing practice which made the ad agency responsible for the costs of the ads unless the agency specifically disclaimed such responsibility to the TV station. The court incorporated this practice in interpreting the contract,\textsuperscript{150} despite the failure of the parties to expressly delegate decision-making to the courts through a vague or open-ended term and despite the absence of any express incorporation.

A number of circumstances suggested that incorporation of the trade practice would be welfare maximizing. Since the ad agency had all the direct contact with the client, and not the television station, they were most intimately acquainted with the creditworthiness risks of the client, it would make sense for any default rule to assess the risk against the agency rather than the television station. The incorporation would


\textsuperscript{150} Kostritsky, \textit{supra} note 5, at 504.
prevent advertising agencies from selling ad time of clients without disclosing the risks to the television station and making it clear that the risks were being assumed by the station. Without the trade usage, the ad agency could sell television ad time for clients without taking into account the full effects of the client’s bankruptcy. That immunity from liability would result if the trade usage were not incorporated and that immunity could act as a drag on gains from trade due to the potential reluctance of stations in the future to enter into contracts for advertising time because of the risk of opportunistic behavior by advertising agencies.\(^{151}\)

When a court intervenes in this way, by deciding to incorporate trade usages, the court, unlike the court in the example that is central to Kraus and Scott’s argument, does not have information *ex post* or subsequent events. Rather, the decision seems a purely legal one that does not depend on unverifiable information that is peculiarly accessible to the parties. The court’s decision to incorporate trade usages, absent specific negation by the parties, is a judicial decision based on the potential for opportunistic behavior that results in the contract being interpreted with extrinsic material. Because there is no express delegation, the court’s intervention must be justified using an analytical framework of cost/benefit analysis.

Similarly, when a court decides whether to broadly interpret a contract that goes beyond the literal chosen means or plain meaning, it must advert to a normative framework. If a company employs and the company agrees “to pay the headhunter for any of the headhunter’s referrals that the company hires,” a court applying the Kraus and

\(^{151}\) See Kostritsky, *supra* note 5, at 504 (discussing Professor Edlin’s example).
Scott approach would conclude that the court should stick to the chosen means because
the parties omitted the use of any vague term and therefore intended to foreclose any
judicial resort to the parties’ goals or objectives in interpreting the contract. However, the
language at issue describes a ministerial act such as paying a fee to a headhunter for the
referrals that are actually hired. The contract is economically incomplete because it does
not say anything about whether there would be any limits on how the headhunter could
perform his duties. That would leave open the possibility that a headhunter could simply
transmit thousands of resumes without screening them in advance and then demand a
payment should the company sift through those resumes and actually hire someone?

Because of that incompleteness, the court should resort to the parties’ overall
objectives to determine if the headhunter has complied with its performance obligation.
That inquiry should go beyond the literal terms to see if there are any implied terms that
would require “performance” by the headhunter to screen the resumes. A court might
well imply such a limit if it considered that a failure to do so could promote opportunistic
behavior that might act as a drag on gains from trade.

The question remains: what distinguishes intervention in the trade usage cases or in
the headhunter case from cases in which intervention is not justified, even though the
parties’ chosen means are no longer achieving the parties’ overall contractual goals,
because intervention would embroil the court in deciding issues, such as seller’s costs, that
it is ill-equipped to decide? First, the decision to invoke trade usage seems to be a purely
legal one that does not depend on accessing unverifiable private information: should a
court incorporate trade customs/usages into the court’s interpretation of the contract unless the parties specifically negate them? Unlike the decision in the example central to Kraus and Scott, the trade usage decision incorporation decision or the resort to reasonableness does not involve the court in acquiring unverifiable information that the parties would have better access to. The trade usages themselves are objective and must be proved to exist and to have reached a particular level of uniformity in observance so the inquiry is not akin to deciding on a factor as manipuable as the seller’s costs. Similarly when a court resorts to a reasonableness test to constrain the discretion that a party might have in performing under a contract that does not necessarily involve the court in accessing information that is private. Instead the court determines what a reasonable interpretation of the terms requiring a company to pay a headhunter for referrals entails. In making that determination, it makes sense for a court to consider how the interpretation of the headhunter’s duties would impact the achievement of goals such as the opportunistic behavior since that is an outcome both parties would want to avoid to minimize drags on trade and maximize surplus. Second, unlike the example central to Kraus and Scott, trade usage cases are not situations in which hindsight will benefit the parties by allowing courts access to information about the state of the world that was not available to the parties at the time of formation. This means that there will not be the same potential for opportunistic behavior that exists when one party tries to escape contractual obligations because of a bad outcome and relies on a court for *ex post* adjustment. Third, in the case of trade usages, the debate centers around the question of whether the trade usages should govern as a default rule unless the parties negate them or whether courts should require parties to opt into such rules if they are to govern the contract. The mere fact that they have agreed on a specific term does not resolve that and it
is not clear that by adopting a specific term of one dozen or a headhunter fee, they necessarily intended to foreclose all judicial interpretation of those terms and relegate the court to a strict formalistic approach.

Because Kraus and Scott focus on a hypothetical that is grounded in the ALCOA case, when the court may well have intervened without adequate analysis about whether or not the intervention would be welfare-improving, and because they assume that all cases in which parties use specific terms and fail to use open-ended terms are like the ALCOA case, they necessarily conclude any judicial intervention would embroil the court in inquiries that they are ill-equipped to make. Instead of assuming that any intervention in which the parties fail to use a vague term will necessarily decrease welfare by forcing the court to make decisions based on information accessible only to a private party, a decisionmaker must consider the particular type of intervention. In each case a court should determine if intervention would necessitate accessing unverifiable information ex post or whether alternatively the court’s decision to intervene could be made based on objective evidence, such as trade usages, or on projections about whether intervention by the court would be likely deter or promote opportunistic behavior (such as a headhunter collecting a fee without having done any substantial work) and whether incorporation would promote the disclosure of information designed to allocate risks to the least cost avoider (as in the Midwest case) and thereby achieve gains from trade.

D. Conditions

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152 But see Goldberg, supra note 114.
Assuming that a contract exists with rights and a court may have to decide whether a party has performed or breached. There are a number of issues involving conditions in which a court may still need to decide what the language means (an interpretation issue) and determine a number of other issues that are not directly addressed or resolved by the contract terms. This is so even if the parties have crafted specific terms detailing the parties’ obligations and have not expressly invoked the court’s aid through a deliberately vague term.

Two non-performance issues might require judicial interpretation: 1) whether a breach has occurred and (2) what are the consequences for the other party of one party’s non-performance. Deciding on whether performance has occurred or not might seem to be a technical matter that could be decided solely by consulting the language of the agreement. Yet, certain performance questions may not be resolved by parties’ agreements. In such cases, when the court decides to supply a default rule that the parties have not explicitly agreed on (such as what order of performance is required), then the court should decide those unresolved issues using a normative or justificative framework which considers how a particular rule would help or hinder the parties’ goal of welfare improvement.

153 If a court finds that one party has failed to perform its contractual obligations, then the breaching party will be subject to a successful action for damages by the other party; non-performance may also excuse the other party from performing. At first, the victim of the breach will be entitled to suspend her own performance. After a certain time, the victim of the breach may be discharged altogether from any further performance obligations under the contract. See RESTATMENT (SECOND) OF CONTRACTS § 237.
Many of the key doctrines surrounding performance, including: what degree of non-performance constitutes a breach, the timing of performance obligations, and whether and when performance is excused, can be rationalized as means to increase the gains from trade and the contractual surplus.

If a court were to decide, as Kraus and Scott have advocated, that it should not intervene in deciding performance issues unless the parties explicitly invited intervention through the use of an open-ended term, that result could discourage trade and increase contracting costs. Kraus and Scott would in each case want a court to reliably enforce the parties’ chosen contractual means and to do so without resorting to the parties’ specific contractual objectives. Presumably, Kraus and Scott would also bar resort to the parties’ broader goals of maximizing gains from trade in deciding whether to intervene in some way because that would force a court to consult objectives that were not part of the chosen means.

Yet, given certain barriers of bounded rationality and the uncertainties about the future state of the world and about parties’ behavior, one could imagine a world in which judicial intervention might nonetheless be optimal because it could solve a problem for the parties at lower cost than the non-intervention alternatives.

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154 Courts must decide whether a breach is material or trivial to decide what duties are owed.  
155 See RESTATEMENT (SECOND) § 241.  
156 Id. §229.  
157 Kraus & Scott, supra note 4, at 2.
Kraus and Scott assume that a court should not depart from or add to the parties’ chosen means without a direct delegation to the courts to make such decisions because without such delegation, the parties intend the court to refrain from supplying a term or a liability rule. Yet, the decision of whether a court should intervene must be based on a comparison of the costs of the court’s intervening against the costs of the court not intervening. Without that comparison, a court cannot surmise what the parties’ preference would be in the absence of any expressed intention. Kraus and Scott assume that if the parties choose specific terms or means, they do not want a court to intervene because doing so will increase back end costs too much by embroiling courts in making choices that should be left to the parties since their “private information as to their contractual intent is systematically superior to a court.”\textsuperscript{158}

This Article suggests that each decision about legal intervention must be decided by weighing what type of intervention is being called for and assessing whether the court is making a choice that is based on “private information” that is particular to the parties and unverifiable to a court (such as information about a seller’s costs) or making choices that depend on the effect of formulating legal rules on incentive effects and on overall gains from trade, considering the costs of opportunistic behavior from intervening or failing to intervene as well as the costs of private contractual solutions and informal enforcement.

1. Interpretation Issue: Promise or Condition

\textsuperscript{158} \textit{Id.}
The first question concerning performance that might arise and require judicial intervention beyond the parties’ chosen means is: whether a promisor is bound to perform even if performance has become more difficult or more costly and no agreement relieves the promisor from performing. Uncertainty about the future complicates this task of delineating performance obligations that extend into the future, making it difficult and costly for the parties to anticipate all of the circumstances that will make performance more costly.

If a party’s performance is more costly or more onerous, one performer might argue that he should have always have an excuse. The law must then formulate an approach for deciding who should bear the risk of performance when it has become more costly and the contract does not decide that issue.

One of the functions of contract is for parties to allocate the risk of certain events that might make it more or less likely that the cost of performance will increase. Accordingly, the law rather resoundingly allocates the risk to the promisor who undertook (by promise) to perform. According to the default rule of contract law, a party who undertakes a contractual obligation bears the risk that he/she will not be able to perform.\footnote{This default rule is known as the “performer’s risk principle.” JODY KRAUS & ROBERT SCOTT, CONTRACT LAW AND THEORY, 622 (4th ed. 2007). The default rule might not apply if an excuse for non-performance applies such as impracticability.} This default rule imposes the performance obligation on the promisor who undertook the commitment and has an absolute duty to perform unless the parties
specifically reallocate that risk or unless the law provides some legal excuse from the obligations.\textsuperscript{160}

In deciding to allocate the risk in that fashion, the law implicitly relies on underlying economic principles to resolve a matter unresolved by the parties.\textsuperscript{161} It assumes that the party who undertook to perform has greater access to information about the nature of the performance and thus will be able to judge more cheaply than the non-performing party what factors will affect performance and make performance more costly. Because of this greater knowledge, the performing party is better able than the non-performing party to easily and cheaply undertake precautions that insure performance will be forthcoming under all future conditions.\textsuperscript{162} Thus, even when contracts do not expressly allocate the risk of performance, the law allocates that risk through a default rule to the least cost avoider, the obligor, in a way that is consistent with lowering the costs of risk and increasing joint gains. The law assumes that the performer would bear the risk as part of the bargain because he can insure against the risk more cheaply.\textsuperscript{163} As a result "the risks associated with the future performance of an executory contract are reduced...."\textsuperscript{164} The law does not allow the obligor to claim that "I cannot perform because it has become more difficult or more expensive for me."\textsuperscript{165}

\textsuperscript{160} Excuses from non-performance are rare.
\textsuperscript{161} KRAUS & SCOTT supra note 160, at 622.
\textsuperscript{162} Id. at
\textsuperscript{163} Id.
\textsuperscript{164} KRAUS & SCOTT, supra note 160, at 622.
\textsuperscript{165} See e.g. U.S. v. Wegematic Corp., 360 F.2d 674 (2\textsuperscript{nd} Cir. 1966).
Because the governing principle for assent-based transactions is the welfare principle, the law should and does select a default rule for excuse from performance that maximizes joint gains for the parties and leads to welfare improvement. In this case, it is the default rule governing the risk of non-performance. In most cases joint gains will be achieved if the party who can most cheaply undertake “cost justified precautions” to prevent the risk of non-performance bears the risks associated with non-performance.\^166 Whoever has undertaken the performance obligation will be the one best situated to discover the risks associated with that obligation and thus can most easily reduce the risk of non-performance.\^167 In effect the performer becomes the insurer who assumes the risk that changed conditions will make the performance more difficult.\^168

In the first performance issue, whether promisors should be excused, the law addresses a contract which is silent on the issue of excuse and the law refuses to intervene by implying an excuse routinely merely because the circumstances have made performance more difficult. This approach could be thought of as consistent with the Kraus and Scott approach of enforcing only the parties’ chosen means unless the parties have expressly invoked legal intervention through a vague open-ended term. Absent such a directive the court should enforce the terms of the offer which offer no excuse.

In some cases however, there are performance issues which are not answered by the contract and courts do intervene to resolve the issues by intervening with default rules

\^166 \textit{Scott & Kraus, supra} note 160, 622.
\^167 Freedom of contract principles would allow a party to escape his performance obligation under certain circumstances.
\^168 \textit{Scott & Kraus, supra} note 160, at 622 (discussing promisor as insurer)
or with suggested rules of interpretation, relying on principles of maximizing surplus, even absent an express delegation by the parties.

The general principle of allocating the risk of future difficulties with performance to the obligor is subject to an exception. If a party can anticipate a future event that will make performance more costly and conditions his performance on the occurrence or non-occurrence of a certain event, the promisor is insulated from the risk of that event by conditioning his performance on the occurrence or non-occurrence of that event.

When the parties anticipate such an event and build it into their contract through an express condition, they clearly intend to shift the risk of the non-occurrence to the other party. Presumably, if the parties have allocated a risk in a particular way, absent reason to believe that the agreement was not voluntary or was procured through fraud, the court will enforce the agreed on risk-allocation. The courts generally require strict compliance with such express conditions. The price that each party agreed to pay or demand from the other party would be priced to take account of the risk that the event might occur but might not occur. The buyer might be willing to pay a higher price to the seller if the seller assumes the risk that the buyer may fail to get bank financing. Thus, if I condition my contractual obligation to buy a home on securing bank financing, then if I

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169 See Farnsworth, Contracts (3rd ed.) § 8.2
170 One major exception is the refusal of courts to enforce express conditions in circumstances where it would result in forfeiture. See infra.
171 See Calamari & Perillo on Contracts (5th Ed.) §§ 11.8, 11.9; Williston on Contracts (4th Ed.) § 38.12 “Since an express condition, like a condition implied in fact, depends for its validity on the manifested intention of the parties, it has the same sanctity as the promise itself. Although the court may regret the harshness of such a condition, as it may regret the harshness of a promise, it must, nevertheless, generally enforce the will of the parties unless to do so will violate public policy.”
fail to secure such financing, I am no longer obligated to buy. The condition functions to shift the risk of the non-occurrence of bank financing to the seller. Presumably, whatever deal the parties reached to allocate an express condition that was known in advance and adverted to by both parties in pricing their contract would maximize the parties’ surplus.

Were a court to upset that risk allocation, and to insist on performance despite the non-occurrence of a condition, it would be redefining the performance obligations of the parties. In such cases the court would not be enforcing the terms of the exchange agreed upon and thus there is no reason to suppose it would still produce gains from trade for the parties. When the parties have identified a certain event as an express condition, the results are generally clear and the court usually gives effect to the condition by permitting one party to suspend its performance and, when the event can no longer occur, be discharged from its obligations if the condition is not met.

Presumably, under the Kraus and Scott approach, when the parties have built an express condition into their contract, that condition constitutes their chosen means which the court should give effect to. Courts should decline the opportunity to rewrite the contract or to overlook express conditions in light of the parties’ contractual objectives.

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173 This is not always the case. In some instances, a court may choose to construe an express condition as a constructive condition of exchange or excuse an express condition in order to avoid forfeiture.
However, courts are often presented with contracts in which the parties have not clarified a number of issues despite the presence of specific terms outlining the parties’ obligations: whether performance is intended to be expressly conditional on another party’s performance, which party is to perform first, and the amount of performance necessary to trigger the other party’s obligation to perform. In such cases, where the chosen means are unclear and provide no clear answer to a court, it may be necessary to determine if judicial intervention through the application of a liability or default rule is justified for welfare improvement. The judicial preference for interpreting an unclear term as a promise rather than a condition and for implying a constructive condition of exchange when the order of performance is not made clear are two doctrines that need to and can be justified under the welfare improvement principle. These doctrines provide examples of instances where courts look not only to the parties chosen means but also to their contractual objectives of maximizing surplus. Judicial intervention can be optimal and efficient despite the absence of any express delegation.

It is not absolutely clear whether Kraus and Scott would foreclose all judicial interpretation to determine whether a condition or promise was intended by the parties’ language. This is what some have labeled the “ex ante version” manifestation of the anti-forfeiture principle.

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174 RESTATEMENT SECOND OF CONTRACTS.
175 Both doctrines often apply where the chosen means of the parties are not clear, the parties have not deliberately omitted the implied terms from the contract, and the court does not need to wrestle with inaccessible and unverifiable information.
176 Kraus & Scott, supra note 4, at 53.
In the example discussed by Kraus and Scott on the interpretation of language as promise or condition, a court must address two provisions of a contract to determine their relationship. The hypothetical contract denied the employer the right to terminate an employee without just cause. It contained a provision that an employee “will, within thirty days of termination given written notice to the employer of any claim of wrongful termination and shall not take any legal action based on the claim within six months of such notice.” Under one reading, the employer’s duty not to terminate for just cause was conditioned on the employee’s duty to give timely notice; under the alternative interpretation, the employee merely gave an independent promise to give timely notice for breach of which he could be liable in damages to the employer. The court resolved the matter by invoking the anti—forfeiture norm. According to Kraus and Scott, because the employee had relied on the just cause provision, the court would be reluctant to create a forfeiture that would deprive the employee of that job security and so interpreted the duty to give notice of a claim as not connected to the just cause provision. Their Article suggests that it is inappropriate for courts to take account of an objective such as anti-forfeiture norm in interpreting language on the supposition that the court should hew exclusively to the terms of the contract, so one can assume that they would find any decision anti-forfeiture norm to be misguided simply because it uses an objective, such as the anti-forfeiture norm, to decide a contract interpretation issue.

The rationale that Kraus and Scott posit underlies the courts’ preference for interpreting uncertain words as promises rather than conditions is based on contractual

\[177\] *Id.*
\[178\] *Id.* at 57.
intent, not public policy; the notion is that “parties would not have understood the
condition to create such a risk [of forfeiture] at the time of formation . . .”  Kraus and
Scott find that courts “stack [] the deck heavily against the funding of conditions”\(^{179}\) through the antiforfeiture norm. The purported rationale is that because parties are
“unlikely to select terms that create the risk of forfeiture,”\(^{180}\) courts should be reluctant to
find that risk and should therefore hesitate to find a condition with its attendant risk of
forfeiture. Although the intent rationale is adverted to, and there is no direct criticism of
the likely judicial result in the employment case, one must suppose that Kraus and Scott
would disapprove the resort to an anti-forfeiture norm to decide a contract interpretation
question since the parties did not expressly invoke judicial aid through a vague term.\(^{181}\)

Because Kraus and Scott seem to be certain that the parties will resolve these
issues through specific chosen means or will deliberately leave matters for future decision
by a court through open-ended terms, Kraus and Scott would presumably limit the court
to enforcement of the parties’ chosen means. The Kraus and Scott approach limiting any
considerations outside the parties’ chosen means, such as reference to an anti-forfeiture
norm, would deny courts the ability to consult the parties’ objective of welfare
maximization in deciding whether a condition or promise was intended. Yet, courts have
developed doctrines such as preference for interpreting ambiguous contract language to
create a promise rather than a condition and a presumed dependency of mutual covenants
by invoking the parties’ contractual objectives and doing so promotes efficiency. It is
perfectly reasonable to suppose that courts might decide that the parties would embrace

\(^{179}\) *Id.*
\(^{180}\) *Id.*
\(^{181}\) *Id.*
an anti-forfeiture norm in order to police against opportunistic behavior unless the parties expressly understood that there was a forfeiture risk in order to minimize the drag on gains from trade. The question that remains is whether it is appropriate for courts to consider the anti-forfeiture principle in determining whether language in a contract creates a condition or not. (A separate and more difficult question is whether courts should override language that clearly creates a condition to implement an anti-forfeiture policy. That issue will be taken up later). A classic case of interpretation involves such clauses requiring the completion of work within a stated period. Courts will construe such language as creating a duty to complete within ten days rather than to make payment conditional on completion within ten days. Farnsworth calls this the “preferred result.”

Although Kraus and Scott are highly critical of the consideration of forfeiture in construing what is ambiguous language, one can understand why courts might prefer this result as the default rule to govern ambiguous language. If a contractor were to risk forfeiture when no language expressly allocated such risk to the contractor through a clearly designated express condition precedent, the severe risk of forfeiture might act as a drag on trade in future transactions. Contractors faced with contract language that does not contain a clear condition, might nevertheless fear that courts following the Kraus and Scott mandate will be dissuaded from considering anti-forfeiture principles in interpreting ambiguous language. Since the risk of forfeiture presents the opportunity for the recipient

\[^{182}\text{See infra.}\]
\[^{183}\text{Kraus & Scott, supra note 4, at ___}\]
\[^{184}\text{Their criticisms are partly premised on the idea that in some specific cases, a forfeiture might be the correct or rational result where the alternative interpretation would result in the court awarding payment when one party needed to be given the discretion to impose a forfeiture result because the value would depend on matters that were unverifiable to a court which would suggest that the supposed benefit had no value at all.}\]
of services to seize upon a minor delay or deviation as a reason to refuse all payment, a
form of opportunistic behavior, a court might well consider that risk in justifying a rule
that prefers an interpretation that minimizes the risk of opportunistic behavior as a way of
maximizing gains from trade by reducing the deadweight loss from unremedied
opportunism.

The consequence of concluding an event is an express condition can be
devastating for a party who has relied in advance of performance since it could result in
forfeiture. This is because if a term is construed as an express condition, and that
condition does not occur, the other party is discharged. Any reliance costs incurred by
the relying party would be non-compensable. If, however, the term is construed as a duty,
the relying party would still be entitled to payment though the other party would be able
to collect for damages for any breach of the duty.

To resolve the question of whether an express condition was intended, the court
requires a normative framework for justifying legal intervention to fill a gap in the
parties’ agreement. In assent-based transactions, the court should use a model of average
behavior to determine what rule parties would seek on the order of performance if their
goals or objectives included: the minimization of transaction costs, the control of the
opportunism hazard, the allocation of risks to the least cost avoider and the maximization
of the parties’ gains from trade, irrespective of who ends up with that share of the gain.

185 RESTATEMENT (SECOND) OF CONTRACTS § 225. See also Dove v. Rose Acre Farms, Inc., 434
In reaching determinations about whether a term should be construed as a condition or a duty, the Restatement indicates that “it is sufficiently unusual for a party to assume the risk”\(^\text{186}\) of forfeiture where the event is not within that party’s control, and that consequently the court should ordinarily avoid an interpretation that results in forfeiture.\(^\text{187}\) The interpretation that avoids forfeiture is one that construes the term as creating a duty to perform for the breach of which they would be liable in damages to the other party. The defaulting party would, however, still be entitled to payment or to the other party performing its contractual obligations.

An example will illustrate. Courts are sometimes called upon to determine whether an event is designated by the parties as a means of measuring time or whether that event is attached to another party’s duty. The Restatement gives an example in which “A, a general contractor contracts with B, a sub-contractor, for the plumbing work on a construction project. B is to receive $100,000, no part of which shall be due until 5 days after Owner shall have paid Contractor therefore.”\(^\text{188}\) The Restatement concludes that the Contractor is required to pay the subcontractor within a reasonable time.

The Restatement example forces a court to decide whether ambiguous language (“not to pay until 5 days after Owner shall have paid”) will be construed as an express condition or merely a duty. In the example it would have to decide whether the general contractor’s duty to pay was expressly conditioned on the Owner paying the general contractor or whether instead the time of payment was merely a designation of when the

\(^{186}\) Restatement (Second) of Contracts Section 227, comment b.

\(^{187}\) Restatement (Second) of Contracts Section 227, comment b

\(^{188}\) Id. at Illustration 1.
subcontractor would be paid. The court could interpret the general contractor’s duty to pay as an unconditional one. In so concluding, and opting against an interpretation that would make the general contractor’s duty expressly conditional on prior payment by the Owner, the RESTATEMENT adopts a presumption that the preferred interpretation is not to treat the time specified (5 days after the Owner pays the Contractor) as an express condition. If a court were to interpret the language as an express condition, the subcontractor would fail to be paid when the Owner became insolvent and failed to pay the Contractor. Such an interpretation would result in a forfeiture for the subcontractor, a result that the RESTATEMENT avoids through its preference for duties over conditions.

In dealing with these issues of interpretation, the question arises why the RESTATEMENT would prefer an interpretation that avoids forfeiture for a party that has relied on the contract. The question then becomes why the RESTATEMENT wishes to avoid such a result when interpreting a term as either a condition or a duty. One could rationalize the rule of construction (preferring an interpretation as a duty rather than a condition) in terms of maximizing the parties’ joint surplus. In every contract, there is a risk that one’s counterparty will act opportunistically. Because of uncertainty about the propensity for such conduct and about the variety of ways that such propensity might manifest itself, it will be difficult for parties to control such potential for opportunistic behavior ex ante in a detailed contract. Inserting even more general clauses into the contract promising to behave in a joint maximizing way may not be effective because their vagueness might render them unenforceable.189

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189 WILLIAMSON, supra note 48, at 63.
In such cases where the behavior of the paying party is not tightly controlled, a court must decide whether that party should have absolute discretion not to pay the performing party in a variety of circumstances over which the performing party has no control, such as the payment by the Owner to the Contractor in the above example. If the performing party has relied and that reliance has resulted in a benefit to the Contractor, the court will prefer an interpretation of no condition so that the subcontractor gets paid.

Were the court to reach a contrary result, they would in effect be giving discretion to the paying party to not pay the performing party for reasons having nothing to do with the performing party’s performance of its contractual obligations. If one assumes that rational parties would want to control that kind of moral hazard and mitigate it *ex ante*, and one accepts the “presumption that the performing party would not have put himself at the mercy of the paying party’s whim,” then it makes sense for the law to presume a duty rather than a condition. The effect of such construction is that the paying party’s whim or discretion not to pay is restrained and payment must be made for services that are rendered. Consequently, the ability to cause a forfeiture to the other party who has satisfactorily performed is constrained.

2. Order of Performance Interpretation Issues

The law of contracts thus must address instances when the parties have not clearly delineated an express condition which tells the court whether performance is required, in what order performance will proceed, and whether there are any preconditions to

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performance. The court must decide whether any implied conditions exist that would have to be satisfied, either simultaneously or as a precondition, before the other party’s performance obligations under a contract become due. When the law intervenes to create implied or constructive conditions in a bilateral contract, it is grappling with issues concerning the sequence of performance. If nothing is stated in the contract, how will the court decide when the respective performances are due? Is there any doctrine that would make reciprocal performance a constructive condition of the other party’s duty to perform? How should the court deal with the absence of any chosen means or express delegation to the court through a vague standard?  

Historically, before Judge Mansfield, when two parties exchanged commitments and nothing was stated that made one party’s performance obligation dependent on the other party tendering performance, the commitments were deemed independent. That meant that one party could sue the other for breach even if he himself were in breach of his own obligations under the contract. Procedural complications meant that a separate action for breach would have to be brought since counterclaims were not permitted.

Thus, an interpretive question for courts in deciding performance issues is whether reciprocal performance is an implied or constructive condition of the other party’s duty to perform when the parties have not expressly conditioned their own

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191 The Kraus & Scott article would not make clear how a court should proceed in the absence of any relevant chosen means and in the absence of any delegation to the court through an open-ended term.

192 MURRAY ON CONTRACTS states “Thus, for the purpose of enforcement, the law treated the two exchanged promises like two separate and distinct contracts. They were independent promises (covenants) bearing no relationship (dependency) to each other.” 1-7 MURRAY ON CONTRACTS § 104.
performance on a reciprocal performance by the other side. A subsidiary issue is whether that reciprocal performance is due simultaneously or at a prior time. The traditional historical answer to this question was that absent an express agreement, a party had to perform regardless of whether the other party was ready or willing to perform its obligations. This independence of contractual obligations was presumed under the doctrine of mutual and independent covenants.\textsuperscript{193}

The reversal of the doctrine of independent covenants began with Lord Mansfield who argued that the “dependence or independence of covenants was to be collected from the evident sense and meaning of the parties and that however transposed they might be in the deed, their precedency must depend on the order of time in which the intent of transaction requires their performance.” This decision depends on the projected assumptions about which approach would be instrumental in achieving maximum gains from trade.\textsuperscript{194}

The modern presumption is that in a bilateral executory contract the duties are presumed to be dependent and due at the same time.\textsuperscript{195} To prevail in an action for breach

\textsuperscript{193} “[T]he class known in the law as mutual and independent covenants [is] where either party may recover damages from the other for the injury he may have sustained by a breach of the covenants in his favor, and where it is no excuse to the defendant to allege a breach of the covenants of the plaintiff in bar of his action.” Smith v. Wiley, 60 Tenn. 418, 420 (Tenn. 1872)

\textsuperscript{194} Kingston v. Preston, 99 Eng. Rep. 437 (K.B (1773). The report of this case appears in the argument for the plaintiff in Jones v. Barkley, 2 Doug. 689, 689-92 (1781). See also 8-32 CORBIN ON CONTRACTS Section 32.5. But see (questioning whether Mansfield was the originator of the doctrine of the mutual dependency of covenants.) cited in AYRES AND SPEIDEL,

\textsuperscript{195} See RESTATEMENT (SECOND) OF CONTRACTS § 234.
one must allege one’s own performance. This is because an implied condition of performance is that there be no uncured material breach by the other party.196

The question for the student of the economics of contracting and for proponents of the Kraus and Scott critique of contract adjudication is why the law would imply such a constructive condition of exchange in a contract if the parties have not specifically delegated that task to the court through the use of an open-ended term. To answer that question one must imagine what kind of contracting world would remain if a party to a contract was required to go forward with his own performance despite the non-performance of the other party. That situation would create the risk that one would have to furnish one’s own performance, in effect a sunk cost, without any assurance that performance would be forthcoming from the other party.197 The injured party would be left to rely on a damage remedy that might not be collectible for numerous reasons.

In deciding that parties did not have to go forward if the promises were deemed dependent rather than independent if the other party demonstrated no willingness to proceed, the Mansfield court implied a term into the contract even though the parties did not expressly delegate authority to the court through a vague term. Intervention took the form of an implied term making one party’s performance obligation dependent on prior or simultaneous performance by the other party. It can be justified in terms of welfare

196 Id. § 241.
197 The Introductory Note to Chapter Ten of RESTATEMENT (SECOND) explains that “[t]o the extent possible, simultaneous performance by both parties is desirable, since this gives each party the opportunity to withhold his own performance until he is sure that the other party's performance will be forthcoming and requires neither party to finance the transaction before he receives the other's performance.”
improvement because without it one party could opportunistically demand performance from the other party without taking any steps towards performance himself. That would increase the chances that the first party could initiate a lawsuit for nonperformance without performing himself and collect the money or performance from the other party and then welch on his commitment. If left unguarded, that risk of opportunistic behavior would add to the costs of contracting.\textsuperscript{198} Parties would have to charge a premium price to take account of the risk that one’s assets would be appropriated.\textsuperscript{199} The risk of uncontrolled opportunism could also discourage some parties from contracting altogether resulting in lost potential gains from trade.

The willingness of a court to imply a dependency between the covenants and a presumed order of simultaneity is an example of judicial intervention.\textsuperscript{200} Such intervention can be explained in terms of maximizing parties’ joint gains and minimizing transaction costs.

In deciding whether an implied term of dependency would advance those goals, one must assess the risks that future parties would face. Without a specific agreement of dependency, parties would remain unprotected from the risk that one party would act opportunistically by demanding performance from the other party without performing. That risk would require one party to turn over assets or money to another party who has done nothing to demonstrate a willingness to perform.

\textsuperscript{198} WILLIAMSON, \textit{supra} note 48, at 33.
\textsuperscript{199} R. J. Coffey and WILLIAMSON, \textit{supra} note 48, at 63.
\textsuperscript{200} Other instances of judicial intervention include gap filling.
To respond to that risk a party could protect itself by insisting on dependency through an agreement that would make reciprocal performance by the other party a condition of continuing to perform. By judicially implying a term of dependency, the courts can create a collective good\textsuperscript{201} that all parties can rely on to furnish automatic protection against opportunism in future transactions that lowers transaction costs. In addition, it encourages contracting that might otherwise not occur. Without assurances that the other party will be restrained from acting opportunistically, a party might hesitate to contract, thereby sacrificing the joint gains that could be achieved. The implied term of dependency provides that security needed to encourage contracting and beneficial reliance on promises. Thus, the law-supplied term of dependency offers a cheap form of security.

Parties would be able to reach private efforts to control opportunism through pre-screening their partners to rule out opportunistic players. However, adverse selection problems such as the tendency to hide one’s proclivities for opportunism could make such an arrangement costly.

The parties could individually craft language of dependency to indicate their intention to make the promises reciprocal obligations. However, the law can easily and cheaply supply the term by implying dependency as a default rule. The law’s intervention would achieve the parties’ goals at a low cost because such intervention would not involve the court in costly tasks, such as attempting to verify unverifiable

\textsuperscript{201} Charles J. Goetz & Robert E. Scott, \textit{The Limits of Expanded Choice: An Analysis of the Interactions between Express and Implied Contract Terms}, 73 CAL. L. REV. 262 (1985) (discussing the idea of a collective good of terms)
contingencies. In that sense it is an efficient default, a simple rule that can be applied easily by courts.\(^{202}\)

The doctrinal examples where courts regularly intervene to maximize surplus by implying terms of the dependency of covenants or by imposing a strong judicial preference for promises rather than conditions contrast with Scott and Kraus’s examples. In their examples, because courts are ill-equipped to ascertain the contracting parties’ true intentions and are subsequently at risk of being manipulated by one party’s opportunistic behavior,\(^{203}\) judicial intervention may indeed be inefficient.\(^{204}\)

These doctrines governing performance demonstrate that even in instances where specific terms are used and express delegation to the court is not articulated, default rules that move beyond the parties’ chosen means to take into account parties’ contractual objectives can lower transaction costs and maximize contractual surplus. Courts fill in gaps routinely left open by incomplete contracts, such as order of performance, with interpretations of contractual language and law supplied rules that would be preferred by a majority of contracting parties. Such doctrines provide efficient ways of adhering to the welfare principle of assent-based transactions by devising default rules and


\(^{203}\) Scott and Kraus seem to focus on price rules or other terms with specificity and contrast them with terms that the parties explicitly set up as vague. This seems to omit from consideration certain types of rules and doctrines such as the doctrine implying a constructive condition of exchange. Kraus and Scott have identified a scenario where a court’s intervention might not be helpful or optimal but that does not suggest that the court’s intervention in every case lacking an open-ended term would be similarly harmful.

\(^{204}\) *Id.* at 56-63.
interpretations based on a model of average contracting behavior which looks to minimize costs, maximize gains, control opportunism, and allocate risks to the least cost avoider. These doctrines implement presumptions which a majority of contracting parties would prefer *ex ante*, thus decreasing the overall contracting costs and increasing overall gains by assuming default rules rather than requiring parties to spend the time and money on contracting for them.

3. **Substantial Performance**

A third performance issue is what degree of performance is required before the other party must also perform. As the parties themselves do not resolve this issue, courts must make the decision. The doctrine of substantial performance is the judicially supplied solution to this question of how much performance by one party is due before the other’s performance obligation will be triggered.

In service and construction contracts, for example, one party must have substantially performed before the other party’s performance becomes due. If the performance by one party is substantial, then the other party renders its own performance. A party who is the victim of a trivial breach will be relegated to a suit for damages. However, if the court determines that the performance is not substantial and

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205 *See* R. J. Coffey 8-36 Corbin on Contracts § 36.1. “When a contract has been made for an agreed exchange of two performances, one of which is to be rendered first, the rendition of this one substantially in full is a constructive condition of the other party’s duty to render the second part of the exchange.” *Restatement Second* § 237

206 *Restatement Second* §
breach), then the other party may suspend its own performance. If after a period of time
for cure has passed, a party is still in substantial breach, the other party is discharged of
its obligations to continue and may also sue for breach.208

The question is what justification can be offered to rationalize this approach to
issue of breach. Why should the legal default rule require a victim of a breach to
continue performing when the other party’s breach is trivial but allow the victim to be
discharged when the breach is a substantial one? The answer may begin to make sense in
terms of maximizing gains from trade if one examines an alternative rule. If the law
allowed a party to seize upon minor defects as a reason not to perform, it would be
sanctioning opportunistic behavior that allowed parties to capitalize on trivial defects as a
reason to end all contractual obligations. As we have seen before, the risk of uncontrolled
opportunistic behavior raises the cost of contracting in many ways including discouraging
contracting altogether by parties who are unwilling to assume the risks of their
counterparty’s uncontrolled opportunistic behavior. It might also raise the cost of
contracting for everyone as parties would then have to build in a higher price to account
for the increased risk of opportunism.

To identify which rule would foster a greater surplus that the parties could share,
one would look for a rule that would ex ante lower the risk of one party acting
opportunistically. By lowering that risk, overall shared surplus would increase. Without
that rule, a concerned party would demand a higher price or forego contracting

208 See CALAMARI & PERILLO on CONTRACTS § 11.18 (5th ed. 2003).
altogether. As Kraus and Scott explain, in a construction contract “the owner-promisee would have an incentive to exploit this situation—threatening to reject the entire project due to a minor defect in construction....[v]iewed ex ante, the parties themselves would prefer the less draconian substantial performance rule in order to reduce opportunistic behavior.”\textsuperscript{209} An owner would be able to capitalize on the vulnerable position in which the contractor finds itself and demand to renegotiate the price downward because the sunk costs expended by the contractor would prevent a ready exit to the market. So, a justification for legal intervention that takes the form of an implied term that requires substantial performance be achieved before the other party comes under a duty to perform lies in the desire to curb the hazard of opportunism.

The law, however, takes a different approach when only a trivial defect is present. In that case, the injured party who is the victim of a breach must still perform but can pursue an action for damages. The question for legal intervention is whether the parties ex ante would want a legal rule that entitled them to stop performing when only a trivial defect was involved or whether a damage remedy would suffice. Because a legal rule granting a right to suspend performance and to discharge for a trivial defect would encourage opportunism, the question is whether the damage remedy itself –without the additional remedies of suspending performance and discharge--would suffice to provide the correct incentives for performance. Since a party guilty of a trivial breach would still have to pay damages and those damages are expected to provide optimal incentives,\textsuperscript{210} the damage remedy should suffice.

\textsuperscript{209} Kraus \& Scott, supra note 160, at 768.
\textsuperscript{210} But see
Another way of explaining this doctrine that requires parties to keep performing in the face of trivial breach is that parties who would insist that a trivial breach should entitle them to stop performing are so unusual that a legal default rule should take account of their unusual preferences. Otherwise, the vast majority of parties would have to contract around a non-optimal rule and that result would increase transaction costs.

4. Overriding The Parties’ Chosen Means: Interpreting Conditions to Avoid Forfeiture: A Study in Judicial Methodology in the RESTATEMENT (SECOND) and in Jacobs & Young

The cases which generate the most criticism under the Kraus and Scott critique are those in which courts override or overlook the parties’ chosen means to implement a goal such as the avoidance of forfeiture. To illustrate the deleterious effect of so doing Kraus and Scott focus on an example from the RESTATEMENT which itself is based on the Jacobs & Young case. Yet, because of limitations in the Restatement example itself, and its abstraction from the facts of the underlying case, the authors draw erroneous conclusions about the negative effects of the court’s consideration of forfeiture. In addition while the authors construct a positive rationale for strict enforcement of the condition based on the fact that such an approach reduces the cost for one party of verifying the difference in quality to a court, the actual case---Jacobs & Young---involved few verifiability problems making the authors’ purported rationale less compelling, at least in cases involving low verifiability problems. Finally, the authors

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211 See Kraus & Scott, supra note 4, at 72.
ignore the key role that the court’s willingness to consider forfeiture issues in improving joint welfare by reducing the costs of opportunism.

In the Restatement hypothetical a party chooses to condition its payment obligation on the satisfaction of a condition to install a particular brand of pipe. The RESTATEMENT sanctions the possible excuse of the condition in cases where the use of one pipe “was relatively unimportant “to the party that specified the condition.212

Kraus and Scott argue that the owner’s use of a condition to install a particular pipe might make sense even in cases where the owner might be aware that several other types of pipe were of the same quality. They argue that an owner in a hypothetical case might well want to insist on a strict condition rather than on a pipe having certain qualities to save back end costs. The use of a condition of a particular pipe would avoid the necessity of an owner showing that the installed pipe was of inferior quality and relieve the owner of that burden of proof.213 Hence, it would be logical to insist on inclusion of a strict condition.

When parties have made a choice and crafted a contract with an express condition, Kraus and Scott argue that it would be wrong to override that choice either by “interpreting” the express condition to be a constructive condition of exchange or to

212 In their article, Scott and Kraus cite to multiple illustrations from §229 of the Restatement (Second) of Contracts in an attempt to show “the degree to which the anti-forfeiture norm undermines the structure of ex ante contractual intent [.]” Kraus & Scott, supra note 4, at __.

213 Id. at 72.
excuse the condition to avoid forfeiture. Kraus and Scott posit that when parties adopt an
express condition, they also intend that the court will strictly adhere to strict enforcement
even if it results in forfeiture. The parties, under this argument, prefer the risk of
forfeiture in the contract and intend to exclude any judicial intervention to police against
the risk of forfeiture since whenever they include an express condition, they intend and
prefer to rely exclusively on informal means to police against opportunistic behavior that
might be facilitated by strict enforcement of the express condition.

Kraus and Scott conclude that based on the RESTATEMENT example itself, “there
is no justification for interpreting the condition to require installation of Reading quality
pipe or for setting aside the condition.” 214 They use the RESTATEMENT example to
illustrate how courts can go astray in setting aside the parties’ chosen means—an express
condition with its attendant risk of forfeiture—to avoid forfeiture. Setting aside the
express condition in such hypothetical cases ignores the cost reasons reason why parties
chose an express condition that could not be satisfied with a product that was met the
same standard. In addition it undermines “ex ante contractual intent.”215

The Kraus and Scott criticism of the RESTATEMENT approach to the excuse
conditions is meant to illustrate the general problem with courts overlooking the parties’
express terms or supplying default rules that were not expressly agreed to. Yet, the effort
to delegitimize judicial approaches to excusing express conditions based on a stylized
RESTATEMENT hypothetical has limitations that are explored in this section. Once the

214 Id. at 72.
215 Id. at 70.
actual case on which the RESTATEMENT example is based is made the central focus of analysis, the willingness of courts to excuse conditions or to interpret express conditions as constructive conditions may make sense in terms of welfare improvement.

The mere fact that parties have agreed on an express condition does not mean that the parties have necessarily foreclosed all judicial intervention to police any and all opportunistic behavior. While it is certainly true in some contexts that informal enforcement and reputational sanctions may be less costly than judicial intervention, the assessment will depend on a number of specific factors that cannot be answered with a unitary solution across the board. The decision should depend on whether reputational sanctions are likely to be effective, whether there are likely repeat dealings between the parties, whether the gains from repeat play will be outweighed by a larger benefit from opportunistic behavior, whether the opportunistic behavior can be detected and is transparent and a number of other factors. Without a comparative assessment, it will be unclear whether informal sanctions or judicial enforcement to police against opportunism will more effectively mitigate the drag on gains from trade generated by unbridled opportunism.

Thus, even if the parties have adopted a specific term, such as an express condition, that does not mean that the parties contemplated every possible situation in which strict enforcement should apply. If the parties had a 500 page contract for an office building and made the entire payment to the contractor expressly conditional on the satisfaction of 100,000 specifications ranging from the type of light switch to the type of
steel beam, one would not necessarily assume that the parties had intended a court to strictly enforce the conditions if doing so resulted in the owner getting a building worth $100,000,000 for $0 because one specification involving the light switch had not been met given the large forfeiture that would result.

Yet, if one adheres to the logic of the Kraus and Scott critique, the court should strictly enforce each and every condition despite the potential for forfeiture as a rational response relieving one party of a burden of proof on equivalence. The Kraus and Scott insistence on adhering to the parties’ chosen means including express conditions even at the cost of a large forfeiture should be rejected in favor of an approach based on whether judicial intervention can improve welfare for the parties. Whether judicial intervention will be salutary will depend on factors such as whether there are verifiably insignificant defects being used to gain a large windfall and a forfeiture in the other party or whether judicial departure from strict enforcement would embroil the court in matters of personal taste and aesthetic judgment which are not verifiable. Scott and Kraus seem to view *Jacob & Youngs* as a case where judicial intervention undermined contractual intent by either excusing the chosen means of the parties, an express condition, or by interpreting the express condition as a constructive condition of exchange. However, further review of the underlying facts of the case shows such judicial interpretation likely prevented one

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216 Kraus and Scott admit in a footnote that the result in the actual Jacobs & Young case may have been justifiable since it “might plausibly be read actually to have enforced the condition as written but to have interpreted the express condition to require installation of Reading quailty...pipe.” Kraus & Scott, *supra* note 4, at 72.
party’s opportunistic attempt to capitalize on a specific term in the contract despite the parties’ intentions.\footnote{217}

The case centers around the construction of a mansion for George Kent by the New York construction firm Jacob and Youngs. One of the specifications of the contract was that “all wrought-iron pipe must be well galvanized, lap welded pipe of the grade known as ‘standard pipe’ of Reading manufacture.”\footnote{218} Almost a year after construction ceased Kent realized that some of the pipe in his home was not manufactured by Reading. Kent’s architect subsequently directed Jacob and Youngs to replace the non-Reading piping.\footnote{219} Because replacing the piping would be incredibly costly and require demolition of substantial areas of the house, Jacob and Youngs left the work untouched and asked for their final payment of $3,483.46 which was to be paid upon final completion of construction.\footnote{220} Kent refused payment and the lawsuit followed.

At trial, evidence showing that all pipe used in the house was of the same quality and price as Reading pipe was held inadmissible and a directed verdict was entered in favor of Kent.\footnote{221} The New York Appellate Division reversed and granted a new trial.\footnote{222} The Court of Appeals of New York affirmed the reversal and directed verdict in favor of

\footnotetext[217]{It should be noted that Scott and Kraus make a distinction between the actual case of Jacob and Youngs and the RESTATEMENT’s illustration. See SCOTT & KRAUS, supra note 4, at 72 n. 124. However, the emphasis on the RESTATEMENT illustration rather than the real world result found in the court’s decision seems to be misplaced.}
\footnotetext[218]{230 N.Y. at 240.}
\footnotetext[219]{Id.}
\footnotetext[220]{Id.}
\footnotetext[221]{Id. at 241.}
\footnotetext[222]{Id.}
Jacob and Youngs. Judge Cardozo, writing for the majority, found that the evidence regarding quality should not have been found inadmissible and in light of that evidence the failure to use only Reading brand pipe was neither fraudulent nor willful and was insignificant in relation to the project. Thus, the condition for Reading pipe fell into Cardozo’s category of promises that “though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant.” “This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture.” The court found that Kent would be entitled to the difference in value between a house with all Reading brand pipe and his actual house containing non-Reading piping, the value of which was nominal to none. Kent was therefore ordered to pay Jacob and Youngs the remaining $3,483.46.

The dissenting opinion contended that while Kent’s requirement of Reading pipe “may have been a mere whim on his part…he had a right to this kind of pipe, regardless of whether some other kind…would have been ‘just as good, better, or done just as well.’”

223 Id.
224 Id.
225 Id. at 242. Cardozo goes on to say that when deciding whether terms should be considered only independent promises, dependent conditions or, as here, somewhere in between “[c]onsiderations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another.”
226 Id. at 243-244.
227 Id. at 244.
228 Judge McLaughlin wrote the dissent. He found that the failure to use only Reading brand pipe was either intentional or grossly negligent, contrasting the opinion of the majority. Id. at 245. McLaughlin noted that only the first shipment of piping was inspected, and found to be Reading, and that all of the remaining orders for piping were simply based on the number of feet needed without specifying a particular brand. Id. at 245-246. Finding that only about two-fifths of the
Richard Danzig’s *The Capability Problem in Contract Law* goes beyond the court’s opinion for an in-depth analysis of the case.\(^{229}\) By shedding light on the surrounding circumstances, Danzig explains that the requirement of Reading pipe was merely a way of denoting the quality of pipe desired rather than a strict requirement of who was to be the manufacturer of the pipe.\(^{230}\) In so doing, Danzig demonstrates that if the court would have denied compensation to Jacob and Youngs, the court would have been fostering opportunistic behavior by Kent in trying to avoid payment despite receiving substantially what he had bargained for.\(^{231}\)

In May of 1913, the two parties entered into a construction contract which contained literally hundreds of required specifications, one of which required the Reading brand piping.\(^{232}\) As noted above, upon realizing that not all piping was Reading brand, Kent’s architect submitted a letter to Jacob and Youngs demanding that the problem be fixed in accordance with articles IV and V of their contract.\(^{233}\) Danzig posits the same piping in the house was Reading and that Jacob and Youngs did not provide an explanation for not complying fully with the contract, the dissent thought questions of good faith existed. *Id.* at 246-247. Because Kent agreed to pay only upon condition that the pipe installed was made by Reading, the dissent was of the opinion that the rule of substantial performance had no application to the case. *Id.* at 247-248.


\(^{230}\) *Id.* at 111.

\(^{231}\) *Id.* at 112. See also George Cohe, *Negligence Opportunism Tradeoff* article

\(^{232}\) *Id.* at 95.

\(^{233}\) *Id.* at 96-7. “Art. IV. The Contractors shall provide sufficient, safe and proper facilities at all times for the inspection of the work by the Architect or his authorized representatives; shall, within twenty-four hours after receiving written notice from the Architect to that effect, proceed to remove from the grounds or buildings all materials condemned by him, whether worked or un-worked, and to take down all portion of the work which the Architect shall by like written notice condemn as unsound or improper, or as in any way failing to conform to the drawings and specifications and shall make good all work damaged or destroyed thereby.”
simple yet interesting question posed by Scott and Kraus of why pipe manufactured by Reading was specified. Danzig’s conversations with Kent’s long time secretary and surviving daughters produced no indication that Kent had any professional or financial connection to the Reading Company whatsoever.\textsuperscript{234} A further review of Reading’s annual reports showed no mention or affiliation to either the Kent or Grace (the maiden name of Kent’s wife) families from 1915-1945.\textsuperscript{235} Thus, it appears Kent must have requested the specific pipe for another reason.\textsuperscript{236}

At the time of construction, wrought iron pipe was 30\% more expensive then the more common steel piping but was claimed by manufactures to be more durable and to require less maintenance.\textsuperscript{237} The wrought iron pipe was advertised to be rising in

\“Art. V. Should the Contractors at any time refuse or neglect to supply a sufficiency of properly skilled workmen, or of materials of the proper quality, or fail in any respect to prosecute the work with promptness and diligence, or fail in the performance of any of the agreements herein contained, such refusal, neglect or failure being certified by the Architect, the Owner shall be at liberty, after three days written notice to the Contractors, to provide any such labor or materials, and to deduct the cost thereof from any money then due or thereafter to become due to the contractors under this contract; and if the Architect shall certify that such refusal, neglect or failure is sufficient ground for such action, the Owner shall also be at liberty to terminate the employment of the Contractors for the said work and to enter upon the premises and take possession, for the purpose of completing the work included under this contract, of all materials, tools and appliances thereon, and to employ any other person or persons to finish the work, and to provide the materials therefore; and in case of such discontinuance of the employment of the Contractors they shall not be entitled to receive any further payment under this contract until the said work shall be wholly finished, at which time, if the unpaid balance of the amount to be paid under this contract shall exceed the expense incurred by the Owner in finishing the work, such excess shall be paid by the Owner to the Contractors; but if such expense shall exceed such unpaid balance, the Contractors shall pay the difference to the Owner. The expense incurred by the Owner as herein provided, either for furnishing materials or for finishing the work, and any damage incurred through such default, shall be audited and certified by the Architect, whose certificate thereof shall be conclusive upon the parties” Id. at 97.

\textsuperscript{234} Id. at 110.
\textsuperscript{235} Id.
\textsuperscript{236} This seems to discount Scott and Kraus’s thoughts that Kent may have “had an emotional, reputational, or business reason for preferring Reading brand pipe over pipe of equivalent quality.” See Scott & Kraus, supra note x, at 72 n. 124.
\textsuperscript{237} DANZIG, supra note 229, at 110.
popularity “in skyscraper construction as well as in other large buildings planned and constructed with expertness and care.”

238 Out of the four major manufacturers of wrought iron pipe, Reading claimed itself to be the largest in the country. 239 Danzig notes, however, that the trade publications of the wrought iron pipe manufacturers “made their comparative claims not so much with reference to their competitors who made wrought iron pipe, as to those who made steel pipe.”

240 This was apparently because the four companies manufacturing wrought iron pipe prior to WWI were largely non-competitive.

241 This appears to be because the quality, price, appearance, composition, and durability of each of the four brands was substantially identical, differentiated only by the name of the manufacture stamped onto the pipe.

242 Thus, while Scott and Kraus posit that that Reading brand pipe may have been made a condition rather then Reading quality pipe in order to lower expected costs of verifying and enforcing the requirement, the costs of verifying Reading quality pipe would arguably be slim to none. In fact, an

238 Id. quoting A. M. BYERS CO., THE SELECTION OF PIPE FOR MODERN BUILDINGS 7 (1916).
239 Id. at 110 citing READING IRON CO., COURT OF ACTUAL EXPERIENCE: WROUGHT IRON PIPE VS. STEEL PIPE 37 (9TH ED., 1911). Reading’s wrought iron pipe had been used in the Metropolitan Life Insurance Building and the Chrysler Building. Id.
240 Reading’s above mentioned publication stated “many leading architects and engineers have drawn their specifications in favor of wrought iron pipe, in instances prohibiting steel pipe entirely.” Id.
241 Id. at 111.
242 Id.
243 Scott & Kraus, supra note 4, at 72. “Even if Kent’s sole objective were to insure the installation of Reading-quality pipes in his house, he might have intentionally conditioned his payment obligations on the installation of Reading brand pipe, rather than Reading quality pipe, in order to lower the expected costs of enforcing that requirement. A term requiring Reading quality pipe sets out a standard which places on Kent the burden of proving that the pipe installed by the builder does not conform with the Reading quality standard. A term requiring Reading brand pipe instead sets out a precise rule which allows Kent to verify performance or non-performance at relatively low cost.”

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employee of the Reading Company was prepared to testify, and Kent in fact admitted in his brief on appeal, that each manufacture’s product was of the same quality.\footnote{244}{DANZIG, supra note 229, at 111.}

Danzig concludes that Reading pipe was specified “[a]pparently because it was the normal trade practice to assure wrought iron pipe quality by naming the manufacture.”\footnote{245}{Id.} Wrought iron pipe manufactures such as Reading warned that steel pipe manufacturers could use names such as “wrought pipe” to mislead buyers and that “it is safer to mention the name of a manufacture known not to use [steel] scrap.”\footnote{246}{Id. Danzig cites one publication which stated that even specifying “genuine wrought iron pipe” did not always exclude wrought iron containing steel scrap.} Danzig’s conclusion is bolstered by the fact that the contract itself states “Where any particular brand of manufactured article is specified, it is to be considered as a standard. Contractors desiring to use another shall first make application in writing to the Architect, stating the difference in cost, and obtain their written approval of the change.”\footnote{247}{Id. at 112.} Additionally, Danzig points out that the “lap welded” pipe requested in the contract was not even made in all the sizes required for construction of Kent’s house.\footnote{248}{Id. at 112 n.8. Scott & Kraus note that “Jacob & Youngs might plausibly be read actually to have enforced the condition as written but to have interpreted the express condition to require the installation of Reading quality, rather than Reading brand, pipe. So interpreted, Jacob and Youngs actually satisfied the condition.” SCOTT & KRAUS, supra note x, at 72 n. 124.}

Danzig then asks why Kent would go through three layers of litigation over a difference in piping that by all accounts is of the same quality as requested. Danzig found that Kent had a reputation of being cost conscious, making it possible that in paying the extra money for a specific type of piping, he wanted to make sure he got what he asked
for.”  However, Danzig’s investigation into the construction of the house and Kent’s overall unhappiness with how construction proceeded indicates that Kent intended to seize on a small and insignificant deviation from the specific words of the contract in order to opportunistically avoid paying the final amount owed because of “other dissatisfactions” in his relationship with Jacob and Youngs.”

While work on the house was supposed to be finished by December 15, 1913, Kent did not actually move into the house until June of 1914 and “minor details of work” still needed to be completed by November, 1914. According to Jacob and Youngs’ complaint, during construction, additional work totaling over $7,000 was needed and the parties had to sign an agreement extending the time frame for construction indefinitely. The Complaint alleged these delays were caused by Kent. Additionally, Kent also deducted $4,031.41 from the original price due to “certain alterations and omissions” by Jacob and Youngs. To put these problems in perspective, Danzig points out that the entire plumbing contract was only $6,000 dollars, making these problems totaling over $11,000 likely to make Kent both discontent and frustrated. One can imagine how a small deviation from the contract terms could be seized upon to show built up disapproval and anger for the overall construction of the house.

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249 DANZIG, supra note 229, at 123.
250 Id.
251 Id. at 113. Construction actually took twice as long as the contract initially specified.
252 Id. citing Jacob & Youngs’ Complaint, paragraphs 4,6,12,13.
253 Id.
254 Id. quoting Jacob and Youngs’ Complaint, paragraph 8.
255 Id.
Thus *Jacob and Youngs* presents a situation where both sides acknowledged that what was received was substantially what was requested. There was objective evidence and a variety of witnesses willing to testify that the brands of pipe used in Kent’s house were of the quality he wanted. Additionally, based on Danzig’s research, the court does not appear to have been dealing with an issue of Kent’s personal taste and thus did not have to struggle with unverifiable information. The court was therefore in a position to evaluate not only the chosen means but the parties’ objectives and contractual ends to make a decision regarding the parties’ intentions that prevented Kent from opportunistically capitalizing on a meaningless deviation in order avoid final payment.

A clear contrast to *Jacob and Youngs* is a case in which issues of taste and aesthetics are involved making the court ill-equipped to substitute its objective judgment for that of the contracting parties. One such case is *O.W. Grun Roofing and Construction Co. v. Cope.* In *Grun*, plaintiff homeowner Cope contracted with defendant Grun to have a new roof placed on her house for a price of $648. Both parties acknowledged that the roof was to be a uniform color with the contract calling for “russet glow” colored shingles, defined by Grun as a “brown varied color.” Upon completion, Cope complained that certain shingles formed yellow streaks across her new roof. Grun attempted to remedy the situation by replacing the streaky shingles but these new shingles did not match the original ones and photographs showed that the roof was still

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256 529 S.W.2d 258 (Tex. Civ. App. San Antonio 1975)
257 *Id.* at 260-261.
258 *Id.* at 261.
not a uniform color. Cope did not pay and Grun instituted a mechanics lien. Cope filed suit and after a trial to a jury Cope was awarded $122.60, the extra amount needed above and beyond the intended price of $648 to hire someone new to replace the roof. Grun was denied any recovery.

On appeal, testimony was given that it was no longer possible to get new shingles that would match the originals in order to replace the discolored ones. Thus the only way for Cope to have a uniform roof, as originally agreed upon, was to have a completely new roof installed. Therefore, the case centered around whether the installation of a new roof that was not a uniform color was substantial performance of the contract. The court set out factors for consideration including, “the purpose to be served, the desire to be gratified, the excuse for deviating from the letter of the contract and the cruelty of enforcing strict adherence or of compelling the promisee to receive something less than for which he bargained.”

The court grappled with what the object and purpose of the parties was. “Was the general plan to install a substantial roof which would serve the purpose which roofs are designed to serve? Or, rather was the general plan to install a substantial roof or uniform color?” The court concluded, “[w]e cannot say, as a matter

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259 Id. at 261. Additionally, Grun apparently only replaced the yellow shingles on two of the three sides of the roof where they appeared, leaving the yellow streaks on the southern side of the house.
260 Id. at 260.
261 Id. at 261.
262 Id. at 261. While there was testimony that the shingles might blend together after a year, the court noted that after ten months the blending had not occurred.
263 Id. at 261-262. The court also noted that the difference in money value of the performance bargained for and that actually given could be considered but that “[t]he deficiency will not be tolerated if it is so pervasive as to frustrate the purpose of the contract in any real or substantial sense.” Id. at 262.
264 Id. at 262.
of law, that the evidence establishes that in this case that a roof which so lacks uniformity in color as to give the appearance of a patch job serves essentially the same purpose as a roof of uniform color which has the appearance of being a new roof.” In affirming the trial court’s decision, the appeals court also denied Grun recovery based on quantum meruit. The court found that there was no significant proof the shingles were even properly installed as they did not blend, and regardless, since the roof had to be completely replaced, Cope received no benefit from Grun’s work nor did she accept the claimed benefit simply by living in the house.

As in Jacob and Youngs, the case of Grun dealt with construction issues regarding the plaintiff’s home; however, the two cases are doctrinally different. The court in Jacob and Youngs either excused an express condition or interpreted the express condition as a constructive condition of exchange while the court in Grun was dealing with an exchange of covenants which were considered a constructive condition of exchange. Both cases, however, deal with a court grappling with contractual terms and the parties’ intentions and whether substantial performance was accomplished. The court in Grun states, “In the matter of homes and their decoration…mere taste and preference, almost approaching whimsy, may be controlling with the homeowner, so that variations which might, under

265 Id. at 263.
266 Id.
267 Even if Grun had involved an express condition rather than a mere exchange of covenants, it seems very likely that a court would reach the same result and refuse to excuse the condition. This is because there was no evidence that the homeowner was refusing to pay for a perfectly good roof nor was she opportunistically refusing to pay when only a trivial breach existed. In such a situation, excusing the condition would have negative effects on trade and would not provide welfare improvement.
other circumstances, be considered trifling, may be inconsistent with that ‘substantial performance’ on which liability to pay must be predicated.”

The difference in the outcome of the two cases can be explained by the combination of a court’s hesitation to substitute its own objective judgment for that of the homeowner in situations where the matters relate to hard to verify information and the desire to curb opportunistic behavior in accordance with the welfare improvement principle. In Jacob and Youngs, the homeowner’s preference for Reading brand pipe appears not to have been simply the homeowner’s personal whim, but rather a standard of quality. As all of the pipe installed in the house was admittedly of equal quality, price, and appearance to the Reading brand, the court did not have to struggle with whether its objective judgment would override the personal judgment and satisfaction of the homeowner. Additionally, in Jacob and Youngs, there was a high risk that the homeowner was acting opportunistically by trying to capitalize on, by all accounts, an objectively verifiable insignificant defect to avoid making final payment. Thus the court was able to intervene and interpret the parties’ intentions, thereby restraining Kent’s opportunistic behavior, without embroiling the court in unverifiable matters.

On the other hand, Grun dealt with a situation where what was given clearly deviated in appearance from what was bargained for and contrary to the piping, which is largely unseen and meant to be functional, a new roof is meant to be both functional and aesthetically pleasing, making the issue a matter of personal taste. In such a case, the court is not in a good position to make a judgment on what satisfies the homeowner’s

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268 See supra note x.
personal preferences regarding what is a satisfactory roof and what is not. It is important to note that the court in Grun did not find that the doctrine of substantial performance was inapplicable to the case. Rather, the court realized that whether substantial performance was achieved was based largely on the aesthetic value placed on the roof by the homeowner, a value that the court was ill-equipped to ascertain. Thus the court declined to grapple with such unverifiable information and deferred to the homeowner’s opinion that substantial performance had not been achieved.

Thus these two cases show that by analyzing the likelihood of opportunistic behavior, the effectiveness of non-judicial enforcement mechanisms, and the availability of objectively verifiable information regarding the parties’ intentions and objectives, a court is able to make a decision regarding whether judicial intervention would be optimal for the parties. While such an analysis requires a case by case analysis, as Judge Cardozo stated in his opinion, “[t]hose who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier.”

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269 Jacob and Youngs, 230 N.Y. at 242-243.
Conclusion

In many contracts, there are a variety of specific terms that do not by themselves contain a broad or open-ended term signifying that the parties have chosen to afford discretion to the court to fill those terms in *ex post* and yet courts intervene in ways that seem justifiable under the framework outlined here. This Article has examined a number of doctrines in Contracts (Section 45, conditions, order of performance sequencing issues, substantial performance) which demonstrate the willingness of courts to intervene with a broad approach to interpretation or with a law supplied liability rule or term even without an express delegation by the parties to the court. If the intervention by courts were as costly and deleterious as Kraus and Scott suggest, then one would wonder why more parties do not opt out of the standard default and interpretive rule, perhaps leading one to suggest that there might be value to the parties from such interventions. The Article concludes that rather than opting for a unitary approach proscribing all intervention absent a party’s express invocation of judicial authority in the guise of an open-ended term, the court should consider a variety of factors to determine whether there are greater net benefits to and efficiency gains from intervening than not intervening. These include whether the intervention or non-intervention is most likely to facilitate or curb opportunistic behavior and thereby potentially create value for the parties by minimizing a drag on gains from trade, the ease and cost of the court’s intervening including a consideration of whether the court can intervene without having to access unverifiable information that is also subject to manipulation by one part (seller’s costs), whether the
court can intervene by constructing a liability rule or deciding a legal question (such as the order of performance) that does not depend on private information but on considerations of projected effects on parties’ behavior given average assumptions about human behavior, whether there are impediments to express contracting, whether informal sanctioning mechanisms exist that include transparency, repeat play and other salient factors, and the effect of intervention or non-intervention on the prospect of uncontrolled discretion in a performance obligation.