

ESSAY

CONTRACTS WITHOUT CONSENT: EXPLORING A NEW BASIS FOR CONTRACTUAL LIABILITY

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This Essay explores an alternative to one of the pillars of contract law, that obligations arise only when there is “mutual assent”—when the parties reach consensus over the terms of the transaction. It explores a principle of “no-retraction,” under which each party is obligated to terms it manifested and can retract only with some liability. In contrast to the all-or-nothing nature of the mutual assent regime, where preliminary forms of consent are either full-blown contracts or create no obligation, under the no-retraction regime, obligations emerge gradually, as the positions of the negotiating parties draw closer. Further, the no-retraction liability regime can be coupled with different damage measures to advance various social goals, including optimal reliance. The theory is applied to areas of contract formation that have produced inconsistent jurisprudence, such as precontractual liability and misunderstandings, and resolves them in a simple and unified fashion. Finally, the analysis provides a fresh understanding of the obligation to negotiate in good faith and explores a new criterion for gap-filling in incomplete contracts.

INTRODUCTION

One of the pillars of the law of contract formation is the principle of mutual assent. According to this principle, a contract forms only when the positions of the two parties meet. When the parties represent

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different conceptions of the terms under which they intend to deal, no contractual liability arises, and both are free to walk away.

Mutual assent has many implications for contract law theory and doctrine. Importantly, it sets the boundary between the precontractual and the contractual stages. Prior to attaining a consensus, while an agreement is still being negotiated, no liability arises between the parties. At some point in time, the positions of the parties (or, more correctly, their outward manifestations) meet, and full expectation liability emerges. Liability, in other words, does not accumulate continuously. Rather, it rises abruptly as soon as the “qualitative” assent test is satisfied.

This principle also implies that a contract cannot exist when the parties remain silent over some important elements of the deal. True, statutory and judicial gap-fillers have eroded this traditional common law approach. Nevertheless, in important areas of the transaction, an absence of affirmative assent to terms still implies a non-contract.

Many of the rules characterizing the legal consequences of the communications at the contract formation stage are also corollaries of the mutual assent principle. For example, a communication is an offer—such that it can be accepted unilaterally—only if it is definite; a response to an offer that does not manifest assent—that changes some of the terms—is deemed a rejection and terminates the power of the offeree to unilaterally conclude a deal; and an offer is revocable at any time prior to its affirmative acceptance.

This Essay suggests that the consensus principle embodied in the mutual assent doctrine might not be a desirable instrument to advance the goals of potential transactors. It argues that limiting contractual liability to cases in which a consensus was manifested fails to reflect the different “tones” of the “understandings” and commitments that parties may express throughout the negotiations. As a result of this failure, the basis for contractual liability, in some situations, may be too narrow to induce optimal reliance by the parties.

As an alternative to the consensus-or-nothing structure, this Essay explores a no-retraction principle. The basic insight is the following: 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.

In contrast to the mutual assent approach, the no-retraction principle developed here suggests that when two parties attach different,

but equally plausible, meanings to their agreed-upon contractual obligation, the absence of consensus would *not* negate any liability. Instead, under the no-retraction principle, each party should have a *right to enforce a contractual obligation according to the meaning intended by the other*. Further, even when the parties have not reached a full-blown agreement or an understanding over terms, as in the case where both parties make serious, but nonconforming, precontractual representations of the proposed terms, the legal consequence should not be mutual rejection accompanied by the freedom to walk away. Rather, the representations of the parties give rise to *bilateral* options: each party can bind (with the magnitude of liability to be specified below) the other to the terms that party proposed. If the proposal is incomplete and gaps need to be filled, they will be filled with terms *most favorable* (within reason) to the proposing party. Thus, while a party is unable to retract, it is only from a deal that includes terms she proposed, supplemented by terms most favorable to her. I will argue that the enforced-against party has no reasonable grounds to reject a deal containing such terms.

Another way to conceptualize this idea is to view liability as a process of continuous convergence. Initially, when the consensus is “thin”—when the two parties differ on many terms of the deal—the option that each party acquires (to enter a deal that is very different from what she proposes and very favorable to the other party) is of minimal burden to the other party. As negotiations move forward and consensus grows, the option that each party acquires becomes more valuable. It is an option to enforce a deal that includes all the terms agreed upon, supplemented with the terms proposed by the other party. Finally, when the two parties reach a full agreement, i.e., mutual assent, the value of this option is identical to the value of the contract. Thus, in effect, the greater the “fraction” of a contract the parties have, the greater the “fraction” of contract liability the plaintiff can enforce.

The no-retraction principle provides a new underpinning for Lon Fuller’s famous notion of “an ascending scale of enforceability.”¹

¹ Letter from Lon L. Fuller to Karl N. Llewellyn, Professor of Law, Columbia University (Dec. 8, 1938), *excerpted in* ROBERT S. SUMMERS & ROBERT A. HILLMAN, *CONTRACT AND RELATED OBLIGATION: THEORY, DOCTRINE, AND PRACTICE* 41 (4th ed. 2001). This idea was introduced in L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 2), 46 *YALE L.J.* 373, 420 (1937) (objecting to the “all-or-nothing attitude” of contract law and urging for a more balanced legal approach that recognizes varying degrees of enforceability).

Fuller argued that weaker measures of damages—restitution and reliance damages—should be available when the grounds for enforcement are weaker. Liability for retraction satisfies Fuller’s ascending scale notion, since it correlates the magnitude of liability with the degree of consensus. It differs, however, in important ways from Fuller’s scale, which was limited to three discrete steps of damages and which lacked a criterion for when “enforceability” should be weaker. Liability under the no-retraction regime is continuous, with the continuity achieved not by switching among damage measures, but by affecting the terms of the deal that the plaintiff can enforce. It provides an operative measure for scaling enforcement that tracks the degree of consensus: the closer the parties’ positions have come, the more severe the liability consequence.

The no-retraction principle may seem a strange basis for liability in a system that is so fundamentally attached to the consensus/agreement principle. Precisely because it seems sufficiently strange to contract scholars and practitioners, such an alternative perspective is not commonly recognized. But the conception of contractual liability arising from a one-sided promise, rather than a two-sided consensus, is not so foreign to historians of the common law. Prior to the nineteenth-century emergence of the *consensus ad idem* theory of contract, liability was implemented through the action of *assumpsit*—the wrong of breaching a promissory obligation created by *one* party. It is only in more recent times that contractual liability merged with the notion of consensus.²

Further, the divorce of obligation from consensus/unanimity and its grounding instead on a principle of “rejectability”—on whether it is reasonable to reject a bargain—is a familiar idea in moral philosophy.³ It is recognized that the notion of consensus as the moral justification for obligation is narrower than the notion of what is unreasonable to reject.⁴ Accordingly, the no-retraction principle provides a specific

² See A. W. B. Simpson, *Innovation in Nineteenth Century Contract Law*, 91 L.Q. REV. 247, 257-58 (1975) (explaining that the notion of consensus was assimilated into the common law by nineteenth-century treatise writers); see also Philip A. Hamburger, *The Development of the Nineteenth-Century Consensus Theory of Contract*, 7 L. & HIST. REV. 241 (1989) (exploring the gradual evolution of consensus notions in common law since medieval times).

³ See, e.g., T. M. Scanlon, *Contractualism and Utilitarianism*, in UTILITARIANISM AND BEYOND 103, 110-12 (Amartya Sen & Bernard Williams eds., 1982) (describing contractualism as an alternative to utilitarianism that focuses on the reasonableness of rejection, rather than on the reasonableness of acceptance).

⁴ *Id.* at 117.

conception of non-rejectability. It is also consistent with extra-legal “no-going-back” norms in negotiations, which, for example, informally sanction a party who responds to the other party’s concessions by toughening, rather than softening, her own proposals.⁵ In this Essay, I will not explore in any depth these historical, philosophical, or sociological aspects. They are mentioned here in passing to suggest that the consensus principle of contract formation—being such a fundamental part of our modern legal and economic heritage—is not the only sensible basis for liability and to propose that an alternative no-retraction basis is at least possible.⁶

In fact, if one looks carefully enough, it is easy to find numerous instances within existing doctrine in which contractual liability is founded not on consent, but on a variant of the no-retraction approach. For example, there are circumstances in which offerors cannot retract their offers either because they chose to make “firm offers” or because the law imposes an irrevocability principle. Here, offerors are legally bound even before acceptance.⁷ Similarly, where the agreement leaves a term to be further negotiated, courts might forbid a party to reject a proposal made by the other party that is very favorable to the rejecting party.⁸ In rationalizing these and related “intermediate liability” doctrines, the courts explicitly invoked the justifications underlying the no-retraction principle. Accordingly, the no-retraction regime can be viewed not as a doctrinal innovation, but rather, as a unifying principle. Recognizing such a principle would accord greater consistency in the application of existing precontractual

⁵ See, e.g., FRED CHARLES IKLÉ, *HOW NATIONS NEGOTIATE* 22-23 (1976) (observing that in international negotiations, it is “improper . . . to revert to a harder position from a more conciliatory one”).

⁶ This exploration of an alternative basis for liability is different than the exploration initiated by scholars like Professor P. S. Atiyah, who examine the case for reliance-based liability. See P. S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 1-7 (1979) (introducing the argument in favor of reliance-based liability). The approach developed in this Essay is different in that it maintains the *promise*, rather than *harm* or *benefit*, as the basis of liability, but does not require consent.

⁷ See, e.g., *Drennan v. Star Paving Co.*, 333 P.2d 757, 759-60 (Cal. 1958) (stating that a subcontractor could not revoke its bid even prior to acceptance by the general contractor, if the general contractor relied upon that bid).

⁸ See I J.M. PERILLO, *CORBIN ON CONTRACTS* § 4.3, at 577-79 (rev. ed. 1993) (surveying cases in which indefiniteness was cured by terms that are maximally favorable to the defendant (the retracting party)); Omri Ben-Shahar, “*Agreeing to Disagree*”: *Filling Gaps in Deliberately Incomplete Contracts*, 2004 WIS. L. REV. (forthcoming) (manuscript at 33-40, on file with author) (outlining several existing doctrines that fill contractual gaps with terms most favorable to the defendant).

liability doctrines and may resolve many other problematic features of the mutual assent doctrine.

To illustrate a doctrinal implication of the proposed approach, consider the situation of a misunderstanding, often regarded as the pedagogical benchmark of the consensus principle. Under the doctrine of mutual assent, where the two parties assign different, but equally plausible, meanings to a basic provision of the contract, and where neither party has reason to know of the other's intent, no meeting of the minds—and thus no contractual liability—can be found.⁹ Where, for instance, the buyer of a cotton shipload intended it to arrive on a ship named *Peerless* that sails in October, and the seller intended it to arrive on a different *Peerless* ship that sails in December, no contract had been formed between the parties.¹⁰ Under the no-retraction approach, in contrast, each party would have the option of enforcing the contract, albeit in line with the meaning intended by the other party. For example, if market conditions changed after an agreement was reached and one of the parties attempted to retract opportunistically, the retracting party could be forced to perform the deal as *she* intended it.

Another important situation in which the no-retraction regime applies is that of preliminary agreements. Currently, drawing the line between precontractual understandings that *are not* enforceable and contractual agreements that *are* implicates one of the most confusing doctrines in contract law. While this line is important to draw—it is the difference between “all” or “nothing” liability—in practice, it is also very difficult to draw in a consistent manner, leading to a confusing and unpredictable jurisprudence.¹¹ Under the no-retraction approach, no line needs to be drawn. When parties reach an agreement in principle over some fundamental terms but plan to further negotiate, each party acquires the option to bind the other to a deal that includes the terms agreed upon, supplemented by proposals made by the other party and terms most favorable to that party. In other words, each party can enforce a full agreement that is at least as

⁹ RESTATEMENT (SECOND) OF CONTRACTS § 20(1) (1981).

¹⁰ *Raffles v. Wichelhaus*, 159 Eng. Rep. 375, 375 (Ex. 1864).

¹¹ See E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 259-60 (1987) (“It would be difficult to find a less predictable area of contract law.”); K. N. Llewellyn, *On Our Case-Law of Contract: Offer and Acceptance* (pt. 1), 48 YALE L.J. 1, 13-14 (1938) (lamenting that rules governing preliminary agreements “are utterly devoid of . . . meaning” when applied to the facts).

profitable to the other party as it had plausibly hoped for when entering the preliminary agreement.

Part II of this Essay will explore these and additional implications of the no-retraction principle. It will offer a fresh look at the requirement of “definiteness” and examine the implications of the no-retraction regime for the doctrines of offer and acceptance and for the duty to negotiate in good faith. This inquiry will also yield an alternative approach to gap-filling in incomplete contracts, a potential contribution to the theory of default rules.

Before proceeding, however, it is worth emphasizing what this Essay is *not* about. It is not about the debate between objective and subjective theories of assent. The no-retraction idea is a substitute for the mutual assent approach, whether taken as an objective idea (convergence of “manifestations”) or as a subjective principle (meeting of the minds). The no-retraction principle replaces the element of *consensus*, the notion that the “positions” of the parties ought to meet. It can therefore be equally relevant to either the objective or subjective approaches, as both embody this notion. Further, this Essay is not about contract law being subsumed by tort principles. True, no-retraction liability can resemble tort liability; it results from a unilateral action not much different than, say, liability for misrepresentation. However, it is nonetheless the will of a party—a “promise”—that ignites liability. The obligation is voluntary and promise-based, yet decoupled: A contract can be *two, potentially different, bargains*, with each party “responsible” for one.

Some of the ideas developed in this Essay have been studied previously. For example, the concept of attaching liability to relied-upon precontractual representations was carefully developed in recent literature¹² and has appeared in earlier legal writings on the precontractual duty of good faith.¹³ In addition, as mentioned above, the idea of

¹² See, e.g., Lucian Arye Bebchuk & Omri Ben-Shahar, *Precontractual Reliance*, 30 J. LEGAL STUD. 423, 431-43 (2001) (analyzing how alternative liability schemes promote optimal levels of precontractual reliance); Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 STAN. L. REV. 481, 507-43 (1996) (exploring efficient reliance as an implicit economic rationale underlying courts’ decisions in contract formation cases); Avery Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 YALE L.J. 1249, 1270-77 (1996) (examining the effects of promissory estoppel on the incentives of negotiating parties).

¹³ See, e.g., Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673, 684-86 (1969) (arguing that a party to a negotiation should be held liable for withdrawing from a partial agreement when the negotiations have given rise to a mutual commitment to bargain in good faith to complete a contract).

a “sliding scale of enforceability” originates from Fuller. This Essay builds on those earlier ideas to develop a general view, uniform across various areas of contracting, of the gradual ascent of liability—of “contracts without consent.” And while many of the doctrinal implications of the no-retraction principle have also been explored previously, these applications have not been viewed before through the general lens developed in this Essay, as representing this “contracts without consent” pattern.

The analysis is divided into two Parts: Part I examines the abstract properties of a principle of no-retraction; Part II applies that principle and briefly explores some doctrinal implications of a no-retraction regime.

I. THE NO-RETRACTION PRINCIPLE: THEORY

A. *The All-or-Nothing Nature of Contractual Liability*

One of the most fundamental features of contractual liability is its emergence in an all-or-nothing fashion. This legal dichotomy is striking because the positions of the parties, who contemplate a deal and negotiate its terms at arms length, converge in a gradual, rather than abrupt, fashion. The process of overcoming differences in initial bargaining positions and eventually achieving consensus is normally a continuous one. During the course of dealmaking, different components of an agreement are typically negotiated sequentially and resolved in piecemeal fashion. Nevertheless, while the parties’ manifested will to be bound exhibits this gradual ascent, the legal consequences attached to it have a discontinuous structure.

Initially, when the parties’ positions are far apart and their will to be bound is weak, there are no legal consequences arising from the negotiations. As the positions of the parties grow somewhat closer and their will to be bound increases, the legal consequences remain null. Eventually, however, there comes a point in the negotiation process at which the positions of the parties are sufficiently close—when their will to be bound is sufficiently strong—that the legal consequences shift abruptly to full contractual (that is, expectation) liability. While the difference in the legal consequences is qualitative—no liability versus full liability—the threshold at which the consequences change is not always qualitatively distinguishable. The difficulty lies in the fact that the doctrine of mutual assent only measures whether sufficient proximity between the parties’ positions has been achieved. It is possible that the threshold of mutual assent may be crossed even

though some issues are left up in the air, so long as the accumulation of the agreed-upon issues is sufficient to set off a presumption of full agreement.

Due to the vagueness of this threshold, courts have been inconsistent in their attempts to draw the line between the no-liability precontractual stage and the full-liability contract.¹⁴ Cases with similar facts, in which the degree of the understanding between the parties was comparable, have been decided differently. Opportunistic retractions from relied-upon understandings have at times been permitted, whereas harmless retractions that occurred immediately after “handshake deals” sometimes have led to heavy damages.¹⁵ This unpredictability of the law also has adverse *ex ante* effects. First, parties might need to specify explicitly the legal consequences to be attached to each negotiation stage, thus increasing transaction costs. Second, and more importantly, the unpredictable dichotomous legal regime makes it more difficult for the parties to ascertain the degree of confidence with which they should go ahead and rely on representations made by their negotiating or contracting partners.

Nevertheless, all-or-nothing mechanisms are often hailed for the certainty that they provide. This line of reasoning argues that if liability arises only after a qualitative test is satisfied in full, the parties will be able to recognize the incidence of liability with greater precision. But while the advantage of certainty is surely associated with specific consent rituals, such as the handshake, the wedding ceremony, or the notary seal, it is hardly apparent in instances where the qualitative test is *substantive* in nature, lacking any ritual. In contract law, the

¹⁴ Commentators have complained about the resulting inconsistency of case outcomes. See Gerald B. Buechler, Jr., *The Recognition of Preliminary Agreements in Negotiated Corporate Acquisitions: An Empirical Analysis of the Disagreement Process*, 22 CREIGHTON L. REV. 573, 574 (1989) (“[T]he decisions in this area . . . continue to appear both confusing and inconsistent to the point where it is said to be virtually impossible to predict the outcome in a particular case.”); Harvey L. Temkin, *When Does the “Fat Lady” Sing?: An Analysis of “Agreements in Principle” in Corporate Acquisitions*, 55 FORDHAM L. REV. 125, 130 & n.23 (1986) (noting how decisions in this area have been inconsistent and how this lack of clearly defined rules has led to uncertainty among negotiators); sources cited *supra* note 11 (summarizing this area of the law as confusing and unpredictable).

¹⁵ Compare *Cont'l Labs., Inc. v. Scott Paper Co.*, 759 F. Supp. 538, 539, 542 (S.D. Iowa 1990) (finding no liability where parties reached an oral agreement that resolved, after many rounds of negotiations, most principal issues and where retraction occurred after one party announced that it “was no longer interested in the venture”), with *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768, 859-66 (Tex. App. 1987) (holding a party liable for lost profits and punitive damages notwithstanding the fact that the parties’ agreement in principle had resulted from only a brief round of negotiations and the defendant’s retraction occurred almost immediately thereafter).

qualitative test of consent—being a standard, not a bright-line rule—does not increase certainty, as it may be satisfied independently of any evident ritual.

B. *The No-Retraction Principle*

Under the no-retraction regime, a party who manifests a willingness to enter into a contract with some given terms should not be able to retract *freely* from her representation. The opposing party, even prior to expressing assent, and unless he affirmatively rejected the terms, acquires an option to bind his counterpart to her representation, and a violation of this option would lead to some liability. Thus, the triggering event that creates liability is not the convergence of two wills, as is the case under standard assent doctrine, but rather, the manifestation of only one will. Once an individual manifests her intent to deal under some terms, she makes a unilateral commitment not to retract from a deal conforming to these terms.

This principle can apply at different stages of the interaction. At an advanced stage of the transaction, when a full-blown agreement is reached but the parties dispute its proper interpretation, neither party can retract from her own intended interpretation; namely, each may be bound to their own interpretation if the other party so chooses. Earlier in the negotiations process, when an understanding emerges over some components of the transaction, neither party can retract from the terms of the preliminary understanding.¹⁶ Finally, even at early stages of the negotiations, as soon as a party manifests an intent to be bound to some terms, she (alone) cannot freely retract from these terms.

¹⁶ A similar approach to precontractual understandings is suggested by Allan Farnsworth. See Farnsworth, *supra* note 11, at 280-81 (explaining that reneging on terms is unfair dealing and should constitute a breach of the duty to bargain in good faith). Variants of this approach were applied in several famous cases. See *Itek Corp. v. Chi. Aerial Indus.*, 248 A.2d 625, 629 (Del. 1968) (stating that an informal letter of intent to merge obligated parties to make a good faith attempt to reach a formal contract of merger); *Grouse v. Group Health Plan, Inc.*, 306 N.W.2d 114, 116 (Minn. 1981) (finding liability where the defendant health clinic revoked its offer of at-will employment only after plaintiff quit his job and declined other employment in reliance on the clinic's offer); *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267, 275 (Wis. 1965) (imposing damages for breach of a promise that never materialized into a contract, based on a reliance/promissory estoppel theory).

1. A Comparison of the No-Retraction and the Mutual Assent Principles

More methodically, the no-retraction approach differs from standard assent doctrine in several fundamental respects:

a. *No Consensus*

A party can be bound in the absence of a consensus over terms. A party is bound to the terms she represented, irrespective of whether the other party represented identical terms or any terms at all. Liability under this approach, like tort liability, results from a unilateral wrongful action of a party—in this case, retraction from a representation.

Put differently, the no-retraction principle “decouples” the legal conception of intent-to-be-bound. Under standard doctrine, either both parties have an intent to be bound, or neither has, as the intent to be bound is inferred from the fit between the parties’ positions, namely, the “thickness” of the consensus. Therefore, the fewer terms included in the understanding, the less likely courts are to recognize the existence of an intent to be bound.¹⁷ Under the no-retraction approach, in contrast, each party’s intent can be inferred separately, and each may intend to be bound to a separate set of terms that favors herself. Consensus is the point at which the “two intents” converge, but the intents may exist prior to, and independently of, convergence.

Under this approach, it is not consensus that creates liability, but rather, each individual’s separate manifestation of intent (and, indeed, it is possible for only one party to be bound). It should be noted that this is not a dramatic departure from existing grounds of obligation. For example, when courts supplement contracts with standard gap-fillers, these additional terms are binding, not because the parties consented to them (they never did), but because they provide a rational basis for contractual obligation.¹⁸ It is this same rational basis that is invoked by the no-retraction approach, applied to each party separately. It might be rational for each party to accept a different set of terms, and it is these terms that the law would prohibit her from rejecting.

¹⁷ U.C.C. § 2-204 official cmt. (2003) (“The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement . . .”).

¹⁸ See Jules L. Coleman et al., *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J.L. & PUB. POL’Y 639, 707-09 (1989) (grounding default rule theories on rationality, rather than on the consent fiction).

b. *Asymmetry*

A prominent feature of assent-based liability is the fact that the terms each party can enforce are identical. If, say, a contractual term (or a gap-filler) specified a price, p , both parties can enforce only that price. Under the no-retraction principle, in contrast, each party might have the option to enforce a different set of terms. If the seller proposed a price, p_s , and the buyer proposed a price, p_b (with $p_s > p_b$), each party may enforce a transaction with a different price: the buyer may enforce a deal that includes the seller's proposed price, p_s , and vice versa. Thus, this regime has a built-in asymmetry. Each party can be forced to transact under one set of terms (her own proposal) but, at the same time, can force the other to transact under another set of terms (the opponent's proposal).¹⁹ This asymmetry is consistent with the notion that each individual, having proposed a different bargain, should be confronted with a different restriction on what she may reasonably reject. Specifically, while each individual may reject the terms that the other proposed, there is less of a reason to allow each individual to reject the terms that she herself represented as acceptable.²⁰

c. *Biased Supplementation of Missing Terms*

When a party makes an incomplete representation, in the sense that it is silent about some elements of the deal, and if the other party acquires an option, the option must specify how these missing elements should be supplemented. The standard gap-filling approach in contract enforcement utilizes "reasonable" or "majoritarian" terms;²¹ more sophisticated approaches utilize *contra proferentem*²² or

¹⁹ Note that the asymmetry is only with respect to the content of the gap-fillers. In other respects, the parties are in symmetric relations because both hold, and both are subject to, an option to deal.

²⁰ It is beyond the scope of this Essay to inquire into the philosophical underpinnings of the non-rejectability of an individual's own representations. For a discussion of the "will theory" origins of the binding force of promises, see JAMES GORDLEY, *THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE* 161-237 (1991). More generally, for the moral basis of this principle of obligation, see Scanlon, *supra* note 3.

²¹ See, e.g., E. ALLAN FARNSWORTH, *CONTRACTS*, § 3.28, at 211-12 (3d ed. 1999) (noting examples of courts inserting reasonable terms for price and time of performance).

²² See 5 MARGARET N. KNIFFIN, *CORBIN ON CONTRACTS*, § 24.27, at 282-83 (Joseph M. Perillo ed., rev. ed. 1998) (interpreting ambiguous contract terms to "adopt the meaning that is less favorable in its legal effect to the party who chose the words").

“information-forcing” defaults.²³ In principle, similar gap-filling techniques could apply under the no-retraction regime; however, this would pose several problems. First, it is not unreasonable to reject majoritarian terms, even if they are reasonable. That is, there may be a “region” of reasonable terms such that a party’s insistence on terms that are in the favorable end of this region and her refusal to be obligated to the midrange or average term is not unreasonable. Second, with standard gap-fillers, the emergence of liability would cease to be gradual. Liability resulting from a preliminary understanding will by and large resemble the liability under a fully specified agreement. With standard gap-fillers, the set of terms in both instances will, on average, be the same. The burden of the no-retraction regime under the standard gap-filling approach will be high: As soon as a party makes a preliminary representation, it can be bound to the “average” contract.

Accordingly, the no-retraction regime would be appealing if the missing terms were supplemented by terms *most favorable* (within the set of reasonable terms) to the enforced-against party. We can think of such gap-fillers as “pro-defendant.”²⁴ This “biased” supplementation in favor of the defendant satisfies two objectives. First, as will be shown, it has sufficient “teeth” to protect the other party against opportunistic retractions, and thus, it provides optimal reliance incentives. Second, it effectively guarantees that the final agreement to be enforced is no worse than what the party who made the proposal or entered the partial understanding could have intended. This is the only agreement of which it can confidently be said that this party manifested her “constructive” intent to be bound. She may have pragmatically hoped for something less favorable, but in the absence of an affirmative statement, the only terms that we can safely impose on her without bending her will are her most favorable terms. These are terms that she has no reasonable or rational grounds to reject.²⁵ As courts intuitively recognize, if one party concedes the terms that are most favorable to the other party in order to overcome the

²³ See, e.g., Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91-118 (1989) (identifying situations in which efficiency-minded courts should fill gaps in a way that is clearly unfavorable to one or both of the parties).

²⁴ Another way to conceptualize this gap-filling approach is *pro-proferentem* (“in favor of the drafter” of the proposal), as distinguished from the *contra proferentem* doctrine (“against the drafter”).

²⁵ See Coleman et al., *supra* note 18, at 648-49 (asserting that the absence of a consent-based justification does not diminish the rationality-based justification).

indefiniteness of an agreement, “there is no longer any way the provision[s] may be construed to [the other party’s] detriment.”²⁶ Consequently, resisting the enforcement of such an agreement is unreasonable, being inconsistent with the party’s prior representations.

d. *Opting Out of the No-Retraction Regime*

The no-retraction regime attaches more costly consequences to early communications between the parties. In a sense, the “freedom from contract” is weakened. As a result, parties that place great value on this freedom can choose to opt out of the liability consequences and opt into the consensus regime. The no-retraction regime is merely a default: Techniques like revocable offers, non-binding proposals, and letters of intent, which are already common in light of existing forms of precontractual liability, could be used to reserve the right of free retraction.

2. Implications of the Key Features of a No-Retraction Approach

Several implications of the above properties should be noted. First, while contractual liability under the mutual assent framework is created abruptly, liability under the no-retraction principle accumulates in a continuous fashion. This liability is still triggered by a discrete event: a serious unilateral representation of terms by a party. However, in terms of relations between the representations of the two parties, the effective burden of this type of liability increases gradually. Initially, before much consensus is achieved, the option granted to the opposing party imposes only a small burden on the proposer. As the negotiation moves along and the proposals made by each party become less one-sided—and thus begin to represent an emerging compromise—the burden of the no-retraction principle grows. That is, the value of the option granted to the opposing party increases. When the proposals made by the parties converge, the burden they impose equals familiar contractual liability. At this stage, the grounds for liability can shift from no-retraction to consent.²⁷

A second, related implication is that parties would have the ability to create obligations that will eventually depend on the identity of the

²⁶ *Busching v. Griffin*, 542 So. 2d 860, 864 (Miss. 1989).

²⁷ The idea that the basis for liability can shift over time, as the parties introduce new elements into their relationship, is a central theme in Atiyah’s view of contractual liability. See ATIYAH, *supra* note 6, at 3-4 (describing the process by which “the ground for imposing [] liability shifts”).

party seeking enforcement. When parties are unable to agree on how to resolve some issues, they will often leave the terms open or ambiguous in order to avoid a negotiation breakdown. Under standard contract law, this practice might render the contract unenforceable.²⁸ The no-retraction principle's use of decoupled supplementation provides a different solution to this problem. Where the missing provisions' content depends on the identity of the party against whom enforcement is sought, the law would guarantee that the issues at stalemate will not provide any basis for unilateral retraction from the rest of the deal.

A further implication worth noting involves certain polar situations. At one extreme, the parties' proposals completely overlap. In this case of consensus, the no-retraction approach does not change any of the familiar legal consequences associated with assent-based contractual liability: Both parties are obligated to an identical set of terms. At the other extreme, the parties have made no proposals at all, never having entered into negotiations. The logic underlying the no-retraction approach, which dictates that missing terms in the proposal be supplemented by the terms most favorable to the party against whom enforcement is sought, can be stretched to provide a basis for obligation even in the absence of proposals, and even prior to any negotiations. Each party can be given an option to force a transaction on the counterparty based on the terms offered by that counterparty (of which there are none) and supplemented by terms most favorable to the counterparty (constituting the entire deal). This polar case represents a transformation of all property rules into liability rules: Endowments can now be taken non-consensually, albeit priced in a way so favorable to the endowment holder that it eliminates, at least from the holder's economic perspective, any cost of such a move.

This last observation explains why liability for retraction ought to be restricted to proposals that are sufficiently rich in detail, or serious. This familiar constraint is regularly applied under the mutual assent regime, whereby contracts are supplemented by gap-fillers only to the extent that the terms over which there is consensus provide a sufficient basis to infer intent to be bound. Likewise, under the no-retraction regime, a party will be bound to her unilateral representation—which can also be supplemented by her most favorable

²⁸ 1 PERILLO, *supra* note 8, § 2.8, at 134 (“[A] ‘contract to make a contract’ is not a contract at all.”).

terms—if the representation provides enough detail to infer that party’s intent to contract under its terms. The mutual assent regime restrains its supplementation methodology in order to protect the voluntary nature of contracts and to preserve the domain of property rules; the same restraint can be employed by the no-retraction regime. Recall: the no-retraction principle is a substitute only to the consensus element of the mutual assent regime. Otherwise, it incorporates all the remaining “checks and balances.”

C. *The Measure of Damages*

The no-retraction principle is a basis for liability, not a damage measure. It replaces the consensus principle as a basis for contractual liability, and consequently, it determines when liability arises, but not its magnitude. The principle of no-retraction can therefore be coupled with various measures of damages, depending on the underlying objective that the remedy seeks to promote. The magnitude of optimal damages, then, would depend on context and the underlying social objective.

There are various social objectives that can justify different measures of damages. Take, for example, the economic perspective. One goal of damages is the prevention of opportunistic breach and the promotion of efficient investment in the relationship. This goal is generally consistent with the expectation measure of damages.²⁹ Accordingly, the no-retraction liability will be coupled with expectation damages in circumstances in which expectation damages are desirable. If a party has already performed a contract and seeks to enforce it upon a retracting, opportunistic opponent, expectation damages would apply.

It is important to note that whenever the no-retraction principle provides a basis for liability that would otherwise not exist under the mutual assent principle, this basis for liability *does* affect the quantity of expectation damages. The plaintiff can only enforce the terms *as intended by the defendant*. The expectation remedy is thus calculated according to the value of the deal to the enforcing party, using the terms offered by the retracting party (which, recall, are supplemented in a manner most favorable to the retracting party). As a result, this is a less generous measure of damages than the standard one

²⁹ See ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 190 (3d ed. 2000) (illustrating how “perfect expectation damages create incentives for efficient performance and breach” and “elicit efficient commitment from the promisor to perform”).

applied in contractual breach. Likewise, with respect to specific performance, the plaintiff can only enforce the deal intended by the defendant.³⁰

There are, however, other contexts in which economic goals would be promoted if the no-retraction liability were coupled with the more modest reliance measure of damages. For example, in situations in which parties have not completed the negotiations but merely have reached some preliminary understandings, the social goal is to induce them to make efficient reliance and choice-of-partner decisions in light of the potential for holdup. In such cases, the optimal remedy for retracting from the understandings and the proposal would be reliance damages.³¹

In general, any applicable damage measure under the standard mutual assent basis for liability could apply under the no-retraction basis for liability as well. The no-retraction principle provides an alternative *occasion* for the apportionment of these damages, not an alternative *measure*. Thus, all the familiar standards for quantifying a measure of damages, such as foreseeability and certainty, continue to apply to damages under the no-retraction approach.

D. Implementation

The no-retraction regime supplements deals with terms most favorable to the retracting party. Unlike majoritarian terms, which can be constructed based on evidence regarding market practices, “most favorable” terms require courts to be able to generate two sets of provisions, depending on the party seeking enforcement. Is the task of identifying such terms too burdensome for courts to accomplish?

It is important to recall that difficulties in application were a perceived feature of another “intermediate” precontractual liability standard, namely, the duty to negotiate in good faith. Indeed, one critic labeled good faith as “an amorphous concept, manifested in endlessly variable settings and forms, . . . [that] does not identify a

³⁰ For example, in *Ontario Downs, Inc. v. Lauppe*, 13 Cal. Rptr. 782 (Ct. App. 1961), the parties agreed in principle over the sale of 16 acres of land for \$50,000, but intended to negotiate where, within the seller’s 450-acre lot, the 16-acre tract lay. *Id.* at 784. The court determined that if the buyer had no contractual right to select the tract location, it could only enforce a deal that included a tract designated by the seller. *Id.* at 787.

³¹ This argument is developed rigorously in Bebchuk & Ben-Shahar, *supra* note 12, and it is illustrated with simple numerical examples in Part I.E, *infra*.

manageable body of law for analytic inquiry.”³² Despite these difficulties, the good faith duty is now an integral part of most legal systems, and implementation problems are no longer perceived as reasons to abolish it.³³ It is also important to recall that other doctrines of gap-filling instruct courts to pick out one-sided terms. The doctrine of *contra proferentem*, for example, designates gap-fillers that are least favorable to the drafter of the contract.³⁴ More generally, penalty default rules also require courts to utilize one-sided, non-market terms.

Having to supplement deals with terms most favorable to the retracting party does not necessarily imply that courts would bear a more burdensome judicial task. In most situations, courts would only have to know the *range* of reasonable terms and then determine whether the retracting party insisted on terms outside this range. In a precontractual setting, when a party retracts from an understanding by refusing to accept a proposal to settle the remaining issues, the court would have to determine if terms exist that are reasonable, but more favorable, to the retracting party than those proposed.

Further, there are compelling reasons to believe that the task of filling gaps with terms most favorable to the defendant is within the courts’ institutional capability. First, in adversarial proceedings, this type of one-sided evidence is precisely what each party presents to the court. Even in the current system, where courts look for majoritarian terms, parties provide self-serving evidence concerning disputed elements. This evidence is treated with justified suspicion by courts that are seeking midrange gap-fillers, but in a no-retraction regime, it would be useful for picking the end-range, or most favorable, gap-fillers. For example, in cases involving an agreement to agree over the price, the court can choose the price as assessed by the defendant’s expert witness.³⁵ Second, the court can extract the information by

³² Eric M. Holmes, *A Contextual Study of Commercial Good Faith: Good Faith Disclosure in Contract Formation*, 39 U. PITT. L. REV. 381, 382-83 (1978) (footnote omitted); see also Clayton P. Gillette, *Limitations on the Obligation of Good Faith*, 1981 DUKE L.J. 619, 642-49 (discussing the problems surrounding the good faith standard within a section entitled “Administrative Difficulties in Remediating Bad Faith”).

³³ See Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CAL. L. REV. 1743, 1807-08 (2000) (maintaining that the difficulty in identifying bad faith should not be a reason for failing to recognize the general duty).

³⁴ See RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981) (providing for “[i]nterpretation [a]gainst the [d]raftsman”); KNIFFIN, *supra* note 22, § 24.27 (rev. ed. 1998) (discussing the *contra proferentem* doctrine).

³⁵ See, e.g., *Lassiter v. Kaufman*, 581 So. 2d 147, 148-49 (Fla. 1991) (affirming the trial court’s decision to pick the price assessed by the defendant landlord’s expert

instructing the defendant to designate the missing terms, with the threat that, if the defendant fails to do so reasonably, the court will pick its own term.³⁶

It should be noted that the principle of no-retraction could be translated into legal commands either by rules or by standards. Nothing in the shift from a consent regime to a no-retraction regime affects the level of precision or generalization of the liability norm. The mutual assent approach is sometimes implemented by rules (e.g., offer and acceptance) and other times by standards (e.g., majoritarian gap-fillers). Similarly, no-retraction can be a basis for rules (e.g., offer-irrevocability) or for standards (e.g., pro-defendant gap-filling).

In the end, however, it 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. In this case, one contribution of the present analysis is in fleshing out an additional reason for the prevalence of the mutual assent regime. This regime has maintained an intuitive appeal, not because it is the natural way for contractual obligations to arise, but rather because it is the easier way for contractual obligations to be enforced.

E. *The Efficiency of the No-Retraction Regime*

The no-retraction regime was presented above as a conceptual advance, as a “natural” legal platform for tracking the progress of negotiations. It provides a more flexible set of tools for transforming the understandings between parties into legal obligations. This Section attempts to rationalize the no-retraction regime on the basis of instrumental, rather than conceptual, grounds. It demonstrates that the no-retraction regime proves superior in settings in which the social goal is to encourage precontractual reliance. In addition, it addresses the concern that a no-retraction regime would chill the incentives of parties to make proposals and distort their decisions to enter and exit negotiations.

witness in a contract that featured an option to renew under a price to be agreed upon by the parties).

³⁶ This technique was used in *Ontario Downs, Inc. v. Lauppe*, 13 Cal. Rptr. 782 (Ct. App. 1961). In that case, the court allowed the defendants to choose a parcel of land to give to the plaintiff in fulfillment of a contract, with the threat that failure to select a reasonable parcel would result in the court allowing the plaintiff to choose. *Id.* at 787.

1. The Holdup Problem

Anytime before or after the agreement, a party can make reliance investments—expenditures that raise the value of the completed transaction, but that have no value otherwise. It has long been recognized that such investments are subject to a distortive holdup problem.³⁷ When the party who incurs the cost of the investment appropriates its full benefit, the incentives to invest are optimal. Underinvestment occurs when the investing party bears the entire cost of the investment but enjoys only a fraction of its benefit.

Consider, specifically, an investment that is made after some initial proposals or understandings have been discussed, but before the parties have bound themselves to a particular division of the “pie.” Take, for example, the case where two merging firms have reached some understanding over the terms of the merger, but have not finalized the agreement. At this stage, one of the firms can make a relationship-specific investment, which would increase the value of the merger should it be finalized. The social goal at this stage is to induce optimal, surplus-maximizing investment.³⁸

2. Comparison of the Liability Regimes

Let us compare two liability regimes. The first—the standard mutual assent rule—imposes no liability on the parties prior to their reaching a full-blown consensus. If, following the investment, the other party insists on terms that are more aggressive than the ones discussed preliminarily and an agreement fails, no liability arises. The second—the no-retraction principle—imposes reliance liability on the other party if he retracts from the preliminary understanding.

Each liability regime creates different incentives for the parties involved in this merger example. Under the mutual assent regime, there is no contract yet, and both parties are free to bargain for their

³⁷ The holdup problem arises when parties cannot contract over reliance expenditures due to high transaction costs, non-verifiability of the investment, and strategic considerations. See Katz, *supra* note 12, at 1278 (describing the holdup problem in relation to precontractual reliance investments). See generally Alan Schwartz, *Incomplete Contracts*, in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 277, 278-79 (Peter Newman ed., 1998).

³⁸ While this goal is strictly efficiency-oriented, it does not conflict with any fairness- or distribution-oriented goals. Since the maximization discussed here is precontractual, the subsequent contract will divide the surplus between the parties according to factors independent of the maximization itself (e.g., the bargaining power of the parties, legal constraints, etc.).

share of the surplus that was added by the investment. In particular, they can ignore the pre-investment representation of terms, as it does not lead to any liability. Their final agreement may deviate from the initial terms and will instead divide the new post-investment surplus. Because the cost of the investment will already be sunk, it will not be factored into the subsequent bargaining. Thus, the investing party can only capture a fraction of the ex post surplus, but since she bears its entire cost, her incentives to invest will be suboptimal.³⁹

Under the no-retraction regime, in contrast, the opposing party is limited in its ability to ignore previous understandings and proposals it made and to extract a portion of the increased surplus. Such bargaining strategies amount to a retraction, and if they are sufficiently aggressive, they will lead to negotiation breakdown coupled with, at the very least, an imposition of reliance liability on the retracting party. This power to impose liability protects the investing party from feeling pressured to acquiesce to new, adverse terms. While renegotiation might still occur, the retracting party must restrain its position to avoid negotiation breakdown. A retracting party cannot make a claim to a division of the pie that leaves the investing party with a negative payoff, given her investment. In effect, any additional dollar the investing party contributes increases the share of the surplus she subsequently can extract by one dollar, enabling her to enjoy the full benefit of the investment. Thus, the investing party cannot be held up by the retracting party, and her incentives to make investments in this interim stage are optimal.⁴⁰ Put differently, a full-blown contract

³⁹ The following example illustrates this distortion. Consider a sale transaction where, prior to any investment by the buyer, the buyer's valuation is 100 and the seller's cost is 0. Assuming equal bargaining power, the parties reach an initial understanding over a price of 50. The buyer can make an investment of 30, increasing her valuation by 50, to 150. It is efficient to make this investment and increase the net surplus from 100 to 120 ($150 - 30$). Without the investment, the price will remain 50 and the buyer's net payoff will be 50 ($100 - 50$). With the investment, when the ex post surplus will increase to 150, the buyer expects that the seller will retract from the initial understanding and that the subsequent agreement will set a price of 75 (midrange of 0 and 150). This will leave the buyer with a net payoff of 45 ($150 - 75 - 30$), lower than the payoff without the investment. Thus, the efficient investment will not be made.

⁴⁰ To see how the rule against retraction resolves the holdup distortion, consider again the above numerical example. *Supra* note 39. In the bargaining round that follows the buyer's investment, although the buyer's valuation increased to 150, the seller cannot insist on a price greater than 120. A higher price will leave the buyer, who invested 30, with a negative net payoff; the buyer will prefer to reject it and impose retraction liability on the seller, thus getting her cost reimbursed. Therefore, the subsequent price must lie in the range between 0 and 120 and—assuming equal bargaining power—will equal 60. The buyer's net payoff will be 60 ($150 - 60 - 30$), greater than

is unnecessary to protect precontractual reliance; the milder no-retraction liability, coupled with reliance damages, will suffice.⁴¹

3. Incentives to Enter Negotiations

The no-retraction principle reduces the parties' freedom *from* contract. In contrast to the all-or-nothing regime, under which a significant portion of the negotiation is conducted without any liability consequences, the no-retraction principle makes it costly for the parties to cease negotiations. This early liability consequence, it might be argued, would discourage parties from entering negotiations, making proposals, and reaching precontractual understandings.⁴²

In situations where parties enter negotiations for reasons other than to transact, this conjectured chilling effect is surely valid, but it may also be quite desirable. If, for example, a party is entering negotiations with an innocent opponent only to extract information from that opponent or to assert pressure on a third party, the negotiations have no social value, and reducing their incidence by attaching liability to retraction is a valuable effect.⁴³ Even if the motivation of the party in entering negotiations is more innocent, forcing her to bear

the non-investment payoff of 50, and thus, the buyer will elect to invest. Note that a retraction does occur, but it is mild enough so that an agreement can still be completed.

⁴¹ This regime, although utilizing reliance damages, does not lead to the familiar overreliance problem, as identified by Steven Shavell and others. *See, e.g.*, Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 479-80 (1980) (explaining how reliance damages can lead to excessive investment). The reason, in a nutshell, is that under no-retraction liability, the reliance investment is not guaranteed to yield returns; there is still the risk that a contract will not be formed and that the investor will have to bear her costs.

⁴² *See* 1 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 3.26, at 361 (2d ed. 1998) (describing a "chilling effect" of discouraging parties from entering negotiations); Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 VA. L. REV. 385, 416-17, 445-46 (1999) (arguing that liability for pre-trade representations in the event of negotiation breakdown would cause "the market to shrink" and would force parties to use more cautious bargaining strategies, thereby wasting opportunities for efficient trade); Wouter P.J. Wils, *Who Should Bear the Costs of Failed Negotiations? A Functional Inquiry into Pre-Contractual Liability*, 4 J. ECONOMISTES & ETUDES HUMAINES 93, 103 (1992) (claiming that precontractual liability "tends to lower inefficiently the incentives of parties to enter contract negotiations at the outset").

⁴³ Indeed, under doctrines such as good faith bargaining and misrepresentation, courts have limited the freedom of parties to strategically enter (and exit) negotiations. *See, e.g.*, 1 FARNSWORTH, *supra* note 42, § 3.26, at 354-55 (describing an example of intentional misrepresentation in lease negotiations in which a court awarded damages based on the lessee's reliance losses).

the cost she inflicted on an opponent would correct the otherwise excessive incidence of failed negotiations.

There are, to be sure, legitimate factors affecting the willingness of parties to enter negotiations and the freedom they seek to exit negotiations. However, to the extent that parties enter negotiations that have the potential of increasing overall surplus, a no-retraction regime would enhance, rather than diminish, their willingness to negotiate. The truth of this counterintuitive argument lies first in the fact that, while the no-retraction regime curbs a party's ability to exit freely, it also provides her with the security that her counterpart will not exit unilaterally. There is a symmetric upside to participating in a regime that restricts the freedom to retract.

More importantly, as stated above, the no-retraction regime improves the parties' incentives to make precontractual investments.⁴⁴ These added investments increase the value that the parties eventually will divide in the contract, making both of them better off relative to a regime—such as the all-or-nothing regime—that does not provide similar reliance incentives. A rule that prohibits retraction from a preliminary representation, so long as it is coupled with reliance liability, will *unambiguously* lead the parties to enter into negotiations in more cases in which there is a potential surplus than they would in the absence of liability.⁴⁵

⁴⁴ *Supra* note 40 and accompanying text.

⁴⁵ This proposition is proven formally in Bebchuk & Ben-Shahar, *supra* note 12, at 456. To illustrate this effect, consider again the above example, *supra* notes 39, 40. Assume now that the seller's cost is not 0, but 110, and that if the parties enter negotiations, the seller makes an initial proposal of a price, after which the buyer can invest and negotiations resume. Assume, as before, that the buyer can increase her valuation from 100 to 150 by investing 30. This is a case where a potential surplus of 10 exists ($150 - 110 - 30$), but only if the buyer invests.

Under the mutual assent regime, the buyer will not invest. The buyer expects that, no matter what the seller's original price proposal was, if she were to invest and increase her valuation to 150, the final price will be set midway between 110 and 150, at 130, thus leaving the buyer with a negative net payoff ($150 - 130 - 30 = -10$). Expecting that the buyer would not invest and that the surplus will remain negative, the parties will not enter negotiations.

Under the no-retraction regime, as long as the seller's initial proposal did not exceed 120, the buyer will invest. If the buyer invests, the seller cannot demand a price greater than 120, as this will lead to breakdown in negotiations and liability. Thus, the price will be set midway between 110 and 120, at 115. This leaves the buyer with a positive net payoff ($150 - 115 - 30 = 5$) and thus, the investment will be made. The seller, too, will end up with a positive payoff of 5 ($= 115 - 110$). Expecting the investment and the resulting positive payoffs, the parties will enter negotiations. Hence, only under this regime will the parties enter negotiations.

Intuitively, the no-retraction regime can be viewed as a commitment device. When parties negotiate a deal, their lack of commitment and their freedom to walk away chills the incentives of their negotiating partners to make reliance investments. This lower reliance level produces smaller contractual pies. For the same reason that parties enter long-term, rather than short-term, contracts—to encourage relationship-specific investment—the no-retraction regime increases the parties' investment in the relationship, thus increasing the surplus.⁴⁶ Indeed, the recognition that precontractual liability enhances the contractual surplus is increasingly prominent in court decisions.⁴⁷

4. Unwanted Transactions

Another concern arising from the parties' diminished freedom *from* contract involves allocative inefficiency: Parties might end up sticking with unwanted contractual partners and, consequently, miss out on opportunities to maximize the potential surplus.

There are several ways to address this concern. Note, first, that parties are not bound to a relationship if it is indeed less efficient than its alternatives. They can, of course, abandon partners, although they will effectively have to share with the rejected party a piece of the increased surplus that is created by the more efficient transaction.

To return, though, to the question of allocative efficiency, it is true that the burden of liability can lead to an inefficient choice of partner. If, say, the initial negotiation partner invested an amount, R , in reliance, and a new partner appears, offering a transaction that is more efficient but not sufficiently so as to enable the initial partner to recover R and still enjoy a greater surplus, the new partner will not be accommodated. While this concern is valid, a couple of observations

⁴⁶ This claim, that the surplus is enhanced under the no-retraction regime, does *not* imply that both parties are necessarily better off under the liability rule. It might well be that the non-investing party, having to negotiate under the potential burden of liability, is worse off than he would have been under the all-or-nothing regime. This distributive effect, however, will not distort the incentives to enter negotiations. A party whose payoff was positive in the absence of liability will not experience a negative payoff under the no-retraction regime. For a technical proof of this claim, see Bebchuk & Ben-Shahar, *supra* note 12, at 456-57.

⁴⁷ See, e.g., *Copeland v. Baskin Robbins U.S.A.*, 117 Cal. Rptr. 2d 875, 884-85 (Ct. App. 2002) (claiming that parties should have assurance that their investments in the negotiations will not be wiped out by the other party's retractions); see also *Venture Assocs. v. Zenith Data Sys.*, 96 F.3d 275, 278 (7th Cir. 1996) (“[A complex negotiation] often is costly and time-consuming. The parties may want assurance that their investments . . . will not be wiped out by the other party’s footdragging or change of heart . . .”).

reduce its severity. First, the potential for the emergence of more attractive partners should be taken into account when reliance is invested. The greater this potential, the less that should be invested in reliance by the initial partner. If courts can limit reliance liability to *reasonable*, not actual, reliance, then the amount of reliance that will be invested when there is a significant chance of a more efficient partner is small.⁴⁸ Second, while reliance by the initial partner becomes a barrier to efficient contracting when a new partner arrives, it increases the efficiency of the contract when a new partner does not arrive. These two observations, taken together, suggest that, if the likelihood of a new partner is high, reliance is not likely to be great (and thus not a significant barrier) and, if the likelihood of a new partner is low, reliance is likely to be elevated, its fruit being enjoyed with high probability. Thus, the expected loss from unwanted partners is fairly small.⁴⁹

II. DOCTRINAL APPLICATIONS

The consensus principle underlies many of the fundamental doctrines of contract formation. Accordingly, an alternative conception of liability would affect the way these doctrines are rationalized and applied. In this Part, I will begin to explore some of the prominent implications of a no-retraction regime.

A. Assent and Misunderstandings

An illustrative case in which a dispute arises regarding the interpretation of a contract's language is one of misunderstanding. A

⁴⁸ When courts can verify the level of reasonable reliance, the investment is contractible and the underinvestment problem can be resolved if the parties expressly specify the desired level of reliance. Indeed, parties often do, and courts are willing to protect such agreements. *See, e.g.*, *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267, 274 (Wis. 1965) (examining a situation in which the parties agreed specifically on pre-contractual investments).

⁴⁹ Formally, let R denote the relationship-specific investment and $V(R)$ the net surplus function satisfying $V' > 0$ and $V'' < 0$. Assume that there is a probability, π , that, after R is sunk, a more efficient relationship will materialize, with a net surplus of W . The optimal investment, R^* , maximizes $\pi W + (1 - \pi)V(R) - R$ and is characterized by the first-order condition $(1 - \pi)V'(R^*) = 1$. We can write R^* as a function of π , which satisfies $dR^*/d\pi < 0$, that is, the higher the probability of W , the lower is the optimal investment that courts ought to protect. An inefficient transaction occurs when $V(R^*) < W < V(R^*) + R^*$; as π increases, R^* decreases, and the likelihood of an inefficient transaction—the chance that W will lie between $V(R^*)$ and $V(R^*) + R^*$ —declines (although it does not reach zero).

misunderstanding occurs when the parties agreed on a particular term but dispute its proper meaning. Does a “chicken” mean a young bird suitable for broiling and frying or an old fowl suitable only for stewing?⁵⁰ Does an obligation to deliver cotton via the *Peerless* ship mean the vessel carrying this name that sails in October or the one carrying the same name that sails in December?⁵¹ Under the prevailing objective theory of assent, the law seeks to trace and enforce the more reasonable among the competing meanings. Accordingly, if one party actually knew at the time of contracting that the other party attached a different meaning, or had reason to know of the attached meaning, this party is “at fault” for the misunderstanding. This fault is thus the basis for tipping the scales in favor of the meaning attached by the other party.⁵²

When no party is at fault—i.e., neither knew or had reason to know of the meaning attached by the other—there is no remaining basis for tipping the scale, and contractual liability does not arise. Although both parties intended to be bound, in the absence of a clear way to select among the competing interpretations, both parties are free to walk away, even if one has already performed its obligation.⁵³ Formally, this no-enforcement outcome—the only logical solution under the mutual assent approach—is a neutral solution, biased toward neither of the proposed interpretations, equally barring each party from enforcing its intended contract. Effectively, however, the no-enforcement solution is usually favorable to the defendant. If the dispute is over the existence or nonexistence of an obligation, the no-enforcement solution happens to be precisely the outcome favored by the defendant, who, at the time of trial, claims that no obligation exists.

⁵⁰ See *Frigalment Importing Co. v. B.N.S. Int’l Sales Corp.*, 190 F. Supp. 116, 117 (S.D.N.Y. 1960) (embodying a contractual misunderstanding of the term “chicken”).

⁵¹ See *Raffles v. Wichelhaus*, 159 Eng. Rep. 375, 376 (Ex. 1864) (resolving a contractual misunderstanding over the meaning of the *Peerless* ship).

⁵² RESTATEMENT (SECOND) OF CONTRACTS § 201(2) (1981).

⁵³ *Id.* §§ 20(1)(a), 201(3). There are two ways through which courts reach the no-enforcement result. First, the absence of one reasonable interpretation implies that there is no meeting of the minds and thus no contract, and consequently, none of the contractual obligations can be enforced. This is the rationale of cases like *Raffles*, 159 Eng. Rep. 375, but such cases are quite rare. Second, and more common, are cases in which the plaintiff simply cannot show that her interpretation is more reasonable. In such circumstances, courts do not imply an absence of a contract, but simply fail to enforce the obligation demanded by the plaintiff. In the procedural standoff with the defendant, because the plaintiff did not meet the burden of persuasion, the defendant’s position—the meaning she attaches to the contract—prevails. See, e.g., *Frigalment Importing*, 190 F. Supp. at 121 (holding that, in order to prevail, the plaintiff has to sustain the burden of showing that its meaning is more reasonable).

And even if both parties agree that an obligation exists but merely dispute its affirmative scope or meaning, it is often in the interest of one of the parties, in light of changed circumstances, to have no obligation at all.

While these cases of pure misunderstanding are quite rare, they constitute an important conceptual benchmark of the consensus principle and have served as the point of departure in the study of mutual assent doctrine.⁵⁴ It is problematic, then, that under the mutual assent doctrine, the court reaches a result that matches neither party's intent. Both parties intended to be bound to *something*, an intention that this otherwise logical outcome frustrates.

The no-retraction approach achieves a different result. The existence of a contract is not at stake, but merely its content. Since there are two competing interpretations, the outcome under the no-retraction approach can also be one of the two. *Each party has an option to enforce the deal, but only under the terms intended by the other.* Note, paradoxically, that by giving the plaintiff an option to enforce a contract based on the meaning assigned by the defendant, the pro-defendant bias inherent in the no-contract result is actually *diminished*. The defendant cannot escape the deal altogether—an outcome she might, in light of changed circumstances or opportunistic motives, prefer—but must yield to the plaintiff's power to enforce the deal as she, the defendant, intended it.

To illustrate the economic sense of a no-retraction approach, consider the *Peerless* ship case.⁵⁵ A contract for the sale of cotton provided for the shipment to be on a vessel identified as the *Peerless*, sailing from Bombay to Liverpool. The buyer intended the shipment to arrive on the *Peerless* vessel that departed in October, while the seller intended the shipment to arrive on the *Peerless* vessel that departed in December.⁵⁶ When the December *Peerless* arrived, the buyer refused to accept the seller's shipment, and the seller sued. Unable to pick the more reasonable interpretation, the court held—and many commentators consider this an inevitable and logical implication of the mutual assent doctrine—that no contract existed and the buyer rightfully rejected the shipment.⁵⁷

⁵⁴ See, e.g., MARVIN CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 36-38 (4th ed. 2001) (introducing the *consensus ad idem* principle by describing the *Peerless* case).

⁵⁵ *Raffles*, 159 Eng. Rep. 375.

⁵⁶ *Id.*

⁵⁷ *Id.* at 376.

Unfortunately, the no-contract outcome allowed the buyer to escape a speculative contract opportunistically.⁵⁸ The no-retraction approach would have elegantly avoided this undesirable result. The buyer-defendant, who claimed to have assigned a different meaning to the shipment term, would not have been forced to accept the seller's meaning, but at the same time would not have been able to retract from his own meaning. The seller-plaintiff could choose whether to accept the deal as the buyer intended it—that is, according to the October terms—or to not enforce it at all. Given the facts of this case, the seller would surely have opted to enforce the deal under the buyer's terms. The existence of two plausible meanings should not have led to the one result nobody intended, namely, no contract.

The result arising from the no-retraction principle is consistent with another solution courts have crafted when unable to select a meaning that is more reasonable, a solution that accords with the procedural allocation of the burden of persuasion. Consider, for example, a deal involving the sale of chicken, with a misunderstanding between the seller and the buyer over what quality of chicken was required.⁵⁹ In a suit by the buyer, who expected a higher quality of chicken than the one intended (and delivered) by the seller, the seller prevailed since the buyer was unable to prove that her interpretation was more reasonable.⁶⁰ This is consistent with the no-retraction approach: A contract exists, but the buyer can only enforce the terms that the seller intended, not the terms as *she* intended. Even though

⁵⁸ Brian Simpson's historical account of this case makes it fairly clear that the buyer-defendant acted opportunistically. A. W. BRIAN SIMPSON, *LEADING CASES IN THE COMMON LAW* 151-53 (1996). It turns out that the buyer, who intended for the cotton to arrive on the October *Peerless*, never explicitly requested delivery when the October *Peerless* arrived, two months before the seller made his own tender attempt. *Id.* at 152. Simpson demonstrates that the buyer lost interest in the entire transaction since the spot price of cotton dropped between the time the contract was formed and the arrival of the October ship, from $17\frac{1}{4}d$ to $15\frac{1}{4}d$ per barrel. *Id.* The contract, which was an instrument of financial speculation on future prices, turned out to be a losing deal for the buyer, who could now acquire the same cotton on the spot market for significantly less. In fact, by the time the December vessel arrived, the spot price recovered back up to almost $17d$. That is, the buyer's loss would have been $2d$ per barrel under his own interpretation of the contract, but only $\frac{1}{4}d$ per barrel under the seller's interpretation. The buyer wanted the obligation to be dismissed, not because of the meaning the seller attributed, but rather because circumstances changed and the contract turned out to be unprofitable.

⁵⁹ This example is modeled after *Frigaliment Importing Co. v. B.N.S. International Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960).

⁶⁰ *See id.* at 121 (noting that both meanings could be grounded in objective definitions of the disputed term and that, as a result, the plaintiff did not sustain the burden of showing that his meaning should prevail).

there was no meeting of the minds, and even without supplementing the disputed term with a court-drafted one, the obligation is enforceable in accordance with the dual-option logic. The terms enforced are the ones intended by the party who turns out to be the defendant.

Note, though, that a *Frigaliment*-type result is reached under rules of procedure rather than principles of contract. The court enforces a contract and chooses its terms even though there is no mutual assent and no clear way to select the more reasonable interpretation. Had the substantive assent doctrine been applied, rather than the procedural rule, it would have mandated a *Peerless*-type result of no contract.⁶¹ A contractual obligation was enforced, in this case, despite the substantive assent doctrine, and solely because of the rules of procedure. (One can imagine a different scenario in which the seller is the plaintiff, seeking payment for delivery that the buyer rejects; there, the court might rule against the seller, as he too would fail to meet the burden of persuasion.) The results in *Peerless* and *Frigaliment* expose, therefore, a tension between the substantive law of assent and the procedural law of contract dispute resolution. The no-retraction approach overcomes this tension. It provides the missing contract-theoretical basis for *Frigaliment*'s decision to enforce a version of the contract that depends on the identity of the defendant. It thus unifies the procedural and substantive perspectives, which can otherwise lead to conflicting results.

B. Precontractual Agreements and the Contract/No-Contract Boundary

During the course of negotiations, parties often reach preliminary understandings acknowledged by handshakes, written memoranda, and the like. At times, these understandings explicitly state that the parties do not intend to be bound until further agreement is reached. Often, however, the existence of intent to be bound is ambiguous and is inferred from surrounding circumstances, such as the comprehensiveness of the understanding. What sets these understandings apart from regular, enforceable contracts is their manifest incompleteness or the fact that the parties have made it clear that they are intended to be supplemented via further negotiations.

⁶¹ Indeed, a year after issuing the *Frigaliment Importing* decision, Judge Henry Friendly admitted that the case might better have been decided on substantive assent grounds. *Dadourain Exp. Corp. v. United States*, 291 F.2d 178, 187 n.4 (2d Cir. 1961) (Friendly, J., dissenting).

Precontractual agreements and agreements to agree pose a difficult adjudicative task under the mutual assent doctrine. On the one hand, it is clear that some consensus has been reached and some commitment made; thus, allowing the parties to walk away freely would frustrate their initial accomplishment. On the other hand, the parties have made it clear that additional agreement needs to be reached before there is a “contract,” and thus, enforcing their precontractual understanding as if it were a contract (and filling its gaps with court-imposed reasonable terms) would deprive the parties of the power they sought to maintain—to reject unfavorable additional terms. Courts, forced to abide by the contract/no-contract dichotomy of the mutual assent doctrine, have found it difficult to reach consistent decisions.⁶² Adjudication in this field has been criticized as “confusing,”⁶³ “inconsistent,”⁶⁴ “all over the board,”⁶⁵ and the “least predictable”⁶⁶ in the entire area of contract law.⁶⁷

Given this unpredictable pattern under the mutual assent regime, the no-retraction principle has the potential of providing a framework for a more consistent treatment of precontractual agreements. Under

⁶² In the area of lease contracts, for example, one court has noted that the decisions dealing with agreements to agree are “in hopeless conflict.” *Walker v. Keith*, 382 S.W.2d 198, 199 (Ky. 1964).

⁶³ Buechler, *supra* note 14, at 574.

⁶⁴ Temkin, *supra* note 14, at 130 n.23.

⁶⁵ Stephen R. Volk, *The Letter of Intent*, 16 INST. ON SEC. REG. 143, 464 (1986).

⁶⁶ See Farnsworth, *supra* note 11, at 259-60 (declaring that “[i]t would be difficult to find a less predictable area of contract law”).

⁶⁷ This confusion can be illustrated by comparing the decisions in two leading cases, *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768 (Tex. App. 1987), and *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69 (2d Cir. 1984). In both cases, the parties reached an agreement on a substantial portion, but not all, of the terms and acknowledged that they had an “agreement-in-principle,” *Texaco*, 729 S.W.2d at 791, or “handshake deal,” *R.G. Group*, 751 F.2d at 73. In each situation, one party retracted, not because it was dissatisfied by the resolution of the missing terms, but rather because it was seeking opportunistic gain, against its previously stated intent. *R.G. Group*, 751 F.2d at 74; *Texaco*, 729 S.W.2d at 786. In *Texaco*, the court found that the deal was enforceable as a contract and awarded damages of record-setting magnitude. *Texaco*, 729 S.W.2d at 795, 866. In *R.G. Group*, on the other hand, the court found that the deal was unenforceable and awarded no damages. *R.G. Group*, 751 F.2d at 79. The court in *R.G. Group* reasoned that in a complex deal with so much at stake—in that case, a 25-branch franchise agreement amounting to millions of dollars—“it would be unusual to rely on an oral understanding,” and thus, “a requirement that the agreement be in writing and signed simply cannot be a surprise to anyone.” *Id.* at 77. Ironically, although in *Texaco*, the stakes and the complexity were far greater—a sale of control in a giant oil conglomerate with a complex ownership structure, where damages exceeded \$10 billion—the court found that intent to be bound could be manifested even prior to the memorialization of all the details into the written agreement. *Texaco*, 729 S.W.2d at 795.

the no-retraction approach, parties would be bound to the terms of the precontractual understanding. But unlike standard contracts, these precontractual agreements would not be supplemented by “reasonable” gap-fillers. Instead, each party would have the option to enforce a contract that contains the agreed-upon terms, supplemented with terms proposed by, or most favorable (within reason) to the other party. Thus, each party has the option to enforce upon the other party a full agreement that is at least as profitable as the other party had plausibly envisioned when entering the precontractual agreement.

The no-retraction approach, when implemented through this dual-option device, provides an intermediate, rather than all-or-nothing, liability consequence to the parties’ precontractual agreement (similar, again, to Fuller’s “sliding scale of enforceability”).⁶⁸ There are different levels of intensity to precontractual agreements: they can lie anywhere on a continuum between very preliminary to almost full consensus. A regime that focuses only on extremes and restricts the legal outcome to either full expectation liability or no liability at all can rarely reflect the varied tones of parties’ partial understanding along this continuum. It also leads the parties to make less-than-optimal reliance decisions. And being so inherently unpredictable, it adds a component of risk that might chill the incentives of parties to reach partial agreements. In contrast, under the no-retraction regime, the burden of liability is proportional to the intensity of the agreement. When very few terms are included in the preliminary agreement, the option that each party has to enforce a contract is relatively less burdensome to the other party, since the many missing terms are supplemented in a way most favorable to the other party. As more terms are contained in the agreement, less one-sided supplementation is needed and the option each party has becomes more burdensome to the other party. When the precontractual understanding is comprehensive and needs no supplementation, the option to enforce it converges with standard contractual liability.

Another way to view the continuity property of the no-retraction regime is to compare the terms of the deal contained in the options that two parties have. A preliminary agreement is, in effect, two contracts, each containing a different set of supplemented terms, with each party having the option to enforce only one of them. When the

⁶⁸ See sources cited *supra* note 1 (pressing for an ascending liability scheme that would be based on different measures of damages).

preliminary agreement contains very few terms, the two contracts are very different from each other. As more terms are contained in the preliminary agreement and less one-sided supplementation is required, the two contracts converge until, when the preliminary understanding is comprehensive, the two contracts become identical.

C. *Good Faith in Negotiations*

The gradual rise of liability under the no-retraction principle provides a systematic foundation for one of the more ambiguous doctrines in contract law—the requirement to negotiate in good faith. In the presence of precontractual agreements, and especially in the presence of an “agreement to agree,” courts have increasingly regulated the freedom *from* contract. While deciding not to enforce these agreements as full-blown contracts, courts require the parties to continue negotiations in a bona fide attempt to reach a full agreement.⁶⁹ In addition, they tailor some measure of reliance liability to a breach of this duty.⁷⁰ It is not clear, however, what the duty to continue negotiations in good faith requires. As a result, the parties are left uncertain as to what type of bargaining tactic might be deemed unreasonable. The no-retraction approach can resolve this ambiguity.

For the good faith duty to be instrumental in inducing optimal precontractual reliance, the negotiation tactics ought to conform, at the very least, to the no-retraction principle developed here. A party would be deemed in violation of the duty if she retracts from terms she previously agreed to or if she refuses to accept new terms offered by the other party that are the most favorable terms for which she can reasonably hope. Refusal to contract under such terms manifests a motivation to break, rather than successfully culminate, the negotiations, and thus exhibits bad faith.

Consequently, if a party insists on terms that exceed standard or average market terms and refuses to accept reasonable, split-the-difference

⁶⁹ See, e.g., *Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co.*, 670 F. Supp. 491, 499 (S.D.N.Y. 1987) (holding that a commitment letter represented a binding preliminary agreement and, thus, obligated both parties to seek to conclude a final agreement by negotiating in good faith).

⁷⁰ See, e.g., *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 73-74 (2d Cir. 1989) (discussing how a party may be liable for out-of-pocket expenses based on a breach of its duty of good faith); *Copeland v. Baskin Robbins U.S.A.*, 117 Cal. Rptr. 2d 875, 885 (Ct. App. 2002) (“[D]amages for breach of a contract to negotiate an agreement are measured by the injury the plaintiff suffered in relying on the defendant to negotiate in good faith. This measure encompasses the plaintiff’s out-of-pocket costs in conducting the negotiations . . .”).

proposals from her counterpart, this is not a bad faith negotiation practice and should not give rise to liability.⁷¹ In line with the non-retraction principle, this party has not retracted from actual or constructive previous representations. But when the other party caves in and concedes all the contested issues, either in accordance with this party's previous demands or in accordance with the best alternative this party can potentially find elsewhere, then the refusal of this party to finalize a deal can be construed as bad faith conduct.⁷² Put differently, one way to determine bad faith is to assess the terms that are *not* proposed. The defendant would want to show that there exist some more favorable terms that were not proposed and that are within the reasonable domain; the plaintiff would want to show that any term more favorable to the defendant beyond what was proposed is not reasonably attainable. In contrast to much of the good faith jurisprudence, this approach determines whether the defendant's negotiation position is in good or bad faith not by the value of this position to the plaintiff, but rather by its value to the defendant.⁷³ To be sure, there are many ethical factors that bear on the issue of what is bad faith in negotiations. This analysis does not exhaust such inquiry. The point here is more limited: To the extent that the social concern is to encourage parties to rely on and invest in the negotiations, the good faith obligation can be instrumental in promoting this goal. In fact, all that is required is a fairly lenient good faith standard, placing a minimal burden on the parties. If parties are precluded from rejecting their own most favorable terms, optimal reliance would ensue.

⁷¹ See, e.g., *PSI Energy, Inc. v. Exxon Coal USA, Inc.*, 17 F.3d 969, 973 (7th Cir. 1994) (holding that a coal supplier had not negotiated in bad faith by insisting on a price that was above the market price).

⁷² This principle was rejected in *Roberts v. Adams*, 330 P.2d 900, 902 (Cal. Ct. App. 1958) (finding no violation of the duty to negotiate in good faith when parties failed to agree on terms of payment, despite the plaintiff's willingness to pay the entire price in cash upfront). See also *A/S Apothekernes Laboratorium for Specialpraeparater v. I.M.C. Chem. Group, Inc.*, 873 F.2d 155, 159 (7th Cir. 1989) (finding no violation of the duty to negotiate in good faith when a party refused to approve a deal that granted all the contested issues in its favor). In the latter case, however, the concession was made after the agreed-upon, sixty-day term to negotiate expired. *Id.* at 156.

⁷³ For the view that bad faith should be assessed by the value of the terms to the plaintiff, see *White v. NLRB*, 255 F.2d 564, 565-66 (5th Cir. 1958) (examining the value of the defendant's offer to the plaintiff in order to determine whether the defendant negotiated in bad faith); Eisenberg, *supra* note 33, at 1810 (asserting that good faith requires a party to accept a fair implication of any agreed-upon term); Farnsworth, *supra* note 11, at 277 (highlighting potential examples of unfair dealing by focusing on the value of proposals to the conceding party).

D. *The Requirement of Definiteness*

The requirement that the agreement be definite is another implication of the mutual assent principle. When the agreement fails to include important terms, it is difficult to determine whether mutual assent was reached. When there is no sound basis to infer what terms the parties might have wanted, the presumption of consent is refuted and no remedy can be provided. To hold otherwise is to “make the contract over” and undermine the privilege of consent that the defendant reserved.⁷⁴ The choice under existing law is, again, between no contract and a full-blown supplemented contract.⁷⁵

The common law has traditionally tended toward the no-contract outcome. For example, a landlord who granted a tenant an option to extend a lease at a price to be agreed upon was not bound in the renewal period; his promise was deemed insufficiently definite.⁷⁶ This traditional result has been weakened under the Uniform Commercial Code’s (the Code) “contract with open terms” approach, that more aggressively supplements the parties’ agreement with reasonable or majoritarian terms, including price terms.⁷⁷ Nevertheless, both traditional common law and the Code share the premise that the problem is dichotomous: either a full-blown contract can be assembled with the aid of gap-fillers, or no contract exists at all.

In contrast, under the no-retraction principle, a promise that is insufficiently definite can give rise to an intermediate result. The party who seeks enforcement of the incomplete agreement is granted an option to enforce the transaction supplemented with terms that are the most favorable (within reason) to the other party. The tenant, in the above example, could enforce a lease extension under the

⁷⁴ See *Sun Printing & Publ’g Ass’n v. Remington Paper & Power Co.*, 139 N.E. 470, 471 (N.Y. 1923) (presenting Judge Benjamin Cardozo’s famous dictum, “We are told that the defendant was under a duty . . . to accept a term that would be reasonable To hold it to such a standard would be to make the contract over”).

⁷⁵ To illustrate this dichotomy, consider the opinions in *Sun Printing*, 139 N.E. 470. An agreement left the price of future installments open, to be resolved in later negotiations. When a finalized agreement was not reached, but after the parties performed some of the immediate obligations, the parties disagreed as to whether there was a binding contract. The court split between two views. The majority, led by Judge Cardozo, reversed the appellate court and held that no binding obligation existed. *Id.* at 342. Meanwhile, the dissent, led by Judge Frederick Crane, argued that the court could supplement the agreement with a reasonable and fair provision. *Id.* at 350-51 (Crane, J., dissenting).

⁷⁶ *Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*, 417 N.E.2d 541, 544 (N.Y. 1981).

⁷⁷ U.C.C. § 2-305 (2003).

landlord's most favorable price index—a price no lower than what the landlord could have sought when the agreement was to be reached.

This option is not equivalent to enforcing the indefinite promise as a contract. The gaps, under this option approach, are filled with terms different than the average/majoritarian terms. Using such majoritarian terms would impose obligations on the defendant that she has not willed. Instead, the missing terms must be such that the completed deal is guaranteed to be no worse than what the retracting party could have presumptively intended when the incomplete promise was made, and it is enforced only if the promisee so chooses.

Indeed, in some situations, courts overcome the indefiniteness of the agreement, using a “cure by concession” technique that is effectively identical to the no-retraction regime. A party that seeks to enforce an agreement can concede the missing terms by accepting terms that are the most favorable to the other party.⁷⁸ In his landmark decision in *Sun Printing & Publishing Ass'n v. Remington Paper & Power Co.*,⁷⁹ Judge Benjamin Cardozo makes reference to such a technique:

If price and nothing more had been left open for adjustment, there might be force in the contention that the buyer would be viewed, in the light of later provisions, as the holder of an option. This would mean that [the buyer] . . . would have the privilege of calling for delivery in accordance with a price established as a maximum.⁸⁰

Cardozo, however, rejects this approach in his decision. Thus, while some courts have overcome the problem of indefiniteness in this way,⁸¹ this approach is by no means universal. The following Section

⁷⁸ See FARNSWORTH, *supra* note 21, § 3.29, at 219 (explaining “cure by consensus”).

⁷⁹ 139 N.E. 470 (N.Y. 1923).

⁸⁰ *Id.* at 470 (citation omitted).

⁸¹ For example, when parties left the payment terms “to be agreed upon,” courts have allowed the buyer to “concede” the full payment in cash and with no delay, namely, in a manner most favorable to the seller. See, e.g., *Morris v. Ballard*, 16 F.2d 175, 176 (D.C. Cir. 1926) (concluding that the purchaser could enforce a deal that had not resolved the terms of payment if he was ready to pay the agreed price under such terms as the vendor might impose); *Matlack v. Arend*, 63 A.2d 812, 817 (N.J. 1949) (stating that if the buyer “waives all credit and offers to pay cash, the defense that the agreement is too indefinite is untenable”). It is not that courts perceive the full payment in cash as the reasonable term that the parties intended. In fact, oftentimes it is quite clear that the parties hoped to agree on installment or credit terms. Rather, courts regard the buyer's willingness to make full payment in cash as a waiver that “obviate[s] any need to come to any agreement as to the manner and form of payment.” *Shull v. Sexton*, 390 P.2d 313, 318 (Colo. 1964).

discusses the instances in which using this gap-filling approach would be desirable.

E. *Filling Gaps in Incomplete Agreements*

The no-retraction regime's solution to the problem of incomplete representation—the option each party has to enforce a contract supplemented by terms most favorable to the other side—can be viewed as a basis for a different principle of gap-filling in incomplete agreements. In contrast to the “mimic the parties' will” approach that fills gaps with reasonable or majoritarian terms, and also in contrast to the information-forcing default rule that fills gaps in a way that minimizes information and communication costs, the no-retraction approach selects “pro-defendant” defaults: one-sided terms most favorable to the enforced-against party. Such default provisions are not aimed at minimizing contract-drafting costs (as are the mimicking defaults), nor do they purport to regulate the information flow during the negotiations (as do “penalty” defaults). Instead, they monitor the parties' decisions to exit negotiations and retract from earlier representations. Moreover, if they are coupled with the reliance measure of liability, they can efficiently regulate precontractual reliance decisions.

This gap-filling approach provides a solution to a problem that is one of the least-theorized sources of contractual incompleteness: parties' inability to agree over a disputed issue.⁸² In these situations, in order to avoid a breakdown in the negotiations and a collapse of the relationship, parties may choose to leave the issue open or resolve it in ambiguous terms. This incompleteness has little to do with drafting costs (in fact, ambiguity is often more expensive to draft), nor with asymmetric information. The all-or-nothing approach and standard gap-filling techniques would clearly violate the parties' choice to reserve mutual veto power on the resolution of the disputed issue. In fact, any gap-filling approach that utilizes definitive default provisions would, if anticipated by the parties, have the *ex ante* effect of precluding them from leaving an issue unresolved. The biased supplementation approach under the no-retraction regime, which effectively provides a *dual*-provision default—with its content depending on the identity of the party seeking enforcement—is consistent with

⁸² See, e.g., OLIVER HART & JOHN MOORE, AGREEING NOW TO AGREE LATER: CONTRACTS THAT RULE OUT BUT DO NOT RULE IN (Nat'l Bureau of Econ. Research, Working Paper No. W10397, 2004) (offering a theoretical model of agreements that are designed deliberately incomplete).

the parties' strategic choice to disagree. In a sense, under this regime, the parties can agree *ex ante* that the unresolved issue will never provide a basis for a unilateral decision to exit the deal, since the other party has an option to concede it, and they can do so without actually resolving the issue. The decoupled default terms enable parties to create an obligation without mutual assent.⁸³

F. *The Mechanics of Offer and Acceptance*

Consensus theory is the foundation of the offer-and-acceptance model of contract formation. If the parties have to reach consensus in order to create contractual liability, then it is necessary to identify two communications that manifest identical terms, and before such a contemporaneous union of communications occurs, both parties must be free to walk away.⁸⁴ Thus, doctrines that address the relations between communications that are either non-identical or that create timing issues, such as revocation of offers, counteroffers, and battles of forms, among others, are all corollaries of the consensus principle. Accordingly, a liability regime that does not build this principle and does not require consensus would have numerous implications for the legal consequences of the offer, acceptance, and other precontractual communications.

Before examining these implications, however, a point of caution is in order. The offer-and-acceptance model of contract formation is not always a useful representation of the negotiation process. In fact, under the premise that motivates much of the analysis throughout this Essay—that mutual assent is reached piecemeal—the offer-and-acceptance model is quite synthetic. There is not a single communication in which a party sets forth the comprehensive list of terms it desires, to which the other party says “I accept.” Instead, communications proceed in many rounds, each relating to a different aspect of the deal. Full-blown offers or counteroffers, if they exist, only trail and memorialize a course of partial understandings. Nevertheless, if the no-retraction idea is to have a general appeal, it must apply to the

⁸³ The argument that parties are often interested in this type of unresolved or interim commitment is developed more fully in a companion paper, Ben-Shahar, *supra* note 8.

⁸⁴ See *Adams v. Lindsell*, 106 Eng. Rep. 250, 251 (K.B. 1818) (“The defendants must be considered in law as making . . . the same identical offer to the plaintiffs; and then the contract is completed by the acceptance of it by the latter.”); Simpson, *supra* note 2, at 258-62 (discussing the historical evolution of the offer-and-acceptance doctrine).

simple transactions in which communications do fit within the offer/acceptance metaphorical framework. Accordingly, the following is a tentative exploration of a few implications of the no-retraction approach.

1. Doctrines that Permit Costless Retraction

Under the mutual assent regime, a party that manifested its willingness to enter an agreement under some terms can freely retract as long as the other party has not accepted these same terms. Thus, if the communication amounts to what the law deems to be an “offer,” current doctrine establishes that it can be withdrawn at no cost before the intent to be bound becomes mutual, namely, any time prior to acceptance.⁸⁵ Under the no-retraction principle, however, retraction in such circumstances is not free, particularly if the other party relied on the proposal. The offeror who revokes the offer must reimburse the offeree at least for the reliance investment incurred after the offer was made. Similarly, if the communication does not amount to an “offer” but is merely a solicitation of offers, or an invitation to deal, current doctrine allows the soliciting party to retract prior to (and even after) the response by the other party, whereas the no-retraction regime will impose liability on the soliciting party who is now unwilling to deal under the terms she solicited.

In some contexts, the law already recognizes mild versions of a no-retraction principle. When a subcontractor makes a bid, which the general contractor uses in computing her own bid, the subcontractor cannot revoke his terms, even before they are affirmatively accepted.⁸⁶ It is not consent that creates liability, but a one-sided, relied-upon proposal.

The no-free-revocation rule raises several potential concerns. First, each party might be less willing to communicate proposals and would

⁸⁵ U.C.C. § 2-205 (2003); *Petterson v. Pattberg*, 161 N.E. 428, 429 (N.Y. 1928) (holding that an offer is revocable anytime before acceptance even though the offeree incurs costs in reliance).

⁸⁶ *Drennan v. Star Paving Co.*, 333 P.2d 757, 759-60 (Cal. 1958). Some courts have criticized this deviation from the mutual assent regime for its one-sided liability, exposing subcontractors to bid shopping and bid chopping. *See, e.g.*, *Pavel Enters., Inc. v. A.S. Johnson Co.*, 674 A.2d 521, 528 (Md. 1996) (noting that *Drennan*'s reasoning has been criticized based on the fact that subcontractors are bound to general contractors but general contractors are not bound to subcontractors). These courts have not recognized, however, the possibility of applying the no-retraction regime *bilaterally*. General contractors, too, can be barred from retracting: once they incorporate the subcontractor's offer into their own bid, they may not retract.

prefer to wait for the other party to put forth a non-retractable proposal, thus preserving its own freedom to walk away cost-free. This problem could be particularly severe in situations where parties expect that new information will affect their willingness to transact. Further, parties might hesitate to enter negotiations, reducing the incidence of efficient contracting.

As a general theoretical matter, this concern is not valid. Recall, first, that if, in light of fresh information, a party wishes to revoke a proposal, she can still do so under the no-retraction regime, but at a cost. The only difference between the no-retraction regime and the consensus regimes is who bears the cost of reliance sunk prior to the proposer's retraction. A party who, in the course of negotiations, acquired new information, can revise her offer, or even dissolve the relationship, but if this retraction leads to a negotiation breakdown, she must reimburse her counterpart's expenses. As argued above,⁸⁷ this added cost of retraction would *increase*, not reduce, the payoff from contracting to both parties, including the proposing party. True, the latter must bear a cost of potential liability for retraction. This cost, however, is more than offset by the benefit she derives from the increased reliance investment by her negotiation partner. Namely, under the no-retraction regime, negotiating partners have the greater security that their counterparts will not retract and walk away from previous proposals, and in the presence of this enhanced security they will have a greater incentive to make precontractual specific investments. These investments, in turn, increase the surplus that both parties end up dividing via the contract. Thus, the proposing party, by surrendering the absolute freedom to retract, energizes the opponent's investment and eventually enjoys the larger contractual pie. For example, a subcontractor is better off when his bid is irrevocable, because the general contractor is more likely to rely on this bid and to incorporate it into her own bid.⁸⁸

Another concern has to do with a party's ability to make concurrent proposals to numerous potential partners, where a contract can be entered into with, at most, one of the respondents. Would the proposing party be liable to respondents who are turned down for their response costs? Would such liability deter parties from making

⁸⁷ *Supra* Part I.E.3.

⁸⁸ See *Drennan*, 333 P.2d at 760 (arguing that the subcontractor benefits by having his bid irrevocable and thereby enabling the contractor to rely on it).

concurrent proposals or from soliciting concurrent bids from multiple parties?

The answer to this concern turns on what is deemed a retraction in the presence of multi-party bids. If it is clear that the intent of the soliciting party is to deal eventually with only one of the respondents, then the 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. Thus, to avoid the burden of excessive liability, the soliciting party need not opt out of the no-retraction regime, but merely clarify to the recipients (if it is not already clear) that the solicitation is not exclusive. Recall that the same problem arises under the mutual assent regime, when more than one party responds to an advertisement. The common law resolves this problem by classifying the advertisement as an "invitation" rather than an "offer."⁸⁹ The advertisement is not open for all recipients to accept.⁹⁰ Here, a retraction does occur if, say, the soliciting party insists on terms different than ones she initially set out, rejects *all* the responses that conform to the solicitation's terms, or does not fairly consider one of the bids. But a retraction does not occur if the soliciting party is rejecting the invited responses after impartially accepting one of the bids.⁹¹

A further concern that the no-retraction regime may raise has to do with the expiration of precontractual proposals. How long must a party, who made a proposal, wait before she can walk away from the negotiations without bearing liability for retraction? Surely, the proposal cannot be open indefinitely, binding the proposing party forever. Under the current regime, a party who made a proposal but then seeks to terminate the negotiations can freely revoke the proposal. Under the no-retraction regime, this course of action is not available, raising concerns that parties would be bound even when the negotiations turned stale.

This concern can be dealt with by defining the retraction restrictions with greater precision. Recall that the limitation on retraction is meant to prevent *opportunistic* retractions that are associated with holdups. Retractions that are a result of impasse—of exhausted bargaining and a sincere futility of negotiations—should not be grounds

⁸⁹ RESTATEMENT (SECOND) OF CONTRACTS § 26, cmt. b, illus. 1 (1981).

⁹⁰ *Id.* cmt. c ("In determining whether an offer is made, relevant factors include the . . . number of persons to whom the communication is addressed.").

⁹¹ For a similar understanding of the obligation to entertain bids, see *Heyer Prods. Co. v. United States*, 140 F. Supp. 409, 413 (Ct. Cl. 1956); Farnsworth, *supra* note 11, at 238-39.

for liability. In the same fashion that current law determines the length of time that unrestricted offers, if not revoked, remain open, no-retraction doctrine can determine the length of time that proposals cannot be revoked. For example, the existing default rule establishes that an offer expires after a reasonable length of time.⁹² Such a rule, if applicable and effective under a regime that permits free affirmative retraction, may also be applicable under a regime that does not permit free retraction.⁹³ The offeror's interest to be free from futile negotiations can be addressed by shortening the term that is considered "reasonable" for an offer to remain open. Of course, the offeror may retract even earlier and, to the extent that the offeree has not yet relied, do so without bearing any liability.

In general, it might be feared that a no-retraction regime, by reducing each party's unilateral control over the termination of the negotiations, would introduce more uncertainty into the negotiations stage. Note, though, that the diminished freedom to retract may only increase, rather than reduce, the parties' certainty as to their position. Under this regime the parties know that serious precontractual statements lead to *certain* intermediate liability. In contrast, under the current regime, parties are often uncertain whether their communications have put them in the realm of contract. The variance inherent in this binary regime, where legal consequences are either null or harsh, is eliminated by the no-retraction regime.

To be sure, transactors who are accustomed to the free-retraction regime might be intimidated by the no-retraction principle and, as a result, instinctively opt out of it. Such a reaction, however, can at most confirm how deep-rooted the consensus principle is in the existing legal folklore. It cannot rationalize the consensus principle or its free-retraction corollary.⁹⁴ Indeed, under different legal systems,

⁹² See RESTATEMENT (SECOND) OF CONTRACTS § 41 (1981) (stating that an offeree's power of acceptance will lapse after a reasonable amount of time unless the offer states otherwise).

⁹³ A similar approach applies to contract negotiations under the National Labor Relations Act (NLRA), 29 U.S.C. §§ 151-169 (2000). Negotiations toward a collective bargain can be terminated, and offers withdrawn, if they have reached an "impasse." A substantial body of case law defined the terms under which such withdrawal can occur. See Farnsworth, *supra* note 11, at 282-83 (discussing the "impasse" concept as it relates to breaking off negotiations).

⁹⁴ Indeed, the requirement of mutual consent—and the need for an offer *and* an acceptance—has been so deeply rooted in the intuitions of scholars and transactors alike that it has often been packed into the definition of contract. James Gordley argues convincingly that there is not a single satisfactory philosophical account as to why an offer cannot be conceived differently, for example, as a commitment that is binding

offers are considered irrevocable unless the offeror expressly stated otherwise.⁹⁵

2. Doctrines That Deal with Nonconforming Communications

When parties exchange communications that do not manifest a consensus, e.g., counteroffers, forms containing different material terms, and the like, the mutual assent regime assigns all-or-nothing legal consequences to their negotiations. On the “nothing” side, under the rigid “mirror-image” rule of the common law, an offeree who accepts most of the terms and adds or modifies others is presumed to reject the original offer, thereby terminating her power of acceptance. Namely, the original offer expires, and the original offeror is free to walk away.⁹⁶ Even under the less rigid approach of the Code, an offeree who is adding or modifying *material* terms in response to an offer is rejecting the offer and, unless the offer is renewed, can no longer accept the rejected terms.⁹⁷ On the “all” side, if the parties’ conduct recognizes the existence of a contract, provisions are filled in liberally.⁹⁸

Under the no-retraction rule, nonconforming communications, whether counteroffers or concurrent proposals, do not automatically cancel out, but are instead baselines that each party sets for the other to accept. This exchange of proposals mode of negotiations represents the prototypical case of gradual convergence of the wills. It is a continuous process whose essence, as argued in Part I, justifies a “convergent” liability regime.⁹⁹ Thus, neither party can unilaterally walk away from the terms it offered, unless the terms are affirmatively

unless and until it is rejected by the other party. GORDLEY, *supra* note 20, at 175-80, 234.

⁹⁵ See, e.g., Franco Ferrary, *A Comparative Overview on Offer and Acceptance Inter Absentes*, 10 B.U. INT’L L.J. 171, 189-90 (1992) (observing that in Germany, Austria, Switzerland, and Portugal, an offer is considered irrevocable). In Germany, an offer is irrevocable after it has been received by the offeree, and it may provide that some elements are left to the determination of the offeree. BÜRGERLICHES GESETZBUCH §§ 130(1), 315 (2000).

⁹⁶ RESTATEMENT (SECOND) OF CONTRACTS § 36(1)(a) (1981) (“[The] offeree’s power of acceptance may be terminated by rejection or counter-offer”); see also *Minneapolis & St. Louis Ry. v. Columbia Rolling-Mill Co.*, 119 U.S. 149, 152 (1886) (determining that, after making a counteroffer that was not accepted, the plaintiff could not fall back on the defendant’s original offer).

⁹⁷ U.C.C. § 2-207(2) (2003).

⁹⁸ § 2-207(3).

⁹⁹ See *supra* note 27 and accompanying text (discussing how the no-retraction regime creates convergent liability).

rejected. As a default, a counteroffer need not be deemed a rejection, but merely a basis for a reverse option. Following the counteroffer, each party has the power of acceptance. In particular, the original offeror may either accept the counteroffer or refine its previous offer, but cannot retract by insisting on more aggressive terms.

A party has, to be sure, a right to terminate the negotiations following a rejection of its offer. As in the case of multiple *concurrent* respondents, where turning down one and choosing another bidder is not a retraction, in the case of multiple *sequential* respondents, the offeror can turn and deal with a subsequent partner after the initial one rejected the offer. This last observation highlights the proper scope of the no-retraction regime. It is not designed to override parties' legitimate motivation to exit negotiations. A party that makes representations of terms may still turn around and refuse to deal if her partner delayed his response unreasonably, rejected her offer outright, or in any other way failed to manifest his acceptance of the offer. Violations of the no-retraction principle occur, in principle, only if the refusal to deal under the previously represented terms is part of a bargaining strategy that aims at capturing a bigger share of the surplus than previously conceded.

CONCLUSION

This Essay explores an alternative to one of the fundamental building blocks of the law of contract formation—the requirement of mutual assent. It does not propose any change in the type of liability that emerges when assent exists, but rather it explores an intermediate species of liability that could emerge when mutual assent does not exist, prior to consensus. It shows that the two regimes converge when a consensus over terms exists; it is only when full consensus is lacking that the two regimes diverge.

The analysis in this Essay focuses on one type of justification for the no-retraction liability regime, namely, an economic justification emphasizing reliance incentives. It identifies reliance damages as the optimal measure of damages for retraction from precontractual representations. It argues, however, that the no-retraction regime could conceptually be coupled with various measures of damages and tailored to promote other objectives of the transacting parties. Surely, other contracting goals and social concerns can be affected by a shift from an all-or-nothing regime to a continuous scale of enforceability, and they may rationalize other remedies.

In comparison to the existing assent doctrines of contract law, the no-retraction principle provides a different approach to many fundamental problems of contract formation. Our brief transdoctrinal journey in Part II demonstrates that under the no-retraction approach, the legal resolution of mutual mistakes, precontractual agreements, conflicting proposals, and more generally, gaps in incomplete contracts, would be different than the existing order under the familiar assent regime.

The analysis in this Essay, being exploratory in nature, is admittedly lacking in rigor and in nuance. As a substitute to the mutual assent "pillar" of contract law, the no-retraction principle potentially applies to numerous contexts, with implications to many doctrines, none of which were treated with sufficient detail here. A more complete defense of the no-retraction regime would also have to identify reasons why the consensus principle prevailed, historically. Accordingly, the analysis here is offered, not as a basis for reform, but as an inquiry into some basic conceptions underlying our legal tradition. It remains for future work to explore the extent to which the approach developed in this Essay has the horsepower to resolve *pragmatically* the problems that have proven difficult for current doctrine and to examine whether these solutions advance the various social objectives associated with contract formation.