The Promise Principle and Contract Interpretation

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Abstract

The promise principle and its roots in a certain type of morality of individual obligation, which play the central role in Charles Fried’s vision of Contract law, have importantly contributed to rescuing Contract law from absorption into Tort law and from the imposition of externally imposed standards that are collective in origin. It makes a mammoth contribution to alerting us to the tyranny of interference with individual self-determination. However, this essay questions whether a promise centered system derived from a moral philosophy of promising (without an observable and testable foundation in reality) and geared to internal individual obligation and duty can provide the basis on which the public law can decide the hard cases in contract law. First, the promise-sufficient principle won’t help when the promises are incomplete. Second, this essay hypothesizes that there is an evolutionary trend toward efficient social contracts (or institutions of any kind), and therefore, if different communities at different times, using the latitude that our cultural genetic make up allow, choose to veer away from that trend, they will suffer by comparison with communities that do not. It is as if they are competing. In understanding what contract law should look like normatively, we must move beyond the purported internally reflective, a priori processes of individual will and understand, through casual and formal empirics and comparisons among economies, the background of how parties’ externally expressed natural impulses act to coordinate on social problems in the games of life. The law should look to how parties act to coordinate through exchange and produce improving welfare when they construct contracts and the rules of contractual enforcement. In that way, contract law will develop around, and not in a manner at odds with, naturalistic sources for normative principles, ones that are consonant with the parties’ own expressions.
For Charles Fried the promise principle unifies the law of Contract and provides its moral foundation. According to Fried, the promise principle promotes freedom and autonomy because it ties contractual obligation to “self-imposed” commitments. By enforcing promises, Contract law advances individual freedom. I will explore why Fried is drawn to the promise and self-imposed obligation as the central organizing elements of contract law, what Fried means by morality, and the connection between individual freedom, morality and contract law. I will explore these connections by tracing the origins of freedom, autonomy and morality back to Kant and other philosophical antecedents.

Fried wants to theorize contract as involving a purely individual morality of promise-making and promise-keeping, which are values in themselves because they promote autonomy. They are self-binding through exercises of will. Fried doesn’t want this master autonomy purpose cluttered up with considerations of mere utility or efficiency, on the one hand, or distributive justice or fairness on the other.
I will then argue that because morality and the promise principle are oriented toward individual, “self-created” obligation they should not guide positive laws. A focus on individually assumed obligations by itself would not explain why contractual institutions which enforce these promises are valuable by “foster[ing] trust” nor provide solutions to difficult Contracts issues.

This essay argues that (1) it is not clear why the legal system should care about enforcing exercises of individual will if doing so doesn’t serve the important social purpose of welfare improvement, and (2) a good deal of what contract law exists for is to solve problems that do not involve figuring out what parties actually promised, but implying terms or interpreting unclear terms in ways that will promote efficient results.

This Essay suggests that the source for using a goal to maximize surplus (welfare) and to promote efficiency should not be based on normative principles that float freely and are formulated on an a priori basis. Nor should the source be an ultimacy that is externally mandated. Instead, this essay suggests that we derive the normative principles for Contracts by looking to neuroscience to see how parties reach agreements or settle on social conventions. These are naturalistic sources for normative principles. In each case, parties, because of the way that their brains are wired, settle on practices or agreements that are efficient equilibria to solve whatever problem needs solving. Courts should not formulate rules that depart too much from the social

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5 Buckley, supra note x, at 18.
6 Id. at 3.
7 See Eyal Zamir, The Inverted Hierarchy of Contract Interpretation, 97 COLUM. L. REV. 1710, 1752-3 (1997)(discussing the dominant role of contract law as the source of meaning for contracts rather than the individually crafted terms). Another way of putting that might be to say that promoting autonomy is not an adequate goal for the legal system, because the morality of autonomous choice cannot be evaluated entirely separately from whether the ends chosen are good or bad; people may freely choose to do all sorts of awful or anti-social things.
8 In most instances the law will prefer efficient rules because otherwise those rules will be overturned by the parties since societies with efficient rules of exchange will thrive and enjoy greater wealth. In some instances, where there are competing efficient equilibria, fairness may emerge as a means of choosing among efficient equilibria. The final section of the paper will suggest avenues for incorporating fairness concerns into this framework for evaluating optimal legal rules.
9 See Binmore, infra note x, at 19 (calling traditional moralists penchant for “appealing to some invented source of absolute authority.” Binmore would include Kant among such traditionalists.
10 See Binmore, infra note x.
contract that parties use to “coordinate their efforts” because the effort would be doomed.12

Thus, contracts, promises, the world of exchange and promising are not just creations of the free will of the parties but are social institutions created and collectively maintained by the law.13 Contract law exists not just to enforce individual will but to support what Durkheim called the “noncontractual foundations of contract law” that are not worked out individually but that subsist in the background as evolving conventions and norms that form the infrastructure to support promises (much as roads permit travel). Individual acts of will do not create this system so we cannot understand the system simply by understanding an individual will. When parties contract, they are free riding or piggy backing on this system of transaction-cost reducing legal rules, norms and conventions. The system naturally incorporates utilitarian criteria because it is structured to make all participants better off.14 The idea would be that the law would start with observing how parties in society solve the game of life and solve the problems that they encounter and what conventions are survivable. They would then treat the facts of the case as a game of life and settle on a solution that would survive. Under Professor Binmore’s theory, conventions to survive must be an equilibrium and efficient. Among multiple efficient equilibria, fairness norms then would help to select an equilibrium that parties consider to be fair. From among efficient equilibrium possibilities, parties will choose an outcome considered to be fair.15

Instead of starting with morality, we should start with people, what their goals and what the institution of contract law is in reality.16 Fried limits Contract to the promise principle and

11 Id. at 3.
12 As Binmore explains, “Nobody is going to consent to a reform on fairness grounds if the resulting distribution of costs and benefits seems to them unfair according to established habit and custom.” Id. at 19.
14 For an interesting study providing empirical support for the improvement in social welfare wrought by the coordinative act of exchange in a private economy, see MCCLOSKEY, infra note x, at 1-53.
15 Binmore thinks that “instead of attributing fairness to a built-in ‘taste for fairness,’ I think we need to regard the subjects in each experimental group as the citizens of a mini-society in which a fairness norm evolved over time as a device to select among the efficient equilibria.” BINMORE, supra note x, at 74.
16 Buckley, supra note x, at 8.
relentlessly rejects the relevance of “considerations of self-interest”\(^\text{17}\) and separates contract law from norms, social conventions, fairness, efficiency, utilitarian concerns, exchange and the goals of the parties entering a contract. He thus arbitrarily excludes the naturalistic origins of exchange and contracting. Without a realistic understanding of men’s proclivities and those origins, including the human characteristics of “contractual man,”\(^\text{18}\) and without an understanding of the parties’ goals in entering transactions and of society’s goal --to promote trust and improve welfare as they are expressed in observable data of how parties bargain and what outcomes they would reach when “a general bargaining problem [is] stripped down to its essentials”\(^\text{19}\) -- we cannot craft rules which will work in reality, nor can we know what contracts are feasible or understand why we have the Contract rules and conventions that we do have.\(^\text{20}\)

Knowledge of the parties’ goals, together with an understanding of the impediments that parties face in achieving their goals\(^\text{21}\) through explicit contracting\(^\text{22}\) will permit a recognition of when legal intervention might improve welfare. Such understanding must be part of any analysis of Contract Law and its doctrines. Without it, we cannot know what Contracts rules will best facilitate exchange between real people, nor can we understand why certain contracts doctrines have survived (objective theory of assent) and others have not (subjective theory of assent).\(^\text{23}\)

\(^{17}\)This separation of self-interest from morals is a development remarked on by Dierdre N. McCloskey in The Bourgeois Virtues (2006) at 254 n.6 (citing Philippe Foot’s point that “A reasonable modicum of self-interest [is an] Aristotelian [necessity] for human beings.” PHILIPPA FOOT, NATURAL GOODNESS 17 (2001).

\(^{18}\)OLIVER E. WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM 43-63 (1985).

\(^{19}\)Binmore, supra note x, at ___.

\(^{20}\)KEN BINMORE, NATURAL JUSTICE (2005)(discussing survival of efficient practices in societies which there is competition between groups).

\(^{21}\)The idea of ascertaining the parties’ goals here is based on observing how parties behave based on observations of human beings.


\(^{23}\)As Professors Ayres and Speidel note, “There was a notable shift in the common law decisions in the early Twentieth Century toward a greater acceptance of the objective theory.” IAN AYRES AND RICHARD E. SPEIDEL, STUDIES IN CONTRACT LAW 233 (7th ed. 2008). “There is however, as one prominent writer observed, ‘a subjective’ as well as an ‘objective’ side to the law of contracts…” Id. at 234 citing Glanville Williams, Mistake as to Party in the Law of Contract, 23 CAM. B. REV. 271, 387 (1945). However, the exceptions to the objective theory tend to occur when no third party would be misled as when the dispute centers on whether the two parties to the contract should be bound by their own shared meaning or an objectively reasonable meaning. See E.A. FARNSWORTH, CONTRACTS § 7.9.
In fact, without an understanding of bargaining impediments and the parties’ goals of maximizing gains from trade while minimizing the transaction costs of exchange, it would be difficult to know why contract law would ever need to go beyond the promise principle or the explicit agreement in order to set default rules, to supply remedies not agreed upon expressly, or to interpret terms in a contract using contextualized evidence in order to achieve the parties’ own autonomous goals. With a rich understanding of parties and their challenges the questions become: what are the rules we have in Contract law? Why do we have those rules? How do they best facilitate exchange while lowering costs for parties? In deciding on the parameters of a framework to resolve such questions we should look at the framework instrumentally, in terms of welfare effects and efficiency considerations. Where there are competing stable and efficient practices, a fairness norm may emerge to resolve cases. If these rules were not efficient and stable, they would not have survived; inefficient or unstable rules or practices will be rejected, and a court should not adopt them even if it serves some goal it finds otherwise compelling (distributive justice, etc).

The idea that contract law can remain isolated from an understanding of human nature, relying solely on the parties’ consent or on the explicit exchange is shared by both law and economics scholars such as Professors Alan Schwartz and Robert Scott and by autonomy scholars like Professor Charles Fried. In their view, once you move beyond the central core of consent

24 If one subscribed exclusively to the will theory, then one would not embrace a theory that departed from individual will since that is the best indicator of one’s will. Fried would admit that the objective theory makes sense but would find liability under the objective theory to be “genuinely contractual only if the hypothetical intentions of the ordinary person provide sufficient grounds for inferring the actual subjective intentions of the parties.” Kraus, supra note x, at 724.
25 Skepticism about the ability of courts or legislatures to create broadly useful defaults dominates the scholarly thinking of the new textualists. See e.g., Alan Schwartz and Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 YALE L.J. 541, 547 (2003) (suggesting that “state can create defaults that business firms would want only under very stringent conditions.”)
26 Kreitner, supra note x, at 455, 457 (discussing isolated view of contract as one confined to enforcement of the parties own agreement and contrasting it with contract as a framework for cooperation among societal agents” and tying that notion back to Karl Llewellyn.)
27 See infra note x __
28 Id. at 455.
29 Id. at 455.
Local instrumentalists such as Schwartz and Scott find that enforcing only the explicit exchange is the most efficient and that deviating from that will undermine efficiency. Kreitner, supra note x, at 455. Global conceptualists such as Peter Benson also share the idea that parties “need contract only to enforce the very things they have agreed upon.” Id.
(Fried) or party sovereignty, you are either outside of the world of true contract 30 or you are unwisely sacrificing the efficiency goals of the parties by importing other outside interests (such as fairness) and undermining the efficient contract reached by the parties. 31

However, since the promise principle will run out whenever contracts are incomplete or ambiguous, it will be impossible for the law to draw the necessary lines, settle decide hard cases, 32 and decide on a variety of issues such as whether the objective theory or subjective theory should govern contracts, without addressing what the parties’ and society’s goals are, thus necessitating a foray beyond the promise principle. How can one decide that whether an obligation of good faith should be implied to prevent opportunistic behavior without understanding why the parties would want to curb opportunism and how opportunism might be costly to curb expressly ex ante? One must understand how the potential for such behavior might affect the pricing of contracts, and what strategies of a private nature 33 might be devised to solve the parties’ problems. In sum, deciding on the nature and shape of contract doctrines while ignoring the players, their goals and their human characteristics is impractical when determining whether the current rules are serving the purpose of improving overall welfare.

Understanding the particular impediments parties face in drafting contracts sheds light on why the parties’ promises might remain incomplete. Incorporating the parties’ and society’s instrumental social goals of improved welfare into Contracts theory would help to make sense of many current doctrines which cannot be reconciled with the promise principle, at least if it exists in isolation. Without an understanding of the barriers to complete contracting that parties face in a second-best world (beset by the opportunism, sunk costs, and uncertainty) that interfere with the parties’ ability to achieve a first-best outcome, one would not need

30 Kreitner, supra note x, at 455.
31 Id.
32 Jody Kraus, Philosophy of Contract Law 701 in The Oxford Handbook of Jurisprudence and Philosophy of Law (Jules Coleman & Scott Shapiro eds., 2002)(discussing how Posner and Dworkin would deal with hard cases and how those differing approaches reflect the underlying methodological differences between law and economists and moral philosophers). “Posner argued that judges should decide hard cases by creating a rule that would be in most parties’ best interest going forward. Dworkin’s objection was that such a rule was unfair because it failed to respect the rights of litigants.” Id.
33 Hostages; Williamson; vertical integration
to go beyond the promise or explicit agreement. Parties could achieve first best contracts on their own. But if one grasps the barriers as well as the private strategies parties might adopt, one might conclude that in some instances a law-supplied intervention would be better for welfare improvement and less costly than a private solution.

**Why Fried is drawn to Making the Promise and Self-imposed Obligation Central**

Fried has done a masterful job of rescuing Contract law from the idea that Contract law is no different from Tort law and of rescuing contracts from the “subordination of a quintessentially individualist ground for obligation,” as well as from “a set of standards that are ineluctably collective in origin and thus readily turned to collective ends.” This is part of the Fried’s effort to rescue contract from an “insidious set of criticisms which den[y] the coherence or the independent viability of the promise principle.”

By focusing on the individual promise Fried emphasizes that contractual agreements originate in private agreement and that the law’s role should be to facilitate private agreement on a neutral basis (rather than to impose external communal controls which interfere with freedom of choice). Fried’s focus on the promise as the essential component of contract stakes out a claim for the “distinctiveness of contract law” and places it squarely within the realm of private assent-based agreement. Fried is skeptical of those who do not pay sufficient attention to the “explicit agreement” and critical of those who are willing to overlook the terms of agreements in order to achieve justice or policy concerns.

For Fried grounding contract in free choice is beneficial and would “lead[] to conclusions profoundly different from those

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34 Grant Gilmore predicted that Torts would swallow Contracts. See Grant Gilmore, The Death of Contract.
35 Fried, supra note 1, at 5.
36 Id. at 2.
37 Id. at 3.
38 Krauss, supra note x, at 689 (discussing autonomy theories’ effort to “explain and justify the conceptual distinctiveness of contract law.”)
39 Id.
40 Fried, supra note x, at ____
that would result from any attempt to rest contract law on other social policies, such as economic efficiency or the redistribution of wealth.” As a normative matter, Fried rejects the intrusion of all external standards into the private agreement. The source of the obligation must rest on the promise; he rejects those critics who “fashion[] contractual obligation as a way to do justice between” the parties.

Fried’s book CONTRACT AS PROMISE renders a mammoth contribution by alerting us to the possible tyranny of interference with individual self-determination and “political freedom.” This desire to rescue Contract, and to preserve a realm in which the individual will matter, can be understood against the background of societies in which communal controls were used to subvert individual choice and preferences (as in communist, autocratic, and socialist societies), and in which everyone was worse off. Although Fried does not dwell on these societies in the text, he refers to Marx in the footnotes. He is drawn to the market not because it promotes efficiency, but because “it is the system of free men freely contracting.”

Fried’s emphasis on promise, self-imposed obligation, and individual choice shows how important personal sovereignty is to him. The key moral principle for Fried in Contract is respect for the individual, the exercise of his freedom, and his autonomy. Fried argues that if we respect individuals as free persons, then we should respect the choices that they make. In fact, as Fried says, if we don’t respect an individual’s promises, “[w]e infantilize him….”

If law respects personhood and sovereignty, then it will also respect the ability of individuals to “dispos[e] of these rights

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42 FRIED, supra note x, at ___
43 Id. at 3.
44 Buckley, supra note x, at ___
45 Professor McCloskey includes any system where there is a “takeover of mercantile wealth by bureaucratic authority the way Chinese, Mughal and Ottoman officials.” McCLOSKEY, supra note x, at 41.
46 Cite to FRIED footnotes.
47 FRIED, supra note x, at 94.
48 Id. at 21.
The notion is that if law fails to respect the individual’s choices and his liberty, then he won’t be able to dispose of his assets and his rights on terms he chooses. Societies that do not respect individual choices deprive people of their freedom and individual liberty. Societies without freedom are worse off than those which respect individual freedom and property.

The rescue of Contract law from the incursions of Tort law has succeeded. The importance of private consensual agreements seems unassailable. But it is less clear whether the idea of promise as self-imposed obligation, derived from a moral philosophy of promising and geared to individual obligation, can provide a basis on which the public law can decide the hard cases in contract law, fill gaps in contracts, interpret intractable language, or supply default rules. Fried himself suggests that the limitations of his system for contract enforcement when he suggests that when there is no contractual answer because the matter is not covered by the promise, the law will often resort to “considerations of fairness” background conventions convenience, sharing and fault principles. Many of these matters may be useful, but they remain outside the domain of Fried’s own closed system of Contract law which remains restricted to the promise principle.

This essay argues that many of these “external” considerations become relevant to Contract law once it is conceived as a system that is not indifferent to the wealth effects of one rule versus another using evidence and observable information based on how parties bargain and what types of social contracts are implemented and survive.

Because bargain theory would seem to be opposed to the promise principle since it refuses to enforce promises not

49 Id. at 2.
50 See also McCloskey, supra note x. Economic prosperity has also been tied to a number of other factors including the degree of legal protection for investors. See Rafael La Porta, Florencio Lopez-De-Silanes & Andrei Schleifer, The Economic Consequences of Legal Origins, 46 J. ECON. LIT. 285 (2008).
51 It is almost as if Fried understands contract as a joint venture made up of two unilateral promises rather than as a bargain and a social contract that solves problems for the parties. For a contrasting view see Binmore who conceptualizes “a social contract interpretation of a bargaining problem.” Binmore supra note x, at 24.
52 FRIED, supra note x, at 84.
53 Id. at 87.
54
supported by a bargain, Fried does not try to incorporate it into any theory of Contract. Fried would instead enforce gratuitous promises under the promise principle. In rejecting bargain theory, Fried suggests that the welfare improvement that is at the heart of a contract with revealed preferences is of no importance to the promise principle or to Contracts.

Because Fried finds the doctrine of consideration incoherent, he ignores that the key to bargain is that a promisor, in proposing an exchange, has signaled that he will be made better off by conduct from the promisee. Under an instrumental view, background conventions, efficiency, fault and even fairness may be found to be part of the institution of contract law that has been designed and implemented to facilitate party and societal goals including welfare improvement that is achieved both through individual bargaining and the institution of Contract law.

Once the instrumental goals of parties are adverted to and observed, the case results and many doctrines otherwise viewed as outside of Fried’s vision contract law can be reconciled as consistent with a broad view of autonomy that takes into account the ability of parties to reach their instrumental goals of welfare improvement.

Morality

Professor Fried’s emphasis on individual promise keeping which was so important in rescuing Contracts from being swallowed up by Tort law with its exclusion of any doctrines that cannot be reconciled with the promise principle and the exclusion of utilitarian criteria is traceable to a particular view of morality that remains staunchly opposed to the consideration of consequences in making individual moral choices. The limits of such a moral system for supporting the institution of contract will be explored in this section, along with an exploration of the place of morality in Fried’s book.

For Fried it is important that Contract law trace its origins

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55 Jody Kraus notes that “the promise principle fails to explain the bargain theory of consideration because no principle can explain it.” *Kraus, supra* note x, at 709.
56 *Fried, supra* note x, at 37.
57 *Fried, supra* note x, at 33, 35. *But see* Kraus suggesting that
to morality. Otherwise, the law might not be justified in enforcing the promises made by parties. All law that is more than self-assertive seeks to provide a justificative framework for itself, or for particular laws.

Several questions need to be posed about morality in this context. Why is Fried drawn to morality as his foundation for Contract law? What does Fried mean by morality, and where does his conception of morality come from? What implications does his conception of morality have for the enforcement of contractual obligations, for the interpretation of obligations and for law-supplied default rules? 58

The following section explains that the nature of the morality to which Fried is drawn to is one that is universal, grounded in respecting the choices made by individuals and derived on an a priori basis. That particular version of morality has historical antecedents which make it inimical to utilitarian or instrumental effects or to any naturalist sources since the idea of Kant was that reality cannot be known and that we must therefore devise normative principles by delving into our own minds since the consideration of such effects would take away from the pure moral choice of an action. Whether that individual morality should determine the nature of a constructed legal system is explored in this and the following section. 59

Fried seeks to ground Contract law in the morality of promise-keeping in order to ensure that it is going to be protected as an enduring truth, separate from external policies that ebb and flow with time. “The validity of a moral, like that of a mathematical truth, does not depend on fashion or favor.” 60 In this he takes the Kantian view of morality as derived a priori, as we will see. But also, for Fried the morality of keeping promises is tied to “respect for individual autonomy.” 61 As Professor Craswell has explained, Fried’s “notions of individual freedom and autonomy require that individuals be allowed to bind themselves

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58 As Professor Craswell has noted, the philosopher’s emphasis on freedom and autonomy “have no such implications for the content of the law’s background rules.” Craswell, supra note x, at 490.
59 See Section XX infra.
60 FRIED, supra note x, at 2.
61 Id.
by promising."  

The idea of morality being tied to a freely undertaken obligation derives in part from the importance placed on personal sovereignty by the deontic writers, including Fried. Promisors are "held morally accountable for their promises out of respect for their right to choose to undertake moral commitments as they see fit."  

But it is not clear that commitment to a personal sovereignty principle and the moral agency of human beings means that the institutional commitment of the law to enforcing contracts has, or should have, any kind of moral component at least if the morality is understood as something external and derived from thinking as opposed to "moral rules that really govern our behavior [and] consist of a mixture of instincts, customs and conventions that are simultaneously more mundane and more complex than traditional scholarship is willing to credit."  

Rather, the commitment to respecting individual choices could instead be explained as a system in which the law respects the choices parties make and attempts to provide a system for achieving the parties' instrumental goals in such a way as to minimize the transaction costs of maximizing surplus. If the law intervenes to sanction individuals, it could do so without reaching any moral conclusions, and it could choose to do so irrespective of whether an individual actually willed to be bound, or not, since the law enforces promises regardless of the inner mental state of the party making the promise.  

As noted earlier, the emphasis on freedom and respecting the choices of individuals, and tying those free choices back to a

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62 Craswell, supra note x, at 497 (emphasis supplied).  
63 Kraus, supra note x, at 1617.  
64 Cite needed  
65 As Professor Kraus explains, "Fried’s principal motivation for advancing the distinctiveness thesis is to support his normative claim that contract law is morally justified because it legally enforces the moral obligation to keep promises." Kraus, supra note x, at 704. However, searching for a normative justification for contract law in the moral obligation to keep promises overlooks that the law does not enforce all promises, but only a select few of those promises. That would suggest that the justification for promissory enforcement would lie elsewhere. It can only be discovered by looking broadly at all of contract law, even the doctrines that Professor Fried would exclude, such as consideration doctrine.  
66 BINMORE, supra note x, at 1 (suggesting that moral rules "are shaped largely by evolutionary forces—social as well as biological."
morality which is separate from human nature and derived \textit{a priori} and “independent of consequences” can be traced back to Kant.\textsuperscript{67} A free will “is one whose actions are not determined by an external force…”\textsuperscript{69} “A free will is one governed by moral law.”\textsuperscript{70} The choices made by rational men are under “a presupposition of freedom.”\textsuperscript{71} The idea is that as free and autonomous individuals, we choose to be governed by moral laws “which we give to ourselves.”\textsuperscript{72}

Fried adopts Kant’s supposition that morality is distinct from human nature when he rejects “considerations of self-interest” and “utility” as inadequate to supply the “moral basis of my obligation to keep a promise”\textsuperscript{73} The argument is that self-interest and utility must be excluded from contract law because it will induce promise-breaking, and that must be immoral under Fried’s theory on \textit{a priori} basis. The competing principle to morality seems to be unlimited self-interest that would provide no limit on promise breaking. Whenever it is more convenient to breach than to honor a promise, the individual constrained only by self-interest will breach promises. As Fried explains: “There is no \textit{a priori} reason for believing that an individual’s calculations will come out in favor of keeping the promise always, sometimes, or most of the time.”\textsuperscript{74}

Fried fears that if we use utilitarianism in Contract law, it will lead to rampant decisions by individuals to break their contractual obligations, and that we must therefore exclude utilitarian calculations from contract law because it will lead to bad effects.\textsuperscript{75} I have two objections here. First, I cannot think of a reason why Fried would say that parties would breach whenever

\begin{footnotesize}
\begin{enumerate}
\item Buckley, \textit{supra} note x, at 18.
\item “Moral principles are not based on properties of human nature but must subsist a priori of themselves.” Kant. Fund.
\item \textit{intro xxvi}. “A free will is one governed by moral law.” \textit{Intro xxvii}
\item \textit{intro xxvi}).
\item \textit{intro xxvii}.
\item \textit{intro xxvi}.
\item \textit{intro xxvii}. “Thus the will is not subject to the law, but so subjection that it must be regarded as itself giving the law, and on this ground only, subject to the law (of which it can regard itself the author.)” KANT, \textit{FUNDAMENTAL PRINCIPLES}.
\item FRID, \textit{supra} note x, at 15.
\item \textit{Id. at 16}.
\item Here is a case where Fried, who ordinarily eschews effects considerations, and wants to craft legal rules without accounting for effects, signals an interest in the negative consequence of promissory breaches.
\end{enumerate}
\end{footnotesize}
they wanted, when in the real world they would face a third party’s decision as to whether *and on what terms* (damages are not ruled out by a Pareto test)\(^{76}\) nonperformance could occur. The second objection is that if one is trying to defend why it is important to ground Contract law in promises and then objects to utilitarianism on the ground that it will undermine promises, in effect one is arguing that one should embrace promise keeping and reject another theory (utilitarianism) because it will lead to promise breaking. That seems to be a defense of promissory commitment based on the idea that an alternative system would not favor promissory commitments; circularity inheres in that defense.

Fried himself recognizes that if the question at issue were what the legislature or the court should do, then “in this version the utilitarian does not instruct us what our individual moral obligations are but rather instructs legislators what the best rules are.”\(^{77}\) So in that case, even for Fried, utilitarian calculations may indeed call for enforcement of promissory commitments.\(^{78}\)

Because Fried makes clear that he is concerned *not* with legislative decisions but only with individual moral obligations, he rejects utilitarianism since he is convinced it will lead to self-interested breaches of promise and undermine the entire system of keeping commitments. What Fried ignores is that individuals making decisions to enter into exchanges want a framework that will promote gains from trade and minimize transaction costs. Because individuals will want a system that will work across transactions, they would reject a *system* that promoted rampant promise-breaking, even if an individual using his *own* utilitarian calculation might prefer *ex post* in an individual case to breach after entering into the contract. If the law allows for everyone whose *own* utilitarian calculus suggests a breach, to breach, the effect will be to raise the cost of contracting for everyone. So, even though *ex post* one might prefer to breach, *ex ante* one will want a system that enforces promises in order to insure that parties are willing to trade and that they will not extract huge insurance premiums against breach. If one accounts for parties’ goals in exchange, including the overall minization of costs, it becomes

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\(^{76}\) Cite to Pareto rule.

\(^{77}\) FRIED, supra note x, at 16.

\(^{78}\) *Id.*
possible to admit utilitarian and self-interest concerns of contracting individuals without creating a system that undermines promise keeping.

Fried excludes the idea that law should be crafted to take account of possible effects, just as Kant excludes effects from the moral calculations that an individual must make. If one follows a course of conduct in part because it brings us personal advantages or benefits, then according to Kant, one is not truly acting according to the categorical imperative.79 Instead, if one takes account of the consequences of an action in deciding on a course of action, then she is not motivated by morality, for “if we are morally motivated, we cannot be moved by any interest outside of morality, for if we do our duty for the sake of something else, we are acting on a hypothetical, rather than a categorical, imperative.”80 For Kant there is a hierarchy of motivations for taking actions, and if we can conclude that an individual acts, not out of instinct nor out of concern for the potential consequences for the self of taking that action, but instead as a result of a completely free choice to do the right thing, then he can be part of “the noble ideal of a universal kingdom of ends in themselves…”81

Fried incorporates the same idea that we must take action purely for its own sake and not because of the advantages it may bring or the effects that the action causes. “In general, we can get the social, collective benefits of trust only if we are faithful for the sake of trust itself, not just for the sake of the resulting benefits.”82

The exclusion of effects is reflected in Fried’s embrace of the idea that in drawing the lines of communicative torts in contracts,83 the effects of a particular rule on future investment for example, a projected effect, should not determine where the lines of disclosure obligations ought to be drawn.84 Fried’s fear is that if we draw lines about disclosure (or resolve some other contracts issue) to achieve certain future effects on parties, then we won’t actually achieve those effects, because parties will be worried that

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79 Cite
80 Introd Kant xxvii.
81 Intro xxx
82 FRIED, supra note x, at 83.
83 See, infra.
84 See infra notes x-y.
if the court finds that in a particular case it is not efficient to protect a party’s existing expectations, then a court will depart from principle and thereby undermine all trust. But this assumes that the desire to protect investment or encourage efficient behavior would be at odds with existing expectations or conventions when in fact those conventions that are prevalent have survived precisely because they are efficient.

The exclusion of effects and of calculations of self interest may make sense for determining levels of morality in Kant’s individually oriented system of obligation. If one is motivated to take the right action solely because of a sense of duty owed, then one is morally superior to one who, while taking the right action, is motivated by self-interest as well. However, the exclusion of effects in determining how the law should craft the rules of contract law does not make sense because those effects, including having rules that facilitate exchange and minimize transaction costs, are central to the goals that the autonomous parties themselves have when entering the contract initially. Ignoring those effects would have negative effects on gains from trade.

The other aspect of morality that informs contract law, in Fried’s view, is that it is wrong to make a promise and then to break it. “To renege is to abuse a confidence he was free to invite or not, and which he intentionally did invite. To abuse that confidence now is like (but only like) lying: the abuse of a shared social institution.” One is left with the question of why reneging on a promise is like lying but not exactly equivalent. How will an analogy to promise breaking as a form of abuse of trust help us to understand what kind of a system is needed to facilitate trust? What constitutes an abuse of trust and why? What are the parameters? This essay suggests that such matters cannot be

85 Id.
86 Fried himself recognizes that the notions of fair dealing “have been adopted or have evolved just because they do lead to efficiency.” Id. at 84. He cautions however, “to conclude from this that efficiency, . . . should determine the result in a particular case, rather than the considerations of fairness I have proposed.” Id.
87 The problem with shying away from deciding hard cases or resolving ambiguity without reference to efficiency is that a court reaching a result that it considers “fair” that is not also efficient will in the long run be overturned by the parties. Fairness should be resorted to perhaps as Professor Binmore suggests when there are competing stable efficient practices/equilibria. Then the parties may choose between such practices by resorting to fairness to resolve the matter. BINMORE, supra note x, at
88 Cf to Kant.
resolved without considering the instrumental effects of denonimating one matter a breach of trust and another matter permissible.

**Limits on Morality as a Foundation for Contract Law**

Several difficulties undermine the usefulness of morality as the basic premise of contract law. First, the specific nature of the morality and the specific contours of morality involved seem to lack a clear foundation. When we look inward to an *a priori* notion of what is immoral without rooting those assertions either in empirical data or necessary inferences, the asserted morality may be just a skyhook that we need not accept.

If morality is equated with individual sovereignty, and the theory contains no limitations on the exercise of sovereignty, it provides no way of distinguishing enforceable from unenforceable promises or of filling in the content of promises when the promise is uncertain or indefinite, nor does it provide a means of determining whether a promise has been made or not.

In addition, by tying the concept of immorality to the invoking of a promise and then deliberately breaching it, the conception of morality and so cannot do much of the heavy lifting in contract law. Because Fried assumes a promise exists, and because he wants to inquire into whether it is permissible to break a promise as a way of establishing the moral bona fides of his theory, he does not draw any distinctions in his examples that would allow one to judge whether a promise had been made or what its content was or whether it should be supplemented and why.

Another limitation of the promise principle is that because it equates morality with individual freedom, it does not provide a way of choosing appropriate background or default rules in contract law. Presumably, as Dick Craswell points out, any background rules could be consistent with a personal sovereignty

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89 BNMORE, supra note x, at 1.
90 As Professor Craswell explains, Fried and other philosophers have a “focus [that] is implicitly limited to cases where there is no question that a promise has been made, and no difficulty in determining the exact content of the promised action.” Craswell, supra note x, at 505.
91 Fried, supra note x, at
notion of morality so long as those individuals could freely opt out of those rules.92

Finally, by focusing on the individual moral obligation and assessing the duty of a promise maker to keep it as a matter of morality, Fried has not articulated whether all promise breakers who renege should under the theory of moral obligation embraced by Fried be liable under all circumstances.93 Nor has Fried articulated whether the rules of Contract law should be exactly congruent with the morality of promising. Kant himself, when he looked at the idea of the morality of promises, was careful to indicate that the laws of inner morality and intention should not necessarily govern positive lawmaking.94

Kant’s vision of the ethical (the “internal,” the “direct”) is expressly distinguished by him from outcomes in jurisprudence (positive law, as contrasted with metaphysical law—noumenal “law”). This is very important. It is not well understood by those who want to take the basic work of Kant on morals and ethics (practical reason) and immediately import it into positive lawmaking. Not even Kant did that, and he expressly cautions against it (even on his terms).

A different way of approaching morality and exploring its implications for contract law would be to reorient Contract law away from the inner law and personal sovereignty toward the society, mores, and contractual rules that we have. “Moral rules that really govern our behavior consist of a mixture of instincts, customs and conventions that are simultaneously more mundane and more complex than traditional scholarship is willing to credit. They are shaped largely by evolutionary forces—social as well as biological. If one wishes to study such rules, it doesn’t help to ask how they advance the Good or preserve the Right. One must ask instead how they evolved and why they survived. That is to say,

92 Craswell, supra note x, at 44.
93 But see his discussion of impracticability.
94 See Kant’s passages relating to positive (what Kant calls judicial or juridical or statutory) law uniformly recognize it is not the personal (internal) will, but rather the common or general will, that dictates the outcome. It’s what Kant means when, in 1780, in a shorter piece, he acknowledged that things change when considering jurisprudence, which implicates what he called meum and teum. See 1780 piece The Metaphysical Elements of Ethics.
we need to treat morality as a science.” 95 Instead of looking inward or to a priori notions of morality and individual obligation, we should look to see what kind of rules we have in Contract law; they are a ready source of the law’s current take on the “ought” of contracting.96 Thus, as an initial step, one could argue that in deciding on whether a particular rule is moral, one might look at the society and at the dominant lawmaker to see what type of rules are being embraced by courts and by those involved in social contracts and then explain why those rules exist and why they have survived.

**Utility, Considerations outside the Promise itself; A need for External Standards**

Fried focuses on the morality of promise and wants to emphasize that the obligation to keep a promise should arise from something that is distinct from the mere utility of a system of promissory enforcement. He is willing to concede that sometimes other matters beyond the promise might be helpful; however, he says that if they come into play, they are non-contractual principles.

Fried also seems to exclude considerations of utility and efficiency and instrumental concerns from contract enforcement questions. He sees them as externally imposed social policies and thereby not justified under the promise principle, because they are inconsistent with the idea of self-imposed obligation.

The concentration on the promise and the exclusion of instrumental concerns from the contracts regime may stem perhaps from Fried’s reading of Kant on duty and moral obligation. In Kant’s mind, the idea of a moral obligation is one that is undertaken freely because it corresponds to a universal law and not because it will or will not benefit one or advance some purpose.97 Thus, if a merchant decides not to overcharge customers because he knows it is his duty not to do so, that choice is worthy of moral approbation.98 Not so, however, if the merchant decides not to overcharge his customers because of possible ill effects on his

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95 BINMORE, supra note x, at ___.
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98 Id.
The attempt to exclude the potential effects of a particular action from a calculation of whether to engage in the activity may indeed follow from the idea that there is a particularly morally worthy quality when one adheres to a duty because it is a universal law and not because it will benefit one’s own self interest. However, Fried’s attempt to exclude potential consequences or instrumental concerns from individual decisions should not govern how the law, as opposed to an individual, decides difficult questions that are beyond the realm of the promise itself. Excluding instrumental concerns might be relevant to deciding whether an individual is or is not adhering to the highest moral standards (we respect the ship-owner more if he refrains from charging due to his adherence to a maxim forbidding such behavior rather than merely acting of his own self interest). However, where the promise principle runs out and there is not an easy resolution to a question involving parties who have entered into an exchange transaction, courts should not use the same moral calculus for deciding on rules and interpreting language that a Kantian or Friedian moralist would use (action taken for its own sake without regard to the consequences) when deciding on what level of obligation is owed.

The moralist seeks to place a premium on behavior that is not governed by instinct or by a consideration of the effects of a certain action. The effort to distance contract law from the instrumental effects of the rules governing exchanges divorces courts from the parties’ own goals in entering into transactions! Since contract rules are designed to serve the needs of those exchanging and provide a system that can maximize value, ignoring those goals seems misguided. If the law imposes rules on the parties that diverge from these efficiency goals, the parties will overturn those rules, thereby adding to parties’ transaction costs. Thus, the embrace of welfare-improving goals that are shared by the parties suggests that efficiency, rather than being an externally imposed social policy, is a part of the framework that should guide decisions on the rules to guide contract formation and the interpretive default rules.

\(^{99}\) Id.
The parties’ goals can be arrived at in an *a priori* matter using assumptions about parties’ desire to maximize gains from trade while minimizing the costs of transacting, including curbing deadweight losses brought on by opportunistic behavior.¹⁰⁰ The law should to the extent possible further those goals by devising a system of contracts with background rules to achieve “the most efficient satisfaction of human wants.”¹⁰¹ Without a resort to instrumental goals and assumptions about average human behavior, it will be difficult to know what kinds of background rules of interpretation will best achieve those goals and how to interpret the words if the promise is unclear. Toward what end?

An alternative way of deciding uncertain cases would be to look at existing expectations or social conventions of the parties or to look at fairness norms not as they are derived in an *a priori* way from one’s mind but from looking at the actual practices of contractual partners. Of course, identifying these background conventions can also be difficult.¹⁰³

**Contract Interpretation: Beyond the Promise Principle**

Often the wording of a contract raises as many questions as it answers. The court must go beyond the express words. Is there a way of doing that which would be consistent with Fried’s concerns about the parties’ autonomy, but that would also advance the parties’ welfare and promote efficiency and exchange? And what does the morality of promising have to do with how to interpret ambiguously written promises? Can the promise principle help resolve such matters?

If one focuses, like Fried, only on the individual morality of obligation and on respecting the freely assumed obligations in order to enhance individual liberty, and if one looks at individuals making such decisions in isolation, then one is still confronted with why the law obligates the individual to obey promises but creates its own rules for promissory enforcement. As Professor Buckley says in commenting on the limits of the idea of “self generated

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¹⁰⁰ Craswell, *supra* note x at 509.
¹⁰¹ Craswell, *supra* note x at 509.
¹⁰² The interplay of fairness norms in deciding among multiple equilibria will be discussed in the Section XX infra.
promises,”104 “Hume’s point, however, is that the resolution does not generate an obligation to perform.”105 The law creates or chooses to give effect to certain conventions or expectations, in order to promote a system that will achieve the parties’ goals of welfare maximization with a low cost system. By creating a low cost system of enforcement, the law can help to create the trust and credible commitments106 that make the entire system of promissory enforcement more beneficial than if we relied on promises and the moral obligation of promising alone.

Once we understand promise-making as part of a system of contractual enforcement which parties “invoke..in order to solve the credible commitment problem”107 and which the law continues to offer to serve those more utilitarian goals, then it becomes possible to see why and how the law would go beyond the promise principle and would supply obligations when the promise ran out or was unclear.

If parties invoke the conventions of promising and contract with the associated public obligation in order to further their instrumental goals of engendering trust in a counterparty, then the law’s preference for the objective theory of contract law and its rejection of the subjective theory in interpreting the words of a contract makes perfect sense. The objective theory clearly undermines the will theory since it proves that “a private act of will for Fried is neither a necessary or sufficient condition” of contractual obligation.108 If the law provided an institution that depended on subjective theories of ascertaining actual will and mental intent, the system would not achieve the parties’ instrumental goals in entering contracts. The subjective theory, if adopted, would act as a drag on gains from trade.

Although Fried would be willing to go beyond the words of a contract and to invoke the parties’ background understandings109 his willingness to do so is so limited that it would not serve the need for a workable system of contract law that would allow

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104 Buckley, supra note x, at 7. (discussing David Hume).
105 Id.
106 Id.
107 Id.
108 Id. at 18.
109 FRIED, supra note x, at 85.
parties to increase their gains from trade. This is because, to be consistent with the will theory, Fried asserts, such conventions should be adverted to only if there is evidence that the background conventions correspond to the parties’ subjective intentions, because only then could one be sure that the importation of background conventions achieved the parties’ wills. The exact normative justification for importing such background conventions into the parties’ agreement remains murky under Fried’s analysis. In addition, as Craswell points out, difficulties in identifying the relevant understandings may make it difficult to implement Fried’s theory.

The question of whether the parties subjectively incorporated certain background understandings into their agreement is inherently an unverifiable matter. Thus it won’t serve the “needs of contract law” unless we know what these background understandings are, and why we should incorporate them. The question is whether and why contract decisionmakers should look to matters external to the contract in deciding on difficult matters of interpretation or filling gaps or deciding on a rule for interpreting all contracts. It may be that courts resort to incorporating background understandings as a way of promoting rules that facilitate exchange and improve welfare for the parties.

There is perhaps another way that adverting to background conventions and utilitarian principles can be reconciled to the autonomy principle. Contract law is all about relationships and allowing people to express their autonomy and enhance gains from trade through relationships. It is important to recognize that there may be important hindrances to their being able to achieve their goals through contract. If bounded rationality, sunk costs and opportunism are all present in a contracting situation, the parties’ agreement may not be able to achieve all of their goals by express language. In some cases intervention by courts beyond the express terms may facilitate autonomy by helping parties to reach their overall goals.

**Examples and Method**

110 Kraus, supra note x, at 724.
111 Craswell, supra note x, at 503.
The first illustration of a doctrine that Fried admits might be one that directly challenges the contract as promise theory is the doctrine of good faith. As Fried explains, it is one of the “doctrines ... said to challenge the concept of contract as promise because in one way or another they deny that the promise is sufficient to define the relations between the contracting parties ... duties of good faith not explicitly assumed by the parties may be imposed if required by good faith.”

Since good faith doctrine implies duties that are not explicitly spelled out in the contract, the question that arises for Fried is whether these implied duties are consistent with the autonomy principle of contract or not.

To determine whether courts’ implications of a good faith duty, as evidenced in particular cases, is consistent with the autonomy principle, Fried examines several cases. This essay will reexamine Fried’s discussion of one of these cases to see whether and why Fried’s justification for and sources for the implied obligation of good faith make more sense once situated as part of an interpretive default rule to promote welfare improvement.

The famous case of Paterson v. Meyerhofer addresses whether the good faith obligation in contractual performance requires that a potential buyer of property who agreed to buy the land from a seller who did not yet own the land to refrain from bidding against the seller in an auction to acquire the property even though there was no express stipulation to that in the contract.

To determine what good faith requires and whether it is consistent with the autonomy principle, Fried posits that the words of a contract necessarily include certain background expectations as matter of subjective intent. In such cases giving effect to such expectations merely implements the parties’ intent and thereby promotes the autonomy principle. For Fried, the key point is to determine whether these background conventions are “a matter of understanding” even though not articulated in the express words of the agreement.

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112 Fried, supra note x, at 75.
113 See cases discussed in Fried, supra note x, at 85-91.
114 97 N.E. 472 (N.Y. 1912).
115 Kraus, supra note x, at 722.
116 Fried, supra note x, at 87.
In the case of the buyer acquiring land and bidding against the seller Fried concludes that the background expectation would be that the buyer the buyer would not actively bid against the seller. Fried concludes that the reason that the matter was not included in the contract is that “it seemed so obvious.” 117 Because Fried finds such expectation to be part of the understanding of the parties, he finds that it is not being imposed as a matter of “choice” and thus not governed by “values, norms”118 but as a matter of the will of the parties. By constructing certain background expectations to be part of the parties’ subjective understanding, Fried finds good faith obligations to be consistent with the promise principle of contract law.

Since evidence of the parties’ subjective understandings is not verifiable, and there is no evidence in Patterson that the buyer did not subjectively intend to bid against the broker at the auction, the question is why and in what cases courts will recognize certain background understandings as part of the interpretive default rule of good faith. The court should focus on why such background understandings exist and why they have survived and whether they should be recognized to be part of the obligation of good faith. The same cases can then be analyzed using a different justificative framework.

The first step is to recognize that certain barriers exist in contracting that may interfere with the parties’ ability to craft a fully contingent contract that deals with all potential problems. If such barriers exist, a court must decide whether intervention in the form of a law supplied obligation beyond the express terms would improve welfare. If this is applied to the Patterson case, one would postulate that the prospective seller faces many types of risk, including the possibility that his counterparty may act in an opportunistic fashion. But he may not have anticipated the need to formulate specific language to control the prospect of competitive bidding by the buyer.

If a court starts with the proposition that the goal of exchange transactions is to maximize gains from trade while

117 Id.
118 Id.
minimizing the transaction costs of doing business\textsuperscript{119} and refers to the instrumental concerns that Fried wants to exclude, it makes sense for a court to recognize that an implied obligation should forbid competitive bidding in \textit{Patterson}. It first recognizes that certain barriers to contracting may interfere with the parties’ ability to fully control for all risks by express contract and those barriers may interfere with the parties’ ability to realize their goals from contracting. If the court decides that it can intervene by supplying a good faith obligation that will constrain bad behavior that the parties may have failed to anticipate, and if the control of that behavior would thereby facilitate exchange, the court should imply such an obligation to advance the parties’ overall goals in entering the exchange.

On the other hand, if a court were to refrain from finding that a good faith obligation would bar competitive bidding in \textit{Patterson}, the court could reasonably fear that such a ruling would chill future transactions. Parties would be concerned that “obviously absurd”\textsuperscript{120} interpretations would be permitted to obtain because the literal words of the contract did not forbid them. Intervention beyond the express words to imply prohibitions on such behavior is beneficial in the sense of being welfare improving. Without the implied obligation prospective brokers will face the prospect of their counterparty bidding against them. Parties in the future will have to undertake costly express measures to prevent such behavior or price the contract to reflect that risk of opportunistic behavior.

If \textit{Patterson} is reconceptualized as an effort by a court to restrain the risk of opportunistic behavior in cases where the parties failed to specifically contract for it due to its obviousness, and if the case is seen as a means of promoting gains from trade while minimizing transaction costs, many of the other interpretation cases can be easily explained. Rather than searching for nonexistent evidence of the parties’ subjective intention, the court should evaluate whether and why barriers to bargaining existed, and whether a particular interpretation going beyond the express terms would facilitate welfare improvement.

\textsuperscript{119} Binmore would also tie the welfare goal into an evolutionary process by which societies in small group settings adopt efficient equilibria as a means of competing against other groups or societies. See Binmore, \textit{supra} note x, at 12. \textsuperscript{120} \textit{Id.} at 89.
Fried is worried that these background understandings are not factual matters, and that they are thus a matter of choice and therefore “in principle arbitrary.” Fried seems most concerned that the doctrine of good faith could be expanded to encompass altruistic duties that are imposed on parties. Since such duties would be “imposed,” they would be objectionable as inconsistent with the promise principle. In fact, he envisions such duties as creating “status” relations that would be at odds with autonomous contracting.

In trying to distance good faith from imposed duties, Fried validates the background understandings by tracing them to the parties’ agreement and understanding. In that way, they are legitimated as something that is consensual. However, if Fried excludes the instrumental concern of providing a set of exchange rules that will facilitate trade while minimizing the transaction costs is excluded, then why does it matter to him that the parties would or would not have agreed to the terms of the contract had they consciously adverted to it ex ante? One could argue that it would not matter at all why these understandings were not included in the contract. While these background understandings exist, the law need not recognize them or make them part of the parties’ agreement. It could have instead put the burden on the parties of ruling out expressly all absurd interpretations or insisting that they expressly anticipate this particular iteration of opportunistic behavior (competitive bidding against the broker) in order for the law to find such behavior a breach. The question is whether requiring such express incorporation of all background understandings serves the parties’ needs and their instrumental goals or alternatively whether law-supplied obligations, including the duty of good faith, fosters those goals.

In reality, the law does choose to incorporate certain of these background understandings in order to minimize the costs of transacting. The reasoning is that there are certain understandings

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121 Id. at 87.
122 Id. at 85.
123 Id. (discussing status relationships discussed by Roberto Unger).
124 In the discussion of Patterson, Fried explains that “one of the things that the broker would say in his defense would be that he thought of the matter, he would certainly have precluded this possibility explicitly in the contract.” Id.
and conventions that are so well accepted that it might actually be costly to require parties to incorporate them into their express contracts because the parties would have yet another issue to bargain over. These conventions are such a part of the fabric of understanding that parties can assume that they will govern. One could also argue that there is a naturalistic basis for recognizing these conventions which have been winnowed down and have survived as stable and efficient and fair practices.\textsuperscript{125}

**Interpretation Cases:**

Perhaps the importance of a consequentialist framework—interpreting contracts to achieve the instrumental values of maximizing value while minimizing transaction costs—can be seen most easily by focusing on one interpretation case. In a large number of such cases the issue is that certain language has been used. In what way does the express term settle the question? This has to be settled by reference to some consequentialist policy. That is, the question will not go away, and the interpreter must resort to a justificational framework that invokes the pursuit of chosen consequences, such as minimizing the ex ante risk (costs) facing parties who use express terms—the consequence sought being to encourage exchanges and the gains they bring.

An illustrative case is *DeLoro*\textsuperscript{126} In *DeLoro*, the United States agreed to buy cobalt metal. The contract gave the buyer the right to an escalation clause if the delivery was late. The escalation clause pegged the price to an amount calculated on the date of delivery.

When the escalation clause was triggered by the supplier’s late delivery, the court had to interpret whether the delivery date meant actual or scheduled delivery date. If the court were restricted to inquiring into the background understanding of the parties to determine if that understanding was part of their subjective intention, that inquiry would not have helped because the parties shared opposite views of the relevant understanding.

The court resolved the dispute by looking at the possible

\textsuperscript{125} See Binmore.
incentive effects of one interpretation vs. the other. Had the court accepted the seller’s interpretation that delivery date meant actual delivery date, the seller would have had an incentive to postpone delivery to increase its profit, and the contract would have rewarded the supplier for its breach.  

The willingness to resort to a common sense business understanding of the deal ruled out an interpretation which would have left the buyer subject to opportunistic behavior by the seller. Ruling out such interpretation is consistent with the instrumental goal of minimizing drags on gains from trade and lowering interpretive risk for parties.

The result in DeLoro and other similar cases promotes the instrumental goal of efficiency and presumably lowers the overall cost of contracting going forward since parties would not have to undertake the costs of protecting against every unnamed form of opportunistic behavior. But the result is still consistent with the autonomy principle. If one supposes that parties entering contracts want to minimize the transaction costs of doing so, then the result fosters autonomy in a broad sense. Had the court not interpreted the delivery date to preclude greater profits from late delivery, future buyers would expend greater costs explicitly contracting against possible opportunistic behavior or screening their partners for trustworthiness or perhaps devising other contractual safeguards that would add to the cost of transacting.

The DeLoro court recognized that limits on bounded rationality may interfere with the ability of parties to reach their goals, those chosen explicitly and those motivating all rational actors, and so it intervened by implying terms to rule out opportunistic behavior that would act otherwise as a drag on gains from trade.

**Gap Fillers: Section 45**

Gaps in contracts are inevitable. Fried recognizes that they may occur and even says that “[i]t would be irrational not to recognize contractual accidents and to refuse to make adjustments when they occur.” Fried is confident that “we know perfectly well how to fill the gaps in a contract.” His solution is to

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127 Id. at ___.
128 See Juliet P. Kostritsky, Limits on Textualism (manuscript on file with author).
129 Fried, supra note x, at 69.
130 Id.
consult “residual general principles of law.”

These principles of resorting to residual principles derive from Dworkin.\textsuperscript{132} They are premised on the idea that even when the express words do not resolve a question, the judge making the decision will not be making or creating new rights. The parties will have rights that exist and that depend on the judge’s “act of reason.”\textsuperscript{133} These rights already exist and will be merely elaborated on by the judge, not created by him. For a judge to go beyond the rights that already exist by creating new rules would necessarily adversely affect one party’s preexisting rights. Such interference would be immoral. It would involve the judge in interfering with existing rights toward the achievement of some instrumental goal.

My view diverges from both Dworkin and Fried. Instead of looking at reason and moral principles in the abstract or residual judicial principles to solve problems for contracting parties, one should begin with human beings as they are and determine what goals they have in contracting and what risks they face in particular settings. Once those goals are determined, then one can begin to determine what contractual rule parties would prefer given the obstacles and risks.

For example, one setting that involves risk is the unilateral contract. Once the offeree begins to perform, the offeree is vulnerable since the offeror could either revoke the offer or engage in opportunistic behavior by making a less favorable deal once the offeree has sunk costs. The question for a court, then, is what is the appropriate solution for the unilateral contract game of life? The currently reigning solution for the unilateral contract (reversing the former common law rule) is to imply a term of irrevocability once the offeree has partly performed.\textsuperscript{134} This is the effect of Section 45. This collective intervention solves the recurring problem of the potential opportunistic exploitation of sunk costs by offerees. The court, in deciding whether to adopt the rule, might consider what the costs of offerees engaging in self-protective measures would be and weigh those against the cost of a law-supplied rule and the costs of opting out for idiosyncratic

\textsuperscript{131} Id.
\textsuperscript{132} Id. at 68.
\textsuperscript{133} Id. at 68.
\textsuperscript{134} RESTATEMENT (2D) OF CONTRACTS § 45 (1981).
bargainers.

A court committed to advancing the goals of the parties, including the goal of welfare improvement, would seek to adopt that rule that would achieve those goals. One could assume that the Section 45 rule would be preferred as the efficient rule since it would discourage offerees from engaging in costly preventative measures; it would also lower opportunistic exploitation of sunk costs; and it should promote reliance on unilateral contracts, thereby benefiting offerors as a class.

First, if one follows the Binmore hypothesis about the biological/evolutionary (shorthand—naturalistic, hence “natural justice”) origins of a community’s survivable understandings, there might be a temptation to justify the intervention doctrine of section 45 by only invoking biological impulse No. 3, by which I mean the dominant fairness view, as expressed, at this time and in this place, by the community (read also Adam Smith’s Impartial Spectator), under genetic compulsion, including genetically enabled but also bounded cultural discretion.

Second, while it is quite true that, in order to be honored by the community, an intervention must meet condition number 3—that is, it must comply with the local expression of golden-rule empathy (as more fully described by Binmore), at this time and in this place, given the state of the community’s responsiveness to its genetic impulses, including its cultural-gene power to vary within genetically imposed limits—it is also true that equilibrium (rationality) and efficiency (stability) are also necessary conditions of an intervention’s survivability as a solution to the unilateral contract “game of life.” So the section 45 law-supplied (completely unexpressed by the parties) term has to be explained on all three grounds.

Section 45 must be shown to be both (1) an equilibrium and (2) Pareto efficient. If it is not both, then it will be evolutionarily

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135 BINMORE, supra note x, at _____.
136 Id.
137 Id.
rejected for one or both of conditions 1 and 2. If it is, and if it is the only efficient equilibrium, then there is no need for a tiebreaker, meaning that element 3 may not need to be explored. If section 45 is only one of several possible efficient equilibrium solutions, then condition 3 the fairness principle must be resorted to as the explanation for why it is the currently reigning intervention.

**Communicative Torts**

Fried’s treatment of communicative torts follows the same pattern of other topics in Contract law suggesting that the obligation to disclose must be measured in terms of adherence to some noumenal concept of playing fair, a metaphysical effects-invariant infrastructure. At the same time, Fried introduces concepts like “conventional entitlements” and other concepts external to the promise that would seemingly be irrelevant under the purely internal rights analysis embraced by Fried early on.

The problem for Fried is that communicative torts often involve non-disclosure which does not directly violate a moral prohibition against lying. Because Fried knows that lying is wrong, it is also wrong to lie to procure an advantage by lying. However, non-disclosure is not an outright lie and thus is not automatically decided under a priori principle against lying. To decide whether a particular case of non-disclosure is actionable, Fried begins with a case addressing whether a seller of a house had an obligation to disclose termite infestation to a buyer.

In wrestling with whether there is a disclosure obligation Fried starts with the proposition that the concept of a lie may occur in ways that do not involve words. Since the seller concealed the termite infestation, that there was “dishonorable behavior” that would prevent the seller from prevailing in a court of equity and prevents the “cheat” from prevailing.

Fried’s purpose in discussing the fraud cases is to delineate that there is in fact a “clear domain of clearly wrongful

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138 *Id.*
139 *Fried, supra* note x, at 83.
140 *Id.* at 78.
He wishes to debunk the critics who see all fraud cases as tied not to wrongful conduct but to an underlying principle that requires “a duty to share information.” He thinks that there is a domain of clearly wrongful conduct that can decide whether the non-disclosure is proper or not. But Fried’s approach leaves the reader wondering how other cases involving non-disclosure would be decided and why.

To test the limits of the non-disclosure obligations, one should examine two other illustrations. In the first, Fried addresses whether a restaurant owner who would benefit from a proposal by a hotel to build on a lot next door has an obligation to share information with the hotel owner that the land is swampy. Fried concludes that there is no duty to disclose such information since “there is no general (altruistic) duty to aid, to share and thus no general duty to share information in order to remove another’s harmful misconception.”

The question in all of these non-disclosure cases is why the law has generally treated silence differently and not actionable unless there is a duty to disclose and why there is no general duty to aid others with information. It is difficult to see how these issues can or should be resolved without paying attention to the matter of whether one rule creates much more wealth than the other. That seems central in understanding why the rules generally made silence not actionable. Presumably, if one were to create a rule system, one would want to allow parties to use information that they created or acquired in order to incentivize parties to acquire wealth.

Fried uses a second example to distance himself from an instrumental analysis and to perpetuate the idea that fairness should decide the rules for non-disclosure cases. The example involves the question of whether an oil company who has discovered that oil exists on a farmer’s land has an obligation to disclose that information in a purchase transaction. Fried suggests that the obligation to disclose should be resolved by looking at the competing equities that might be proposed for each side. Fried

\[141\] *Id.* at 79.
\[142\] *Id.*
\[143\] *Id.* at 81.
finds that the “fact that the oil company knowingly takes advantage of the farmer’s ignorance hardly raises such an equity” in favor of the oil company.  

Fried ultimately finds that the oil company need not disclose because “the better informed party cannot compensate for the other’s defects without depriving himself of an advantage on which he is conventionally entitled to count, his failure to disclose will not cause the equities to tilt against him.”

Fried rejects Kronman’s instrumental analysis which looks to see whether a disclosure obligation would provide better incentives for knowledge acquisition and greater overall wealth. In rejecting such an effects-based justification, Fried emphasizes the personal obligation to engage in fair conduct with the oil company without regard to whether that fair treatment encourages investment or not.

The problem is that Fried is treating the legal question of disclosure as equivalent to a personal obligation to follow the moral path. In Fried’s mind (as in Kant’s) moral worth is determined by adhering to the moral path for its own sake regardless of the possible effects.

Fried concludes that because effects-based thinking should be avoided in one’s own internal moral decision making, it should not play a role in public legal decisions about when to require disclosure obligations. Yet, at the same time by invoking “conventionally entitled” expectations, Fried is adverting to a long-standing expectation which presumably may have survived because it is efficient. How can one decide which expectations should be legitimated by the law without considering the wealth effects of different disclosure rules?

Conclusion

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144 Id. at 82.
145 Id. at 83.