

Symposium on Jurisprudential Perspectives of Contract

Introduction: The Purposes of Contract Law

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INTRODUCTION: THE PURPOSES OF CONTRACT LAW

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In recent years, interest in the theory of contract law has increased. Many articles and several recent books have developed philosophical or jurisprudential perspectives on contract law.¹ This introduction aims to place the major views in perspective by considering what theories might try to do and briefly outlining the major approaches to the central questions of contract law. The theories cannot be developed in detail.

THE FUNCTIONS OF CONTRACT THEORY

Gerald Fridman begins his paper in this symposium by suggesting that lawyers and philosophers may have different purposes in examining contract law. Philosophers, he suggests, are often concerned to examine the language of lawyers about contracts or the ethical and other reasons for recognizing and enforcing contracts, while lawyers are concerned to determine whether a legally binding arrangement has been made. Fridman is correct to note that theories of contract law can be developed for different purposes, and he is perhaps correct about the usual emphases of philosophers and lawyers. However, it is better to note the different functions a theory of contract law can have without identifying these functions with one or another group of theorists.

At least three distinct functions can be served by a theory of contract (or other part of) law: prediction, explanation, or justification. Most theories seek to serve all these functions but differ in the relative emphasis they place on them. Fridman implicitly ascribes the function of prediction to lawyers—to determine whether a legally enforceable arrangement has been made. Doing this primarily involves predicting what courts would do were they confronted with the arrangement. Lawyers, however, usually want to do more than predict what courts will do; they want to be able to draft arrangements and make presentations that will persuade courts to en-

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1. Among the books are the following: P. ATIYAH, *PROMISES, MORALS, AND LAW* (1981); C. FRIED, *CONTRACT AS PROMISE* (1981); I. MACNEIL, *THE NEW SOCIAL CONTRACT* (1980).

force them. Consequently, a predictive function is often best fulfilled by stating the theory in the terminology courts use. Due to the doctrine of precedent, judges usually at least state their decisions in terminology of previous cases. Unless one is a total cynic about judicial behavior, one can reasonably expect to influence their decisions by arguments framed in that terminology. Consequently, if the primary function of a theory is predictive (and persuasive), it is likely to be stated in standard legal terminology, drawing heavily on the reasons and language of appellate court opinions.

A second function of contract theory is to explain. Explaining is not the same as predicting. The view that explanations and predictions are symmetrical has largely been abandoned in philosophy of science. It is even more obvious that they are not the same in law. While the doctrine of freedom of contract might have been a good basis for explaining court decisions in the early twentieth century, it would have been a poor basis for predicting future developments of contract law.

Explanations can occur on at least two different levels. At the first level, a theory might seek to increase understanding of how various court decisions fit together and how the law develops. Explanations of this sort may be closely tied to the type of prediction discussed above. By classifying cases under various legal doctrines, one can see how they fit together and predict how new cases will be decided. However, insofar as explanations are based on past cases, they might not be reliable guides to future decisions. Judges change their minds, new judges with different views are appointed, and the law develops. Nonetheless, the doctrine of precedent works to preserve the same general rationale and pattern of decisions, so one can often perceive developing trends and extrapolate them into the future.

Explanation can also be sought at a second level—that of understanding the role of contracts and contract law in society. While explanations of the first level are likely to stick closely to the principles enunciated by courts, explanations at this second level are much less likely to do so. Instead, they are apt to draw on economic, sociological, and historical perspectives. The terminology is likely to be that of the social sciences. The explanations are likely to be by causes rather than by reasons as on the first level. If one can identify underlying causes and trends, then predictions can be made. However, because the explanations are by causes rather than reasons, explanations of this second level are less likely than those

of the first level to provide practicing lawyers persuasive arguments to use in court.

A third function of contract theory is justification. The aim is to justify contract decisions, doctrines, and principles. Because explanations of human conduct often indicate its significance for individuals and society, justification can be closely tied to explanation. Nonetheless, to explain is not to justify, so justification will often involve indicating that elements of contract law are not the best and should be revised or reformed. Some theorists assume that the bulk of contract law must be justified; that any theory that implied the bulk of contract law is unjustified must be mistaken. This approach corresponds to a common approach to ethical theory in which the aim is to formulate general principles that will account for and systematize strongly held moral beliefs, such as that torture, lying, and breaking promises are wrong. Here is not the place to discuss the appropriateness of this method, but one should realize that with it justification will only result in incremental revision. Radical reform cannot be developed.

Although the functions of prediction, explanation, and justification are often related to one another and most theories seek to fulfill all three, they are not identical and can lead in opposite directions. An explanation of a doctrine may indicate that it is simply not justified. Moreover, explanation and prediction do not necessarily go together. Consequently, one must determine which function is predominant in a theory one examines or constructs. Often, strong disagreement between theories or their proponents stems from unrecognized differences in emphasis on functions.

THE QUESTIONS AND TRADITIONAL ANSWERS

In a contract action, the plaintiff needs to show that there was a contract imposing a duty to the plaintiff on the defendant, that the defendant breached that duty, and that a particular legal response (usually the payment of damages) is appropriate. Traditional contract law had (and to some extent still has) several doctrines surrounding each of these elements that often made it hard for plaintiffs to prove their cases. It is useful to briefly note them. Proving the existence of a contract was (and is) often difficult. First, there had to be an offer specifying all the major terms and acceptance of that precise offer. If a business sent an offer on its printed form to purchase 1000 widgets from another firm, which accepted the offer on its printed form, a contract might not have existed. The accept-

ance form would probably not have the identical conditions as the original offer form. Second, the existence of a contract required consideration—something provided in exchange for the promise. Standardly this might be paying money or a promise to do something in return. Later the law came to also recognize detrimental reliance, for example, taking a lost dog to its owner in response to an advertisement offering to pay a reward for the dog's return.

Once a plaintiff establishes that a contract exists, the plaintiff still has to prove that under the contract the defendant owed a duty to him or her. Historically, courts were strongly inclined to restrict duties to those expressly stated in the contract. The parol evidence rule rarely permitted verbal evidence of promises not included in a written document. Moreover, the doctrine of privity restricted duties to the other parties to the contract. If a person bought an item for another person to use, the seller had no duty to the second person because that person was not a party to the contract. Over time the courts have relaxed these stringent rules, often implying promises in contracts and making exceptions to the parol evidence and privity rules.

Generally, showing that the defendant breached the duty has not been a major focus of court cases. It is often clear that the defendant did or did not do something, for example, complete construction of a barn. The issue is most likely to be disputed when the defendant's duty requires conduct meeting some standard, for example, supplying merchandise that is fit for normal use or building a house that meets construction standards.

Finally, the plaintiff must show that a certain legal response is appropriate. The general principle is that contract damages should place a plaintiff in the position he or she would have been in had the defendant performed as specified in the contract. The plaintiff is supposed to receive his or her "expectation interest"—what the plaintiff expected to make from the deal. Three important rules have limited these damages. First, the plaintiff is required to mitigate damages by trying to secure substitute performance. Second, damages are also limited to those the defendant should have foreseen as likely to result from his or her breach. Third, penal damages are not awarded; the purpose of damages is simply to compensate the plaintiff.

Courts do not generally award specific performance. By trial time the performance would often not be of benefit to the plaintiff; indeed, the rule requiring plaintiffs to mitigate damages increases the likelihood of this being so. In a few cases, courts will order

specific performance, usually when something unique is involved, such as the transfer of land or of a unique art object.

The traditional rules of contract law yielded harsh results in many situations. The difficulties of the parol evidence and privity rules were mentioned above. Perhaps the most difficult aspect, and one not yet fully resolved, stems from the concept of contractual duties. If no contract exists, then no duty exists and contract law is necessarily silent. For example, if because of mutual mistake no contract exists, then a plaintiff has no contractual recourse no matter how much he or she may have expended. The courts did and do in fact usually provide remedies, but conceptually they are not considered to be in contract. On the other hand, if a contractual duty does exist, then the defendant is liable for full contractual damages. Today, however, courts often manage to provide lesser damages (the plaintiff's reliance interest) if full damages would be inappropriate.

RECENT THEORIES

Although recent theories of contract law differ in the extent to which they retain or coincide with traditional contract law, on the whole they find the extant contract law acceptable. The following discussion emphasizes their conception of the purpose of contract behavior and law and briefly indicates some of their implications for answers to the three central questions: When does a contract exist and impose a duty? What constitutes breach of a contract? What legal remedy is appropriate?

Agreement and Promise

One type of recent contract theory takes agreement or promise as the central element. This type of theory has a long history and many variations which cannot be considered here. The paper by Gerald Fridman in this symposium sketches an agreement theory. The primary purpose of contract law, he contends, is to enforce the agreement of the parties. For there to be a contract, substantial agreement must exist and the parties must have freely intended to be legally bound. In interpreting contracts, courts are primarily trying to carry out the intent of the parties. A breach occurs when one party foils the intentions of the other party. The breaching party can then be held to pay damages for consequences of the breach that were foreseeable at the time the agreement was made. In short, throughout, the purpose of contract law is to carry out the intentions of the contractors, including the payment of damages in case of failure to perform.

A similar yet distinct view advanced by Charles Fried holds that the purpose of contract law is to enforce promises. In making a contract, one invokes the practice or convention of promising, which provides a way of getting others to trust one to perform in the future. Once one has done so, it is wrong not to fulfill one's promise for the reasons Kant gave, namely, it violates trust and exhibits disrespect for the other person.² On this view, if things go awry and no contract is made, then the promise principle does not provide a basis for relief. Instead, other principles apply, such as the principle of benefit which requires compensating others for non-gift benefits received from them.³ In general, expectation damages are appropriate for breach of contract, because they provide the benefits the plaintiff was promised.

Páll Árdal in his paper in this symposium presents an argument that, if correct, undermines Fried's account. Árdal contends that no *prima facie* obligation to keep promises exists (thus undercutting the moral basis of Fried's promise principle). Promises are symbolic acts involving a commitment to the realization of what is promised. As such, nothing inherent in them supports their being kept. Whether promises should be kept depends on their content and the interests of the promisor and promisee. Moreover, implicit promises, a favorite way for judges to achieve fair decisions, are not really promises at all. Árdal illustrates the implications of his view by considering an actual case.

The differences between Friedman's agreement and Fried's promise theories are subtle. As Friedman notes, on his view all contracts involve promises, but not all promises imply contracts. Fried would agree. The central difference between them appears to concern what makes contracts binding. On Friedman's view, it is the agreement (intention) of the parties to be legally bound. On Fried's view, promises are morally binding and courts enforce some but not all of them to maintain trust in society and the freedom of individuals to determine the major aspects of their lives.

The theories of Friedman and Fried are both close to traditional contract law doctrines. That is, the terminology and statements are close to those found in judicial opinions. Moreover, they both emphasize the freedom of people to make arrangements as they desire. Indeed, Fried greatly emphasizes the importance of contract law in enabling individuals to maximize their freedom by making specific

2. C. FRIED, *supra* note 1, at 17.

3. *Id.* at 25.

arrangements for the future. Both views also confront the difficulties of traditional contract law when no contract is found to exist. Fried refers such problems to other parts of the law, such as restitution.

In this respect, both views appear unable to explain much of the law surrounding contracts. The inability to explain these matters within the framework of contract theory might not bother Fried, for he does not appear to seek to explain as much as to justify contract law. He claims to show that the promise principle is the moral basis of contract law.⁴ Although he also hopes to explain contract law, he wants to explain it on a moral basis. Although Friedman appears to take prediction as primary, he is more concerned with explanation than Fried is. Indeed, he might plausibly contend that one advantage of his view over the promise view is that it can explain more of contract law.

Economic Analysis

In contrast to the agreement and promise theories, the economic theory of contract law primarily emphasizes the explanatory function of theory. Moreover, the aim is to explain contract law at the second level. It is not strongly argued that the language of judicial opinions explicitly conforms to the theory, although it is often urged that judicial language is not incompatible with it. Like the agreement and promise theories, however, the economic theory takes the freedom to contract to be important. The freedom is not important for the sake of the autonomy or freedom of individuals, but because free exchange between individuals tends to maximize value. Value is determined by the free preferences of individuals, so if two persons voluntarily arrange an exchange, say, money for goods, then both individuals' preferences will be satisfied; both will get something more valuable to them; and value will be maximized.

Thus, according to the economic theory the primary purpose of contract law (indeed, all law) is to maximize value. The test for rules of contractual liability is whether they "will create incentives for value-maximizing conduct in the future."⁵ Thus, the requirement of consideration for a contract is explained on the ground that without it no *exchange* occurs (so value cannot be increased) or the courts have no way of determining whether the transaction would max-

4. *Id.* at 1.

5. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 68 (1977).

imize value.⁶ The defenses of fraud and duress can also be explained as rebutting the presumption that the exchange would maximize value.⁷ Finally, most of the traditional rules of damages can be explained as maximizing value.⁸ The plaintiff should receive expectation damages so that the defendant breaches only when he or she can make enough from an alternative arrangement to compensate the plaintiff. No penal damages are imposed because that would discourage a person from breaching a contract when more value could be realized by breach and compensation. Similarly, a plaintiff should have a duty to mitigate damages, for otherwise resources will be wasted, that is, not used to maximize value.

One would expect an economic theory to explain much of contract law, for it is predominantly the law of the market. It has become popular to challenge the economic theory as a justification of contract and other law. Obviously, even if it does provide a good second level explanation of contract law, this need not amount to a justification of contract law. In particular, value maximization need not be one's only or even main concern. One might also be concerned with equality of distribution. The expression "value maximization" obscures an important point, namely, that the primary value in question is wealth. Other values are included only insofar as they are part of the preferences of the parties to the exchange. And a preference for equality by a poor party to a projected exchange is not likely to be reflected in the resulting bargain, say, in a lower price. Consequently, while economic theory might fulfill the function of second level explanation reasonably well, it is not likely to fulfill the function of justification well.

A promise theory and an economic theory might differ with respect to penal damages. If the purpose of contract law is to enforce promises, then it might be plausible to invoke penal damages to encourage people to fulfill their promises. Fried does not discuss penal damages, but he does support expectation damages when they exceed reliance costs as taking persons and their assumptions of obligations seriously.⁹ Penal damages might also be imposed, it seems, to encourage trust and make people take their assumptions of obligations seriously. However, while an economic theory supports expectation damages, it would never support penal damages, because they would prevent value maximization.

6. *Id.* at 69-70.

7. *Id.* at 79-80.

8. *Id.* at 88-93.

9. C. FRIED, *supra* note 1, at 20-1.

Relational Analysis

According to relational theory, economic analysis best applies to a form of contract that is becoming less important in modern society. Contracts occur along a spectrum of relations between people, varying from quick, one time transactions between strangers at one end (the purchase of gasoline at a distant independent station) to indefinitely continuing relationships at the other (employment or marriage). Although all contracts involve some more complex set of relationships between the parties and contracts fall on a continuum, frequently relational theorists speak of two contrasting types—discrete transactions and relational contracts. Different goals are involved in these two types of contracts and they involve different norms. The elements of exchange and choice keep contract distinct from tort law, which also deals with the relationships between people.¹⁰

Ian Macneil has set out the different norms which he claims are involved in these two types of contracts.¹¹ Discrete transactions are governed by a norm calling for planning and bringing the future into the present on the basis of consent. One might say that the discrete norm promotes abstractness; that is, it ignores the identities of the parties and tries to eliminate temporal differences. In contrast, the relational norms promote concreteness by emphasizing role integrity (which partly defines the parties), preservation of the relation (rather than viewing it as a one time matter), harmonization or elimination of conflicts in the relation, and consideration of “supra-contract” norms (noncontract norms that apply to the relationship).

Elsewhere Macneil analyzes the values involved in the norms for these types of contracts.¹² He contends that relational analysis is value neutral in the sense that different societies will instantiate the norms in their own social contexts. Thus, relational analysis does not necessarily imply a commitment to liberalism. Instead, the norms are ones that must generally be involved if exchange relations are to occur. Not each norm must be fully realized in each contract, but in general practice these norms must be followed.

It thus becomes clear that relational analysis, like economic analysis, emphasizes second level explanation. The norms are not

10. I. MACNEIL, *supra* note 1, at 50.

11. *Id.* at 59-70.

12. Macneil, *Values in Contract: Internal and External*, 78 NW. U.L. REV. ____ (1983).

capable of justifying contract law, because they are descriptive. Although Macneil claims that the norms not only describe the way people behave "but the way they *ought* to behave," at best they describe how people *think* they ought to behave.¹³ The norms are hypothetical; if one wants to preserve relations, then one ought to behave in such and such a manner. The norms describe "the behavior that does occur in relations, must occur if relations are to continue, and hence ought to occur so long as their continuance is valued."¹⁴ If one wants to end a relationship (employment, marriage), then one need not be concerned to conform to the norms.

The relational theory is more of a framework for legal analysis than a theory for a specific legal system. As B. J. Reiter notes in his paper in this symposium, it is like an engine waiting to be powered. One must add the particular social relations of a society before one can draw any particular conclusions. As such, relational theory can explain exchange relations in any society. This is another reason why it is incapable of providing justifications.

In his paper in this symposium, Philip Mullock tries to provide an alternative perspective on the same phenomena the relational theory addresses. He wants to look at relations from the point of view of participants in them, which he calls a hermeneutical approach. Mullock develops the concepts of conventional action and conventions to explain exchange relations. Conventional action is more inclusive than promising, so by implication Mullock also rejects promise theories of contract law. Obligations can arise from conventional actions without promises, although the obligations are not as strong or inclusive as those arising from promises. Although Mullock does not develop the point in great detail, he notes that his theory provides a basis for contractual damages that do not go to the full extent of expectation damages.

Reasonable Expectations

Another recent theory of contract law contends that "the fundamental purpose of contract law is the protection and promotion of expectations reasonably created by contract."¹⁵ Because two parties are involved, only those expectations of which the other party was or should have been aware are to be protected.¹⁶ On such a theory,

13. I. MACNEIL, *supra* note 1, at 38.

14. *Id.* at 64; *see also id.* at 59.

15. Reiter & Swan, *Contracts and the Protection of Reasonable Expectations*, in *STUDIES IN CONTRACT LAW* 6 (B. Reiter & J. Swan eds. 1980).

16. *Id.* at 7.

the existence of a contract itself may become a secondary consideration, for the primary one will be to protect and promote reasonable expectations arising out of relations. (Thus, the theory is closely connected to the relational theory.) The existence of a traditional contract is only one factor to consider in deciding to impose liability, and then only because it affects reasonable reliance and expectations. A person should be held liable when that person should realize that another might reasonably rely to his or her detriment or entertain reasonable expectations on the basis of the first person's conduct.¹⁷ Thus, tort and contract law tend to merge. Traditional contracts only establish or acknowledge relations from which reasonable reliance and expectations arise.

In his paper in this symposium, Reiter explores the significance of a requirement of good faith for contract theory. He argues that an adequate theory will be two-tiered, that is, have some very general principles at one level and more specific principles at a lower level. Contracts derive their binding force or moral justification from community views. Moreover, contract law cannot be sharply separated from other areas of law. Reiter then explores the importance of these and other points for Fried's view of contract as promise.

The crux of a reasonable expectations theory is how one determines what expectations and reliance are reasonable. Cases often involve differing expectations of the parties, and courts must decide which set to enforce. Thus, one needs a method to determine which expectations are reasonable or justified.¹⁸ The usual approach, which Reiter adopts, is to look to express commitments in contracts, clear implications from the wording of the contract, or the general practice in such activities. Although contractors can mutually recognize almost any obligations by their contractual promises, in the final analysis even the expectations and reliance arising from them depend on accepted norms requiring the fulfillment of promises. Consequently, the ultimate standards for reasonable expectations and reliance are accepted community norms.

The question then arises whether such a theory can have a justificatory function. Particular legal decisions and doctrines can be justified by reference to the agreement of the parties to the contract and accepted social norms (including holding people to the ar-

17. Reiter, *Contracts, Torts, Relations and Reliance* in *STUDIES IN CONTRACT LAW* 242 (B. Reiter & J. Swan eds. 1980).

18. P. ATIYAH, *supra* note 1, at 67-8.

rangements they accept). However, can one justify the accepted social norms? Obviously, any such justification is apt to be complex. One is apt to have a form of positivism, namely, the function of law is to provide fair and just enforcement of certain social norms, whatever they might be, in order to promote a smoothly functioning society (or whatever). This type of justification differs significantly from Fried's argument for the promise principle, for Fried claims that the promise principle is justified for any society.

Another potential difficulty for the reasonable expectations theory is that expectations and reliance appear to point to different contract damages. In a classic paper, Lon Fuller and William Perdue argued that reliance can be the basis for justifying damages yet expectation be the basis for determining the amount of damages.¹⁹ Essentially, in contracting with one party a person relies on that person and forgoes opportunities to contract with others. In the final paper in this symposium, Richard Bronaugh examines the possible import of lost opportunities for contract damages. In particular, he criticizes the Fuller and Perdue argument. One cannot, Bronaugh argues, rely on a promise by the other party in contract formation, for no promise exists until the offer has been accepted. Thus, one cannot rely on a promise in accepting the offer.

CONCLUSION

What, if anything, hinges on these different theories. As the discussion of the functions of theory sought to indicate, they will agree about the solution to many contract cases. If P orders 1000 widgets from D but D ships only 500, then P is entitled to expectation damages. This result ensues whether one argues on the basis of agreement, promise, economic value maximization, relational theory, or reasonable expectations. Similarly, they all imply that if D enters a contract under duress, D need not perform. The core and clear cases of contract law will likely remain untouched no matter which of these theories one adopts.

This does not mean that the theories imply the same solutions in all cases. Significant differences arise in borderline cases. For example, they might not provide the same solution to a case of mutual mistake as in *Sherwood v. Walker*.²⁰ In that case, Walker sold Sherwood a presumably barren cow, but the cow turned out to be fertile

19. Fuller & Perdue, *The Reliance Interest in Contract*, 46 YALE L.J. 52 (1936).

20. 66 Mich. 568, 33 N.W. 919 (1887).

and worth much more than the contract price. Walker thereupon refused to deliver the cow to Sherwood. Fried considers mutual mistake to vitiate the contract.²¹ An economic analysis, however, would be concerned to allocate the risks that the cow is fertile so as to maximize value; the seller should probably assume the risk of a barren cow being fertile because the seller is in a better position to know.²² A reasonable expectations approach would probably come to the same conclusion for essentially the same reasons.²³

In other cases, the economic and reasonable expectations theories might differ. For example, the economic theory would imply warranties only if the seller could most cheaply detect and provide for the eventuality. However, community expectations might not be the most efficient; that is, the community might well expect a party to assume liability even if that party is not in the best position to do so efficiently. To the extent a reasonable expectations theory evaluates reasonableness by community standards and they are not the most efficient, it will differ from the economic theory. At this point it is tempting for a reasonable expectations theorist to argue that community expectations are not reasonable. If one makes that argument, then it is not accepted community norms that ultimately count, but some notion of reasonableness that is independent of community norms. This will greatly change the type of justification such a theory can provide for contract law. It then becomes less culturally relative and more of the sort Fried attempts to provide.

At this point, one must return to the functions of a contract theory. The crucial question is what one wants a theory for. Until one becomes clear what one wants a theory to do, arguments for and against one or the other are often confused and misplaced. For example, if one wants a theory to provide a moral justification of contract law, then criticisms that Fried's promise theory does not comprehend as much of contract behavior as does Macneil's relational theory are simply misplaced. Similarly, if one wants a theory to explain the role of contract behavior in society, arguments that Macneil's relational theory does not provide an adequate justification are irrelevant. Many theorists hope to provide a theory that fulfills all three functions, but there is no a priori reason to believe this is possible. Indeed, unless one assumes that the law is always as good as possible, it is a priori implausible that a theory that pro-

21. C. FRIED, *supra* note 1, at 59.

22. R. POSNER, *supra* note 5, at 73-4.

23. Swan, *The Allocation of Risk in the Analysis of Mistake and Frustration*, in *STUDIES IN CONTRACT LAW* 201-04 (B. Reiter & J. Swan eds. 1980).

vides an adequate explanation will also provide a satisfactory justification.

Does this mean that several theories can be correct? Yes, it does, but "correct" is relative to purposes—a correct prediction, a correct explanation, or a correct justification. Nor can one clearly argue that one function has precedence over the others. Unless it is justified, the law is an ass. But any justification that ignores how the law functions in society at both the general level and as perceived by participants in the legal system (judges and lawyers) will be irrelevant to society and merely an ass of another color. Thus, an adequate justificatory theory must rest upon an adequate explanatory one. But if one wants to promote the well-being of citizens, one will need a justificatory theory to know that one is doing good, not harm. In this sense, and this sense only, the justificatory function of legal theory is primary.