COMMENTARIES

CONTRACTS—ONLY *WITH* CONSENT

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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 essay to which I reply, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*,[1] is his second work on that topic, following his 2001 article with Lucian Bebchuk entitled *Precontractual Reliance*.[2] Collectively, these pieces provide a comprehensive analysis of the relationship 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 recommends. I first address the propriety of using a single regime to resolve preconsensual and postconsensual problems. I then consider whether the characterization of Ben-Shahar's proposal as a default rule responds to the concerns that I raise in the first part of my discussion.

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1 Omri Ben-Shahar, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*, 152 U. PA. L. REV. 1829 (2004).

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

I. TWO REGIMES

The most elegant aspect of Ben-Shahar's essay is its use of a single model to resolve problems arising along a continuum, starting at the point when parties begin to consider a transaction and running through to the period after they have come to a formal agreement.[3] 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 that 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.[4] 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)[5] to a different liability regime after that moment (expectation damages for breach of contract).[6] In their place, a no-retraction regime would substitute a gradual and continuous increase of liability throughout the preconsensual period,[7] culminating in full expectation damages at the point of the contract.[8]

Before beginning an affirmative critique, it seems important to note a threshold ambiguity in the difference between the proposed regime and the existing law. The existing law already permits the

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[3] *See* Ben-Shahar, *supra* note 1, at 1833 (describing his theory as a "unifying principle").

[4] *See id.* at 1834-35 (applying the no-retraction regime to preliminary agreements).

[5] *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 prompted the court to impose a duty to negotiate in good faith, even when no such commitment arose through agreement); E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 273-85 (1987) (listing several courses of conduct that courts have held to be "unfair dealing" in precontractual negotiations, such as "improper tactics" and "non-disclosure").

[6] *See* RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (outlining the default measure of damages under the current common law).

[7] *See* Ben-Shahar, *supra* note 1, at 1838 (describing the spectrum of liability throughout the negotiations process).

[8] *See id.* at 1859 ("When the precontractual understanding is comprehensive and needs no supplementation, the option to enforce it converges with standard contractual liability.").

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 acted reasonably in expending money based on the actions of the other party.[9] 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 financer, even in the absence of a contract that would permit expectation damages.[10]

Although the no-retraction regime is plainly 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 what already exists in the current law. The 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 legal remedy usually arises where one party (based on conduct of the other) justifiably relies on the fact that a contract is forthcoming.[11] Ben-Shahar's proposal provides a remedy at an earlier stage (before the parties reach a point when it is fair to assume that a contract is forthcoming). Ben-Shahar's discussion, however, says little about how to determine which communications create liability. His model takes as a given that "serious" communications will induce an appropriate measure of reliance and that all other communications will be ignored.[12] That model, however, simply assumes away the problem—which largely occupies the existing doctrine—of determining what types of promises are sufficiently serious to warrant reliance on the part of the recipient.[13]

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

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[9] *See* RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981) (setting forth the doctrine of promissory estoppel).

[10] *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 in which courts used promissory estoppel to enforce "relied-upon nonreciprocal promises").

[11] *See* RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981) (noting that courts can remedy injustice resulting from reasonable reliance on a promise).

[12] *See* Ben-Shahar, *supra* note 1, at 1843 (defining "serious" communications and positing that liability for retraction ought to be limited to such communications).

[13] This problem is the general topic of Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 STAN. L. REV. 481 (1996). Craswell notes that liability often "turn[s] on whether the party . . . attempting to withdraw said anything the law will interpret as a 'promise' on which the other party 'reasonably' relied." *Id.* at 482-83.

of liability based on the gradual juxtaposition of negotiating positions.[14] Reliance damages, as typically contemplated, have the same type of all-or-nothing switch that expectation damages under consent-based liability rules do. Thus, although a party can recover nothing expended before it is reasonable for that party to rely, it can recover everything that is reasonably expended after it is reasonable to rely.[15] Ben-Shahar's proposal, in contrast, seems to contemplate a sort of quasi-expectation liability regime, in which each party is always 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 the 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 in the number of agreed-upon issues to a slow increase in monetary liability. He assumes that a court practicably could enforce a gradual increase in liability at any stage through a combination of (a) the then-agreed-upon terms and (b) the least favorable terms on all other subjects. As the ratio of agreed-upon 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.

Putting those threshold questions aside, the principal purpose of my response is to consider the propriety of Ben-Shahar's unified framework. Ultimately, my response to the proposal is the standard move one would expect from a scholar of a particularizing tendency like myself: This framework 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.

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[14] *See* Ben-Shahar, *supra* note 1, at 1831 ("Thus, in effect, the greater the 'fraction' of a contract the parties have, the greater the 'fraction' of contract liability the plaintiff can enforce.").

[15] *See* Farnsworth, *supra* note 5, at 224-25 (discussing this timing problem in calculating reliance damages).

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 process of dividing the surplus that the contract would create.[16] 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 generate more credibility, and thus more effectiveness at inducing reliance,[17] the proposed regime would impose liability on those who "retract" serious negotiating proposals.[18] That conclusion rests on his analysis (here and in his work with Bebchuk)[19] of the benefits that will arise from enhancing the ability of the promisee to adapt her behavior in response to a credible promise.

The obvious question is whether such an analysis gives due weight to the costs of promising that inevitably arise when promises are made subject to greater legal sanction.[20] Ben-Shahar, of course, recognizes this possibility. Indeed, Ben-Shahar notes that his proposal will "weaken[]" parties' "'freedom from contract.'"[21] He argues that this weakening is not a significant problem because "parties that place great value on this freedom can choose to opt out of the liability consequences and opt into the consensus regime."[22] I have three general responses to that line of reasoning: (1) Ben-Shahar overestimates the importance of opportunism in the preconsensual period and understates the importance of risk assessment; (2) Ben-Shahar underestimates the adverse effects of enforcing nonreciprocal promises; and (3) in practice, parties can make their negotiating commitments credible without this regime.

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[16] The model is set out formally in Bebchuk & Ben-Shahar, *supra* note 2, at 430.

[17] This form of analysis builds implicitly on Goetz & Scott, *supra* note 10.

[18] *See* Ben-Shahar, *supra* note 1, at 1838 (describing the theoretical operation of no-retraction principles during negotiations).

[19] Bebchuk & Ben-Shahar, *supra* note 2, at 446-47, 456-57; Ben-Shahar, *supra* note 1, at 1847-53.

[20] Here I, too, draw on the framework articulated in Goetz & Scott, *supra* note 10, at 1265-88. My specific concern is with the costs of promising that Charles Goetz & Robert Scott discuss. *See 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 of these ideas, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 559-62 (2003).

[21] Ben-Shahar, *supra* note 1, at 1842 (emphasis omitted).

[22] *Id.*

1. How Important Is Opportunism?

I was asked to contribute a Commentary with both empirical and doctrinal emphases as a counterpart to the philosophical and analytical emphases 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 Commentary. Still, some useful empirical intuitions may shed light on the matter.

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), in which price and timing are the main issues and in which little information about the specific asset need be assembled. In that context, opportunism may be an important problem in negotiations. On the other hand, such a case rarely produces 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 dominates each negotiation. Neither perspective is complete. My point, however, is that the search for a unified framework can succeed only if that framework addresses both the commodities context (on which I consider Ben-Shahar to focus) and other, more information-laden contexts.

The core of Ben-Shahar's 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.[23]

[23] *Id.* at 1830 (emphases omitted).

The inconsistency of this proposal with current commercial practice in some settings is striking. To take one anecdotal and relatively simple example, imagine a party that wishes to purchase an industrial tool and sends several "request for quote" inquiries to prominent suppliers.[24] 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.[25] Essentially, the regime starts from the assumption that an invitation to begin negotiations is ordinarily binding because a decision to retreat from such an invitation is necessarily opportunistic. It is easy to conclude 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.[26] It is also easy to see, as Ben-Shahar acknowledges quite

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

[25] Ben-Shahar addresses the multiple-party problem explicitly, 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* Ben-Shahar, *supra* note 1, at 1868 ("[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. *See infra* Part II (identifying "[p]roblems with [o]pting [o]ut").

[26] 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* Ben-Shahar, *supra* note 1, at 1852 ("[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. *See id.* at 1847 (claiming that "the no-retraction regime proves superior in settings in which the social goal is to encourage precontractual reliance"). As my example (and most of the other examples in this critique) suggests, there often will not be a reciprocal likelihood of retraction. 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 a $550 million reciprocal termination fee in a 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.

openly,[27] that his framework might substantially increase the transaction and litigation costs associated with such a "request for quote" inquiry.[28]

But it is not particularly useful 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 Ben-Shahar's proposal. On that point, I discern three broad limitations on the application of a no-retraction rule: (1) the limited value of this proposal for relational contracts; (2) the limited domain of contracts in which preconsensual surplus is important; and most significantly, (3) the importance of information in 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.[29] The efficacy of those mechanisms is likely to be undermined, not bolstered, by the addition of legal liability to nonreciprocal negotiating statements.[30] That harm is particularly likely to occur when the

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[27] *See* Ben-Shahar, *supra* note 1, at 1847 ("[I]t might well be that a mutual assent regime with majoritarian defaults is cheaper to administer than a no-retraction regime with pro-defendant gap-fillers.").

[28] 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 precisely what types of statements will establish a duty to go forward and at what time any such statements must be honored before the proposer can retract without fear of liability. *See id.* at 1843 (explaining why liability for precontractual reliance attaches only "to proposals that are sufficiently rich in detail"). Even if those issues could be clarified, this rule still would produce considerable complexity in cases involving parallel negotiations on multiple possible structures for a transaction (parallel discussions of asset and stock purchases, for example).

[29] *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 reputation to resolve information asymmetries).

[30] *See* Goetz & Scott, *supra* note 10, at 1281 ("[I]n contexts in which 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.

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, as often will be the case.[31] It is difficult to know, of course, what share of contracts is discrete, rather than relational. It is plain, in any event, that the number of contracts involving discrete negotiations is sufficiently substantial to warrant separate legal treatment. The problem with a unified theory, then, is that the theory's 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.[32] 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.[33] On the other hand, preconsensual investments seem unnecessary in many cases. For instance, in Ben-Shahar's employee-relocation example,[34] the preconsensual investment frequently 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,

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REV. 1641, 1693 (2003) (concluding that the enforcement of agreements that parties intentionally left indefinite would be "counterproductive," even when the hoped-for reciprocity fails).

[31] *See* Bernstein, *supra* note 29, at 1789 (suggesting that in some markets "nonlegal sanctions such as reputation bonds are strong enough, . . . making a legally enforceable provision unnecessary"); Scott, *supra* note 30, at 1657 (noting that parties often appear to prefer "the indefinite agreement" to the more complete, "explicit[,] and verifiable alternative that they ignored").

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

[33] 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 Article 2 of the Uniform Commercial Code 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).

[34] *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." (footnote omitted)).

an empirical question exists with regard to the size and frequency of valuable preconsensual investments. That question surely must be influenced by the prevalence of contractual models that permit postcontract 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.[35] Ben-Shahar's formal model[36] assumes that the need for large preconsensual investments is commonplace. If, however, that need is not so commonplace, 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.[37]

Third, Ben-Shahar assumes that the parties have perfect information.[38] That assumption is not, of course, unusual, and it does allow 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 a process of dividing the surplus, but a collection of information and allocation of risk.[39] In that paradigm, the parties are constantly exchanging, acquiring, and assessing information about the transaction

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[35] *See* Mark P. Gergen, *The Use of Open Terms in Contract*, 92 COLUM. L. REV. 997, 997-98 (1992) (discussing such contracts generally).

[36] *See* Ben-Shahar, *supra* note 1, at 1849 nn.39-40, 1851 n.45 (describing the relevant equations).

[37] Moreover, in assessing the benefits of his model, it is not clear that we should include cases in which precontractual surpluses are important if the existing law seems to provide adequate mechanisms for inducing appropriate investments. Because the courts normally provide for a recovery in the most prominent example that he offers (the subcontractor bid case discussed above) in which it is important that the surplus be precontractual, the size of the domain that benefits from his proposal is not apparent.

[38] Bebchuk & Ben-Shahar, *supra* note 2, at 430. 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).

[39] That perspective is common in the economic analysis of preconsensual negotiation, including the following articles, two of the many influential works on this subject: Goetz & Scott, *supra* note 10 (examining the function of promises and the impact of liability on the making of promises in a world of imperfect information and costly legal processes); Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 VA. L. REV. 385 (1999) (analyzing the economic incentives that underlie the dealmaking process, with a focus on exploring how they vary under alternative institutional and market structures and how legal liability may shape them).

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.[40] For example,[41] consider parties negotiating over the acquisition of a large, real estate project. On day ten of negotiations, 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 established for both parties that the field of negotiation should shift to reflect the new information. Similarly, information received 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, this paradigm views each party's negotiating position at any given time as reflecting its then-current estimate of the asset's value, using predictions regarding 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 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.

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[40] *See* Farnsworth, *supra* note 5, at 280-81 (discussing "[r]eneging" in contract negotiations).

[41] 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.

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. Ben-Shahar (along with Bebchuk) explains that a retraction is not opportunistic if made "after it has become clear that the profitability of the intended trade is so low that trade is not desirable."[42] It is difficult, however, to know precisely what that statement means. Circumstances can change in many ways that might affect the desirability of a transaction, ranging from the receipt of information about the quality of the particular asset, to the receipt of 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 the receipt of information about the value of the asset directly (such as competing offers to purchase the asset).[43] 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?[44] 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.[45] As Bob Scott recently explained, the likelihood

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[42] Bebchuk & Ben-Shahar, *supra* note 2, at 447.

[43] Mark Gergen, for example, explains *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267 (Wis. 1965), in this way. *See* Mark P. Gergen, *Liability for Mistake in Contract Formation*, 64 S. CAL. L. REV. 1, 32-33 (1990) (presenting this particular analysis of *Hoffman*).

[44] 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. 1903, 1920 (2004) ("It may happen, for example, that the slow pace of convergence causes one party to conclude that the final deal will not be worth its transaction costs and therefore to withdraw its last offer and abandon the negotiation altogether."). A perfectly rational view that the transaction costs of concluding an agreement are likely to exceed the potential profits from any eventual agreement is entirely legitimate but at the same time quite difficult to verify in court.

[45] *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").

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 "unverifiable" by courts.[46]

More fundamentally, the question of 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 involves an effort by one party to take advantage of another party's existing investments by making offers that "hold up" the invested party.[47] But whether the test for "desirable" trade will perfectly match transactions that do not involve the "holdup" problem on which he focuses remains uncertain. 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 that 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.[48] Moreover, as Ben-Shahar himself explains in his work with Lisa Bernstein,[49] information about a party's valuation of a specific contracting opportunity often will constitute proprietary information that cannot be revealed costlessly either to a negotiating partner or to a judicial forum assessing the propriety of the retracting party's actions.[50] A regime that starts from the presumption that backtracking and retraction are opportunistic is unlikely to provide a sensitive resolution of disputes that arise out of this type of interaction.

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[46] *See* Robert E. Scott, *Rethinking the Default Rule Project*, 6 VA. J. 84, 87-91 (2003) (noting that a party's private valuation rarely is verifiable by a court and discussing the problems with default rules that rely on such information).

[47] *See* Bebchuk & Ben-Shahar, *supra* note 2, at 426 (discussing opportunistic offers as those "that leave the other party with a net negative payoff").

[48] *See* Goetz & Scott, *supra* note 10, at 1296 (discussing likely error costs of judicial enforcement in this area); Scott, *supra* note 46, at 87-90 (portraying the unverifiability of information like a party's valuation of the contract as a barrier to the efficient formation of contracts); Scott, *supra* note 30, at 1687 (analyzing the role of indefiniteness in the resolution of contract suits).

[49] Omri Ben-Shahar & Lisa Bernstein, *The Secrecy Interest in Contract Law*, 109 YALE L.J. 1885 (2000).

[50] *See id.* at 1886-88 (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).

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, which steadily decreases 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 into a final transaction unless the uncertainty and variance could be reduced to a level appropriate for their business models.

Consider, for example, a lender investigating potential loan transactions. For rational reasons, the lender might prefer to specialize in making loans that involve a particular level of risk.[51] Such a lender, through the course of the transaction, might provide relatively detailed predictions of the likely terms on which it would enter into a final transaction. As evidence is collected about any particular transaction, the potential terms might shift back and forth. But the lender would have no intention of entering into 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.[52]

[51] Among the most obvious reasons for such specialization are (1) that the lender might be able to price the risk of such transactions more accurately through experience with a portfolio of transactions involving homogenous risk and (2) that the lender might specialize in the management of assets involving 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.

[52] *See infra* Part II (addressing three major problems inherent to Ben-Shahar's suggested system). One minor point to mention here 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 that 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. *See, e.g.*, Farnsworth, *supra* note 5, 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.

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None of the foregoing is intended to suggest that no parties 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 Charles Goetz and Robert Scott,[53] it does not warrant extended discussion. Essentially, the concern is that a rule allowing a party to recover its reliance costs[54] creates a moral hazard because that party no longer has an optimal incentive to limit the expenditures that it makes in reliance on the promise in question.[55]

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[53] Goetz & Scott, *supra* note 10, at 1285.

[54] 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. *See* Bebchuk & Ben-Shahar, *supra* note 2, at 423 (describing reliance expenditures as "investments that will raise the value of performance if the contract is formed but will have a lesser value otherwise"); Ben-Shahar, *supra* note 1, at 1848 n.37 (employing the term for a similar meaning). 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. *Id.* at 1845, 1871. Because Ben-Shahar ties his work directly to the tradition (which he dates to L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 2), 46 YALE L.J. 373 (1937)) analyzing the relative merits of expectation and reliance damages, Ben-Shahar, *supra* note 1, at 1831 & n.1, 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 the 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 10, at 1288. I assume here that Ben-Shahar intends something similar.

[55] *See* Craswell, *supra* note 13, at 494-95, 499 (arguing that expectation damages result in incentives for excessive reliance upon the promise and that reliance damages

As a general matter, Goetz and Scott argue, that problem calls for caution in adopting legal rules that enforce nonreciprocal promises.[56] 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.[57]

Ben-Shahar's formal model seems to recognize the problem with a regime of strict preconsensual liability.[58] However, why is the regime discussed here not subject to the same problem of excessive reliance? His discussion of this regime does not seem to address the problem directly.[59] It is, of course, difficult to gauge the extent of that moral hazard in the real world, and 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 another cost of a no-retraction regime, which must be offset by the benefits the regime offers in enhancing the credibility of nonreciprocal promises made in negotiations.

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are even worse in this respect); Goetz & Scott, *supra* note 10, at 1285 (noting that reliance damages create "a moral hazard because the promisee will not exercise optimal self-protection"). Obviously, in some cases it might not be optimal to adopt a remedy that obligated a breaching promisor to pay damages that exceed the optimal amount of reliance. As Craswell notes and as I have explained elsewhere, however, those kinds of supracompensatory promises might be highly rational in certain circumstances. *See* Craswell, *supra* note 13, at 499-500 (listing economic factors that might justify such damages); Mann, *supra* note 29, 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 20, 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 supracompensatory remedies as a default rule contrary to the intention of the parties.

[56] *See* Goetz & Scott, *supra* note 10, at 1281 (noting that, under certain conditions, "[n]onenforcement of . . . nonreciprocal 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 13, 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 the existing doctrine already may address adequately.

[57] *See* Goetz & Scott, *supra* note 10, at 1294 (asserting that "promises made during preliminary bargaining are not enforceable until the bargain is sealed by an agreed exchange").

[58] *See* Bebchuk & Ben-Shahar, *supra* note 2, at 434 (proposing a strict precontractual liability rule that prompts "each party [to] choose[] a level of reliance investment that is excessive, given the other party's investment").

[59] *See id.* at 445-47 (describing several scenarios in which parties will generate "optimal reliance" but neglecting to address the potential for "excessive reliance").

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 by how much the 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 examine what can be gleaned from the existing literature and observations of commercial practice as a mechanism for judging how well or how poorly the system works *without* this framework. If the system works relatively well as it stands, then little can be gained by adopting this new regime to enhance the credibility of preconsensual promises.

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 on this point: the results of a survey of corporate general counsels by my colleague Russell Weintraub.[60] Among other things, that survey investigated the use of firm offers.[61] The results strongly suggest that firm offers are widely prevalent in the business world, particularly among larger firms. Overall, about 76% of respondents received them, and about 73% said that they made them.[62] On the question of whether the offers are reliable, the responses were almost unanimous: 95.2% rely on them, and 96.8% expect offerees to rely on them.[63] Lest this unanimity seem an odd artifact of small businesses and therefore not important to "real" commerce, Weintraub reports that the prevalence of firm offers was directly proportional to the size of the respondent: 83.6% of billion-dollar companies received them, 75% of companies in the $500 million to $1 billion range received them, and 57.1% of companies in the $100 million to $500 million range received them.[64]

As the discussion in a preceding subsection implies,[65] firm offers work only in a relatively simple type of transaction, in which the

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[60] *See* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 13-45 (presenting the results from a survey that Weintraub sent to the general counsels of 182 American corporations).

[61] For a definition of a "firm offer," see U.C.C. § 2-205 (2003).

[62] Weintraub, *supra* note 60, at 27.

[63] *Id.*

[64] *Id.* at 27-28.

[65] *See supra* Part I.A.1 (analyzing the information-related problems inherent in a no-retraction regime and determining that the regime would prove more appropriate for rather simplistic transactions).

offeror needs no factual investigation to determine its willingness to transact and the price at which it would transact. In those transactions, the simple and commonly used device of the firm offer should be adequate to provoke reliance. Most negotiations, however, involve interactions that are more complex. In those situations, parties commonly use obvious transactional devices such as earnest money or deposits to foster preconsensual investigation.[66] For example, in many contexts (most obviously the sale of commercial real estate), a prospective purchaser at an early stage of the transaction deposits 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 prospective purchaser. At the end of this period, the purchaser either will proceed to purchase the property or will decide to walk away.[67]

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.[68] Most important for present purposes, the contracts will include detailed provisions regarding the ultimate disposition of the deposit. Generally, the contracts will list conditions justifying the purchaser's decision to terminate the arrangement with a return of the deposit or, alternatively, justifying the seller's retention of the deposit if the purchaser fails to proceed.

Another obvious example, which involves probably the greatest amount of preconsensual investment, is the inclusion of lockup and breakup fees in merger and acquisition agreements. Those fees are frequently quite large.[69] A substantial academic literature addresses the possible positive and negative incentives such fees might have on the affected transactions.[70] Nevertheless, there seems to be little

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[66] *See, e.g.*, McBrien v. Master Dev., Inc., 840 F. Supp. 362, 365 (E.D. Pa. 1994) (involving the use of a signed letter of intent, which included a deposit provision, for the investigation of property during negotiations); Farnsworth, *supra* note 5, at 249-51 (describing the use of earnest money in precontractual negotiations).

[67] *See* Farnsworth, *supra* note 5, at 249-53 (discussing such preliminary agreements generally).

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

[69] *See, e.g.*, Brazen v. Bell Atl. Corp., 695 A.2d 43, 47-50 (Del. 1997) (awarding a $550 million fee to the plaintiff for the termination of a merger agreement).

[70] For a sampling of this literature, see Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 COLUM. L. REV. 682 (1990);

doubt that, as between the contracting parties themselves, those fees represent a potential strategy to minimize transaction costs when opportunity costs and other preconsensual investments are a major focus of the preconsensual stage of the transaction.

A final example appears in the large lending transaction.[71] Those transactions typically involve a large deposit or application fee by the borrower at the time that the parties commence a serious collection of information about the proposed investment. Again, those transactions involve considerable preconsensual investments by the parties; 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 for the lender to assess in connection with finalizing the details of the proposed transaction. Similarly, a brief contract related to the deposit or to the 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 good understanding of an appropriate deposit amount, given the complexity of the investigation to be undertaken and 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 sometimes have good reasons for erecting intentionally indefinite agreements. As Bob Scott explains in his recent study of such cases,[72] these arrangements may do a much better job than more definite agreements of policing problems of shirking in performance.[73] Moreover, because these intentionally indefinite arrangements appear to be intertwined with

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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).

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

[72] Scott, *supra* note 30, at 1675-85. Obviously, ambiguity exists as to whether intentionally incomplete contracts should be deemed 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 next in the context of postconsensual transactions, *infra* Part I.B.

[73] *See* Scott, *supra* note 30, at 1692 (concluding that intentionally incomplete agreements, by creating norms of "self-enforcement," may be "more efficient than legal enforcement").

nonlegal sanctions, a broad doctrine providing for more enforcement would diminish their effectiveness.[74]

B. *After Consent*

The no-retraction model applies most significantly to the period before consent.[75] 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 partial enforcement regime in the postconsensual period often deprives 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, this premise seems to dispense with the concept of contractual interpretation as a device for ascertaining the parties' likely intent with respect to a disputed question.[76] Contractual interpretation 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 understandings of ambiguous provisions.[77] Given the ease of locating ambiguity in contractual provisions, this concept could be quite debilitating if afforded broad application. After a careful reading, however, it seems

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[74] The expression of this caution does not simultaneously imply that such arrangements should never result in judicial enforcement. As I discuss below, *infra* text accompanying notes 98-121, I think the existing, more nuanced scheme for judicial enforcement is likely to be less damaging than Ben-Shahar's scheme, which discounts the features important in current doctrine: the existence of consent and the justifiability of the reliance.

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

[76] It also assumes that courts are not readily capable of recognizing and responding to opportunism directly, an assumption that is certainly contestable. *See, e.g.*, T.W. Oil, Inc. v. Consol. Edison Co. of N.Y., 443 N.E.2d 932, 938-39 (N.Y. 1982) (refusing to accept the buyer's opportunistic rejection of a technically nonconforming tender by the seller).

[77] *See* Schwartz & Scott, *supra* note 20, at 583 (arguing that "the best interpretive default for firms is textualist when the issue is what their contract language meant").

clear that Ben-Shahar in fact does not contemplate the broad application of his proposal in a postconsensual setting. Rather, he applies it in only a few localized settings, which I will now consider in turn.

1. Indefiniteness

Ben-Shahar's most important application relates to indefinite contracts.[78] In that context, he argues that courts should not fill gaps with majoritarian terms (his description of the dominant approach in the Uniform Commercial Code and in the common law), but rather, should fill gaps with pro-defendant terms.[79] For the reasons discussed at the beginning of this Section, it is quite doubtful that his approach would improve upon existing practice. At least in the absence of any information-forcing effects, the majoritarian outcome best serves both parties.[80] Moreover, the long-term effects of Ben-Shahar's 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 rule, then, might result in a practice of increasingly extreme positions, with judges choosing between extreme positions that are far less satisfactory than anything the plaintiff plausibly could have expected when it entered the agreement.[81]

2. Misunderstanding

The doctrine of misunderstanding applies when both parties assign materially different meanings to the same term of the contract.[82] The classic case is the well-known *Peerless* situation, in which a contract for materials on the ship *Peerless* was understood by the buyer and the

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[78] *See* Ben-Shahar, *supra* note 1, at 1845-47, 1864-65 (explaining gap-filling with regard to incomplete agreements).

[79] 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). I limit myself here to a response to the brief points he makes in the essay at hand.

[80] *Cf.* Schwartz & Scott, *supra* note 20, at 584-90 (arguing for a plain-meaning, "majority talk" default in cases where a contract is silent on a matter).

[81] Furthermore, as I discuss elsewhere, *supra* note 74 and accompanying text; *infra* note 99 and accompanying text, 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.

[82] RESTATEMENT (SECOND) OF CONTRACTS §§ 20(1), 201 (1981).

seller to refer to different ships of the same name.[83] In the absence of fault on either side, the existing doctrine treats such a situation as a failure of mutual assent, and thus a failure of the contract.[84] 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 to treat the contract as a failure in its entirety.[85] In fact, much can be said for the view that it is wrong to let the contract be treated as entirely lapsed.[86] Ben-Shahar's proposal thus suggests a sensible possibility for providing some response to the question of where the losses might have fallen without an enforceable agreement.[87]

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.[88] Brian Simpson's comprehensive treatment of the *Peerless* case, for example, leaves the impression that the common use of the ship name *Peerless* at the time reasonably should have led *both* parties to inquire further about the particular ship involved in the

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[83] Raffles v. Wichelhaus, 159 Eng. Rep. 375 (Ex. 1864). For a thorough discussion of the case, see A. W. BRIAN SIMPSON, LEADING CASES IN THE COMMON LAW 135-62 (1996).

[84] RESTATEMENT (SECOND) OF CONTRACTS §§ 20(1), 201 (1981).

[85] Ben-Shahar, *supra* note 1, at 1856.

[86] In the misunderstanding context, the view is not entirely novel. *See* Cady v. Gale, 5 W. Va. 547, 565 (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 "[t]he 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 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 611, at 699 (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.* 1 B. S. 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.

[87] 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. . . . [T]he rule should be that where each party is equally at fault, out-of-pocket losses should be split evenly." (footnote omitted)).

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

transaction.[89] Indeed, surely on those facts, at least one party had some reason to know of the potential for misunderstanding.

In truth, the doctrine of misunderstanding does not seem to apply often outside of a first-year law student's classroom. It is the rare case in which 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* sections 20 or 201 to conclude that the parties were not equally at fault.[90] Thus, I have the sense that Ben-Shahar includes the misunderstanding doctrine not because he believes that it raises one of the most important issues of practical contract interpretation, but simply because it is an issue for which his approach may prove 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.[91] Ben-Shahar argues that the application of an all-or-nothing approach or a standard gap-filling technique would violate the parties' choice for ambiguity.[92] It is just as plausible, however, to think that the parties' choice for ambiguity reflects a considered willingness to allow the

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[89] *See* SIMPSON, *supra* note 83, at 140-41 (stating that at least eleven ships named *Peerless* were in existence but that the individual ships were easily identified at the time by use of their captains' names); *see also* Melvin A. Eisenberg, *Mistake in Contract Law*, 91 CAL. L. REV. 1573, 1613 (2003) ("Given a common practice of using the same name for more than one ship, both parties . . . were at fault . . . .").

[90] For examples of this phenomenon, see *NL Industries v. GHR Energy Corp.*, 940 F.2d 957, 969 (5th Cir. 1991); *Downey v. Clauder*, 811 F. Supp. 338, 340 (S.D. Ohio 1992); *Schaer v. Webster County*, 644 N.W.2d 327, 338 (Iowa 2002); *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).

[91] Ben-Shahar, *supra* note 1, at 1857-60, 1864-65. In my experience, the application of this doctrine 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, enforceable positions. I never experienced such a situation during my years of negotiating contracts.

[92] *See id.* at 1858 ("[E]nforcing their precontractual understanding as if it were a contract . . . would deprive the parties of the power they sought to maintain—to reject unfavorable additional terms.").

issue to be resolved later in the discretion of a third-party decision maker. 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 court later would view that party's position as more reasonable.[93] My intuition is that contracting parties are more likely to think that the latter risk is the one they are taking.[94]

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 principle might present 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 traditional rule is more likely to implement the expectations of the parties. Of course, that might be because lawyers expect application of the traditional rule, so 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.[95]

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

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[93] *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.").

[94] 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, 2699-700 (2000) (discussing results of interviews that address reasons why parties decide to enter contracts without resolving known disagreements about the terms of the relationship and indicating that such parties deem "the costs of reviewing and then negotiating about nonimmediate terms . . . simply not worth the benefit").

[95] Ben-Shahar, *supra* note 79, attempts a more extended defense of the rule suggested here. It is far beyond the scope of this critique to address that article, however.

acknowledges the problem of promising costs that I discuss[96] and suggests that parties can avoid those costs by contracting out of the rule.[97] Thus, Ben-Shahar asserts, 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: (1) the possibility that the need to contract out of the rule will lead to significant overenforcement costs, (2) the likelihood that the existing rule has substantial information-forcing benefits that Ben-Shahar's rule would discard, and (3) the likelihood that a regime granting an untrammeled right to opt out would lead to unacceptable levels of abusive behavior.

The question remains, of course, whether any of this critique 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 establishing in negotiations that they do 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 any 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 related to opting out of them,[98] but also because of the possibility that courts may prove unwilling to accept a decision to opt out of them.[99] 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, however, the problems with the proposed default rule are broader than the global concerns with incorrect default rules.

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[96] *Supra* Part I.

[97] Ben-Shahar, *supra* note 1, at 1842; *see also supra* text accompanying note 22 (quoting Ben-Shahar's principal conclusion in this regard).

[98] 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, 891 (2003) (quoting Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1598 (1999)).

[99] *See* Schwartz & Scott, *supra* note 20, at 608 n.144 ("[C]ourts tend to regard state-created defaults as presumptively fair or efficient."). As Ian Ayres intimates, whether the right answer is that courts should make it as easy as possible to opt out of default rules has yet to be determined. *See* Ayres, *supra* note 98, 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."

A. *Overenforcement*

The first point is a simple one, drawn from the seminal discussion of this problem by Goetz and Scott.[100] As mentioned 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 parties will not limit their expenditures to reasonable amounts.[101] Goetz and Scott explain that the 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.[102]

The other side, of course, is that the imposition of those remedies *before* the parties have an opportunity to contract out of them poses a serious danger of overenforcing 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.[103]

The point of course can be overstated. As noted above, parties have entered preliminary agreements in which they could opt out of such a regime in many contexts.[104] Indeed, it seems clear that such agreements are common.[105] However, the import of that practice 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.

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[100] Goetz & Scott, *supra* note 10, at 1277-88.

[101] *See supra* Part I.A.2 (describing "[t]he [p]roblem of [e]xcessive [r]eliance" as one which involves a moral hazard created by a rule which allows parties to recover their reliance costs); *see also* Goetz & Scott, *supra* note 10, at 1285 (identifying the problem of a moral hazard).

[102] Goetz & Scott, *supra* note 10, at 1295-97.

[103] 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 Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 612 (1998) (positing that "contracting parties view default terms as part of the status quo").

[104] *Supra* notes 60-71 and accompanying text.

[105] *See* Farnsworth, *supra* note 5, at 257-58 (describing such agreements in the mergers and acquisitions context); Johnston, *supra* note 39, at 403-04 (describing the use of such agreements in the negotiations surrounding the sale of a business); Scott, *supra* note 30, at 1677 (describing "indefinite bonus agreements" in which a "nonverifiable bonus" is promised in return for "additional, nonverifiable performance").

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.[106] In the existing system, absent some substantial amount of unfair dealing (the subject of the next Section),[107] 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 such expenditures any more than the analogous rule that limits recovery for unforeseeable consequential damages.[108] 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.[109]

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 will be spent and agree on an allocation of responsibility for those expenditures if the transaction does not go forward. That contractual freedom is, after all, what allows 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 the duplication of effort. To return to the real estate purchase example from above,[110] 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

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[106] *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 95-100 (1989) (examining penalty default rules as "a way to encourage the production of information"). For a discussion of information-forcing defaults in the retraction context, see Craswell, *supra* note 13, at 545-46.

[107] *Infra* Part II.C.

[108] For an argument that the rule of *Hadley v. Baxendale*, 156 Eng. Rep. 145, 151 (Ex. D. 1854), does a poor job of forcing the production of that information, see Eisenberg, *supra* note 5, at 1771-79; Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 CAL. L. REV. 563, 587-98 (1992).

[109] *See* Schwartz & Scott, *supra* note 20, at 598 n.116 (describing "information-forcing" default rules that "create an incentive for a party to disclose relevant information to its contract partner").

[110] *Supra* p. 1883.

systematically alters the incentives of parties to make those decisions jointly. Because joint decisions about the collection and analysis of information generally will be superior to separate decisions, the benefit of the no-retraction regime seems questionable.

C. *Untrammeled Freedom from Contract*

Perhaps the most striking aspect of the proposal is its apparent willingness to afford people an unqualified ability to opt out of any regime for preconsensual liability.[111] 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,[112] 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.[113] Nonetheless, the idea of good faith as an ineradicable backstop for behavior that is not commercially acceptable is one that proves 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.[114]

Thus, I am puzzled by Ben-Shahar's willingness to leave this area entirely to the will of the parties.[115] 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

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[111] Ben-Shahar, *supra* note 1, at 1842.

[112] 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. U.C.C. § 1-304 (2003).

[113] Inherent in the concept of "good faith," of course, is the notion 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 which has no general meaning or meanings of its own").

[114] *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").

[115] Perhaps I overread Ben-Shahar's views here. At one point, he does recognize the importance of the duty of good faith. *See* Ben-Shahar, *supra* note 1, at 1846 ("[T]he good faith duty is now an integral part of most legal systems . . . ."). At another point, he discusses a truncated version of a duty of good faith in negotiations. *See id.* at 1860-61 (exploring the duty of good faith as it would pertain to no-retraction liability). It is still not clear, however, that the duty would apply to parties that opted out under his regime.

about opportunism might not persuade a sophisticated and informed business to adopt a regime in which it would be bound by those positions.[116] The acknowledgment of these reasons, however, does not then 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.[117] Some of them report behavior that plainly should be sanctionable. Whether those cases are characterized as involving unfair dealing,[118] the violation of a duty of good faith,[119] or simply circumstances in which nonreciprocal offers have been made in ways that justifiably induced reliance,[120] 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 also the parties *most* likely to insist on opting out of any optional legal regime,[121] it seems illogical to consign this issue entirely to the parties.

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 proposal is interesting and 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

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[116] *See supra* text accompanying notes 24-28, 43-52 (contrasting the no-retraction regime with current commercial practices and providing examples of legitimate reasons for opposing the regime).

[117] I do not share Ben-Shahar's pessimism about the state of the law in this area. This area of law began to develop in only the last few decades, so the fact that it remains in flux should not be at all surprising. Moreover, this state of continuing change should seem even less surprising given the deep academic doubts about the reasons for which liability should be appropriate.

[118] *See* Farnsworth, *supra* note 5, at 280-85 (recommending the imposition of a duty of fair dealing).

[119] *See* Eisenberg, *supra* note 5, at 1796-813 (discussing the evolution of a "duty to negotiate in good faith"); Goetz & Scott, *supra* note 10, at 1319-20 (discussing the liability for bad faith in preliminary negotiations).

[120] *See* Craswell, *supra* note 13, at 538 (arguing that the cases compensate reliance "especially where the other party appears to have wanted the first party to rely").

[121] *See, e.g.*, Channel Home Ctrs. v. Grossman, 795 F.2d 291, 293-96 (3d Cir. 1986) (exhibiting the willingness of a party, who later broke a promise to negotiate in good faith, to enter into written agreements about these precontractual negotiations); *see also* Eisenberg, *supra* note 5, at 1799-802 (commenting on the *Channel Home* case).

good deal of industry-specific and transaction-specific research of the important underlying factual questions discussed in this Commentary. The most important inquiry would be to gain some empirical understanding 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 bare description would imply. In its fullest sense, the existing law 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.