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**The Holmesian Bad Man
Flubs His Entrance**

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Abstract

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Forthcoming, *Suffolk University Law Review*, Symposium on *Contract as Promise* at Thirty Years.

In his 1980 *Contract as Promise*, Charles Fried famously argued that in the event one side fails to perform on the main subject of a contract, we should vindicate the moral bindingness of promises by giving the nonbreacher expectation damages. Over the years, other liberal contract theorists have argued just as strenuously for specific performance on the same grounds.

I argue here that both sides in this dispute are wrong. The right position for a will theorist or any other stripe of liberal contract theorist to take with respect to acceptable alternatives to performance is, in the first instance, no position at all—or more precisely, that each side should have whatever alternatives the parties agreed she should have. If liberal contract theorists ought to have no first-order moral preferences among possible alternatives to performance, what accounts for the almost universal view to the contrary? The short answer, I suggest, is blame it on Holmes.

The Holmesian Bad Man Flubs His Entrance¹

- Barbara H. Fried²

A. Introduction

Thirty years after its publication, *Contract as Promise* remains the canonical presentation of a liberal, autonomy-based conception of contractual obligation. In Charles Fried's words, "[t]he moral force behind contract as promise is autonomy: the parties are bound to their contract because they have chosen to be," and their "rights and duties [are] as far as possible a function of their own will and not of standards of justice external to that will."³ While other strains of liberal contract theory (consent-based, obligation-based) may differ from Prof. Fried's "will" theory of contracts in other respects, they all share his foundational commitment to the view that promissory obligations, unlike most other forms of obligation, are voluntarily assumed. The same is true of most liberal, autonomy-based conceptions of promissory obligation in the moral realm.⁴

The question I wish to pursue here is this: Having established the voluntary nature of promissory obligation, has liberal contract theory (hereinafter LCT) put

¹ Forthcoming, Suffolk University Law Review, Symposium on *Contract as Promise* at Thirty Years (2012).

² William W. and Gertrude H. Saunders Professor of Law, Stanford University. I am grateful to Joseph Bankman, Dick Craswell, Tom Grey, Mark Kelman and the participants in the Symposium for their helpful comments. Special thanks to Jeffrey Lipshaw, whose good idea the Symposium was, and to Charles Fried for supplying the occasion.

³ *Contract as Promise* (Harvard University Press, 1980), pp. 67-68.

⁴ See, e.g., Joseph Raz, "Promises and Obligations," in *Law, Morality, and Society*, ed. P. M. S. Hacker and Joseph Raz, 210-228 (Oxford: Clarendon Press); Seana Shiffrin, "The Divergence of Contract and Promise," 120 *Harv. L. Rev.* 708 (2007); Thomas Scanlon, "Promises and Practices," *Philosophy and Public Affairs* 19 (3):199-226. Randy Barnett, "A Consent Theory of Contracts," 86 *Colum. L. Rev.* 269 (1986).

itself out of a job? What further role, if any, does it have to play in elaborating the nature and content of promissory obligation?

It clearly has something to say about why promising to do X imposes obligations of some form on the promisor, where a mere expression of a future intention to do X would not. Indeed, of the enormous philosophical literature on promising, the overwhelming majority is addressed to just this question (or so my casual survey suggests). It presumably also has something to say about the preconditions for concluding that a promise was freely, rationally and deliberately—that is, voluntarily—made. This is no small subject, and implicates a host of issues concerning procedural fairness (duty to disclose, misrepresentation, economic duress, etc.) as well as mental capacity.

Finally, LCT does not itself require that the expressed wills of the parties always take precedence over other considerations. In extreme cases, liberal contract theorists could well conclude that those expressed desires should be trumped by paternalistic, public policy or fairness considerations. But all of these considerations are, in Prof. Fried's terms, "standards of justice external to that will," and hence not matters on which will theory itself can shed any light.⁵

⁵ I am presupposing that LCTs have a minimalist, procedural notion of autonomy that looks to whether the parties assented to the terms of the deal of their own free will, and not a more robust, substantive one that looks to whether the arrangements the parties have voluntarily entered into will enhance their capacity for self-determination going forward. Even the minimalist account cannot wall off inquiry into substantive fairness entirely. As is evident from the history of unconscionability doctrine, past a certain point the substantive unfairness of the deal will be taken by almost everyone as evidence that the disadvantaged party did not enter into the contract knowingly and willingly. But anyone who routinely looks to the fairness of the contract to determine the voluntariness of the agreement is not an LCT, as I am using the term.

The question is, does LCT have *anything* to say about the permissible content of X, beyond saying that parties may give X any content that they wish and courts should, as far as they are able, resolve any dispute between the parties in accordance with the parties' own intentions?

I think the answer is no. Rereading *Contract as Promise* in full thirty years after its publication, I was surprised to discover that for the most part (the other) Prof. Fried agrees. Much of the book is devoted to two lines of argument, both consistent with that conclusion.

The first line of argument repudiates, as inconsistent with the will theory of contracts, common-law doctrines that override the parties' clear intent. Prof. Fried's treatment of consideration is illustrative here. Acknowledging the irreducible contradiction between "the liberal principle that the free arrangements of rational persons should be respected" and the requirement, embedded in the doctrine of consideration, that in order to be respected those arrangements must include what the law recognizes as a "bargain," Prof. Fried concludes, in effect, so much the worse for the consideration doctrine: "Freedom of contract is freedom of promise, and... the intrusions of the standard doctrines of consideration can impose substantial if random restrictions on perfectly rational projects."⁶

Second, Fried argues that once we are unable to discern the parties' intent, will theory runs out, and any remaining gaps in the contract must be filled by resort to other (external) notions of justice. Prof. Fried's thoughtful treatment of the doctrines governing changed circumstances (mistake, frustration, impossibility,

⁶ *Id.* at p. 35.

impracticability) is illustrative here. As Prof. Fried notes, the defining problem presented by changed circumstances cases is that the situation the parties now find themselves in was one they failed to foresee when they entered into the agreement. As a consequence, “[t]he one basis on which these cases cannot be resolved is on the basis of the agreement—that is, of contract as promise. The court cannot enforce the will of the parties because there are no concordant wills. Judgment must therefore be based on . . . nonpromissory standards of justice” like restitution, reliance or loss-splitting.⁷ I concur.

There is, however, one substantive issue about which most if not all proponents have taken LCT to have something important to say: the consequences that should follow in the event the promisor fails to perform on the main subject of the promise. In *Contract as Promise*, Prof. Fried famously argues that the promisee’s right to an expectation measure of damages is logically entailed in the will theory of contract. Other liberal contract theorists have argued, with equal vehemence, that specific performance is the appropriate legal response, and that promisors have a corollary moral duty to perform voluntarily, if they reasonably can.⁸

⁷ *Id.* at 60, 61, 69. Prof. Fried goes even further, arguing that when courts fill gaps by “interpolating terms to which the parties in all probability would have agreed but did not,” they are equally appealing to an external standard that has left the will theory of contracts in the dust. *Id.* at 60. Of course Prof. Fried is right that when the court interpolates terms, it is imposing those terms on the parties. But the same could be said of all acts of interpretation, including of language within the four corners of a contract. Distinctions can be drawn here, between a possibly desperate but nonetheless genuine effort to get at the parties’ likely intent through intrinsic and extrinsic evidence, and giving up on the parties’ intent entirely and substituting instead an external standard (loss-splitting, etc.) because it seems to the court ‘fair.’ The former, I think, is better thought of as an extended form of contract interpretation, the motivation for which could well come out of will theory. Whether will theory has any light to shed on the interpretive practices that will get us closest to the parties’ true desires is another question.

⁸ Seana Shiffrin, “The Divergence of Contract and Promise”; Thomas Scanlon, *What We Owe to Each Other* (Harvard University Press, 1999), pp. 301-02.

Both views, I believe, are mistaken, and derive from the same error: thinking that the consequences that should flow from nonperformance of the main subject of the contract are external to the parties' agreement, rather than an integral part of that agreement. Once one views each party's obligations in the event it does not go forward with the proposed exchange as just another term in the agreement, from the perspective of LCT what one party owes the other if it chooses not to go forward is just whatever the parties themselves agreed it would owe under those circumstances.

In the event the contract is silent on a party's options in lieu of performance, LCT implies that the court should choose the term it thinks the parties themselves would have said was implicit in their deal, had they spoken to the issue ex ante. Most of the cases in which liberal contract theorists have strong convictions that X (specific performance, expectation damages, etc.) is the appropriate term for the court to impose can best be explained, I believe, not by a first-order belief that X is what a (generic) promisor owes a (generic) promisee in the event of nonperformance, but instead by an intuition that X is what *this particular promisor and promisee* had in mind, or would have said they had in mind if they had spoken to the issue ex ante. Those intuitions may well be right much of the time. But right or wrong, they are an exercise in contract interpretation, not first-order morality.

Finally, if the court has no evidence from which to infer the parties' intent, it will have to choose a gapfilling term on some other basis. At that point, LCT is out of a job, for the reasons eloquently stated by Prof. Fried with respect to changed

circumstances and other unprovided-for cases: Once we are outside the scope of the parties' voluntarily assumed obligations, we are outside the domain of LCT.

The same analysis applies in the moral as opposed to the legal realm, leading to the same conclusion. The massive literature on the moral bindingness of promises establishes only that if you promised to do X or led others reasonably to believe you promised to do X, you should do it if it is reasonably within your power to do it. It says nothing about what the content of X is. The strict reading that liberal theorists have given to promissory language in the moral realm, like the strict reading they have given in the legal realm, I believe is best understood as a judgment not about the sorts of commitments people *ought* to make to each other, but rather about the sort that they *did* make. That is to say, it too is an act of interpretation. In particular, it is based on a surmise that when parties make promissory noises about doing X, they usually mean to commit themselves to do X (or, on an objective interpretation of meaning, can reasonably be understood by the promisee to have done so) and, unless they expressly condition their promise, they mean (or can reasonably be understood by the promisee to mean) that commitment to hold unless it becomes impossible or extremely burdensome to do so.

While that strict interpretation of promissory language may get the parties' intentions right much of the time in the legal realm, in the moral realm it is very likely to get things wrong. The reason for this difference has to do with the different contexts in which promissory-type noises are made. Much of the literature on the morality of promising focuses on gratuitous promises between intimates (friends, family). In the context of those relationships, what parties mean

when they make promissory noises is idiosyncratic, often opaque to third parties, and (I believe) typically more forgiving than a strict interpretation presumes.

In short, then, LCT, like its analogue in the moral realm, *has* put itself out of job when it comes to determining the appropriate consequences of nonperformance. I am hardly the first to make this argument. Richard Craswell has urged it with respect to *all* default contract rules, noting that the “fidelity principle,” which asserts that parties should be held to their commitments, “is consistent with any set of background rules because those rules merely fill out the details of what it is a person has to remain faithful to, or what a person's prior commitment is deemed to be.”⁹ More recently, in an important article that has not gotten the attention it deserves in the ‘philosophy of promising’ literature, Robert Scott and George Triantis have elaborated the argument with respect to remedies in particular. The traditional default remedies (expectation damages, reliance damages, specific performance), they argue, should be regarded as part of a much larger menu of termination rights (‘exit options’) that give “one party the option to walk away from the contemplated exchange.” As with any other term of the deal, the choice among available exit options should be regarded in the first instance as a matter for the parties to negotiate.¹⁰

But there is a different set of issues concerning nonperformance that *are* external to the parties’ deal and that do implicate questions of first-order morality: the duty of a promisor to comply voluntarily with whatever terms, *including exit*

⁹ “Contract Law, Default Rules, and the Philosophy of Promising,” 88 *Mich. L. Rev.* 489 (1989), at 490.

¹⁰ Robert E. Scott, and George G. Triantis, “Embedded Options and the Case Against Compensation in Contract Law,” 104 *Colum. L. Rev.* 1428 (2004).

options, she agreed to. This is one of the many duties that constrain opportunistic behavior over the life of a contract. Many of the hardest problems in contract law involve determining when legitimately self-interested behavior turns into sharp dealing of one form or another. Unlike the choice of exit options, this is an issue that LCT may well be able to shed some important light on. I return to this possibility at the end.

If readers are with me so far, the question naturally arises, how could the debate between specific performance, reliance, restitution and expectation damages have gone on for so long between people who ought to have no first-order moral preferences among these or any other exit options? The short answer, I suggest below, is, blame it on Holmes.

Finally, a word about terminology. The conventional description of expectation, reliance, specific performance, etc., as “remedies” (or “damages”) for “breach of contract” loads the dice in favor of the standard view that failure to complete the contemplated exchange is a wrong, the appropriate response to which is an issue of first-order morality. Hence, for the balance of the piece I reserve the language of “breach” for cases in which a promisor *neither* performs on the main subject of the contract *nor* complies voluntarily with any of the agreed-on alternatives to performance. Scott and Triantis’s description of the standard contract remedies as “exit options” or “termination rights” might be thought to load the dice in the other direction, cleansing the failure to complete the exchange that is the main subject of the contract of any tinge of wrongfulness. I will ultimately side with Scott and Triantis here. But in order to avoid pre-judging the issue, for the

balance of the piece I refer to the legal options in the event of nonperformance on the main subject of the contract—whether they are specified in the contract or supplied by default rules—as “alternatives to performance.”

B. Liberal contract theorists’ first-order preference for expectation damages or specific performance

In *Contract as Promise*, Prof. Fried defends the morality of expectation damages as follows:

If I make a promise to you, I should do as I promise; and if I fail to keep my promise, it is fair that I should be made to hand over the equivalent of the promised performance. In contract doctrine this proposition appears as the expectation measure of damages for breach. The expectation standard gives the victim of a breach no more or less than he would have had had there been no breach- in other words, he gets the benefit of his bargain....

[T]he proper measure of the promise was the promise itself, that is, the expectation. The promise principle was embraced as an expression of the principle of liberty—the will binding itself, to use Kantian language, rather than being bound by the norms of the collectivity—and the award of expectation damages followed as a natural concomitant of the promise principle.¹¹

The view that expectation damages are the appropriate remedy in the case of nonperformance has a long pedigree. It is famously enshrined in Holmes’s characterization of a contract as a promise in the alternative: to do what you said you would do (that is, perform) or to pay a compensatory sum equal to the expected value of performance. It is the backdrop against which Fuller and Purdue mounted their famous argument for the moral superiority of restitution or reliance damages

¹¹ *Id.* at 17, 19; see also 117. For a more recent expression of what I read to be similar sentiments, see Daniel Markovits, “Making and Keeping Contracts,” 92 *Va. L. Rev.* 1325, 1361 (2006).

over expectation damages. And of course, it is reflected in the choice of expectation damages as the default term in the common law and the UCC. But, appropriately for an LCT, Prof. Fried has declined to give existing law any moral precedence. So the question is: assessing the matter from first principles, why would Prof. Fried conclude that expectation damages rather than specific performance is the “natural concomitant of the promise principle”?

Prof. Fried is an outlier among liberal contract theorists in this regard. In the moral realm, philosophers are pretty much of one mind that “doing what you said you would do” requires you to do it, not to do something else instead. In Thomas Scanlon’s words, “[t]he obligation to fulfill a promise” is not “neutral between warning, fulfillment and compensation.” If you promise to do X, you should fulfill that promise by doing X. If you fail to do X, providing the promisee with advance warning and/or compensating them for any disadvantages they suffer as a result of your not doing X is better than nothing. But in the first instance, “the obligation one undertakes when one makes a promise is an obligation to do the thing promised, not simply to do it or to compensate the promisee accordingly.”¹²

The case for importing the same obligation into the legal realm has been put most forcefully by Seana Shiffrin in her recent article, “The Divergence of Contract and Promise”:

[T]ypically a promisor is morally expected to keep her promise through performance. Absent the consent of the promisee, the moral requirement would not be satisfied if the promisor merely supplied the financial equivalent of what was promised. Financial substitutes might be appropriate if, for good reason, what was promised became impossible, or very difficult,

¹² *What We Owe to Each Other*, 301-02.

to perform. Otherwise, intentional, or even negligent, failure to perform appropriately elicits moral disapprobation. If contract law ran parallel to morality, then contract law would—as the norms of promises do—require that promisors keep their promises as opposed merely to paying off their promises.”¹³

It is not hard to see why liberal contract theorists would be drawn to specific performance over expectation damages in the typical case. After all, if what you expected was performance, wouldn't ordering the promisor to perform be the most straightforward way for the court to give you what you expected? Does Prof. Fried's preference for “expectation damages” rest on anything more than an inadvertent pun on the word “expectation”?

My guess is that Prof. Fried's defense of expectation damages is largely explained by historical context, and that if he were writing on a clean slate today, he might well argue for specific performance instead.¹⁴ In 1980, when *Contract as Promise* was published, contract theory was completely dominated by Fuller and Purdue's tripartite division of remedies into restitution, reliance and expectation. Writing against that backdrop and with the immediate goal of refuting Fuller and Purdue's case for the moral superiority of reliance over expectation damages—an argument echoed in Patrick Atiyah's *The Rise and Fall of Freedom of Contract*, published the year before *Contract as Promise*-- Prof. Fried naturally focused his attention on the choice between expectation and reliance damages, rather than on a

¹³ 120 *Harv. L. Rev.* at 722.

¹⁴ Indeed, in response to Seana Shiffrin's recent forceful case against expectation damages, Prof. Fried has at least partially recanted, or at least good-humoredly acknowledged that his continued efforts to defend the superiority of expectation damages have an air of desperation about them. *Harv. Law Rev. F.* 120:1 (2007).

third alternative not even on the table at the time: a general presumption in favor of specific performance.¹⁵

C. Whose Contract Is This, Anyway?

In my view, both sides in this dispute are wrong. The right position for a will theorist or any other stripe of liberal contract theorist to hold with respect to the alternatives available to the promisor in lieu of performance is, in the first instance, no position at all—or more precisely, that the promisor has available whatever alternatives the parties agreed he should have. If the promisee has agreed to give the promisor a free option to walk away from the contemplated exchange, or an option to walk away upon the payment of specified liquidated damages, assuming the agreement is informed and voluntary, why should a liberal contract theorist want to substitute his own preferred alternative (payment of expectation damages or an order of specific performance)? Whose contract is this, anyway?

The strongest evidence that liberal contract theorists do not fundamentally disagree with this analysis is how they respond to contracts that clearly specify the consequences to the promisor in the event of nonperformance. Almost without exception, they wouldn't hesitate to enforce such a provision, provided they have no reason to doubt the other side's informed consent to it.¹⁶

¹⁵ In his oral comments at this Symposium, Prof. Fried stated that he was motivated to write *Contract as Promise* in significant part to refute Atiyah's defense of reliance damages, an account that lends further support to this inference.

¹⁶ The only exception I am aware of is Daniel Markovits, "Making and Keeping Contracts," *id.* Speaking of parties' efforts to contract around the default rule of expectation damages, Prof. Markovits writes: "Moreover, the positive law is hostile to efforts to undermine this expectation principle... even when such efforts are efficient. Thus, the law *generally* declines to enforce agreements that fix contractual remedies at levels that cannot be characterized as securing a contractual expectation, either because they are too large in a way that is penal rather than compensatory, or because they are too small in a way that effectively abandons all forward-looking contractual commitments." While Markovits

Consider in this regard the famous example Prof. Fried offered in *Contract as Promise* in support of expectation damages as the appropriate measure of “what a promise is worth”:

I enter your antique shop on a quiet afternoon and agree in writing to buy an expensive chest I see there, the price being about three times what you paid for it a short time ago. When I get home I repent of my decision and within half an hour of my visit-- before any other customer has come to your store—I telephone to say I no longer want the chest.

In support of awarding the shop owner expectation damages (which he takes in this case to exceed reliance), Prof. Fried argues as follows:

Put simply, I am bound to do what I promised you I would do—or I am bound to put you in as good a position as if I had done so. To bind me to do no more than to reimburse your reliance is to excuse me to that extent from the obligation I undertook. . . Since by hypothesis I chose to assume the obligation in its stronger form (that is to render the performance promised), the reliance rule indeed precludes me from incurring the very obligation I chose to undertake at the time of promising.¹⁷

Underscoring the moral wrong of letting people walk away from purchases they regret upon the payment of only reliance damages, Prof. Fried states:

is speaking only of the positive law here, since his larger project assumes that the positive law is entitled to a presumption of correctness, I read this as a normative endorsement of a quasi-mandatory regime of expectation damages (In fact, Prof. Markovits, like Prof. Shiffrin, greatly overstates how difficult it is for parties to contract around default remedies, but that is another matter. For more on this point, see Barbara Fried, “What’s Morality Got to Do With It?,” 120 *Harv. L. Rev. F.* (2007))

Prof. Shiffrin can be read as accepting only grudgingly promisors’ right to limit their liability on the main promise, and appears to draw the line (as a moral matter) at promises that turn out to be purely illusory. “The Divergence of Contract and Promise,” *id.* But as I have argued at length elsewhere, I think what’s really bothering Shiffrin is not that the ‘promisor’ has committed to nothing, but that her nonpromise is delivered in language that amounts to a taunt. See Barbara Fried, “What’s Morality Got to Do With it?,” *id.* If a ‘promisor’ states straightforwardly, “I’ll try to pick you up at the airport on Sunday, but no promises— something else may come up. Call me when you’re about to get on the plane, and I’ll let you know if I can make it,” I presume that Prof. Shiffrin would conclude that while the speaker may have created some expectation in the other party that she would show up, she has not promised to. As a result, she has no moral duty to show up (although she may have a moral duty to notify the listener in the event she won’t make it).

¹⁷ *Contract as Promise*, at 19. Prof. Fried’s assumption that expectation is positive and exceeds reliance presupposes that the seller cannot fully mitigate damages through resale, either because resale is impossible or (unlikely on these facts) because he is a lost-volume seller.

“[H]olding people to their obligations is a way of taking them seriously and thus of giving the concept of sincerity itself content.... If we decline to take seriously the assumption of an obligation because we do not take seriously the promisor’s prior conception of the good that led him to assume it, to that extent we do not take him seriously as a person.”¹⁸

Now consider the following variants on Prof. Fried’s example:

(a) The contract specifies that I may take the chest home on approval, and return it any time within 72 hours for a full refund.

(b) The contract specifies that in the event I change my mind, I may return the chest within 60 days for a full refund, less a “restocking fee” equal to 10 percent of the purchase price.

(c) The contract specifies that once the chest is removed from the store, it is not returnable.

(d) The contract specifies that the chest may be returned within 14 days, but only for a store credit.

The alternatives to performance supplied in these variants include a right to walk away with no liability (alternative (a)); specific performance (alternative (c)); what might be a form of reliance damages (alternative (b)); and a liquidated damages provision that, in economic substance, is a little less than expectation damages (alternative (d)). Alternative (a) would have been called an illusory contract in the bad old days, but now we would simply call it a free option contract for the buyer.

All of these termination rights are commonplace in commercial contracts, as are a host of others that don’t resemble any of the four conventional ‘remedies’ that

¹⁸ *Id.* at 20-21.

anchor the academic literature (specific performance, expectation, reliance or restitution). Consider the following:

1. Seller hereby grants Buyer an option to buy Blackacre at a purchase price of \$500,000, which option is exercisable anytime prior to January 1, 2012. Buyer hereby agrees to pay \$20,000 for the option, the entire amount payable upon signing this agreement. In the event that Buyer elects to go forward with the purchase of Blackacre, the \$20,000 will be applied to the purchase price. In the event Buyer elects not to exercise the option, Seller will retain the \$20,000.
2. Lender agrees to loan Borrower \$500,000 towards the purchase of Blackacre. The loan shall accrue interest at five percent interest per annum, compounded monthly. The principal amount of the loan plus accumulated interest will be payable in level-payment monthly installments over fifteen years. The loan shall be on a nonrecourse basis, secured by Blackacre. In the event that Borrower is in more than three months' default on the loan at any time, Lender may foreclose on Blackacre and sell it at auction, retaining proceeds up to the balance still owed on the loan and turning the rest (if any) over to Borrower. In the event the sale price at auction is less than the outstanding balance Borrower owes on the loan, Lender shall have no further recourse against Borrower.
3. Studio X hereby agrees to retain SM to star in a film project entitled "Our Fair City." Studio agrees to pay SM \$750,000 as a retainer, payable in full in sixty days, which shall be SM's to keep whether the movie is made or not. In the event the movie is made, SM will, in addition to the \$750,000, receive five percent of net profits from the film.

Each of these examples describes a commonplace deal. The first is a paid-for option to purchase. The second is a standard nonrecourse loan agreement. The third (a variant on *Parker v. Twentieth Century-Fox Film Corp.*)¹⁹ is a form of a "take or pay" (or "pay or play") clause, giving the buyer of goods or services the option to "take" those services in-kind or pay a stipulated kill fee/retainer. In each case, the agreement is identical in substance to a contract to perform X (buy Blackacre, repay the loan in full, hire SM to perform in Our Fair City), with a liquidated damages provision in the event of nonperformance that is worth substantially less than the

¹⁹ 474 P.2d 689 (1970).

expected value of performance. The only difference is rhetorical. Rather than phrasing the obligation to pay money as a “remedy” for breach of promise to perform, my three examples present it explicitly as an alternative to performance on the main subject of the contract. If — as I believe — LCTs would not object to any of these three contracts, provided the parties understood what they were agreeing to, why should mere verbal differences change their view of the moral acceptability of a buyout option?

One possible answer is that the very explicitness of the buyout option in each of the above examples reassures LCTs that the party that stands to be bought out understands the terms of the deal and regards the buyout option as a perfectly acceptable alternative to performance. In contrast, when faced with a contract that relies on (unstated) default remedies, they worry that the party liable to be bought out understood the contract to carry a stronger obligation to perform than it really does. Similarly, if a contract describes the buyout option as “liquidated damages,” they worry that the parties will misread the contract to impliedly require a good faith effort to perform, with liquidated damages as a last-ditch compensatory measure if performance proves impossible.

Both of these seem to me very reasonable concerns, but they do not implicate the morality of substantive contract terms. Once again, they reduce to problems of contract formation and interpretation. Provided that the buyout provisions in question were knowingly and voluntarily agreed to by both parties, I presume Prof. Fried and virtually all other liberal contract theorists would have no moral objections to enforcing any of these provisions-- indeed, consistent with the premise

that “persons’ rights and duties as far as possible a function of their own will,” would consider themselves morally *compelled* to enforce them. Fried acknowledges as much with respect to consequential damages, arguing that we should award them if and only if we have reason to think that the seller of a defective good “under[took] this measure of responsibility,” and treating express waivers as presumptive evidence that he did not (“such a limitation would generally be respected.”)²⁰ Given his commitment to honoring the parties’ intent, surely Prof. Fried would regard as ludicrous the argument (for example) that in variant (a), permitting me to “repent” of the choice to buy the chest and return it with impunity within the 72 hours would “fail to take seriously [my] prior conception of the good,” and to that extent fail to take me “seriously as a person.”²¹

Prof. Fried, I presume, would respond by pointing out that his argument for expectation damages (over reliance damages, in his case) was explicitly conditioned on the “hypothesis [that the buyer] chose to assume the obligation in its stronger form,” and that in altering his hypothetical, I have done away with that precondition. As a result, in variant (a), while I changed my mind about the chest, I did not change my mind about the legal obligations I undertook with respect to the chest, as I am merely exercising one that was provided for from the start—to return it for a full refund within 72 hours.

Fair enough. But that is just another way of saying that the parties are free to stipulate any alternatives to performance that they wish, and that Prof. Fried’s own preference for expectation damages kicks in only as a gapfiller, when the contract is

²⁰ *Contract as Promise*, at 23.

²¹ *Id.* at 20-21.

silent on the subject.

The same point holds for specific performance (or, in the moral realm, a moral obligation to perform voluntarily if performance is reasonably possible). Scanlon, for example, explicitly conditions his Principle F on the promisor's having given assurances that he will perform.²² While Scanlon does not state that the promisor's "assurances" are limited by any express conditions the promisor has put on his obligation to perform, in view of Scanlon's willingness to *imply* conditions that would reasonably be understood to be within the promisor's intent, it seems pretty clear he would honor such express conditions.²³

Is it possible for liberal contract theorists to salvage *some* first-order moral preference for expectation damages or specific performance, by arguing that while the parties' intentions control, in the event those intentions are unclear, the law should select the gapfiller based on first-order moral concerns? I think not, for reasons anticipated by Prof. Fried in his discussion of gapfilling in the context of changed circumstances. If a contract is ambiguous or silent on exit options, LCT implies we should seek to fill the gap with our best guess as to what the parties intended, or what they would have said they intended if the question had been put to them at the time of the agreement. When courts have no basis on which to make a better than random guess about the parties' intent, they could use the resulting gap in the contract terms as an opportunity to smuggle in their own policy preferences. But, as Prof. Fried argued with respect to changed circumstances cases, since the choice of a gapfilling term has nothing to do with the parties' own desires

²² *What We Owe to Each Other*, p. 304.

²³ *What We Owe to Each Other*, pp. 304, 309-311.

(which are by hypothesis undecipherable), those policy preferences have to reflect some norm or norms that are external to LCT.

To say that what liberal contract theorists take to be first-order problems of morality reduce in the end to problems of contract interpretation is not to say that the problems are unimportant or easy to resolve. They are neither. It is also not to say that that they can be resolved without recourse to moral considerations of any kind. Inevitably, questions of what parties meant by what they said (or didn't say) bleed into questions of what it would have been reasonable or fair for them to mean (or say). But if LCT itself has anything to say about the sorts of fairness concerns that should govern contract interpretation, that connection has yet to be spelled out.

D. Personal Promises

Up until now, I have focused on alternatives to performance in commercial contracts. But the same analysis applies to promises made in the context of personal relationships, leading to the same conclusion: autonomy- or reliance-based theories of promissory obligations imply no first-order moral preference about the scope of promissory obligation.

Scanlon and others have argued that doing what we promised to do and not some other thing is more important in the personal than the commercial context, because in the personal context X is more likely to "have no monetary or other equivalents."²⁴ I have no quarrel with the argument as far as it goes. But once again,

²⁴ *What We Owe to Each Other*, p. 301.

it only goes so far. In particular, it leaves open how we determine whether you have in fact committed yourself to do X, and what the content of X is.

As in the commercial realm, autonomy theorists have quite properly insisted on individuals' moral prerogative to state a current intention to do X without creating a moral obligation to do X, and (within very broad limits) to supply whatever content to X that they wish, including qualifying the primary duty articulated in X as they wish. Given those commitments, whether a particular promissory-type utterance in fact creates a binding promise and, if so, what the content of that promise is, are both, in the first instance, questions of interpretation— of what the 'promisor' meant and/or what the 'promisee' reasonably took her to mean.

At this point, the parallels between commercial and personal promises become more strained, in my view. As I suggested above, in the realm of commercial contracts, resolving any ambiguities in favor of a strict view of promissory obligation may well come closer to the parties' true intent than any other interpretive rule of thumb. But I don't think that is true in the personal realm. Sometimes it is easy to infer from the words and the context in which they are spoken that when someone promises a friend that he will do X he means X and not anything else. Scanlon's example of the Guilty Secret seems to me such a case.²⁵ But there a number of reasons to think such cases are the exception and not the rule.

First, the closer the relationship and the more serious the obligation at issue, the more likely that the existence of such an obligation not only goes without saying;

²⁵ *What We Owe to Each Other*, pp. 302-03.

it goes *only* without saying. If your nearest and dearest says to you, as he is about to take off on a business trip, “Don’t worry, honey, I promise I won’t sleep with anyone while I’m on the road,” that is the time to start worrying. As a consequence, the most important promissory obligations in the personal realm may well be the ones we are silent about.

Second, in intimate relationships people tend to develop their own private, shared understandings of the meaning of their words and actions, understandings that are layered with personal history and that are often opaque to third parties. In the commercial context, the fact that the legal system might eventually be called on to interpret and enforce a contract gives parties a reason to conform their language to normal usage. But in the context of intimate relationships, where parties almost never resort to legal enforcement, they have no such incentive. As long as they understand each other, that’s all that matters.

Consider the following example. Ann offers to pick up her sister Betty at the airport on Saturday. On Friday, Ann is invited to a friend’s beach house for the weekend-- something she would very much like to do. She tries to reach Betty but fails, and leaves a voice mail for her that says, “Sorry, something’s come up, and I can’t pick you up tomorrow.”

Is Ann a moral cad? The honest answer is, we have no idea. It all depends on what Ann and Betty understand Ann’s offer to entail. Just for starters, it could mean: (a) “I’ll pick you up Saturday if I’m in the mood on Saturday”; (b) “I’ll pick you up, provided nothing else comes up between now and then”; (c) “I’ll pick you up unless something important comes up between now and then” (in which case, to

decide whether Ann is a cad, we also have to know whether Ann's going to the beach house is something the two of them would regard as "important"); (d) "I'll pick you up, unless there is an emergency"; (e) "I'll pick you up or find someone else to do it"; (f) "I'll pick you up or, if for some reason I don't, you should take a cab and I'll reimburse you for it."

To hazard any informed guess about which of these or a multitude of other meanings Ann and Betty attached to Ann's words, we'd have to know a lot more about them and their relationship. If I had to guess, knowing only that they are sisters and that all that is at stake is a trip from the airport, I would probably pick (c). But the one thing I am sure of is that I would not pick (d)-- the default interpretation most liberal contract theorists argue should be given to a promise that is, on its face, unconditional.

E. Blame it on Holmes.

If it is so obvious (at least to me) that liberal contract theorists should have no first-order preferences about the allowable alternatives to performance, what accounts for the universal view to the contrary?

Ironically, I think it can be traced back in part to Holmes's famous characterization of a contract as a promise in the alternative-- to perform the "promised event" or "pay a compensatory sum":

Nowhere is the confusion between legal and moral ideas more manifest than in the law of contract. Among other things, here again the so-called primary rights and duties are invested with a mystic significance beyond what can be assigned and explained. The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it — and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you

commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference.”

In his eagerness to provoke those who, in his memorable phrase, “think it advantageous to get as much ethics into the law as they can,” I believe Holmes got wrong where in the life of a contract morality and law come apart. Holmes’s error is encapsulated in his misleading analogy of contract to tort law. In the case of conduct regulated by tort law, criminal law or other mandatory regulatory regimes, we do not voluntarily assume the relevant standards of conduct; they are imposed on us for the good of others. Typically, paying the legal penalties imposed for failure to comply with those standards is generally *not* the moral equivalent of complying with them. When the state sets the speed limit at 65 MPH, it is not indifferent as between people driving 65 MPH on the one hand, and driving 100 MPH and paying the statutory fine for speeding on the other, and only a Holmesian bad man would think otherwise.

But contracts are a very different case, precisely because the duties in question are voluntarily assumed. Given that the parties to a contract generally have no moral duty to assume *any* contractual obligations to each other, if they voluntarily choose to do so, why should they not be free, morally speaking, to limit the scope of those obligations by providing one or both sides with alternatives to performance? And why would Holmes believe that only a Holmesian bad man would think it appropriate to exercise one of those provided alternatives, in lieu of performance?

I leave it to Holmes scholars to sort out the answer. Maybe Holmes assumed that if a contract was silent on termination rights, the parties expected performance, period. If so, then it *would* take a Holmesian bad man to think that paying a compensatory sum was the equivalent of performance, for reasons I explore below. But the more likely answer, I suspect, is that Holmes, like modern-day liberal contract theorists, was thinking of expectation damages not as a default term when the contract was silent on termination rights, but as a mandatory term imposed on the parties irrespective of their own desires. That view of expectation damages was much closer to the truth in Holmes's day than our own, given the host of rules that restricted parties' abilities to contract around expectation damages (the bar on penalty provisions, hostility to specific performance, refusal to enforce free option contracts, etc.) But even then, parties had considerable flexibility to contract around expectation damages on the low side. In our own time, parties are generally able to provide for any alternatives to performance that they wish, provided they take care in drafting the contract.²⁶

While resoundingly rejecting the positivist view of legal obligation that motivated Holmes to treat 'doing what you promised' and paying damages if you don't as equivalent options, liberal contract theorists and all other first-order moralists about remedies (Fuller and Purdue, Atiyah) have taken on board his implicit, erroneous assumption that 'doing what you promised' and paying damages if you fail to do it *are* two different alternatives—that is to say, that remedies for

²⁶ Some formal constraints remain on parties' ability to tailor termination rights (e.g., the bar on penalty damages, courts' reluctance to order specific performance in personal services contexts). But as I have argued elsewhere, the constraints are relatively few, and for the most part possible to contract around with careful drafting. See Barbara Fried, "What's Morality Got to Do With It?," *id.*

nonperformance are external to the contract (promise), rather than an explicit or implicit term of the contract (promise). The result, in my view, has been to channel much of the intellectual energy of liberal contract theorists in the legal realm and their counterparts in the moral realm into a dispute that they have no stake in.

F. What's Morality Got to Do With It?

Law and morality do come apart in contract law, but at a different place and in a different manner than Holmes seized on. They come apart *not* when the promisor opts to exercise an agreed-on alternative to performance, but when she refuses to perform *or* comply with any of the agreed-on alternatives to performance, either denying liability on pretextual grounds or, while not denying it, putting the promisee to the trouble and expense of forcing her to comply with her obligations under the contract.

The gap that most matters here is not between morality and law-on-the-books; it is between morality and law-in-action. By the time one is done paying the costs entailed in enforcing one's contractual rights, few rights are worth the paper they are (or aren't) written on. The law provides some sanctions for bad-faith noncompliance: the doctrine of bad-faith breach of contract; Rule 11 sanctions for frivolous defenses, etc. But those sanctions are generally inadequate to protect the value to the promisee of whatever alternatives to performance the promisor agreed to. Parties can negotiate for additional terms to protect the value of their rights under the contract (prepaid deposits; attorneys' fees to the winning party;

mandatory arbitration, etc.). But these too are often inadequate; they also do not always work to the advantage of the party who was wronged.

This is the point at which we should haul the Holmesian bad man out of the mothballs and cue him up to respond, “So what? All that means is that most contract rights are worth far less than their face value—basically, they are worth the face value discounted by the probability that the promisor will *not* turn out to be a Holmesian bad man who refuses to perform *or* comply with any of the agreed-on alternatives to performance.” And, continues the Holmesian bad man, “If the promisee is unhappy about that reality, she could have protected her interests by requiring a deposit, or security in another form, or by contracting only with parties she has particular reason to believe will *not* turn out to be Holmesian bad men.” And the Holmesian bad man’s modern-day analogue, efficient market man, will helpfully chime in as well, to note that the promisee who contracted with a stranger she had no reason to trust—or worse yet, reason to distrust-- paid for no more than what she got, because the increased likelihood that this particular promisor would breach in bad faith was priced into the contract.

I find these arguments unpersuasive, as I assume all liberal contract theorists would, but think they are morally distinct from the arguments offered by the original Holmesian bad man. The promisee stiffed by a bad faith breach did not sign on to the promisor’s right to walk away with impunity in the same sense that the shop owner in alternative (a) above signed on to the buyer’s right to walk away with impunity. The victim of a bad faith breach may well have understood *ex ante* that most contractual rights are worthless if the other side chooses not to comply

voluntarily, and may even have priced that risk to some extent into the contract. But the fact that it is too costly to vindicate most of our legal rights if they are not voluntarily respected is, at the end of the day, a reality thrust on all of us without our consent, and one against which we can rarely protect ourselves fully by altering the terms of the contract.

This is the point at which contract law is properly analogized to tort law-- a fact reflected in the short-lived tort of bad faith breach of contract. The promisor who bargains for the choice to perform or pay liquidated damages but then does neither, saying to the stiffed promisee, "So sue me," is in the same league, morally speaking, with the tortfeasor who drag-races at 100 MPH through downtown streets and says to the cops, "So give me a ticket." The actions of both rightly stink in the nostrils of those who think that morality has a role to play in the law, and for much the same reason. There is a difference between doing what you ought and making someone else force you to do what you ought, and that difference *is* a matter of first-order morality.

Prof. Fried and Prof. Shiffrin both anticipate this argument. Even if we were to accept the Holmesian view of a contract as a promise (in the alternative) to perform or pay damages, Prof. Shiffrin argues, "if the breaching party fails to perform and fails to pay damages voluntarily, there is a breach even on [this] reinterpretation of the meaning of the relevant promise."²⁷ And Prof. Fried, having in fact accepted that paying expectation damages is the equivalent of performance, argues that the promisor is still under a moral obligation

²⁷ "The Divergence of Contract and Promise," *id.* at 728.

to pony up voluntarily “full compensation measured by the promisee’s expectation.” The difference is, Profs. Fried and Shiffrin believe that *voluntarily doing* whatever it is you promised to do is an additional moral obligation, on top of the obligation to perform unconditionally (in Shiffrin’s case) or to perform or pay expectation damages (in Fried’s). I think it is the *only* first-order moral obligation implicated in the choice of alternatives to performance.

In the moral realm, it doesn’t add much if anything to our understanding of promissory obligation to stipulate that whatever we promised to do, we ought to do *voluntarily*. The requirement of voluntariness is already implicit, if not explicit, in what it means to do what we promised to do. Not so in the legal realm. Whether and when we have a moral duty not to exploit the costs associated with enforcing our legal duties is a very difficult question, the answer to which has profound implications for almost every aspect of law-- contracts, criminal conduct, tortious conduct, workplace safety standards, emission controls, you name it. To take just one much debated question, to what extent may tax lawyers advise their clients about the so-called audit lottery-- that is, the very low chance their returns will ever be audited? To what extent may individual taxpayers act on the basis of that knowledge? Is cheating a little bit on your taxes—like going 75 MPH in a 65 MPH zone—morally acceptable, but cheating a lot—like going 100 MPH-- not? Should it matter *why* the law is underenforced (e.g., because it is fallen into desuetude, because detection is very difficult or very costly, because its enforcement would be a low priority even if it were costless)? And how should the law respond to the reality that in at least some aspects of our daily lives, most definitely including

paying our taxes, we are virtually all Holmesian bad men who will take advantage of underenforcement to undercomply with our legal obligations? These are all enormously important and complicated questions that have gotten little sustained academic attention, outside of the optimal penalty literature in law and economics.

In contracts, exploiting the costs to the other side of enforcing its legal rights is just one of a larger set of opportunities that arise over the life of a contract to take what is arguably unfair advantage of the other side. Other examples include misleading the other side in pre-contract negotiations about one's intentions to consummate the deal; failing to disclose material information concerning the value of the deal; taking advantage of a drafting error in one's favor; inserting terms that contravene the other side's "reasonable expectations" about what the contract says, without bringing them specifically to the other side's attention; and requesting modifications of agreed-on contract terms in the middle of performance, when you know you have the other side over a barrel. Virtually everyone would agree that, up to a certain point, these are all acceptable forms of self-interested behavior, but there is no consensus on where that point is or even the criteria that would help us locate it. We generally owe nothing to our negotiating partners before we have a valid contract, but still, there are limits to how much we can jerk them around in pre-contract negotiations.²⁸ Each side is responsible for reading and understanding the contents of their contract, except when they are not.²⁹ Contract modifications agreed to by both sides are enforceable, except when they are not.³⁰

²⁸ *Pop's Cones, Inc. v. Resorts International Hotel, Inc.*, 307 N.J.Super. 461, 704 A2d 1321 (1998).

²⁹ *Market Street Associates v. Frey*, 941 F.2d 588 (7th Cir., 1991).

³⁰ *Kelsey-Hayes Co. v. Galtaco*, 749 F. Supp.794 (E.D. Mich. 1990).

Where to draw the line between taking fair and unfair advantage of the other side in these and a host of other points in the life of a contract is perhaps the hardest set of questions that contract law has to grapple with. Interestingly, they are questions that even die-hard law and economics types recognize to have an irreducible moral dimension.³¹ Given that consensus, it is somewhat surprising how little attention they have received in the LCT literature. Perhaps this is because there is so little to say-- we know sharp dealing, bad faith, opportunistic behavior when we see it, and all that. But I don't think that is true. Contract law (like autonomy theory) is, at root, an uneasy marriage of permissible self-interestedness and mandatory other-regardingness: We have a right to pursue our own projects in life, provided we do not unfairly impede others' attempts to do the same. All the action lies in figuring out when we cross the line in various contexts, and there is often no consensus on the answer. Unlike the question of what sorts of alternatives to performance the parties to a contract may voluntarily agree to, these are all questions about which, I suspect, LCT has something important to say.

³¹ See, e.g., *Market Street Associates v. Frey*, 941 F.2d 588 (7th Cir., 1991) (Posner, J.); *Industrial Representatives, Inc., v. CP Clare Corp.*, 74 F.3d 128, 129-130, 132 (7th Cir. 1996) (Easterbrook, J.). See also Ian Ayres and Gregory Klass, *Insincere Promises: The Law of Misrepresented Intent* (Yale University Press, 2005)