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Contracts with Consent: A Contextual Critique
of the No-Retraction Liability Regime

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CONTRACTS WITH CONSENT: A CONTEXTUAL CRITIQUE OF THE NO-RETRACTION LIABILITY REGIME

Ronald J. Mann[†]

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My friend and former colleague Omri Ben-Shahar has established a reputation for providing nuanced and well-grounded applications of economic analysis to important problems of contract law. In recent years, he has undertaken the ambitious task of exploring a significant topic at the boundary of contract law: liability for problems that arise out of efforts to form a contract. The paper to which I reply, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*,¹ is his second paper on that topic, following his 2001 paper with Lucian Bebchuk on *Precontractual Reliance*.² Collectively, these papers provide a comprehensive analysis of the relation between opportunistic behavior and contract law.

My goal in this reply is not to challenge that analysis directly, but rather to test its boundaries. As a thematic matter, I discuss the practical domain in which the proposed new basis for contractual liability is useful, and examine the plausibility of the doctrinal solutions that Ben-Shahar proposes. I first discuss the propriety of using a single regime to resolve preconsensual and postconsensual problems. I then consider whether the characterization of his proposal as a default rule responds to the concerns that I raise in the first part of my discussion.

I. Two Regimes

The most elegant aspect of Ben-Shahar's paper is its use of a single model to resolve problems arising along a continuum, starting at the point where parties begin to consider a transaction and running through to the period after they have come to a formal agreement. Although that unified model is provocative, I do not think Ben-Shahar has made a case for it. On the contrary, however passé it might seem to provide a defense of a long-standing doctrinal framework, I argue that the existing framework reflects real and important functional distinctions, which Ben-Shahar's proposed framework cannot readily accommodate.

The proposed regime rests on a considered rejection of the significance of any specific moment at which negotiating parties intentionally and consciously agree to be bound by a contract. Thus, in this regime, the date of the closing ritual is of no special importance. Specifically, this regime would discard aspects of the existing framework that provide a discontinuous shift from one liability regime before that moment of closing (principally tort-based liability for bad-faith negotiation)³ to a different one after that moment (expectation

¹ Omri Ben-Shahar, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*, 152 *U. Pa. L. Rev.* __ (2004).

² Lucian Arye Bebchuk & Omri Ben-Shahar, *Precontractual Reliance*, 30 *J. Legal Stud.* 423 (2001).

³ See Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 *Cal. L. Rev.* 1743, 1811-13 (2000)(discussing cases in which a party's conduct resulted in a court imposing a duty to negotiate in good faith, even when no such commitment arose through agreement); E. Allen Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 *Colum. L. Rev.* 217, 269-85 (1987)(listing several courses of conduct that courts have held to be "unfair dealing" in precontractual negotiations, such as improper tactics and non-disclosure).

damages for breach of contract).⁴ In their place, a no-retraction regime would substitute a gradual and continuous increase of liability throughout the preconsensual period, culminating in full expectation damages at the point of the contract.

Before beginning an affirmative critique, it seems important to note a threshold ambiguity in the difference between the proposed regime and existing law. Existing law already permits the recovery of reliance damages in circumstances that do not involve a bargain, specifically, where the party that seeks to recover reliance damages can show that it was reasonable to expend money based on the actions of the other party.⁵ Thus, if a financing partner tells a developer that it should proceed to break ground on a building on the assumption that the parties will be able to work out the details of a financing arrangement, the developer has a good case for reliance damages against the financier, even in the absence of a contract that would permit expectation damages.⁶

Although the no-retraction regime plainly is different, the extent of the difference is not entirely clear. If Ben-Shahar contends that parties should be liable for expenditures made by potential contract partners only after they make serious proposals, he is saying something not substantially different from current law. Current law would permit such damages if, considering the circumstances, the expending party reasonably could treat the proposal as a license to spend money. That usually happens where one party (based on conduct of the other) justifiably relies on the fact that a contract is forthcoming. Ben-Shahar's proposal may simply provide a remedy at an earlier stage (before the parties reach a point where it is fair to assume that a contract is forthcoming) and may extend that remedy to all expenditures, regardless of the reasonableness of the expending party's position.

A central ambiguity in that proposal is how to determine which communications create liability. Ben-Shahar's model takes as a given that "serious" communications will induce an appropriate measure of reliance and that all other communications will be ignored. That simply assumes away the problem – which occupies much of existing doctrine – of determining what types of promises are sufficiently serious to warrant reliance on the part of the recipient.⁷

However, that narrower understanding of Ben-Shahar's proposal is inconsistent with his emphasis on a slow and gradual development of liability based on the gradual juxtaposition of

⁴ See **Restatement (Second) of Contracts** § 347 (1981)(outlining the default measure of damages under the current common law).

⁵ See **Restatement (Second) of Contracts** § 90 (1981).

⁶ See Charles J. Goetz & Robert E. Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 **Yale L.J.** 1261, 1305-09 (1980)(discussing several cases where courts used promissory estoppel to enforce "relied-upon nonreciprocal promises"); Waltons Stores (Interstate) Ltd. v. Maher [1988], 164 CLR 387, available at <http://www.austlii.edu.au/cgi-bin/disp.pl/au/cases/cth/high%5fct/164clr387.html?query=%7e+waltons+and+maher> (last visited Feb. 27, 2004).

⁷ This problem is the general topic of Richard Craswell [48 *StanLRev* piece currently first cited in note 48].

negotiating positions.⁸ Reliance damages, as typically contemplated, have the same type of all-or-nothing switch that expectation damages under consent-based liability rules do. Thus, a party can recover nothing expended before it is reasonable for that party to rely; however, it can recover everything that is reasonably expended after it is reasonable to rely.⁹ Ben-Shahar's proposal, in contrast, seems to contemplate a sort of quasi-expectation liability, in which each party always is liable for the expectation of the other party for those points on which the first party has offered a position. As the comprehensiveness of the position increases, the potential liability increases. As the juxtaposition increases, the real-world likelihood that the proposal would be enforced increases.

That precisely reticulated increase in liability is substantially different from current law. I do not think, however, that it works out in practice quite as simply as Ben-Shahar's presentation suggests. It is not clear, for example, how he would match a slow increase of agreed issues to a slow increase in monetary liability. It appears that he assumes that a court practicably could enforce a gradual increase through the mechanism of enforcement at any stage of a combination of (a) the then-agreed terms and (b) least-favorable terms on all other subjects. As the ratio of agreed terms to least-favorable terms increased through the course of negotiations, the recoverable amount would increase. Whether such a complicated proposition can be implemented by courts is a threshold question about the proposal.

The principal purpose of my response is to consider the propriety of such a unified framework. My response to such a framework is the standard move one would expect from a scholar of a particularizing tendency like myself: that it fails to pay due regard to the considerations that affect parties on either side of the traditional line at which the parties agree to be bound.

A. Before Consent

The central contribution of Ben-Shahar's project is its treatment of the period before consent. Because the project focuses on opportunism, he uses a model in which negotiation is a division of the surplus that the contract would create.¹⁰ Within that model, any retreat from a negotiating position plausibly is viewed as an opportunistic effort to capture an inappropriate share of the surplus. To enable those negotiating positions to be made more credible, and thus more effective at inducing reliance,¹¹ the proposed regime would impose liability on those who "retract" serious negotiating proposals. That conclusion rests on his analysis (here and in his work with Bebhuk) of the benefits that will arise from enhancing the ability of the promisee to adapt its behavior in response to a credible promise.

⁸ See Ben-Shahar, *supra* note 1, at 5 ("Thus, in effect, the greater the 'fraction' of a contract the parties have, the greater the fraction of contract liability the plaintiff can enforce.").

⁹ See Farnsworth, *supra* note 3, at 224-25 (discussing this timing problem in calculating reliance damages).

¹⁰ The model is set out formally in Bebhuk & Ben-Shahar, *supra* note 2.

¹¹ This form of analysis builds implicitly on the work of Goetz & Scott, *supra* note **Error! Bookmark not defined.**

The obvious question is whether this analysis gives due weight to the costs of promising that inevitably rise when promises are made subject to greater legal sanction.¹² Ben-Shahar of course recognizes this possibility. Indeed, Ben-Shahar notes that his proposal will “weaken[]” parties’ “freedom from contract.”¹³ He argues that this weakening is not a significant problem because “[p]arties who value this freedom greatly can choose to opt out of the liability consequences.”¹⁴ I have three general responses to that line of reasoning: that Ben-Shahar overestimates the importance of opportunism in the preconsensual period and understates the importance of risk assessment; that Ben-Shahar underestimates the adverse effects of enforcing nonreciprocal promises; and that in practice parties can make their negotiating commitments credible without this regime.

1. How Important Is Opportunism?

I was asked to contribute a response with an empirical and doctrinal emphasis, as a counterpart to the philosophical and analytical emphasis to be expected from the other commentators. It is, of course, not practical to conduct any substantial empirical investigation of the relevant questions in the brief space of this essay. Still, some useful empirical intuitions may shed light on the analysis.

Ben-Shahar’s analysis focuses on opportunism. The benefits of that approach, as I mentioned above, are significant. It gives us a keen understanding of the effects of existing and possible legal regimes on the potential for opportunistic behavior in preconsensual negotiations. The difficulty is in moving from that laboratory-like understanding of opportunism to a richer world of contracting in which opportunism is not the only (or even the dominant) factor that affects negotiations.

At its heart, Ben-Shahar’s work implicitly seems to use as its paradigm a contract for the sale of simple assets (such as commodities), where price and timing are the main issues and where little information about the specific asset need be assembled. In that context, it may be that opportunism can be an important problem in negotiations. On the other hand, those cases rarely produce the kinds of complex and protracted negotiations that should be the focal point of rules for negotiation misconduct.

My background, in contrast, leads me to wonder how this analysis would apply in contracts involving complex assets such as going concerns or commercial real estate, transactions in which a host of informational issues dominate each negotiation. Neither perspective is complete. My point, however, is that the search for a unified framework can

¹² I draw here on the framework articulated in Goetz & Scott, *id.* at 1265-88. My specific concern is with the costs of promising that Goetz & Scott discuss. See Goetz & Scott, *id.* at 1271-74 (evaluating how prospective sanctions modify the behavior of promisors, including a description of the “regret contingency” and certain precautionary costs). For a recent elaboration, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *Yale L.J.* 541, 559-62 (2003).

¹³ Ben-Shahar, *supra* note 1, at 23 (emphasis omitted).

¹⁴ *Id.*

succeed only if that framework addresses both the commodities context in which I see his focus, and also other, more information-laden, contexts.

The core of his analysis is a no-retraction principle, which he states as follows:

a party who manifests a willingness to enter into a contract at given terms, should not be able to freely retract from her manifestation. The opposing party, even if he did not manifest assent, and unless he rejected the terms, acquires an option to bind his counterpart to her representation or charge her with some liability in case she retracts.¹⁵

The inconsistency of this proposal with commercial practice in some settings is striking. Consider, to take one anecdotal and relatively simple example, a party that wishes to purchase an industrial tool and sends several “request for quote” inquiries to prominent suppliers.¹⁶ Absent some special term in the “request for quote” inquiry, the party looking for the tool could be held liable for the expenditures made in responding to the inquiry by each of the suppliers--or possibly even for expectation damages, computed using a price term favorable to the purchaser.¹⁷ Essentially, the regime starts from the assumption that an invitation to begin negotiations ordinarily is binding, because a decision to retreat from such an invitation is necessarily opportunistic. It is easy to think that application of this rule in such a situation would substantially chill the ability of parties to enter such negotiations without first opting out of the applicable default legal regime.¹⁸ It also is easy to see, as Ben-Shahar acknowledges

¹⁵ Id. at 3 (emphasis omitted).

¹⁶ The example could arise in numerous similar contexts: general contractors negotiating with subcontractors, sports teams negotiating with multiple players for the same position, etc.

¹⁷ Ben-Shahar addresses the multiple-party problem specifically, suggesting that all will be well as long as it is made clear that the proposal is being sent to multiple parties or the parties otherwise opt out of his regime. See id. at 61 (“[T]he original proposal to the multiple parties can be understood to include an implicit condition that no more than one of the responses can lead to a deal.”). As discussed below, I do not think it is an entirely adequate response to say that people can opt out of his regime, particularly in a setting in which the parties have not yet contracted.

¹⁸ Ben-Shahar argues that his proposal will not chill negotiations for two general reasons. He argues broadly that both parties will benefit from the enhanced accuracy of preconsensual investments that his proposal will bring. See id. at 37 (“[T]he no-retraction regime can be viewed as a commitment device. When parties negotiate a deal, their lack of commitment . . . chills the incentives of their negotiating partners to make reliance investments.”). More specifically, he argues that his proposal provides reciprocal benefits by allowing each party to be sure that the other party will not retract. As this example (and most of the other examples in this critique) suggests, there often will not be a reciprocal likelihood of retraction. See id. at 31 (claiming that “the no-retraction regime is superior in settings in which the social goal is to encourage precontractual reliance”). Moreover, even in cases of reciprocal negotiation, it is not at all plain to me that parties would prefer his proposal, given the moral hazard and uncertainty to which it subjects them. Rather, sophisticated parties in such a case may prefer to liquidate their liability for a specific sum, a practice that I discuss below. See, e.g., Brazen v. Bell Atl. Corp., 695 A.2d 43, 45 (Del. 1997) (approving \$550 million reciprocal termination fee in merger agreement between telecommunications firms). Thus, although a no-retraction rule might be useful in some cases, it might deter negotiations in cases for which Ben-Shahar’s assumptions hold untrue, especially nonreciprocal cases. To assess the significance of that problem, of course, requires a better understanding of the contexts in which reciprocal negotiations might occur.

quite openly,¹⁹ that it might substantially increase the transaction and litigation costs associated with such a “request for quote” inquiry.²⁰

It is not particularly useful, however, to focus solely on specific settings in which the proposal is inconsistent with current practice. Rather, my goal is to generalize about the proper domain of this proposal. On that point, I discern three broad limitations on the application of a no-retraction rule: the limited value of this proposal for relational contracts; the limited domain of contracts in which preconsensual surplus is important; and, most importantly, the importance of information to preconsensual negotiation.

First, the problem of opportunism can have dispositive weight only in discrete contracts. As the literature on relational contracting suggests, the parties to contracts that involve ongoing relationships have many privately designed mechanisms for dealing with opportunism.²¹ Those mechanisms are likely to be harmed, not bolstered, by the addition of legal liability to nonreciprocal negotiating statements.²² That is particularly true, as often will be the case, when the parties have arranged their affairs in reliance on a particular set of self-enforcing rules that are different from the contract rules that might be available in a judicial forum.²³ It is difficult

¹⁹ See Ben-Shahar, *supra* note 1, at 30 (“[I]t might well be that a mutual assent regime with majoritarian defaults is cheaper to administer than a no-retraction regime with its pro-defendant gap-fillers.”).

²⁰ By subjecting parties to substantial liability from the moment that they begin negotiations, Ben-Shahar’s proposal increases the importance of careful legal advice and of a precise understanding of the relevant legal rules from the earliest moment of negotiations. In its current form, the proposal is vague as to such issues as precisely what types of statements will establish a duty to go forward and the time that any such statements must be honored before the proposer can retract without fear of liability. See *id.* at 24 (explaining why liability for precontractual reliance attaches only to proposals that are “sufficiently rick in detail”). Even if those issues could be clarified, this rule still would have considerable complexity in cases involving parallel negotiations on multiple possible structures for a transaction (parallel discussions of asset and stock purchases, for example).

²¹ See Lisa Bernstein, Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms, 144 *U. Pa. L. Rev.* 1765, 1788 (1996)(explaining why “rational transactors might deliberately leave aspects of their contracting relationship to be governed, in whole or in part, by extralegal commitments and sanctions”); Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 *Am. Soc. Rev.* 55, 63 (1963)(“[C]ontract and contract law are often thought unnecessary because there are many effective non-legal sanctions.”); Ronald J. Mann, Verification Institutions in Financing Transactions, 87 *Geo. L. J.* 2225, 2226 (1999)(describing how commercial parties use nonlegal mechanisms, such as collateral and reputation, to resolve information asymmetries).

²² See Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1281 (“[I]n contexts where self-sanctions are already effective and the prospects of improved information are poor, the social gains from enforcement are negligible and may be exceeded by implementation costs.”); Robert E. Scott, A Theory of Self-Enforcing Indefinite Agreements, 103 *Colum. L. Rev.* 1641, 1693 (2003)(concluding that enforcing agreements that parties intentionally left indefinite would be “counterproductive,” even when the hoped-for reciprocity fails).

²³ See Bernstein, *supra* note 21, at 1789 (suggesting that in some markets “nonlegal sanctions such as reputation bonds” are strong enough, “making a legally enforceable provision unnecessary”); Scott, *supra*

to know, of course, what share of contracts is discrete, rather than relational. It is plain, in any event, that the number of contracts that involve discrete negotiations is sufficiently substantial to warrant separate legal treatment. The problem with a unified theory, however, is that its overarching framework imposes costs on any subset of cases for which it is not optimal. The entire class of relational contracting may fall into that category.

Ben-Shahar's analysis also rests on the assumption that preconsensual investments are crucial in many settings. That assumes, in turn, that surplus often can be created only (or, perhaps, most optimally) by preconsensual rather than postconsensual investments. Again, this framework has obvious application in many cases. The case of a contractor relying on an unaccepted bid of a subcontractor in the contractor's own bid is a common one.²⁴ The ability of the parties jointly to profit from a successful bid by the contractor is enhanced considerably by the ability of the contractor to treat the subcontractor's bid as credible.²⁵ On the other hand, preconsensual investments seem unnecessary in many cases. For example, in Ben-Shahar's employee-relocation example,²⁶ the preconsensual investment often would be suboptimal. How often does it create substantial value for an employee to quit an old job before finding a new job? At bottom, there is an empirical question about the size and frequency of valuable preconsensual investments. That question surely must be influenced by the prevalence of contractual models that permit post-contract creation of surplus through the use of open terms in cases in which one party must invest before the other if the payoff is to be maximized.²⁷ Ben-Shahar's formal model²⁸ assumes that the need for large preconsensual investments is commonplace. If that is not so, then the benefits that his model provides--by limiting the adverse effects of opportunism on those investments--will not be large enough to offset the countervailing costs of holding the promisor so liable.²⁹

note 22, at 1657 (noting that parties often appear to prefer "the indefinite agreement" to the more complete, "explicit and verifiable alternative that they ignored").

²⁴ See, e.g., *Drennan v. Star Paving Co.*, 333 P.2d 757, 760 (Cal. 1958) (finding that mistake in subcontractor bid proposal did not prevent court from awarding damages to contractor who relied on that proposal).

²⁵ For an interesting variation on that situation, see *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772, 805 (9th Cir. 1981) (holding that the duty of good faith under Hawaiian law prevents an open-price supplier from raising its price after its customer has submitted bids, even if the supplier was not aware of the specific bids).

²⁶ See *Bebchuk & Ben-Shahar*, supra note 2, at 423 ("[I]n negotiating an employment contract, the employee may quit other jobs, acquire knowledge about the new task, or turn down competing offers, while the employer may prepare tasks and facilities for the potential employee.").

²⁷ See Mark P. Gergen, *The Use of Open Terms in Contract*, 92 *Colum. L. Rev.* 997 (1992) (discussing such contracts generally).

²⁸ See *infra* note 40 and accompanying text (describing the relevant equations).

²⁹ Moreover, in assessing the benefits of his model, it is not clear that we should include cases in which precontractual surpluses are important if existing law seems to provide adequate mechanisms for inducing appropriate investments. Because the courts normally provide for a recovery in the most prominent

Third, Ben-Shahar assumes that the parties have perfect information.³⁰ That is not, of course, an unusual assumption, and it does have the virtue of allowing him to sharpen the analysis of the effects opportunism will have on the willingness of potential contract partners to rely on the likely success of negotiations. On the other hand, it has the debilitating effect of excluding from his paradigm much of what is important in the reality of contract negotiation. Imagine a paradigm in which negotiation is not division of surplus, but collection of information and allocation of risk.³¹ In that paradigm, the parties are constantly exchanging, acquiring, and assessing information about the transaction in question, decreasing the areas of risk as they increase the areas of knowledge.

For a transaction of that type, it would be perfectly customary to retreat from a previous negotiating position.³² For example,³³ consider parties negotiating over the acquisition of a large real-estate project. On day ten, based on the information available, the purchaser might be willing to suggest an \$80 million price, reflecting an expected or “typical” allowance for environmental risks that have not yet been evaluated. On day eleven, after the purchaser receives an environmental report showing many unexpected difficulties, the purchaser’s proposed price might fall to \$70 million, for reasons that the seller would regard as entirely legitimate. The acquisition of information that allowed both parties more accurately to estimate the likely value of the asset going forward should have made it clear to both parties that the field of negotiation should shift to reflect the new information. Similarly, information a few days later indicating that a major tenant had decided to renew its lease might cause the purchaser’s price to return to the \$80 million range.

More generally, that paradigm views each party’s negotiating position at any given time as reflecting its then-current estimate of the value of the asset, using predictions of the likely resolution of large numbers of contingencies--predictions that depend on information available to the parties at that time. As time goes on, more and more information is collected, steadily decreasing (though of course never eliminating) uncertainty about the future income flows the asset might generate. The continuing resolution of uncertainty has two effects on the

example that he offers, in which it is important that the surplus be precontractual (the subcontractor bid case discussed above), the size of the domain that benefits from his proposal is not apparent.

³⁰ See Bebhuk & Ben-Shahar, *supra* note 2, at 430 (“It is assumed that the parties have perfect information.”). For an earlier effort to model the implications of imperfect information in this context, see Richard Craswell, *Performance, Reliance, and One-Sided Information*, 18 *J. Legal Stud.* 365 (1989).

³¹ That perspective is common in economic analysis of preconsensual negotiation. It seems to me that it is important in, to mention only a few important papers, Goetz & Scott, *supra* note **Error! Bookmark not defined.**, and Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 *Va. L. Rev.* 385 (1999).

³² See Farnsworth, *supra* note 3, at 280-81 (discussing “[r]eneging” in contract negotiations).

³³ My examples of necessity reflect the simplifying assumption that negotiations proceed along a single continuum that can be characterized usefully by a single numerical “price.” The reality, of course, is that even simple negotiations are likely to involve many issues that cannot easily be collapsed into a single dimension that resembles a monetary equivalent. That reality--absent from my examples--is a large part of what makes it difficult to suppose that retraction ordinarily is improper.

development of the transaction. First, by reducing the expected variance of outcomes, it diminishes the importance that the parties' levels of risk aversion might have on their ability to reach an agreement. Second, by removing specific items of risk that the parties must allocate for the transaction to result in a consensual arrangement, the continuing production of information decreases the complexity of the contract that is necessary to reflect such an arrangement.

To be sure, nothing in Ben-Shahar's surplus-division paradigm is formally inconsistent with this information/risk paradigm. There is no logical reason why parties that have not yet collected all of the information relevant to the success of a project could not be bound by their negotiating positions. Moreover, the proposed regime includes a safety valve specifically designed to accommodate changes of position that are not opportunistic. Specifically, Ben-Shahar explains that a retraction is not opportunistic if it is made "after it has become clear that the profitability of the intended trade is so low that trade is not desirable."³⁴ It is difficult, however, to know precisely what that means. Circumstances can change in many ways that might affect the desirability of a transaction, ranging from information about the quality of the particular asset, to information about markets that might affect the value of the asset indirectly (such as the business plans of parties that might rent or otherwise use the asset in the future), to information about the value of the asset directly (competing offers to purchase the asset).³⁵ Ben-Shahar offers no baseline for deciding what type of trade is considered "desirable." Desirable for whom? Is it desirable to sell an asset at a price lower than the price at which it originally was purchased? Does it matter how long the asset has been on the market? Does it matter how long the parties have been negotiating without coming to an agreement?³⁶ Without a baseline, it is difficult--perhaps impossible--for parties to understand what types of retractions would be opportunistic. From that point, it should go without saying that judges are not likely to resolve those questions costlessly and without error.³⁷ As Bob Scott recently explained, the

³⁴ Bebchuk & Ben-Shahar, *supra* note 2, at 447.

³⁵ Mark Gergen, for example, explains Red Owl in that way. See Mark P. Gergen, Liability for Mistake in Contract Formation, 64 *S.C.L. Rev.* 1, 32-33 (1990) (discussing Hoffman v. Red Owl Stores, 133 N.W.2d 267 (1965)).

³⁶ As Daniel Markovits points out, a duty not to terminate negotiations is a striking departure from commercial practice that is likely to include very little conduct that parties would find improper and a great deal of conduct that parties would view as unquestionably legitimate. See Daniel Markovits, The No-Retraction Principle and the Morality of Negotiations, 152 *U. Pa. L. Rev.* (2004). A perfectly rational view that the transaction costs of concluding an agreement are likely to exceed the likely profits from any eventual agreement is likely to be entirely legitimate but at the same time quite difficult to verify in court.

³⁷ See Bebchuk & Ben-Shahar, *supra* note 2, at 448 (recognizing that courts must "be able to verify claims of changed circumstances and to distinguish between realizations that were or were not expected by the parties").

likelihood of inefficiency and moral hazard makes it particularly problematic to adopt a default rule, such as the one I examine here, that relies on information that is “unverifiable” by courts.³⁸

More fundamentally, the question whether trade is “desirable” does not seem to define “opportunism” in a useful way. Ben-Shahar suggests that the opportunism with which he is concerned is an effort by one party to take advantage of another party’s existing investments by making offers that “hold up” the invested party.³⁹ It is not clear that the test for “desirable” trade will perfectly match transactions that do not involve the “holdup” problem on which he focuses. As discussed above, parties acting within the information/risk paradigm often will have legitimate reasons for backtracking that have nothing to do with the “holdup” problem--reasons that a rational negotiating partner would perceive as legitimate, and which seem impossible to evaluate under Ben-Shahar’s “desirable trade” standard. Importantly, it is not at all clear that such reasons would be apparent to the contracting partner or verifiable by a court without significant cost to the parties. Thus, it would be difficult for the parties to write a contractual provision that specified the “holdup” problem in a way that reliably would produce “correct” results under judicial scrutiny.⁴⁰ Moreover, as Ben-Shahar himself explains in his work with Lisa Bernstein, information about a party’s valuation of a specific contracting opportunity often will be proprietary information that cannot be revealed costlessly either to a negotiating partner or (in much the same way) to a judicial forum assessing the propriety of the retracting party’s actions.⁴¹ A regime that starts from the presumption that backtracking and retraction is opportunistic is unlikely to provide a sensitive resolution of disputes that arise out of this type of interaction.

A second reason that negotiating partners whose interactions are best described by the information/risk paradigm might not wish to have their negotiating positions held binding is to preserve the ability to opt out of negotiations entirely. The heart of the information/risk paradigm is a continuing collection of information, steadily decreasing uncertainty and risk, so that the expected variance in outcomes of the asset decreases in the estimation of both parties. Parties with standardized investment regimes as a matter of policy would not be willing to enter a final transaction unless the uncertainty and variance could be reduced to a level appropriate for their business models.

³⁸ See Robert E. Scott, Rethinking the Default Rule Project, 6 *Va. J.* 84, 87, 89-91 (2003)[hereinafter Rethinking Default Rule](noting that a party’s private valuation rarely is verifiable to a court and discussing the problems with default rules that rely on that information).

³⁹ See Bebhuk & Ben-Shahar, *supra* note 2, at 426 (discussing opportunistic offers as those “that leave the other party with a net negative payoff”).

⁴⁰ See Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1296 (discussing likely error costs of judicial enforcement in this area); Scott, Rethinking Default Rule, *supra* note 38, at 87, 89-91; Scott, *supra* note 22, at 1687 (analyzing the role of indefiniteness in resolution of contracts suits).

⁴¹ See Omri Ben-Shahar & Lisa Bernstein, The Secrecy Interest in Contract Law, 109 *Yale L.J.* 1885, 1886-88 (2000)(arguing that parties often desire to keep private the information used to value lost profits and that this “secrecy interest” may outweigh a party’s compensatory interest).

Consider, for example, a lender investigating potential loan transactions. For rational reasons, the lender might prefer to specialize in making loans of a particular level of risk.⁴² Such a lender, through the course of the transaction, might provide relatively detailed predictions of the likely terms on which it would enter a final transaction. As evidence was collected about any particular transaction, the potential terms might shift back and forth. But the lender would have no intention of entering a final transaction, on any terms, unless sufficient information could be obtained to lower the uncertainty and expected variance of the transaction to the level typical of the lender's portfolio. To be sure, those parties could opt out of this regime and avoid the undue costs it might impose on their promises. As discussed below, however, that solution seems to deprive the parties of gains available under the existing regime.⁴³

* * * * *

None of the foregoing is intended to suggest that there are not parties that negotiate a transaction from equal perspectives of substantially complete information. Nor is it intended to suggest that parties do not shift during the course of their negotiations, even before a formal moment of consent, to a regime in which they expect to be bound by their ongoing representations. However, the limited range within which negotiations of that type occur makes problematic the application to all negotiations of a default rule predicated on opportunism as the central problem.

2. The Problem of Excessive Reliance

Parallel to the empirical concerns discussed above is an analytical concern that the award of reliance damages in the preconsensual setting will create excessive reliance. Because the basic point is a simple one, made decades ago by Goetz and Scott, it does not warrant extended discussion. Essentially, the concern is that a rule that allows a party to recover its reliance costs⁴⁴ creates a moral hazard because that party no longer has an optimal incentive to limit the

⁴² Among the most obvious reasons for such specialization are (1) the lender might be able to price the risk of such transactions more accurately through experience with a portfolio of transactions of homogenous risk and (2) the lender might specialize in the management of assets of a particular level of risk, through the employment of lending officers and loan servicing employees with skills appropriate for assessing that particular level of risk.

⁴³ One minor point related to the foregoing relates to the division of responsibility in large firms. For many firms, relatively low-level representatives, who would not in the view of the firm have authority to bind the firm in any way, will negotiate important business issues on behalf of the firm. Such a firm agrees to be bound at an appropriate step in the process, through action by individuals formally authorized to obligate the firm. *E.g.*, Farnsworth, *supra* note 3, at 219 (describing the corporate negotiating process). A regime that starts from the assumption that opportunism is the cause of the unwillingness of senior executives to agree to a transaction approved by lower executives does not comport with this arrangement.

⁴⁴ There seems to me some confusion between Ben-Shahar's concept of reliance expenditures and the remedy for reliance damages. The first concept, reliance expenditures, is a term Ben-Shahar uses here (and in his work with Bebchuk) to include all contract-related expenditures. [pincite] Ben-Shahar's model analyzes a rule that provides for recovery of those expenditures, which he characterizes generally as a rule providing for reliance damages. [pincite] Because Ben-Shahar ties his work directly to the tradition (which

expenditures that it makes in reliance on the promise in question.⁴⁵ As a general matter, Goetz and Scott argue, that problem calls for caution in adopting legal rules that enforce nonreciprocal promises.⁴⁶ In their view, that problem is especially salient in the context of preconsensual negotiation, where the decision of the parties not to be bound formally is most likely to reflect a conscious opting out of the consensual remedial regime.⁴⁷

Ben-Shahar's formal model seems to recognize the problem with a strict regime of preconsensual liability.⁴⁸ It is not clear, however, why the regime discussed here is not subject to the same problem of excessive reliance. His discussion of this regime does not seem to address the problem directly.⁴⁹ It is of course difficult to gauge the extent of that moral hazard in the real world. I am aware of no empirical evidence about the frequency or severity of that problem. However, this objection raises a credible and plausible concern that may represent

he dates to Lon Fuller) analyzing the relative merits of expectation and reliance damages, [pincite] he plainly contemplates his proposal as an extension of reliance damages to the precontractual period. The problem, however, is that there is a distinction between reliance damages, which typically would include only the expenditures made in reliance on the offer, and Ben-Shahar's reliance expenditures, which would include larger category of project-related costs. Goetz and Scott recognize this issue and use the term "reimbursement damages" to describe what courts actually award, as opposed to a theoretically optimal recovery of "reliance damages." Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1287-88. I assume here that Ben-Shahar intends something similar.

⁴⁵ See Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 *Stan. L. Rev.* 481, 494-95, 499 (1996)(arguing that expectation damages result in "[i]ncentives to rely excessively" for the promise and that reliance damages are even worse in this respect); Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1285(noting that reliance damages create a moral hazard for the promise not to "exercise optimal self-protection"). That is not to say that in some cases the optimal outcome might not be to adopt a remedy that obligated a breaching promisor to pay damages that exceed the optimum amount of reliance. As Craswell notes and I have explained elsewhere, those kinds of supra-compensatory promises might be highly rational in certain circumstances. See Craswell, *supra*, at 500 (listing economic factors that might justify such damages); Mann, *supra* note 21, at 2235 (discussing the benefits of the "punitive bond approach," which would provide a bonding mechanism for "far beyond the amount of the funds involved in the transaction"). See also Schwartz & Scott, *supra* note 12, at 617 (arguing that penalty clauses in contracts can "permit parties to induce efficient relation-specific investments"). It is not clear, however, and certainly not suggested by Ben-Shahar, that courts should impose supra-compensatory remedies as a default rule contrary to the intention of the parties.

⁴⁶ See Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1278-81 (noting that, under certain conditions, "[n]onreciprocal promises is . . . the optimal choice"). Craswell argues that courts can solve the moral hazard problem by enforcing the promise only in cases in which the promisee's reliance was efficient. Craswell, *supra* note 43, at 494-95. To the extent courts can make that determination under the existing regime, Ben-Shahar's decision to depart from that regime would reinstate a moral hazard problem that existing doctrine may address adequately.

⁴⁷ See Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1294-96 (noting that "promises made during preliminary bargaining are not enforceable until the bargain is sealed by an agreed exchange").

⁴⁸ See Bebchuk & Ben-Shahar, *supra* note 2, at 434 (proposing a strict precontractual liability rule).

⁴⁹ See *id.* at 446-47 (describing several scenarios under which parties will make "optimal reliance").

another cost of a no-retraction regime that must be offset by the benefits the regime offers in enhancing the credibility of nonreciprocal promises made in negotiations.

3. Credible Promises Before Consent

The final issue in assessing the promise of this new framework in the period before a consensual agreement is to gauge how much legal enforcement of nonreciprocal promises is likely to improve upon existing mechanisms for making preconsensual promises credible. As with the foregoing discussion, I make no pretense of providing true empirical analysis. My goal, rather, is to suggest what can be gleaned from the existing literature and observation of commercial practice as a mechanism for judging how well or poorly the system works without this framework. If the system works relatively well as it stands, then there is little to be gained by adopting this new regime to enhance the credibility of those promises.

On that point, my impression is that the system works quite well in allowing parties to create relatively nuanced offers of credibility if they wish to do so. I start with the main piece of empirical evidence of which I am aware: the results of a survey of corporate general counsel by my colleague Russell Weintraub.⁵⁰ Among other things, that survey investigated the use of firm offers.⁵¹ That survey strongly suggests that firm offers are widely prevalent in the business world, particularly among larger firms. Overall, 76% of respondents received them and 74% said that they made them.⁵² On the question of whether the offers are reliable, the responses were almost unanimous: 95% rely on them, 97% expect offerees to rely on them.⁵³ Lest this seem an odd artifact of small businesses not important to “real” commerce, Weintraub reports that the prevalence of firm offers was directly proportional to the size of the respondent: 84% of billion-dollar companies received them, 75% of companies in the \$500 million to billion-dollar range of annual sales, and 57% of companies in the \$100 million to \$500 million range.⁵⁴

As the discussion in the preceding section implies, firm offers work only in a relatively simple type of transaction, in which the offeror needs no factual investigation to determine its willingness to transact and the price at which it would transact. In those transactions, the discussion suggests, this simple and commonly used device should be adequate to provoke reliance. Much of negotiation, however, involves interactions that are more complex. In those situations, however, there are obvious transactional devices such as earnest money or deposits that are commonly used to foster preconsensual investigation. For example, it is common in many contexts (most obviously the sale of commercial real estate) for a prospective purchaser at an early stage of the transaction to deposit a substantial sum of money (often several percent of the purchase price) with a third party. The parties will sign a contract that provides for a period during which the seller will collect and provide information about the property to the

⁵⁰ Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 *Wis. L. Rev.* 1 (1992).

⁵¹ For a definition of firm offers, see Uniform Commercial Code § 2-205 (1989).

⁵² Weintraub, *supra* note 50, at 27.

⁵³ *Id.*

⁵⁴ *Id.* at 27-28.

prospective purchaser, at the end of which the purchaser either will proceed to purchase the property or will decide to walk away.⁵⁵

Those contracts involve a considerable investment by the seller, both because of the cost of collecting and providing information, and because of the opportunity cost of committing for some specified time to sell the property only to a particular purchaser.⁵⁶ Most important for present purposes, the contracts will include detailed provisions regarding the ultimate disposition of the deposit. Generally, the contracts will list relatively detailed conditions that will justify the purchaser in deciding to terminate the arrangement with a return of the deposit or, alternatively, that will justify the seller in retaining the deposit if the purchaser fails to proceed.

Another obvious example, which involves probably the greatest amounts of preconsensual investments, are the lockup and breakup fees often included in merger and acquisition agreements. Those fees often are quite large.⁵⁷ There is a substantial academic literature on the possible positive and negative incentives such fees might have on the affected transactions.⁵⁸ Nevertheless, there seems to be little doubt that as between the contracting parties themselves those fees represent a low-transaction-cost way of dealing with cases in which opportunity costs and other preconsensual investments are a major focus of the preconsensual stage of the transaction.

A final example is the large lending transaction.⁵⁹ Those transactions typically involve a large deposit or application fee by the borrower at the time the parties commence a serious collection of information about the proposed investment. Again, those transactions involve considerable preconsensual investments by the parties, as the lender incurs the interest-rate risk inherent in committing to loan funds at a specified rate at a specified date in the future, while the borrower undertakes to collect information that the lender will assess in connection with finalizing the details of the proposed transaction. Similarly, a brief contract related to the deposit or fee will provide that the fee is--or is not--refundable if the transaction fails for specified reasons. As in the previous examples, the transaction costs of those devices for institutional actors should be quite low. Experience will give both borrowers and lenders a

⁵⁵ See Farnsworth, *supra* note 3, at 249-51 (discussing generally such preliminary agreements, including those involving earnest money).

⁵⁶ See *id.* at 225-29 (emphasizing the lost opportunity element of reliance damages).

⁵⁷ E.g., *Brazen v. Bell Atl. Corp.*, 695 A.2d 43, 47-50 (Del. 1997) (approving \$550 million reciprocal termination fee in merger agreement between telecommunications firms).

⁵⁸ E.g., Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 *Colum. L. Rev.* 682 (1990); Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 *Minn. L. Rev.* 239 (1990); Stephen Fraidin & Jon D. Hanson, *Toward Unlocking Lockups*, 103 *Yale L.J.* 1739 (1994); Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 *Stan. L. Rev.* 1539 (1996); David A. Skeel, Jr., *A Reliance Damages Approach to Corporate Lockups*, 90 *Nw. U. L. Rev.* 564 (1996).

⁵⁹ In addition to the contextual situations discussed in the text, there is the common possibility that highly liquid parties would reach the same outcome through use of a standard liquidated damages provision.

good understanding of a deposit amount appropriate given the complexity of the investigation to be undertaken, as well as the types of circumstances in which it might make sense for the fee to be kept or returned.

At the other end of contracting practices, parties have good reasons in some circumstances for erecting intentionally indefinite agreements. As Bob Scott explains in his recent study of such cases,⁶⁰ these arrangements may do a much better job than more definite agreements of policing problems of shirking in performance. Moreover, because these arrangements appear to be intertwined with nonlegal sanctions, it appears that a broad doctrine providing for more enforcement would diminish their effectiveness.⁶¹

B. After Consent

The major application of the no-retraction model is the period before consent.⁶² Ben-Shahar's presentation, however, extends his aconsensual regime into the postconsensual period as well. My basic concern here is that the application of his limited enforcement regime in the postconsensual period seems, with a possible exception in some rare and odd cases, to deprive parties of the benefits of a reciprocal bargain in cases in which they have made one.

The basic premise of the unified model is that an important part of the resolution of postconsensual disputes can occur through interpreting disputed contract provisions by reference to the positions that parties took during the preconsensual period. As a general matter, that seems to dispense with the concept of contractual interpretation as a device for ascertaining the parties' likely intent with respect to a disputed question.⁶³ Those doctrines rest fundamentally on the concept of consent--the party has taken steps that objectively can be treated as consent to a contract and should be bound by the objective meaning of the contract. It will defeat much of the point of drafting a contract if courts are no longer to find the best understanding of the contract to which both parties have consented, and instead permit parties to enforce the contract only to the limits of their contracting partner's demonstrable

⁶⁰ Scott, *supra* note 22, at 1675-85. There obviously is ambiguity in deciding whether to treat intentionally incomplete contracts as preconsensual or postconsensual transactions. I treat them here as preconsensual because that seems to me most plausible. However, the problem is closely related to the problem of interpreting intentionally indefinite agreements, which I discuss below in the context of postconsensual transactions.

⁶¹ That is not to say that such arrangements should never result in judicial enforcement. As I discuss in Part II, *infra*, I think the existing, more nuanced scheme for judicial enforcement is likely to be less damaging than Ben-Shahar's scheme, which ignores the features important in current doctrine (the existence of consent and the justifiability of the reliance).

⁶² See Bebachuk & Ben-Shahar, *supra* note 2, at 443-52 (outlining and describing the implications of the no-retraction rule in precontractual situations).

⁶³ It also assumes that courts are not readily capable of recognizing and responding to opportunism directly, an assumption that certainly is contestable. See, e.g., *T.W. Oil, Inc. v. Consolidated Edison Co.*, 443 N.E.2d 932 (N.Y. 1982) (refusing to accept buyer's opportunistic rejection of technically nonconforming tender by seller).

understandings of ambiguous provisions.⁶⁴ Given the ease of locating ambiguity in contractual provisions, this could be quite a debilitating concept if it had broad application. On careful reading, however, it seems clear that Ben-Shahar in fact does not contemplate broad application of his proposal in a postconsensual setting. Rather, he applies it only in a few localized settings, which I consider in turn.

1. Indefiniteness

Ben-Shahar's most important application probably relates to indefinite contracts.⁶⁵ In that context, he argues that courts should not fill gaps with majoritarian terms (his description of the dominant approach in the UCC and common law), but rather should fill gaps with pro-defendant terms.⁶⁶ For the reasons discussed at the beginning of this section, it is quite doubtful that his approach would improve on existing practice. As discussed above, at least in the absence of any information-forcing effects, the parties jointly are likely to be best served by the majoritarian outcome.⁶⁷ Moreover, the longer-term effects of that rule could be most deleterious. For example, it would give parties a bad incentive in litigation: if the rule of law is that you will only be held to the position you concede to be correct, you have a powerful incentive to take an extreme position. The result, then, might be a practice of increasingly extreme positions, with judges choosing between extreme positions far less satisfactory than anything the plaintiff plausibly could have expected when it entered the agreement.⁶⁸

2. Misunderstanding

The doctrine of misunderstanding applies when both parties assign materially different meanings to the same term of the contract.⁶⁹ The classic case is the well-known Peerless situation, in which a contract for shipments on the ship Peerless was understood by the buyer and seller to refer to different ships of the same name.⁷⁰ In the absence of fault by either party, existing doctrine treats such a situation as a failure of mutual assent, and thus a failure of the

⁶⁴ See, e.g., Schwartz & Scott, *supra* note 12, at 573-84 (arguing that “the best interpretive default for firms is textualist when the issue is what their contract language meant”).

⁶⁵ Ben-Shahar, *supra* note 1, at 52-55.

⁶⁶ Ben-Shahar provides a more expansive articulation of that point in Omri Ben-Shahar, “Agreeing to Disagree”: Filling Gaps in Deliberately Incomplete Contracts, 2004 **Wis. L. Rev.** (forthcoming 2004). I limit myself here to a response to the brief points he makes in the paper at hand.

⁶⁷ See also Schwartz & Scott, *supra* note 12, at 584-90 (arguing for a plain-meaning “majority talk” default in cases where a contract is silent on a matter).

⁶⁸ Furthermore, as discussed above, there is good reason to think in many cases that judicial enforcement of indefinite agreements under Ben-Shahar's regime might undermine the efforts of parties with such agreements to opt out of legal enforcement entirely.

⁶⁹ **Restatement (Second) of Contracts** §§ 20(1), 201 (1981).

⁷⁰ *Raffles v. Wichelhaus*, 159 Eng. Rep. 375 (Ex. 1864). For a thorough discussion, see **A.W. Brian Simpson, Leading Cases in the Common Law** 135-62 (1995).

contract.⁷¹ Ben-Shahar takes the view, building on his view of negotiations, that it would be better to allow either party to enforce the contract to the limits of the other party's understanding, rather than treat the contract as an entire failure.⁷² There is in fact much to be said for the view that it is wrong to let the contract be treated as entirely lapsed.⁷³ Ben-Shahar's proposal thus provides a sensible possibility for providing some response to the happenstance of where the losses might have fallen without any enforceable agreement.⁷⁴

The basic problem with gauging the practical significance of that proposal is the assumption that these contracts often fail because neither party was at fault. It is more common, it seems, for both parties to be at fault.⁷⁵ Brian Simpson's comprehensive treatment of the Peerless case, for example, leaves the impression that the common use of the name "Peerless" at the time reasonably should have led both parties to inquire further about the particular ship involved in the transaction.⁷⁶ Indeed, surely on those facts at least one party had some reason to know of the potential for misunderstanding.

In truth, the doctrine does not seem to apply often outside the first-year classroom. It is rare to find a case where a court finds that a misunderstanding between the parties obviates the mutual assent necessary to form a contract. It is common for a court that purports to apply Restatement § 20 or § 201 to conclude that the parties were not equally at fault.⁷⁷ Thus, I have

⁷¹ **Restatement (Second) of Contracts** §§ 20(1), 201 (1981).

⁷² Ben-Shahar, *supra* note 1, at 42.

⁷³ In the misunderstanding context, the view is not entirely novel. See *Cady v. Gale*, 5 W. Va. 847 (1871) (enforcing against the husband's estate an agreement to convey the wife's land that was void against the wife, with an explanation that "the doctrine has been long and firmly settled by the authorities in England, that where a vendor contracts to sell a larger interest in the real estate than he has title to," a court will compel him to convey such an estate or interest as he may have, if the vendee "is willing to accept such title and interest"); 3 **Corbin on Contracts** § 611 (1960) (stating that when a defendant successfully claims mutual mistake, a "court may say that the transaction was 'void,'" and yet "if the defendant had been content with the agreement as made, in spite of the mistake, it is believed that he could have enforced it against the other party"); *cf.* **Basil Markesinis et al., The Law of Contracts and Restitution: A Comparative Introduction** 205-06 (1997) (discussing the "right to 'save' the contract by agreeing to those terms which the mistaken party had in mind when initially agreeing to the contract"). I thank Alan Rau for those references.

⁷⁴ For a similar response, see Melvin Aron Eisenberg, The Responsive Model of Contract Law, 36 **Stan. L. Rev.** 1107, 1124 (1984) ("Since in such a case any out-of-pocket loss incurred by either party results from the equal fault of both, there is no good reason why only one party should bear it. Rather, the rule should be that where each party is equally at fault, out-of-pocket losses should be split evenly.").

⁷⁵ See id. at 1123-24 (arguing that in cases like the Peerless case, "[t]he probability is high . . . that both parties are at fault").

⁷⁶ See Simpson, *supra* note 70, at 140-41 (stating that there were "at least eleven ships called Peerless," but that the individual ships were easily identified at the time using their captains' names); see also Melvin A. Eisenberg, Mistake in Contract Law, 91 **Calif. L. Rev.** 1575, 1613 (2003) ("Given a common practice of using the same name for more than one ship, both parties . . . were at fault . . .").

⁷⁷ E.g., *Schaer v. Webster County*, 644 N.W.2d 327, 338 (Iowa 2002); *Downey v. Clauder*, 811 F. Supp. 338, 340 (S.D. Ohio 1992); *NL Industries, Inc. v. GHR Energy Corp.*, 940 F.2d 957, 969 (5th Cir.

the sense that Ben-Shahar includes the misunderstanding doctrine not because of a sense that it raises one of the most important issues of practical contract interpretation, but simply because it is an issue for which his approach can be useful.

3. Intentional Incompleteness

Ben-Shahar also applies his concept to situations in which the parties intentionally agree to incomplete or ambiguous contracts because of a decision not to resolve the substance of a particular issue.⁷⁸ Ben-Shahar argues that application of an all-or-nothing approach or a standard gap-filling technique would violate the parties' choice for ambiguity.⁷⁹ It is just as plausible, however, to think that the parties' choice for ambiguity reflects a considered willingness to allow the issue to be resolved later in the discretion of a third-party decisionmaker. Thus, the parties might rationally believe that the expenditure of further resources to reach agreement on an issue that is unlikely to arise would be best served by an ambiguous contract, with each party holding the expectation that a later court would view that party's position as more reasonable.⁸⁰ My intuition is that contracting parties are more likely to think that the latter risk is the one they are taking.⁸¹

I have not identified a specific adverse economic effect of this part of the no-retraction proposal. On the other hand, I do not understand the formal model to go so far as to provide support for the proposal either. Thus, I think Ben-Shahar is only suggesting as a doctrinal matter that this might be an attractive default rule. I find that suggestion intriguing, but am inclined to think that there is considerable plausibility in the traditional rule, and that the

1991); *Moody v. McLellan*, 367 S.E.2d 449, 451 (S.C. Ct. App. 1988); *Exxon Corp. v. Bell*, 695 S.W.2d 788, 790 (Tex. Ct. App. 1985);

⁷⁸ Ben-Shahar, *supra* note 1, at 55-57. In my experience, this is also a rare occurrence. Ambiguities arise much more frequently where the parties either fail to anticipate and include contractual language to address a particular issue that later arises or fail to think through the consequences of contractual language that is used in light of an issue that later arises. In some circumstances, of course, one of the parties is aware of an ambiguity in the contract language, but that party does not seek to clarify the language out of a desire to reduce further negotiation costs. Only where the parties actually discussed an issue and then intentionally inserted an ambiguity into the contract would there be alternative positions that could be enforced. I never experienced such a situation during my years negotiating contracts.

⁷⁹ *Id.* at 56-57.

⁸⁰ See Arthur Allen Leff, *The Leff Dictionary of Law: A Fragment*, 94 *Yale L.J.* 1855, 2007 (1985) ("In fact, intentional ambiguity is sometimes desired . . . as when parties to a contract would rather not face a potential issue, preferring instead to deal with the issue ambiguously and leave the solution of the problem, should it arise, to determination by subsequent litigation.").

⁸¹ Perhaps the strongest support for that intuition is the common practice of including in negotiated contracts a clause that explicitly excludes from the contract any positions the parties might have expressed during precontractual negotiations. To get a sense for the contracting context, see Daniel Keating, *Exploring the Battle of the Forms in Action*, 98 *Mich. L. Rev.* 2678, 2699-2700 (2000):2699-2700 (discussing results of interviews about reasons parties decide to enter contracts without resolving known disagreements about the terms of the relationship, and indicating that such parties believe that "the costs of reviewing and then negotiating about nonimmediate terms are simply not worth the benefit").

traditional rule is more likely to implement the expectations of the parties. Of course, that might be because lawyers have a sense of the traditional rule, so that implementation of the no-retraction rule could conflict with their expectations. I do not think, however, that Ben-Shahar has gone far enough here to make a case that his rule provides sufficiently superior outcomes to justify the change.⁸²

II. Problems with Opting Out

As with any issue involving the articulation of a rule for contracts, it is important to consider the extent to which the rule should be a default rule, around which the parties readily can contract, or a mandatory rule, which would govern notwithstanding the intentions of the parties. That issue is particularly important here, because Ben-Shahar recognizes much of the problem of promising costs that I discuss in Part I and suggests that parties can avoid those costs by contracting out of the rule. Thus, Ben-Shahar suggests, a no-retraction regime will impose no such costs because parties can avoid this rule when it would be costly to them. This part of my analysis considers three points: the possibility that the need to contract out of the rule will lead to significant overenforcement costs; the likelihood that the existing rule has substantial information-forcing benefits that Ben-Shahar's rule would discard; and the likelihood that a regime that grants an untrammelled right to opt out would lead to unacceptable levels of abusive behavior.

There is a question, of course, whether any of this matters if the only point in question is a default rule. Ben-Shahar consciously offers his system as a default rule, out of which parties could contract at will by the simple device of making it clear in negotiations that they did not wish to embrace his aconsensual regime. If I have done nothing more than identify reasons that some businesses might embrace for rejecting his regime in certain transactions, then I have done little to show harm from his rule: businesses worried about opportunism will leave themselves in the no-retraction regime and businesses worried about risk will opt out to the more traditional system. Recent scholars, however, have come to recognize more generally that incorrect default rules necessarily impose substantial costs on parties, not only because of the costs of opting out of them,⁸³ but also because of the possibility of judicial unwillingness to accept a decision to opt out.⁸⁴ If these scholars are right, then the analysis above, standing alone, would be enough to suggest problems with the adoption of the no-retraction default rule. In my view,

⁸² Ben-Shahar, *supra* note 66, makes a more extended defense of the rule suggested here. It is far beyond the scope of this critique to address that paper.

⁸³ Ian Ayres in particular discusses the "iron law of default inertia" that is, in his view, an "important determinant of human action." Ian Ayres, *Valuing Modern Contract Scholarship*, 112 *Yale L.J.* 881, 890-91 (2003)(quoting Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 *Stan. L. Rev.* 1591, 1598 (1999)).

⁸⁴ *See* Schwartz & Scott, *supra* note 12, at 608 n.144 (noting that "courts tend to regard state-created defaults as presumptively fair or efficient"). As Ian Ayres suggests, it is not clear that the right answer is that courts should make it as easy as possible to opt out of default rules. *See* Ayres, *supra* note 83, at 897-99 (pointing to "basic unanswered questions about how the law should set opt-out rules"). My point here is that courts in fact do resist opting out, which makes the default rules more "sticky."

however, the problems with the proposed default rule are broader than the global concerns with incorrect default rules.

A. Overenforcement

The first point is a simple one, drawn from the seminal discussion of this problem by Goetz and Scott. As discussed above, remedies that allow parties to recover the entire amount that they expend in reliance on a promise create a moral hazard, a risk that the party will not limit its expenditures to reasonable amounts.⁸⁵ Goetz and Scott explain that imposition of those remedies after a formal agreement is less problematic, because the agreement provides a context in which the parties can select an enforcement regime that deals with such problems.⁸⁶

The other side, of course, is that imposition of those remedies before the parties have an opportunity to contract out of them poses a serious potential of overenforcement of those promises. To put it another way, in the preconsensual context, the least reliance should be placed on default rules, because the parties are least likely to have had an opportunity to contract around the default rules in an informed way.⁸⁷

The point of course can be overstated. As discussed above, parties have entered preliminary agreements in which they could opt out of such a regime in many contexts. Indeed, it seems clear that such agreements are common.⁸⁸ However, the import of that practice, as suggested above, is simply to narrow the field within which the no-retraction proposal will have an effect. My concern is with the effects of the proposal within the field where it will apply. In that field, it can have a substantial cost precisely because parties have not had an opportunity to opt out of it.

B. Information-Forcing Defaults

The no-retraction regime also discards a useful feature of the existing regime: its ability to force the transfer of information as a predicate to liability.⁸⁹ In the existing system, absent some substantial amount of unfair dealing (the subject of the next section), a party will not expect to recover the costs it expends at the preconsensual stage unless a specific contractual provision deals with the problem. This rule does not in fact prevent parties from recovering

⁸⁵ Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1285.

⁸⁶ *Id.* at 1295.

⁸⁷ Because the discussion here relates only tangentially to consumers, I doubt that Russell Korobkin's analysis of the status quo bias has a major impact. See Russell B. Korobkin, The Status Quo Bias and Contract Default Rules, 83 *Cornell L. Rev.* 608 (1998)(positing that contracting parties view default terms as part of the status quo).

⁸⁸ See Farnsworth, *supra* note 3, at 257-58 (mergers and acquisitions context); Johnston, *supra* note 31, at 403-04 (sale of business negotiations); Scott, *supra* note 22, at 1677-79 ("indefinite bonus" agreements).

⁸⁹ See Ayres & Gertner, *supra* note 83, at 95-100. For a discussion in this context, see Craswell, *supra* note 45, at 545-46.

such expenditures, any more than the analogous rule that limits recovery for unforeseeable consequential damages.⁹⁰ It does, however, prevent parties from recovering for those items after the fact if they do not reveal them to their negotiating partner before the fact.⁹¹

Thus, for example, if parties believe that certain expenditures efficiently would provide information about particular risks of going forward, they can agree that the funds would be spent and agree on an allocation of responsibility to pay for them if the transaction does not go forward. That is, after all, what it means for parties to agree upon breakup fees or to post a refundable or nonrefundable deposit of earnest money or the like. This system permits parties to allocate those expenditures in the way that seems best to the parties at the time. Moreover, its information-forcing aspects can force a joint decision on the timing and nature of expenditures, which should increase the effectiveness of those expenditures by limiting duplication of effort. To return to the real-estate purchase example from above, a joint decision on the scope and timing of an environmental audit doubtless is superior to a unilateral decision by the prospective buyer.

By removing the link between the disclosure that is inherent in consent and the obligation to compensate, the no-retraction regime systematically alters the incentives of parties to make those decisions jointly. Because joint decisions about collection and analysis of information likely will be superior to separate decisions, the benefit of the no-retraction regime seems questionable.

C. Untrammelled Freedom from Contract

Perhaps the most striking aspect of the proposal is its apparent willingness to allow people to have an unqualified ability to opt out of any regime for preconsensual liability.⁹² The basic premise of the law in this area--indeed of the entire Uniform Commercial Code--is that parties cannot control their exposure entirely. In areas policed by a duty of good faith,⁹³ the parties always must recognize the potential for liability no matter what their contracts say. It may be that untethered good-faith obligations fit uncomfortably with the general predilection that commercial law has for rules that are certain and predictable.⁹⁴ Nonetheless, the idea of good faith as an ineradicable backstop for behavior that is not commercially acceptable is one

⁹⁰ For an argument that the rule of Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. D. 1854) does a poor job of forcing the production of that information, see Eisenberg, *supra* note 3, at 1771-79 and Melvin Aron Eisenberg, The Principle of Hadley v. Baxendale, 80 **Calif. L. Rev.** 563 (1992).

⁹¹ See Schwartz & Scott, *supra* note 12, at 598 n.116 (describing “information-forcing” default rules).

⁹² See Ben-Shahar, *supra* note 1, at ___.

⁹³ The duty of good faith applies not only in areas where courts adopt it by common law, but also in all transactions governed by the Uniform Commercial Code. UCC § 1-304 (2001).

⁹⁴ It is of course part of the point of the concept of good faith that it not be reducible to a simple definition. See Robert S. Summers, “Good Faith” in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 **Va. L. Rev.** 195, 196 (1968)(stating that “good faith” is “a phrase with no general meaning of its own”).

that is deeply woven into our culture. However uncertain it might seem, it is too late in the day to argue seriously that it is harmful for businesses to be subject to that sort of review.⁹⁵

Thus, I am puzzled by Ben-Shahar's willingness to leave this area entirely to the will of the parties.⁹⁶ I understand why parties may not want to be bound directly by the positions that they offer in negotiations. As discussed above, there are strong reasons why concerns about opportunism might not persuade a sophisticated and informed businessperson to adopt a regime in which she would wish to be bound by those positions. That does not mean that there should be no recourse whatsoever for misbehavior in the process of negotiation. The reporters are replete with cases in which parties have challenged misdeeds in that process.⁹⁷ Some of them report behavior that plainly should be sanctionable. Whether those cases are characterized as involving unfair dealing,⁹⁸ violation of a duty of good faith,⁹⁹ or simply circumstances in which nonreciprocal offers have been made in ways that justifiably induced reliance,¹⁰⁰ the central point remains that the law has done well in imposing a backstop that cannot be removed by contract. Because the parties likely to engage in that behavior are the parties most likely to insist on opting out of any optional legal regime,¹⁰¹ it seems illogical to consign this issue entirely to the parties.

III. Conclusion

As always, Ben-Shahar provides a careful economic analysis and a welcome willingness to embrace the implications of real-world qualifications. My remarks today are intended in that spirit. I hope they illustrate both the contribution he has made and the boundaries that cabin it. This is an interesting proposal, which is likely to spark a considerable academic debate. My main point is that serious consideration of the proposal as a policy recommendation should be preceded by a good deal of industry-specific and transaction-specific research of the important

⁹⁵ See James J. White, *Good Faith and the Cooperative Antagonist*, 54 *SMU L. Rev.* 679, 679 (2001)(acknowledging that “no court, nor any academic writer, has ever been so bold or so gauche as to suggest that good faith should not attend the obligations of parties under the UCC”).

⁹⁶ Perhaps I overread Ben-Shahar's views here. He does recognize at one point (Ben-Shahar, *supra* note 1, at 49-50) the importance of the duty of good faith, and discusses a truncated version of a duty of good faith in negotiations at another (*Id.* at ___). It is not clear, however, that the duty would apply to parties that opted out under his regime.

⁹⁷ I do not share Ben-Shahar's pessimism about the state of the law in this area. This area of law began to develop only in the last few decades, so it is not at all surprising that it should still be in considerable flux. That is particularly true given the deep academic doubts about the reasons for which liability should be appropriate.

⁹⁸ See Farnsworth, *supra* note 3, at 280-85.

⁹⁹ See Eisenberg, *supra* note 3, at 1796-1813; Goetz & Scott, *supra* note **Error! Bookmark not defined.**, at 1319-20.

¹⁰⁰ See Craswell, *supra* note 45, at 536-40 (arguing that the cases compensate reliance “especially where the other party appears to have wanted the first party to rely”).

¹⁰¹ E.g., *Channel Home Centers v. Grossman*, 795 F.2d 291 (3rd Cir. 1986) (discussed in Eisenberg, *supra* note 3, at 1799-1802).

underlying factual questions discussed above. The most important inquiry would be to gain some empirical understanding in context of the reasons that parties commonly retreat from bargaining positions. Of secondary importance, though still of considerable value in assessing his proposal, would be knowledge in various contexts of the actual practices of parties in making their negotiating offers binding, or nonbinding. Although Ben-Shahar's proposal arguably is simply a change of a default rule, an understanding of commercial views as to the "right" answer would be important to a fair assessment of the likelihood that the change would be positive.

Related to that point, it is easy to ask why it would be important to change a default rule around which sophisticated parties can contract. I hope I have suggested some credible reasons why the existing body of contract law is more than that. In its fullest sense, it is a system of contextual rules, evolved over many years to deal with issues specific to particular transactions and industries. It would be imprudent to discard the role of consent in that system without further thought.