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Contract Law and Social Morality

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I. PREFACE

My aspiration in this book is to probe, unpack, and supplement the mental models we use to understand the obligations that arise from promising and contracting. The thesis I advance is straightforward, even if not intuitive. It is this: when people make or exchange promises, they do more than simply bind themselves to a future course of action. They also bind themselves to a method of reasoning about their future course of action, a method we might call values-balancing reasoning.

I have a second, related claim: when a judge evaluates the legal obligations that arise from promising and contracting, implementing legal doctrine in the context of a dispute, the judge also employs a method of reasoning about the determinants of legal obligations. The judge considers the contextual factors and circumstances that determine how doctrine ought to be applied, which also entails a method of values-balancing reasoning.

Not surprisingly, the method of reasoning that persons ought to use to determine their promissory behavior is the method of reasoning judges use to implement doctrine. Under the view I present, judges resolve disputes that arise from promising and contracting by using a method of values-balancing reasoning about a person's obligations. That method of reasoning is the one they believe people should use when people in a promissory, contractual relationship decide how to behave. When people behave as they would if they had used the same method of reasoning as judges, the normativity of the law is unified with the normativity of people's own reasoning. When that happens, the distance between law on the books (how people ought to behave) and law on the ground (how people actually behave) shrinks.

What is at stake is not the death, but the disintegration, of contract law.

* The articles collected here were first presented at the KCon conference held at the McGeorge Law School in February 2020. One of the panels at that conference discussed a draft of a book written by Professor Gerhart called Contract Law and Social Morality, which will be published by Cambridge University Press in March of 2021. Although the scholars commenting on the draft did not reduce their comments to writing, Professor Gerhart has given us permission to publish the preface and introduction to the book in order to give readers a flavor of what they will find in the book that benefited from the discussion.

Without an integrating methodology of reasoning about obligations, contract law is in danger of disintegrating under the weight of disparate theories, pluralistic values, obtuse words, specialized doctrine for different kinds of contracts, and contradictory doctrine. Do courts determine obligations through theories of autonomy, reliance, empowerment, consent, or wealth maximization? If people determine the obligations of promising and contracting by the value of autonomy, which aspects of autonomy matter: freedom from contract, freedom to bind oneself, or the right to rely on others? What justifies a separate restatement for consumer contracts, and will we soon face a restatement for sophisticated businesspeople and another for small businesses? Should courts address contract modification as a question of consideration or by what is fair and equitable? And what does *fair and equitable* mean? What about *good faith* and *unconscionability*? As new kinds of contractual relationships evolve, can contract law adopt to new contracting practices and designs?

As an antidote to contract law's possible disintegration, I offer a mental model of how people ought to make decisions about their obligations. Mental models help us organize our understanding of complex systems, which is why mental models can help us organize our understanding of promising and contracting. Mental models incorporate a framework within which we can process the multifaceted data that we must organize if we are to create a coherent picture out of the particulars of the moral and legal landscape of promising and contracting. The existing mental models of contracting and promising are well known: doctrinal rules, moral principles, social practices, efficient incentives, and theories of autonomy, reliance, empowerment, consent, wealth and well-being within cooperative relationships. In this book, I suggest a supplementary mental model that I hope will add strength and nuance to these mental models.

I do not choose among existing mental models, nor do I pit one against another; I seek not to shift paradigms but to illuminate them, perhaps even to find consilience among them. Instead, I hope to add to our understanding of promising and contracting by articulating a mental model that seems to provide a substructure supporting existing views of promising and contracting. This book is animated by the straightforward claim that we can identify a way of non-doctrinal reasoning about obligations that arise from promising and contracting a reasonable person would use to determine her obligations under changing circumstances, given the promises and contracts she has made. This method of reasoning determines how we ought to treat each other in the context of promising and contracting.

This approach does not require that we re-litigate *The Death of Contract.*[1] That magisterial work assumed tort law was swallowing contract law because courts were introducing the notion of freewheeling, judicially created obligations into contract law. That is not my view. Instead, I affirm that obligations in

1. GRANT GILMORE, THE DEATH OF CONTRACT (Ohio State University Press 1974; 2d ed. 1995).

contract are derived from, and reflect, the autonomy that promising, contracting parties exercise, so that when legal sources articulate the obligations that flow from promising and contracting, their analysis is grounded in the choices made by the parties. I seek instead to breathe new ideas into contract doctrine by suggesting that reasoning as a reasonable promising party would about the obligations derived from promising and contracting fills spaces that existing mental models leave unattended. My inquiry is epistemic: by what circumstances and factors do we inform our intuitions about what a reasonable person would do when disputes arise under the terms of a promise or contract?

I seek to present a way of non-doctrinal reasoning about relational disputes that may illuminate the factors and circumstances that determine their resolution, without necessarily changing outcomes or providing determinate answers. Illumination, not normative prescription, is my goal. If I am able to more clearly identify the important moving parts that allow us to connect the authority of a promise or contract with the resolution of a promissory dispute, I will have succeeded. And I do not seek a complete picture of the complex field; the test of any mental model is not whether it is always right or complete, but whether it is useful.

Because this book focuses on a method of reasoning about obligations—what we might call values-balancing reasoning—the mental model it presents offers a lens for evaluating the obligations that arise from promising and contracting when, as is frequently the case, disputes cannot be settled by the terms of the contract. Under this view, when obligations are unclear or disputes arise, contract doctrine must be implemented in disputed circumstances. Obligations must then be determined by a method of reasoning that reflects, but is not determined by, the words of the contract, and of contract law, doctrine and principles.

Values-balancing legal reasoning is embedded in a view about the sources of law judges use to decide disputes. In any dispute, each party has interests that it hopes to attain in the resolution of the dispute. Those interests, as interests, are largely irrelevant to the resolution of a dispute, but interests can also be understood to represent important social values. In any dispute, one party is likely to have a personal, opportunistic interest, but we do not know which party that is until we fully understand the party's obligations. To do that, we need to understand the values each party represents—values such as reliance or freedom not to be bound without consent. Ultimately, the resolution of the dispute implicates the well-being of each of the parties and the values each party represents; one party argues they should have been able to rely on actions of the counterparty and the other argues they should not be bound without their consent. A judge resolves the dispute by determining, in the dispute's context, which party's values count and why. That is a values-balancing choice because is based on the values each party presents to the court as a basis for resolving the dispute. One of the parties is taking an incorrect, value-defective position because the party has failed to consider adequately the well-being of the other party when reasoning about the arguments and positions it will advance. The loss must fall

somewhere and the parties or a judge determines the allocation of the loss by determining how best to balance the values implicated in the dispute, given the terms of the exchange. Once the judge determines how the exchange allocated the losses, the judge has given us a new insight into the nature of promissory obligations. That insight can guide persons in a relationship when they must reason about their obligations. Values-balancing reasoning about promises determines promissory obligations—or so I claim.

II. INTRODUCTION: UNDERSTANDING IMPLIED OBLIGATIONS: REASONING AND METHODOLOGY

A. Reasoning About Obligations

Formidable barriers stand in the way of developing a unifying theory of contracts. When disputes arise, contract terms may not provide an unambiguous basis for determining obligations. Indeterminate terms, unexpressed but implied obligations, and unaddressed *ex post* circumstances all require a basis from which we can use the raw material of the exchange—its text and context—to determine each party's obligations. The variety of subject matter, promissory utterances, and relationships that promising and contracting encompass adds layers of complexity to any effort to find a single method for deciphering obligations. We might wonder whether we should ever hope to develop a unified mental map for evaluating promissory relationships as different, for example, as intimate social relationships and detailed provisions for maximizing cooperation over time. The variety is capacious enough to house many kinds of theories, but the realm is diverse enough to suggest the impossibility of a general, coherent theory of contracting and promissory obligations.

Moreover, although it is widely understood that contracting requires the parties to identify and allocate the risks that threaten the success of their relationship, and that the allocation of risks determines a party's obligations, it is not always clear how the parties have in fact allocated the risks. Risks, and thus obligations, are the subject of the exchange and therefore cannot be assumed to fall one way or the other until we fully understand the exchange's bargaining dynamics. If a party rents an apartment from which to see a coronation parade, one would think that party would bear the risk of the coronation being cancelled. Yet, if the party informs the owner of the reason for the rental, the risk can easily shift to the owner.[2]

Any approach to promising and contracting must also account for both the person who would take advantage of the other party (the Holmesian bad person) and the person who would do the right thing once they knew what was right in

2. *See* PETER M. GERHART, CONTRACT LAW AND SOCIAL MORALITY ch. 12 (Cambridge Univ. Press, forthcoming Mar. 2021).

the circumstances (the Hartian good person).[3] Indeed, depending on the context, the good and the bad person may inhabit the same person. That puts in play the concept of a contract. Are we to think of promising and contracting as a struggle between two parties with proclivities to take advantage of each other, or as mechanisms for achieving cooperative outcomes? And if the answer is that we need to do both, how do we maximize cooperative solutions while inhibiting opportunism or shading? How do we simultaneously encourage and control the power that promises and contracts entail? Should contracting be conceived as an adversarial process by which one party can seek to control the darker angels of the other party, or should contracting be perceived as a process of building trust and shared goals?

Contract law has mechanisms for addressing these questions, of course: gaps fillers, interpretive techniques, and rules concerning consideration, promissory estoppel, excuse, and remedies. And contract theory has plenty of ideas about what contract law does, how it functions, what obligations it entails, and how contract law facilitates cooperation and wealth production. But how are we to choose among those ideas, and on what basis should we make a choice between ideas that seem to offer conflicting visions? Philosophers reason on the basis of moral principles or social practices to determine the obligations that promising and contracting entail. They seek to determine fair or moral obligations from the raw material of promising and contracting. Economists, on the other hand, emphasize that promising and contracting increase wealth. They seek, from the same raw material, to determine efficient incentives. Is the search for justified endpoints predetermined by our choice of starting points?

Before we give in to balkanization (with different theories for various kinds of promises and contracts), or to pluralist surrender, we might turn to a mental model that explores a method of non-doctrinal reasoning about obligations as a possible unifying lens.[4] That is what this book proposes. Starting with the intuition that beneath the diverse views about promising and contracting lies a realm of reasoning that supports, justifies, and explains what we know, this book explores one such realm of reason that seems to be common to, and undergird, a wide variety of views about contracting.

Consider the possibility of focusing on how people ought to reason about their obligations, given the text and context of their relationships. We might find

3. The role of these prototypes persons in contract theory is discussed in *id.* at ch. 8.

4. Two trends threaten the unity of thought about promises and contracts. One is the trend toward bespoke rules for different kinds of contracts, suggesting that we need different rules for contracts between sophisticated businesspeople and, say, between sellers and consumers. The other threat to the unity of promising and contracting is the trend toward pluralistic theories—theories that highlight various values but fail to provide a way of understanding the relationship between them. Roy Kreitner, *On New Pluralism in Contract Theory*, 45 SUFF. U.L. REV. 915 (2011–2012). Brian Bix, CONTRACT LAW: RULES, THEORY, AND CONTEXT (Cambridge 2012). A pluralistic theory is unnecessary and unwise. Pluralistic theories are essentially anti-theories, denying the very idea that we can grapple with contracting's contextuality; they resort instead to a melting pot of values without a method of understanding how those values relate to one another.

a method of reasoning that, because of its properties, displays the hallmarks of moral reasoning about relationships: neutrality, universality, and allegiance to relational expectations. We might also find that the same method of reasoning is used by people who want to minimize costs and maximize the gains from exchange. That is what this book seeks to do. By asking the parties to understand their individual interests in terms of the social values their personal interests would advance, and then asking the parties to reason about how they ought to reason about conflicting values behind the veil of ignorance, we can identify which decisions were made with the proper moral and maximizing reasoning. Under this approach, the parties are obligated to subject their private interests to the interests of the relationship by reasoning about the relative weight of contesting values as if they did not know how the resulting rules would affect their private interests.

Consider the situation of parties facing a dispute. Rather than resorting to doctrine as a dispute settlement mechanism, this book offers a method of reasoning as the way of filling the gap of indeterminacy in doctrine and theory. Reasoning allows the parties to address whether the contractual language is imprecise or incomplete, how the contractual language ought to be interpreted, and what to do when unanticipated events arise. Reasoning helps implement legal doctrine when legal requirements are vague, amorphous, or incomplete.[5] And because not all promises are legally enforceable, reasoning helps appreciate why and when some obligations are relegated to relational settlement.

Consider also the role of reasoning in resolving disputes. The law provides the basis on which disputes are to be resolved; that basis has to be generalizable to assist in resolving similar disputes. The law's quest is to find the basis for determining obligations when the parties, unable to resolve their disputes, resort to third-party dispute resolution. Dispute resolution ought to be faithful to the choices the parties made while providing authoritative guidance for future disputes. Courts face bounded knowledge[6] and conflicting information about the tradeoffs the parties made, and the cost of acquiring and processing relevant information is itself a cost of contracting, a cost that is magnified if contracting parties lack confidence in a court's ability to interpret the conflict to reflect their exchange. Courts are in the position of attempting simultaneously to minimize

5. George M. Cohen, *Interpretation and Implied Terms in Contract Law*, *in* CONTRACT LAW AND ECONOMICS 125, 128 (Gerrit De Geest ed., ENCYCLOPEDIA OF LAW AND ECONOMICS, 2d ed. 2011) ("[i]t seems fair to say, however, that many if not most contracts are incomplete, or at least the question of their completeness is itself a legitimate question for judicial interpretation.").

6. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 44–45 (1985). ("[Bounded rationality] acknowledges limits on cognitive competence" and it is "the cognitive assumption on which transaction cost economics relies."). This assumption assumes that economic actors are "*intendedly* rational, but only *limitedly* so." *Id.* at 45 (quoting SIMON 1961). *See also* Vincent P. Crawford, *Boundedly Rational Versus Optimization-Based Models of Strategic Thinking and Learning in Games*, 51 J. ECON. LIT. 512, 517–18 (2013), Ronald M. Harstad & Reinhard Selten, *Bounded-Rationality Models: Tasks to Become Intellectually Competitive*, 51 J. ECON. LIT. 496, 503 (2013), and Matthew Rabin, *Incorporating Limited Rationality into Economics*, 51 J. ECON. LIT. 528 (2013).

dispute resolution's information and the error costs, which co-vary.[7] But a sound method of reasoning about obligations reduces information costs (by identifying what information is necessary) and error costs, thus reducing the costs of contracting.

Importantly, the authoritative guidance we expect from judicial dispute resolution is most successful if judges make transparent the method of reasoning the promising, contracting parties ought to use when addressing contractual disputes. Such transparency helps to align how judges think about obligations with the method the parties ought to use to think about obligations. If parties to a contract use identical methods of reasoning about obligations, they can settle disputes on their own. If the parties cannot settle the dispute, one of them is reasoning in the wrong way, and the court is forced to correct that method of reasoning.[8]This book explores a supplementary method of legal reasoning in three parts. Part I justifies the search for reasoning that undergirds authority and theory. Chapter One sets out three characteristics of promising and contracting that characterize promissory obligations: relationality, self-directedness, and contextuality. Relationality emphasizes the interdependence of promissory obligations: a promisor makes a promise to someone to do something, and the recipient of the promise must decide what to do in response to the promise. Promises of the kind contract law addresses are other-directed. Yet promises are also self-directed; they seek to advance the private projects of the promisor. This duality identifies the tension of promising: promises are self-directed but create a form of interdependence that requires other-directed behavior. Promises are also highly contextual: a promise to have lunch with a friend is different from a promise to have lunch with a potential business partner. Reasoning about obligations must be able to take context into account, which begs the question of which contextual details matter and why they matter.

The remainder of Part I examines various approaches to promising and contracting and finds their implementation to require a supplemental theory of reasoning. Chapter Two presents a legal realist critique of reasoning from authority; it argues that reasoning from authority (legal reasoning) does not fully

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7. Minimizing error costs requires information. Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 577 (2003) (emphasizing that because contracts are incomplete, "firms will attempt to write contracts with sufficient clarity to permit courts to find correct answers, though with error."; *see also*, Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583 (2005). (discussing the relationship between negotiating, drafting, interpretive, and enforcement costs).

8. Implicitly, this approach views the common law process to be a dispute settlement process rather than a rule-making process. To be sure, the resolution of individual disputes can provide the grounds for determining rules to govern behavior, but those rules are rarely stated with sufficient justificatory specificity to govern the contextual details of the next dispute. For that reason, the settlement of relational disputes does not turn on a rule but instead on a way of reasoning about the factors and circumstances that allow the parties and legal decisionmakers to determine how parties in a relationship ought to treat each other. That is what courts do when they resolve a dispute, whether they do so by referring to the terms of a promise, to the implementation of legal rules, or to the factors and circumstances that were used to determine the outcome of prior disputes. Courts implement rules by reasoning, and that method of reasoning is the method of reasoning they want the parties to follow.

reveal the reasoning process necessary to apply the authority to individual contexts. The chapter does not deny the authority of authority; it locates that authority in non-doctrinal reasoning rather than in command. In addition to pointing out the difficulty of implementing legal doctrine and concepts without a supplemental method of reasoning, the chapter makes an important point about contract theory. Because promising and contracting have the quality of relationality, no single value can capture the essence of promising and contracting. Promising and contracting involve the autonomy, reliance, empowerment, consent, wealth and well-being of at least two people, and those valuable attributes clash. What we value for one party is at odds with what we value for the other party; even if we care about the autonomy of both parties, their autonomy pulls in opposite directions. There must be some basis for deciding whose autonomy, reliance, empowerment, consent, wealth, and well-being matter.

The final two chapters of Part I examine philosophical and economic theories. Although these theories are not monolithic, they seem to suffer from indeterminacy and therefore from insufficient justificatory and implementary reasoning. Moral principle theories are able to claim a moral justification. However, to be implemented, they call for a moral implementary reasoning. Moral practice theories—because of their contextuality—can be implemented through the context that reveals the social practices, but they call for a form of moral reasoning that justifies the morality of practices. Both moral principle and practice approaches can profitably be supplemented with a method of reasoning that contextually examines the source and scope of obligations.

Economic theories are theories of maximization: they capture the relationality and contextuality of promising and contracting. Yet even if we view economic theories through a broader maxim and (say well-being rather than wealth), maximization theories seem to be indeterminate without a supplementary mode of reasoning. For several reasons, contracts often do not make the obligations of the parties clear. Transaction costs increase the costs of detailed provisions, the bargaining parties may choose from among a range of unarticulated trade-offs and contractual gaps (including gaps from ambiguous language) are common. Only an interpretation that reflects the exchange the parties made will support the institution of contracting and enhance socially valuable transacting.[9] Yet when disputes arise, it is because the terms of the contract have run out. Then, obligations must be determined by identifying how the parties implicitly assigned various risks, their shared but unarticulated assumptions, and the obligations that flow naturally from the choices the parties made. Such issues also call for a method of reasoning about the source and scope of obligations.

Having sought to establish that legal authority and theory would profit from a

9. Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 569 (2003).

supplemental method of reasoning, Part II of the book presents the outline of an appropriate method of relational reasoning. The central characteristic of this method of reasoning is that it is non-doctrinal; it does not start with authority, doctrine, or theory. Instead, it displays a method of reasoning about the contest of values implicated in a dispute, suggests a method by which those values might be balanced, and ends up with a decision that respects both sets of values but reconciles them in a fair and efficient way. I call it values-balancing reasoning.

Values-balancing reasoning posits that a contractual dispute represents a contest between conflicting values—say reliance and freedom to change one's mind. It identifies those values and provides a method for determining how to reconcile value conflicts in particular contexts. Because this mental model focuses on how conflicting values ought to be reconciled, the mental model focuses on a process (a methodology) of reasoning rather than on the rules generated by the process of reasoning.[10] Because the mental model takes into account the values presented by two autonomous persons, it serves to supplement and implement approaches based on a single value—such as fairness or efficiency.[11] And because the mental model is trans-contextual, I offer it as a possible unifying methodology for understanding contract law.[12]

This mental model claims to be moral reasoning because it embodies reasoning built on values that are universal, neutral, and attentive to relational expectations. The model is maximizing because it recognizes that values must be traded off against each other and that what matters are the consequences of that trade-off for the well-being of two persons. The theory of reasoning purports to identify obligations that are both fair and efficient precisely because they come from a method of reasoning that is both deontic and consequential.

Two key ideas animate this method of reasoning. The first is that it is rational

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10. The ideas presented here have many ancestors. I build on the path suggested by James Gordley, namely that contract law involves the Aristotelian concern with "what people should choose to do" once they are in a relationship. James Gordley, *An Aristotelian Theory of Contracts*, *in* THE THEORY OF CONTRACT LAW; NEW ESSAYS 265, 268 (Peter Benson ed., 2001). Under this conception, contract law "is concerned with how, through voluntary agreements, people are able to get things that help them lead a better life while being fair to others. Consequently, it is concerned with the value of what is chosen, with the value of choosing rightly." *Id.* Similarly, I seek to amplify the ideas of Daniel Markovitz, *Contracts and Collaboration*, 113 YALE L. REV, 1417, 1504 (2004), that the obligation of contract (under good faith) is neither the duty to act in your contract partner's best interests, nor is it license to act in whatever way would best serve your own. It is, instead, a commitment to the relationship "structured around a shared understanding of a voluntary obligation." Under the view presented here, the obligations of contracting are reciprocal obligations of each party to employ a method of reasoning tethered to the terms and context of the bargain, but that is implemented contextually.

11. Moreover, by supplementing theories of fairness and efficiency, I add to efforts to find common ground between these two kinds of theories. Jody Kraus, *Reconciling Autonomy and Efficiency in Contract Law: The Vertical Integration Strategy*, 11 PHIL. ISSUES 420, 421 (2000). Jody Kraus, *Legal Theory and Contract Law: Groundwork for the Reconciliation of Autonomy and Efficiency in Contract Theory*, 1 J. Soc. Pol. & Legal Theory 385 (2002).

12. This discussion was also foreshadowed in Michael Bratman, *Shared Agency: A Planning Theory of Acting Together*, 172 PHIL. STUDIES 3375 (2015) (developing a theory of shared reasoning to accomplish cooperative activities) and by SCOTT J. SHAPIRO, LEGALITY 274, 276, 278 (Harv. U. Press 2011) (developing a theory of law as planning that allows us to see the law of a contract as a process of reasoned planning).

to take into account the well-being of others when making decisions, and thus to make other-regarding decisions. Economic rationality is not limited to self-interest; it is often efficient to rely on others and to internalize their well-being into one's decisions. Humans do not choose between self-interested or altruistic motivations; their self-interest also leads humans to be other-regarding. Indeed, contracting would be difficult if bargaining partners were oblivious to the interests of the counterparty. "Getting to yes" (as it were) is not just an exercise of self-interest; it is an exercise of choices that are other-directed to advance self-directed interests.

The second central idea of Part II is that obligations do not arise by operation of law out of thin air. Obligations flow from—and are reflected in—the choices people make. The obligations that flow from personal choices are then recognized by law. A person is under one set of obligations if a person decides to make fireworks; the person is under a different set of obligations if a person decides to join a monastery. Obligations are self-imposed in the sense they follow the choices people make. The idea of self-imposed obligations and other-regarding choices are related. The choices one makes often imply the obligation to be other-regarding. The choices are not just self-directed but—because they affect others—are other-directed. Other-directedness is the source of obligations to others. Part II ends by showing how values-balancing reasoning illuminates and explains the relationship between law on the ground and law on the books, the nature of cooperation, the development of trust in relationships, and the dynamic of order without law.

Part III of the book then applies the idea of values-balancing reasoning to enduring doctrinal controversies: formation, performance, the problem of standard terms, doctrines that excuse performance, and remedies. Because values-balancing reasoning is non-doctrinal reasoning, it yields interesting insights about the source and implementation of contract doctrine.

The application chapters in Part III amplify and illustrate the claims made in Part I that reasoning from authority is, without more, an inadequate basis for reasoning about promissory and contractual relationships. But the chapters do something more: the chapters suggest that reasoning about obligations precedes doctrine and, in fact, doctrine is the concluding point rather than the starting point for appropriate reasoning. This allows values-balancing reasoning to focus directly on the issue for which doctrine is giving an answer and, in a sense, to replace doctrine. Under this view, the idea of consideration becomes the answer to this question: at what point can a promisor no longer revoke or modify a promise? Implied obligations (including good faith) become the answer to this question: when a promisor makes a choice, what kind of obligations are naturally implied by that choice? The doctrine surrounding standard term contracts becomes the answer to the question: would the counterparty reasonably have expected to encounter these terms? The doctrine of excuse becomes the answer to the question: given the circumstances of the exchange, which party bore the risk of unaddressed future events? And questions surrounding contractual remedies

are driven by this question: given the context of the exchange, what was the aggrieved parties expected contractual surplus and how does the law protect that surplus? The application chapters also reinforce the contextuality of promising and contracting. In the approach offered here, we do not seek a hypothetical set of obligations, nor determine what obligations most people—or most reasonable people—would have accepted. The answers to those counterfactual questions may well differ from the obligations the parties agreed to. We will search, instead, for the obligations a person reasoning in a values-balancing, other-regarding way would have understood about how the parties divided the risks, the proper interpretation of a disputed term, whether a party is shading on its obligations, and other attributes of the contract.[13]

Several general features of values-balancing reasoning are relevant to thoughts about contract law. Under this approach, obligations are not external to the relationship. They do not represent attempts to address distributional values or social ills. Obligations are self-imposed and self-controlled, subject only to the constraint imposed from the choice to invoke the practice of promising that the parties reason in an appropriate way about their obligations. This may mean, of course, the parties must take into account the circumstances of the counterparty, but only when other-regarding reasoning suggests those circumstances are relevant. This book provides no refuge for scholars who would use the law to impose external standards of socially appropriate behavior on contracting parties.

This approach also accounts for both the Hartian good person and the Holmesian bad person. For the party who would fulfill the party's commitments, but is unsure about what those commitments entail, the basic obligation to reason in the appropriate, values-balancing way about obligations would reveal those commitments. For the party who would achieve unbargained-for gains, a court can identify shading and opportunistic behavior by identifying behavior that does not reflect the appropriate, values-balancing reasoning.

The values-balancing approach also addresses the persistent concern that generalist courts will not successfully discern and interpret obligations. Values-balancing reasoning does not require a special knowledge of the economics of exchange or the art of the deal. Courts need not steep themselves in the theory of moral hazard or adverse selection to determine which party is reasoning in a value-balancing way when disputes arise; those economic concepts are, after all, intuitive. Courts need only to understand the reasoning the parties should have used, given the terms of the contract.

Finally, the approach does not subsume contract law within tort law. It conciliates the two doctrinal categories by identifying their reasoning

13. As an illustration, if I agree to have lunch with a friend next week, the agreement is not likely to specify the obligations or excuses that accompany the agreement. Yet, the obligations can be inferred from the nature of the relationship and how another regarding person would think about the obligations of the agreement given the relationship. Under most circumstances, a right-thinking person would understand that if something important comes up the obligation to have lunch is probably excused, but that the agreement comes with an implicit obligation to call the friend so that she can make other plans.

substructure. This book endorses "the promise principle, which is the principle by which persons may impose obligations [on themselves] where none existed before."[14] And it endorses the principle that in a promissory or contractual relationship, the parties get to design the obligations they are willing to assent to; as is often said, the parties legislate their own obligations. However, in the view presented here, neither the promise principle nor the self-legislation metaphor determine the existence or scope of the obligations that flow from a promise or contract once disputes arise. The scope of any obligation necessarily invokes the proposition that under certain circumstances one ought to consider the well-being of others in a values-balancing way, which I believe to be the unifying principle of private law.[15] Each person in an exchange, in pursuit of its private projects, absorbs burdens that benefit a counterparty. Reasonable people use values-balancing reasoning, and it is that method of reasoning that I believe breathes life into our understanding of how a reasonable person makes reasonable, contextual decisions.[16]

If anything, the ideas here seek to strengthen contract law by providing a new lens for viewing the origins and meaning of the law. By saying, as I do, that parties must act reasonably toward each other, given the terms and context of their exchange, I seek to identify a perspective on how people ought to treat each other that is inherent in human interaction, no matter what legal category we put the interaction in. And my perspective on the process of reasoning that a reasonable person will use to determine her obligations provides, I believe, a potent analytical framework for legal decisionmakers to explore the contours of legal obligations.

B. Methodological Commitments

Because the ideas developed in this book reflect methodological commitments that may not be widely shared, the reader may find a summary of those commitments helpful.

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14. CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 1 (Harv. U. Press 1981).

15. This is the third (and final) book in my trilogy about the other-regarding person and social morality (what we owe each other). The other two cover torts and property: PETER M. GERHART, TORT LAW AND SOCIAL MORALITY (Cambridge U. Press 2010); PETER M. GERHART, PROPERTY LAW AND SOCIAL MORALITY 109–22 (2014).

16. Torts, contracts, and property are differentiated by the source of the obligations to others, not by the scope of the obligations or the method of reasoning that determines the scope. In tort law, the obligation to others comes from creating a risk or standing in relation to someone that makes an actor responsible for the risks the other faces. In property, the source of obligations is the concept of ownership (which creates obligations for both owner and non-owner). In contract law, the source of the obligation is a promise. Yet in all three areas of private law, the existence and scope of any obligation is determined, I maintain, by the obligation to reason in the kind of values-balancing way that I present in this book. This requires each person in a relationship to account in a values-balancing way for the well-being of the person who would otherwise bear an avoidable loss. This principle applies to issues of formation (the existence of a duty), performance (the scope of a duty), and remedy (the losses that could have been, and should have been, avoided).

There is, I posit, a substructure to the law—a substructure of reason. In the domain of promising and contracting, that substructure lies in the method by which persons who need to make decisions about their obligation ought to reason about what people owe each other. The method of reasoning I have in mind is not the method usually associated with legal reasoning. It is a method of reasoning about the factors and values that give rise to obligations, determinants of outcomes that are non-legal in the sense their content does not depend on legal authority (even though the method of reasoning is reflected in legal authority).

Consider the distinction between the law's structure and its substructure. The law's structure lies in legal authority, including doctrine, rules, standards, presumptions, and in contract law a contract's text and context. Conventional legal reasoning focuses on reasoning from that authority. On the other hand, the substructure consists of the method of reasoning that led to the authorities and to structural relationships, a method the structure may not reveal. Contracts develop out of a method of the joint reasoning of two parties; that reasoning led to the way the parties structured their relationship. If we understand the shared reasoning from which the contract arose—i.e., the contractual substructure—we can more accurately determine the obligations embedded in the contract. Similarly, legal authority comes from some method of reasoning that reflects the reasoning that has guided the evolution of the laws structure.[17] If we can understand the method of reasoning that formed legal authority—i.e., the law's substructure—we can more accurately understand how the doctrinal structure ought to be implemented. The authority of contracts and of law is determined by non-legal factors, and those determinants underlie and help implement the authority.

Under this view, authority's commands lie not directly in the words of the authority but in the method of reasoning that led to the author's use of the command's words. "Because I said so" is not a sufficient basis for following authority. To implement authority when new disputes arise, we need to extract and replicate the method of reasoning that led to the authority, and then apply the method and content of that reasoning to the dispute that must be decided. This approach turns conventional legal reasoning on its head; rather than start with authority, we start with the factors and values that led to the authority, making the implementation of authority the output of the reasoning (and a new basis for reasoning about how to implement authority).

Implementing this methodology requires a method of identifying the factors and values that determined authority. In this connection, we do well to put aside what judges say and to concentrate on what judges do. Justice Stevens famously

17. In a state of nature, before law existed, the first legal decision, the one that purported to create authority, must have been grounded in a method of reasoning that did not itself depend on authority. That method of reasoning, if it was worthy of being called legal authority, must have been about the factors and values that the decisionmaker found to be attractive. A role of the dice would not serve as legal authority. The factors and values that led to that first authoritative decision would then support its implementation in subsequent cases.

said that "this Court reviews judgments not opinions."[18] By that, Justice Stevens signaled that the law is found in a dispute's outcome (i.e., in courts judgment in favor of one party or the other), and not in judicial opinions that seek to justify the judgment (outcome) in terms of doctrine. A dispute's outcome is binding on the parties and on any person similarly situated, but whether the outcome has a binding effect on other persons depends on reasoning about which persons are in the category of "similarly situated" persons.[19] The judge's opinion can be influential in that subsequent determination, but to have a binding effect on others the law depends on a subsequent finding of similarity, and that depends on how one reasons about similarity not on prior judicial statements. The binding effect of any outcome on other parties depends on how the two compare, and that comparison depends on what determined the prior decision not on what the judge says determined the prior decision.[20]

Judicial opinions suffer from the problem of inductive reasoning—the imperfections that arise when a judge tries to identify a general rule from the resolution of a particular dispute. They also suffer from the problem of deductive reasoning—the difficulty of reasoning from a general rule to a particular conclusion without knowing the determinants of the general rule. Those imperfections give rise to the problems of reasoning from authority I outline in Chapter Two—the problem of finding a way of reasoning about the particular in the context of a general rule.[21] Take, as an example, the legal doctrine of consideration. It is one thing for a judge to find a promise unenforceable for lack of consideration (the outcome of a dispute about a promise's enforceability) and quite another to explain **why** the promise was unenforceable for lack of consideration. Too often judicial justifications amount to a declaration (rather than a justification) and often a tautological declaration. A judge will say a promise was unenforceable for lack of consideration because there was no

18. Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842 (1984).

19. Jody Kraus uses this distinction to understand debates in contract law. Jody S. Kraus, *From Langdell to Law and Economics, Two Conceptions of Stare Decisis in Contract*, 94 VA. REV. 157 (2008). Jody S. Kraus, *Transparency and Determinacy in Common Law Adjudication: A Philosophical Defense of Explanatory Economic Analysis*, 93 VA. L. REV. 287 (2007), explores the jurisprudential implications of the distinction between outcomes and judicial explanations. *See also*, Adam N. Steinman, *To Say What the Law Is: Rules, Results, and the Dangers of Inferential Stare Decisis*, 99 VA. L REV. 1 (2013).

20. This approach does not deny the power of stare decisis. It simply locates the power of stare decisis in the outcome of cases, not in the rationale that judges provide for the outcome. The power of precedent comes in determining whether a subsequent case is like a prior case so that the outcome of the prior case serves as precedent. The determination of the "likeness" of cases depends not on doctrine but on the facts and circumstances (the non-doctrinal determinants) that are relevant to the outcome.

21. Theory and doctrine often try to understand legal obligations in terms of generality, rather than in terms of contextuality. It is sometimes thought that the rule of law requires generality, lest each case be decided on the basis of something that is unique to that case only, such as appearance, pedigree, or class. But the generality of any statement about legal doctrine and concepts generates the problem that I seek to address in this book—the gap between the law's expression of its requirements and the implementation of the law's requirements in the many contexts in which it is implemented. The challenge the positivist concept of law presents is how to understand a particular, contextual dispute as part of a more general set of principles that restrict the resolution of disputes to factors that ought to matter.

consideration without explaining the method of reasoning that led to that conclusion. By contrast, if we could answer the question of **why** the judge determined there was no consideration—without clothing the outcome in doctrinal garb—we would better understand how the decision's authority should be implemented in other contexts. Judges seem to have a well-honed intuition about how to reason toward justified outcomes but seem to be less skillful in justifying their results in non-doctrinal terms.

Focusing on outcomes (and not on doctrinal explanations for outcomes) addresses the problems of inductive and deductive reasoning that undermine reasoning from authority. If outcomes are the appropriate unit of analysis to determine what the law requires or enables, an appropriate methodology for legal reasoning is to examine a series of cases that seem to address similar kinds of problems and sort them by their outcomes; some on one side of an issue (say, finding consideration) and some on the other (say, finding no consideration). Then, focusing on the facts and circumstances that seem to differentiate one case from another, a process of reverse engineering allows us to identify the factors that appear to explain the divergent outcomes.[22] This provides only a conjecture, of course, for the outcome of the next dispute may give us a different view of the determinants that matter. But the process of developing conjectures and testing them against seemingly different disputes (hypothetical or real) increases confidence we can identify the non-doctrinal determinants that seem to influence judicial outcomes.

Facts alone, however, are not enough to explain similar-looking cases that have different outcomes. Something more is at work to guide a judge's intuition. Values matter, and, in particular, it matters how judges balance values against each other. Disputes arise because people have interests that clash. But, as I explain in Chapter Five, that clash can be understood as a clash of values rather than a clash of interests. Arguments about competing interests invoke competing principles, each of which represents a value important to society. That is why a methodology of outcomes leads to a methodology of value-balancing. The methodology of value-balancing asks how a person or legal decisionmaker who takes the values of promising and contracting seriously will reason about the implications of those values for the resolution of a dispute.

I call this method of reasoning values-balancing legal reasoning. It is *legal* reasoning because it portrays the reasoning that seems to inform a judge's

22. The approach here is aligned most closely with Ronald Dworkin's interpretive theory of "constructive elaboration." RONALD DWORKIN, LAW'S EMPIRE 49–56 (Harv U. Press 1986). Like other theories of reasoning, the idea of values-balancing reasoning seeks to achieve the goal of treating like cases alike, achieving justifiable outcomes, and ensuring the coherent pursuit of worthy objectives. *See, e.g.*, Barbara Fried, *The Limits of a Non-consequentialist Approach to Torts*, 18 LEGAL THEORY 231 (2012) (arguing that a theory of law must have substantive content that only a consequentialist theory can supply); Jody S. Kraus, *Legal Theory and Contract Law: Groundwork for the Reconciliation of Autonomy and Efficiency*, in LEGAL AND POLITICAL PHILOSOPHY: SOCIAL, LEGAL & POLITICAL PHILOSOPHY 385, 388 (Enrique Villanueva, ed., Rodopi 2002) (recommending a "vertical" understanding of the relationship between the deontic and the consequential).

intuition when judges decide private disputes, given the institutional constraints of private law dispute resolution. It is *values-balancing* because it takes seriously the moral values that underlie any private dispute, deploying a method of reasoning that allows decisionmakers to compare moral claims raised by disputing parties. It is values-balancing because it employs a method of reasoning that gives moral weight to disparate values raised in a dispute in a way that minimizes the moral sacrifice required by an exercise of comparative moral values.

Theories of cooperation reflect the values-balancing methodology. When parties exchange enforceable promises, they reach an equilibrium—a balance of burdens and benefits that each party finds to be in its private interest. But this equilibrium comes under pressure as new circumstances challenge the expectations that formed that equilibrium. Sometimes, the equilibrium is so changed that one or both parties desire to withdraw from the exchange. In other instances, the parties can adjust their expectation to new realities. Either way, it is reasoning about how the coordination of private interests can create value and stabilize through changing circumstances.

Fortunately, humans seem to have a built-in methodology for identifying a new equilibrium that reflects their need to adjust their original relationship to new circumstances. If we did not have that methodology, voluntary cooperation would be limited. In fact, most disputes arising in the course of performing a contract or executing a promise are settled as part of identifying what the relationship entails. Some disputes are settled because private parties have built into their relationship the norms of cooperation that will guide the location of equilibrium of the relationship as circumstances change. Some are settled because the parties have set up private governance mechanisms for settling disputes and adjusting obligations to new realities. But many are settled because people invest in the relationship and understand the adjustments that must be made for the sake of the relationship.

As a result, parties to a commercial relationship often act as if the authority of contract terms and contract law are irrelevant to the relationship.[23] When faced with unexpected circumstances, parties in a relationship are able to recognize adjustments they must make in their own expectations to minimize the counterparty's burdens. Cooperation is possible because people reason with a fairness norm that allows them to restore a relationship to equilibrium when circumstances change, and they must understand their obligations in light of the promises they have made. The fairness criterion is contextual because it takes into account the circumstances the parties face. The fairness criterion is also universal because it follows a version of the Golden Rule that is itself universally followed across religions and cultures: do unto others as you would have them do unto you if you had their private goals and preferences. This is what I call other-

23. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 55–67 (1963).

regarding reasoning—the recognition that our own well-being depends on the well-being of others. The other-regarding fairness criterion allows people to understand the consequences of their behavior and to reason about their behavior in a way that reflects the *ex ante* bargain of the parties. People are willing to accept the burdens of additional costs so the partner in the relationship can avoid unnecessary cost, and so the relationship continues to produce the joint benefits that were originally anticipated. Values-balancing reasoning implements that fairness criterion.

Because cooperation depends on how people reason about their relationship, our analytical focus shifts from how people behave to how people reason about their behavior. This seems to be at odds with the idea that the law functions to control behavior, providing authority for what people should do or refrain from doing. But reasoning and behavior are connected in an important way.

Whether a particular behavior meets legal norms is contextual, and therefore not authoritatively determined by a rule of behavior. Killing another is improper behavior unless done in self-defense (or when done in service of the state). As Justice Cardozo reminded us, driving at ninety miles an hour means one thing if done on the street and another if done on the racetrack.[24] As a result, the law must evaluate behavior by asking whether a person thinking reasonably about her behavior in a particular context would behave the way she did. A contract calls not just for certain behavior, but also for a certain way of reasoning about one's behavior given the contract's terms and context.

Importantly, I am not arguing that a promisor must actually use the appropriate reasoning for the court to find her behavior to be appropriate. Instead, I am arguing that she must act as if she had used the appropriate reasoning. The determination of appropriate behavior depends on evaluating how a person who reasoned appropriately would have behaved, even if the person decided how to behave by flipping the dice. That is why motivations are irrelevant to the law when the behavior is of the kind required under the law. My point, however, is this: the law expects people who make promises and contracts to behave as if they had thought in a moral way about their obligations, and the law determines what behavior is required under a promise or contract by examining how a person in that situation would have behaved if the person had used moral reasoning. That is the role of the reasonable person—to provide a basis for evaluating the reasoning that determines which behaviors people should follow.

The values-balancing other-regarding methodology has implications for how we understand the concept of law.

By focusing on the law's reasoning substructure, the methodology allows us to break down doctrinal boundaries that form the law's structure. Doctrinal boundaries are historically determined and haphazard. Judges decide disputes; theorists put them into categories. If judges or theorists do not correctly define

24. Palsgraf v. Long Island Ry. Co., 162 N.E. 99, 100 (N.Y. 1928).

the determinants of a category, they may define meaningless categorical boundaries. Some theorists then seek to seal off one category from another, even if the categorical boundaries turn out to be artificial in light of the factors and values that actually determine how judges settle disputes. We are told a contract is defined by the fact that parties had an opportunity to bargain over their commitments, but this seems to artificially separate contracts from unbargained-for obligations, like simultaneous exchanges, or the terms and conditions of software use. Yet if we denominate the field as covering all exchanges, then it is difficult to exclude from the field obligations imposed in tort under product liability, which are obligations derived from exchange relationships. Perhaps what binds contract law with other private law doctrines is neither bargaining nor exchange, but the concept of reasoning in a values-balancing way about obligations to others.

Additionally, values-balancing reasoning suggests the potential to successfully integrate deontic and consequential reasoning. The decades-long debate about the relative merits of these two categories of theory—those that rest on moral conceptions and those that rest on the consequences of action—is largely resolved by values-balancing reasoning. It is possible for moral theory to take consequences seriously without resorting to the simple additive devices of consequential theories. Reasoning morally about consequences is not an oxymoron because the method of moral reasoning that satisfies the requirements of moral thought (the deontic) is separate from its contextual implementation (which takes consequences into account in a moral way). A theory of values-balancing legal reasoning recognizes and embraces values on which morality and law are founded. Yet it is contextual because it shows, without loss of moral weight, how those values are balanced against each other in particular contexts. It is also universal in the sense it provides a universal method of reasoning about one's obligations, based on immutable values that respond to local contextual details, including local communicative practices and social norms.

The idea of values-balancing reasoning presents a view of moral behavior based on reasoning. Unlike other views about the morality of promising, the views expressed in this book do not assume that the moral obligations are self-evident or absolute.[25] Instead, it assumes moral behavior reflects the moral reasoning that determines what behavior is appropriate in the circumstance. It affirms the moral command that promises should be kept but seeks to identify the obligations of promising to implement that moral command. It thus affirms the Holmesian view that "law is the witness and external deposit of our moral life."[26] This approach substantially decreases the divergence between moral and legal obligations; it does not eliminate that divergence. It does, however, explain why and when moral obligations are not turned into legal obligations.

25. Seanna Shiffrin, *The Diverge of Contract and Promise*, 120 HARV. L. REV. 708, 727 (2007) (assuming that a promise requires performance and that breaking a promise requires repair).

26. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897).

The theory here locates the authority of authority not in what authority commands but in the reasoning that authority authorizes. The reasoning that led to the authority provides a good reason to obey authority; the fact that authority commands is not. When the command of authority is worth following it is because the authority reflects the way people ought to reason about their obligations to others. This approach thus denies that legal normativity has some special qualities that are different from the normativity of good moral reasoning about obligations to others.[27] The idea that law commands or enables certain behavior is affirmed only insofar as the law commands or enables a method of reasoning about what one should do. Among other things, this means that the way people successfully think about their obligations derived from promising and contracting is not distinct from, but is reflective of, the method of reasoning that legal requirements impose on a relationship. Law on the ground is less distant from law on the books than is normally assumed.

The approach here also explains why pluralistic and compartmentalized theories are unsatisfactory; they seem to deny the unity of relational obligations because they focus on obligatory behavior, rather than obligatory reasoning about behavior. Because the morality of behavior is context-specific, obligatory behavior may well change with the context, even if the appropriate method of reasoning does not. Indeed, the value of pluralistic or compartmentalized theories shrink further in light of the advantages of a methodological theory of appropriate reasoning. Because appropriate reasoning takes context seriously but is itself a consistent methodology, a theory of moral reasoning provides the unified and unifying theory of promising and contracting no other theory is able to provide.

A methodological theory is a theory of how a right-thinking person would reason about her behavior in light of her promises or promissory conduct. Such a theory allows a theorist to draw on the values that animate the evaluation of behavior, but it orders those values in a way that reasoning people would order those values, and it orders the values in a way that connects them to the contextual detail that calls on decision or another. The theory does not replace existing theories of promising; it extends and completes them.

27. Scott Hershkovitz, *The End of Jurisprudence*, 124 Yale L.J. 1160, 1181, 1192, 1196–97 (2015).

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