CONTRACT AS VOLUNTARY COMMUTATIVE JUSTICE*

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2020 MICH. ST. L. REV. 725

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* We would like to thank the participants at the Obligations Group Conference on Unjust Enrichment (Melbourne, Australia, December 4, 2020), the 14th International Conference for Contract Law (New Orleans, March 2019), the Edinburgh League Theory Festival (May 2019), and the Hong Kong Maritime Commercial Law Center working paper series of City University of Hong Kong (September 2018) for their comments on this Article. We are also indebted to Hanoch Dagan, Rick Bigwood, Chunyan Ding, Geraint Howells, Alexander Loke, and Mikis Tsimplis for their comments and to Melvin Eisenberg and Robert Cooter for their friendship and exchange of views over the years.

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INTRODUCTION

At present, there is no generally accepted theory of why contracts are binding. We will propose one based on an idea that goes back to Aristotle: contract as voluntary commutative justice. In principle, a contract of exchange should be enforced when it is both voluntary and economically fair. It is voluntary so long as a party puts a higher value on what he is to receive than on what he is to give. Voluntariness is subjective and personal; economic fairness is not. An exchange is economically fair when the performance that each party is to make is equivalent in economic value to the one that he is to

receive. Performances are equivalent in economic value when each party is compensated for the risks that the contract places on him.

In Part I, we see why that explanation better accounts for the enforceability of contracts than modern explanations based on autonomy and efficiency. We then hope to show how this theory can explain the principal common law doctrines that govern when and how a contract of exchange is enforced. Some doctrines such as unconscionability, impracticability, and consideration are concerned with fairness, even though consideration supposedly is not. We consider them in Part II. In Part III we consider others that concern voluntariness such as mistake and frustration of purpose. In Part IV, we discuss remedies for breach of contract.

I. WHY CONTRACTS ARE BINDING: AUTONOMY, EFFICIENCY, OR COMMUTATIVE JUSTICE

In the nineteenth and early twentieth century, jurists in common law and civil law jurisdictions produced what scholars such as Melvin Eisenberg have called "classical contract law." The founders of "classical law" defined contract in terms of autonomy: Contract is the will of the parties. Their theories were unable to explain why a contract is binding at all, why sometimes the parties are bound to terms to which they did not agree, and why sometimes the law will not enforce terms to which they did agree. As we will see, these questions cannot be answered by theories that explain contractual obligations by autonomy alone. Nevertheless, no generally accepted theory of contract law has taken their place. As Grant Gilmore said almost half a century ago, "The systems have come unstuck and we see, presently, no way of gluing them back together again."[1]

In a footnote to a book he wrote two years later, *The Ages of American Law*, Gilmore observed presciently that a new approach was emerging to fill the theoretical vacuum.[2] It uses economic analysis to resolve legal problems and explains contract law in terms of efficiency. Pareto efficiency is a state in which one person cannot be made better off without making another worse off. Contracts are efficient because they enable each party to receive something he values more than what he gives to the other party. We will see that this approach cannot answer the very questions that stymied the nineteenth century will theorists.

1. GRANT GILMORE, THE DEATH OF CONTRACT 102 (1974).
2. GRANT GILMORE, THE AGES OF AMERICAN LAW 108 n.11 (2d ed. 2014).

These questions can be answered, we believe, by an older approach that goes back to Aristotle and is based on his idea of contract as voluntary justice.[3] In principle, a contract of exchange should be voluntary and economically fair. It is voluntary as long as a party puts a higher value on what he is to receive than on what he is to give. It is economically fair when the performance that each party is to make is equivalent in economic value to the one that he is to receive. Performances are equivalent in economic value when each party is compensated for the risks that the contract places on him.

According to this approach, a contract is binding because allowing a party to back out of a contract after he has been compensated for assuming a risk would be similar to allowing that party to renege on a fair bet. When a party was not compensated for assuming a risk, the contract is unfair and, in principle, it should not be enforced.

We will examine theories of contract based on autonomy and efficiency and then describe our alternative based on commutative justice and voluntariness.

A. Autonomy

According to "will theories," a contract is enforceable because the promisor has chosen to commit himself.[4] According to "transfer theories," the will theories do not explain why the promisee should have the right to enforce a contract. Their explanation is that the promisor chose to transfer that right to the promisee. Hanoch Dagan and William Heller have proposed a "choice theory" in which the law provides a range of contracts of different types, and the parties choose one which best serves their interests.[5] We discuss these theories in turn.

1. *Will Theories—Old and New*

It would be anachronistic to say that the common law had a law of contract before the nineteenth century. Instead, there was an amorphous case law concerned with when a promise could be enforced under the writs of covenant or assumpsit. Except for a few

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3. *See* ARISTOTLE, NICOMACHEAN ETHICS V.iv 1132^{a}–1133^{b}.

4. *See, e.g.*, Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 272 (1986).

5. HANOCH DAGAN & MICHAEL HELLER, THE CHOICE THEORY OF CONTRACTS 14 (2017).

pages in William Blackstone's *Commentaries on the Laws of England*, there was no literature on contract aside from the decided cases.[6] In the nineteenth century, common law treatises began to arise. The treatise authors, like their contemporaries in continental countries, developed what we now call "will theories" of contract. They defined contract as the assent or agreement of the parties.[7] As A.W.B. Simpson said, the will of the parties was regarded "as a doctrinal *grundnorm*, from which all other rules are derived."[8]

The new feature was not that the parties must express their will or assent in order to be bound by a contract. Jurists said as much since the time of the Romans.[9] In Roman law, a party needed to assent to enter, for example, into a sale or a lease, but the law then supplied the terms that "good faith" required in that type of contract.[10] The innovation of the nineteenth century jurists was to claim that the will or assent of the parties was the source of all of their contractual obligations.

The will theories could not explain why a contract is binding. They could not explain why courts read so called "implied terms" into a contract to which the parties never agreed to resolve problems that they never contemplated. Nor could they explain why courts sometimes refused to enforce a severely unfair contract to which both parties agreed.

For the nineteenth century will theories, the parties were bound because they agreed to be bound. No further explanation was thought

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6. *See* A.W.B. Simpson, *Innovation in Nineteenth Century Contract Law*, 91 L.Q. REV. 247, 250–51 (1975).

7. *See* 1 SAMUEL COMYN, A TREATISE OF THE LAW RELATIVE TO CONTRACTS AND AGREEMENTS NOT UNDER SEAL 1 (New York, Isaac Riley 1809); JOHN NEWLAND, A TREATISE ON CONTRACTS, WITHIN THE JURISDICTION OF COURTS OF EQUITY 1 (Philadelphia, Benjamin Warner 1821); JOSEPH CHITTY, JUN., A PRACTICAL TREATISE ON THE LAW OF CONTRACTS, NOT UNDER SEAL; AND UPON THE USUAL DEFENCES TO ACTIONS THEREON 3 (London, S. Sweet, R. Milliken & T. Clark 1826); 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW 450 (Charles M. Barnes ed., Boston, Little, Brown, & Co., 13th ed. 1884); C. E. Dodd, *On the Construction of Contracts.—Assent.—Construction.*, 12 LEGAL OBSERVER J. JURIS. 249, 249 (1836); WILLIAM W. STORY, A TREATISE ON THE LAW OF CONTRACTS NOT UNDER SEAL 1 (Boston, Charles C. Little & James Brown 1844); Professor Carey, *A Course of Lectures on the Law of Contracts*, 4 L. TIMES & J. PROP. 448, 463 (1845); 1 THEOPHILUS PARSONS, THE LAW OF CONTRACTS 6 (3d ed. 1857); STEPHEN MARTIN LEAKE, THE ELEMENTS OF THE LAW OF CONTRACTS 7–8 (London, Stevens & Sons 1867).

8. Simpson, *supra* note 6, at 266.

9. *See* Dig. 2.14.1.3. (Ulpian, *Ad edictum*).

10. *See, e.g.*, Dig. 19.1.1.1. (Ulpian, *Ad edictum*).

necessary. Contract had been defined as the will or agreement of the parties. As Valérie Ranouil observed of the French will theorists, the binding force of contract was taken for granted rather than justified.[11] She quoted Emmanuel Gounot's description of their view: "The contract is binding because it is the contract."[12] Common lawyers agreed. Indeed, they were puzzled that according to the doctrine of consideration, not all agreements were binding.

Their failure to provide any further explanation is an instance of the conceptualism of classical contract law. Once contractual obligations were defined as arising from the will of the parties, it followed by definition that the parties were obligated once they had expressed their will to be bound. In *Liberty of Contract*, Roscoe Pound described this sort of reasoning as "mechanical jurisprudence, a condition of juristic thought and judicial action in which deductions from conceptions . . . are developed logically at the expense of practical results."[13]

The same circularity is inherent in any theory that claims the ultimate reason the parties are bound to a contract is that they chose to be bound. Charles Fried and Ernest Weinrib have constructed modernized will theories based on a Kantian idea of autonomy.[14] According to Fried, "In order that I be as free as possible, that my will have the greatest possible range consistent with the similar will of others, it is necessary that there be a way in which I may commit myself."[15] Critics such as Eisenberg have pointed out that a person who is bound by a promise he is unwilling to keep has fewer options than he did before, and to that extent, is less free. As Eisenberg said, "Nothing in autonomy theory compels favoring earlier choices over later choices, and coercing a contracting party to take an action he now autonomously declines to take."[16]

Neither can a theory based on will or autonomy explain why the law reads "implied terms" into a contract to which the parties never

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11. *See* VÉRONIQUE RANOUIL, L'AUTONOMIE DE LA VOLONTE: NAISSANCE ET EVOLUTION D'UN CONCEPT 71–72 (1980).

12. EMMANUEL GOUNOT, LE PRINCIPE DE L'AUTONOMIE DE LA VOLONTE EN DROIT PRIVE: CONTRIBUTION A L'ETUDE CRITIQUE DE L'INDIVIDUALISME JURIDIQUE 129 (Arthur Rousseau ed., 1912); *see also* RANOUIL, *supra* note 11, at 72 n.31.

13. Roscoe Pound, *Liberty of Contract*, 18 YALE L.J. 454, 457 (1909).

14. *See* CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 8 (1981); ERNEST J. WEINRIB, CORRECTIVE JUSTICE 5 (Timothy Endicott et al. eds., 2012).

15. FRIED, *supra* note 14, at 13.

16. *See* Melvin A. Eisenberg, *Theory of Contracts*, *in* THE THEORY OF CONTRACT LAW 206, 233 (Peter Benson ed., 2001).

agreed to resolve problems that they never contemplated. Oliver Wendell Holmes and Samuel Williston rejected the will theories because the will of the parties is clearly not the source of these terms. As Williston said, "To assume first that everybody knows the law, and, second, that everybody thereupon makes his contract with reference to it and adopts its provisions as terms of the agreement, is indeed to pile a fiction upon a fiction . . . ."[17] They proposed an "objective theory" which defined contract as a set of consequences that the law attaches to what the parties said or did whether the parties willed these consequences not.[18] The question they did not answer was why the law should attach one set of consequences rather than another. Charles Fried, who thought the basis of contract law is the principle that promises are binding, acknowledged that when a court reads terms into a contract, no one should make "the futile attempt to bring these cases under the promise principle."[19] Fried's critics have pointed out that if he is right, the promise principle cannot explain most of contract law.[20]

A theory based on will or autonomy is also unable to explain the relief that courts sometimes give when an exchange is severely unfair. According to the nineteenth century will theorists, the parties should be bound by whatever terms they agreed on. As Joseph Story said:

> [E]very person, who is not, from his peculiar condition or circumstances, under disability, is entitled to dispose of his property in such manner and upon such terms as he chooses; and whether his bargains are wise and discreet, or profitable or unprofitable, or otherwise, are considerations, not for Courts of Justice, but for the party himself to deliberate upon.[21]

Before the nineteenth century, courts of equity had given relief when a contract was "unconscionable."[22] They continued to do so in the nineteenth century despite the will theories. Nevertheless, they no longer said that the reason was that the bargain was unfair. Instead, as A.W.B. Simpson observed, they said that they were giving relief for

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17. 2 SAMUEL WILLISTON, THE LAW OF CONTRACTS § 615 (1920).

18. *Id.* § 20.

19. *See* FRIED, *supra* note 14, at 60–61, 63, 69.

20. *See* Eisenberg, *supra* note 16, at 279; *see also* Conrad Johnson, *The Idea of Autonomy and the Foundations of Contractual Liability*, 2 L. & PHIL. 271, 300 (1983).

21. 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA 267 (Boston, Charles C. Little & James Brown, 4th ed. 1846).

22. *See* JAMES GORDLEY, THE PHILOSOPHICAL ORIGINS OF MODERN CONTRACT DOCTRINE 147–51 (1991) [hereinafter PHILOSOPHICAL ORIGINS].

fraud and that the harshness of the terms was evidence of fraud.[23] Yet that could not have been their real reason. In the cases in which they gave relief, the victim of the harsh bargain did not allege that the other party lied to him.[24] The courts were giving relief because of unfairness while refusing to admit they were doing so because the will theories could not explain why they should.[25]

The same difficulty is inherent in any theory that believes the ultimate reason that contracts are binding is that the parties expressed their will to be bound. Fried acknowledged that despite the principle that promises are binding, "Some bargains, though they meet all of the tests I have set out so far, seem just too hard to enforce."[26] For example, a rescuer should not be able to charge too much to save the cargo of a disabled ship. He did not explain why.

2. *"Transfer" Theories*

As Hanoch Dagan and Michael Heller noted, autonomy by itself does not answer the question: "Why should free individuals not be able to change their minds without legal liability?"[27] One response, they observed, has been the formulation of so-called transfer theories.[28] The will of the promisor creates a legal right in the promisee to require that the promisor perform.[29] For the promisor to refuse to do so is unjust because it deprives the promisee of that right.[30]

According to Peter Benson in his recent book *Justice in Transactions*:

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23. *See* A.W.B. Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533, 569 (1979).

24. *See* James Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587, 1599 (1981) [hereinafter *Equality in Exchange*].

25. *See id.* at 1598–99.

26. *See* FRIED, *supra* note 14, at 109.

27. DAGAN & HELLER, *supra* note 5, at 21.

28. *See id.* at 33.

29. *See id.* at 34.

30. *See* Seana Valentine Shiffrin, *Promising, Intimate Relationships, and Conventionalism*, 117 PHIL. REV. 481, 507, 516 (2008) (explaining the effect of a promise is to create a moral obligation in the promisor and a "power" in the promisee to hold the promisor to the promise and how it is a "transfer of a party's power to change one's mind to the other party"); *see also* ARTHUR RIPSTEIN, FORCE AND FREEDOM: KANT'S LEGAL AND POLITICAL PHILOSOPHY 109 (2009). According to Arthur Ripstein, the will of the parties can transfer a preexisting right from one to the other. *See id.* It can also "create new rights," including rights to things that need not exist as fully determinate antecedent to the transfer. *Id.*

> [One must] understand contract formation as itself effectuating between the parties a kind of *transactional acquisition* that vests in them exclusive entitlements with respect to what they have promised one another. And since the acquisition of each party is from the other, it is constituted by a transfer between them. . . . [B]reach of contract can now plausibly be viewed as an injury to the rights already vested at formation. Breach becomes the equivalent of attempting to "take back" or "withhold" what, as a matter of rights, one has *already* given over to the other.[31]

According to Arthur Ripstein, the will of the parties can transfer a preexisting right from one to the other.[32] It can also "create new rights, including rights to things that need not exist as fully determinate prior to the transfer."[33] According to Seana Shiffren, "[A] promise by B [to A] creat[es] a moral obligation to A and the power in A to insist on or to release B from performance."[34] "[T]he power behind making promises . . . involves the transfer of a party's power to change one's mind to another party."[35]

Benson noted that this explanation of why contracts are binding is not a new one. He correctly observed that it was proposed by "the great natural law writers in the continental civilian tradition, including Hugo Grotius and Samuel Pufendorf."[36] As the senior author has shown elsewhere, Grotius had taken it from a group of philosopher–jurists active in the sixteenth and seventeenth century known to historians as the late scholastics.[37] The late scholastics will be of interest throughout this Article because they were the first to attempt a synthesis between the civil law of the Romans and the philosophical ideas of Aristotle and in particular, the idea of contract as voluntary commutative justice.[38]

Cajetan (1469–1534) argued that a person who had been promised a gift could not demand as a matter of commutative justice that the promise be kept. Certainly, the promisor acted wrongly by breaking his promise, and in that sense the promise was binding. But making a gift is a matter of liberality, not of commutative justice. The refusal to perform leaves the disappointed party no worse off than if

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31. PETER BENSON, JUSTICE IN TRANSACTIONS: A THEORY OF CONTRACT LAW 8 (2019).

32. *See* RIPSTEIN, *supra* note 30, at 116.

33. *Id.*

34. Shiffrin, *supra* note 30, at 507.

35. *Id.* at 516.

36. BENSON, *supra* note 31, at 10.

37. JAMES GORDLEY, THE JURISTS: A CRITICAL HISTORY 96–97 (2013) [hereinafter THE JURISTS].

38. *See id.* at 84–101.

the promise had never been made. Cajetan concluded that the promisee could only claim that the promisor acted unjustly toward him if he had become worse off by changing his position in reliance on the promise.[39] The leading late scholastics disagreed with Cajetan. Luis de Molina (1535–1600) pointed out that if the donor had given something away and delivered it to the donee, it would belong to the donee.[40] Under the Roman law, the donor could not then take it back unless the donee was guilty of gross ingratitude.[41] But there is nothing magical about the moment of delivery. In principle, Molina argued, the donor ought to be able to transfer the right to a thing, or the right to claim it, in advance of delivery. If he did, then depriving him of that right by failing to perform violates commutative justice.[42] Leonard Lessius (1554–1623) agreed, Hugo Grotius (1583–1645) agreed with Lessius and Molina, and later writers such as Samuel Pufendorf (1632–1694) followed Grotius.[43]

A "transfer theory" explains why, when the promisor transferred a right to the promisee, a contract was enforceable. Of itself, however, it does not explain why the promisor should wish to transfer such a right or why the law should honor his intention. As Grotius noted, if a promisor wished, he could express his intention to perform, or even declare his moral commitment to perform, without transferring such a right.[44] For Benson and Ripstein, the reason is freedom. According to Benson, "[T]his transactional conception . . . presupposes particular notions of freedom and equality specified in terms of the innate mutual independence of all persons in relation to others."[45] According to Ripstein,

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39. *See* CAJETAN (TOMASSO DI VIO), COMMENTARIA to THOMAS AQUINAS, SUMMA THEOLOGICA II-II, Q. 88, a. 1; Q. 113, a. 1 (1698).

40. *See* LUDOVICUS MOLINA, DE IUSTITIA ET IURE TRACTATUS III, disps. 272, 281 (1614).

41. The rule is described in LEONARDUS LESSIUS, DE IUSTITIA ET IURE, CETERISQUE VIRTUTIBUS CARDINALIS LIBRI QUATUOR lib. 2, cap. 18, dub. 8, no. 52 (1628), and MOLINA, *supra* note 40, at disps. 272, 281.

42. *See* MOLINA, *supra* note 40, at disp. 262.

43. *See* LESSIUS, *supra* note 41, at lib. 2, cap. 18, dub. 8, no. 52; HUGO GROTIUS, DE IURE BELLI AC PACIS LIBRI TRES II.xi.1.3-4 (1688); SAMUEL PUFENDORF, DE IURE NATURAE LIBRI OCTO III.v.5-7 (1688); JEAN BARBEYRAC, LE DROIT DE LA GUERRE ET DE LA PAIX DE HUGUES GROTIUS n.2 to II.xi.1; n.1 to II.xi.3 (1729); JEAN BARBEYRAC, LE DROIT DE LA NATURE ET DES GENS . . . PAR LE BARON DE PUFENDORF n.10 to III.v.9 (1734).

44. *See* GROTIUS, *supra* note 43, at II.xi.1.6; 2.1-4.

45. BENSON, *supra* note 31, at 468.

> An obligation of right concerning future performance is a title to compel that performance, consistent with the freedom of the obligee, just as a permission granted through consent is a title to do something to another, consistent with that person's freedom. Arrangements between private persons are expressions of their respective freedom . . . .[46]

So, as with the will theories, the value ultimately at stake is the parties' freedom to do as they choose. Transferring a right to another to enforce a contract in advance of performance is an exercise of one's freedom, as is anything else that one freely chooses to do. To call it an exercise of one's freedom says nothing about why a party would want to exercise his freedom in that way. It says nothing about why the law of contract protects this exercise of freedom. It cannot explain, any more than a will theory, why the law reads the terms that it does into a contract. As Richard Craswell pointed out, a theory based on autonomy cannot explain what terms the law should read into a contract. Any set of terms would be consistent with the freedom of the parties to choose the terms by which they will be bound.[47]

Benson maintained that unfair terms are inconsistent with the "abstract equality" of the parties. The market price or exchange value of a performance, "[b]eing inherently relational, the same for all and not decided by anyone in particular, . . . embodies the very same kind of abstractly equal relational standpoint that contractual equality requires and that parties, as equal persons, may reasonably be presumed to accept when contracting with each other."[48] "[I]t is the conceptualization of the substance of the considerations [given by the parties] as exchange value that brings out with full clarity contract's abstraction from particularity and its being an expression of the parties' abstract equality."[49]

Granting that the parties are "equal," or, if you like, "abstractly equal," it is hard to see why the market price has to do with their abstract equality. Why, to treat the other party as my equal, must I exchange at prices that are not determined by any party? Is it because these prices are fair? But why would the fact that they are not determined by either party mean that they are fair? Is it because, in Benson's words, there is a "presumed intention" in contract of

46. RIPSTEIN, *supra* note 30, at 112.

47. *See* Richard Craswell, C*ontract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 514–29 (1989).

48. BENSON, *supra* note 31, at 185.

49. *Id.* at 386.

exchange, which "is an intention to give and receive equal value"?[50] If so, is this not another ultimately unsuccessful attempt to base substantive fairness on the autonomy or intention of the parties?

Shiffrin does not commit herself as to whether autonomy explains why the promisor can transfer a right to the promisee to require performance. She thinks it is "plausible that the power is inherent in the basic rights and capacities of self-governing individuals," but "will not try to establish definitively that the power . . . is inherent in the capacities of an autonomous moral agent."[51] Her main line of argument, however, is that in human relationships, and particularly intimate or personal relationships, "we must have the power to make binding promises to permit relationships of some complexity with the right moral dynamics to develop and flourish."[52] Thus, she recognizes that the reason promises should be binding, and, indeed, the reason a party would want to make a binding promise, depends on what that party can accomplish by doing so. The reason will be different in different intimate and personal relations, and different again in an exchange among strangers. But to understand the rights of the promisee, we need to understand what that reason is.

3. *Choice Theory*

According to Dagan and Michael Heller, contract theories that turn on the question "[W]hat is freedom?" "have reached a dead end."[53] They have proposed a "choice theory," which recognizes that the parties are best served in different ways in different types of contracts. They recognized that such an approach resembles that of Roman law, in which, as noted earlier, parties consent to enter into a contract of a certain type, which is normally governed by terms which they do not provide.[54]

Nevertheless, the terms of these contracts must vary to reflect "goods" other than the value of autonomy itself. Like Shiffrin, they are asking what a party can accomplish by making a binding promise. But this search takes them in the wrong direction if we are looking for what the parties can accomplish by entering into a contract of

50. Peter Benson, *The Unity of Contract Law*, *in* THE THEORY OF CONTRACT LAW: NEW ESSAYS 118, 188 (Peter Benson ed., 2001) (internal emphasis omitted).

51. Shiffrin, *supra* note 30, at 520.

52. *Id.* at 516.

53. DAGAN & HELLER, *supra* note 5, at 10.

54. *See id.* at 8.

exchange. According to Dagan and Heller, "The main goods of contract are utility and community."[55]

Dagan and Heller noted that they "are using the terms utility and efficiency interchangeably."[56] In the next section, we will see that one cannot explain the terms the law reads into a contract in terms of efficiency. According to Dagan and Heller, "community" is reflected particularly in contracts that concern "work" and "home," presumably because people who enter into such contracts are seeking community and not merely material benefits.[57] No doubt. But if one listed the values that parties seek when they enter into an exchange, there would be no reason to stop with community. When a person buys a violin or tickets to the symphony, his values are aesthetic. When he enrolls in a university or buys a book, his goals—often, one would hope—include the acquisition of knowledge. When he buys a gym membership, his goals may be health and athletic excellence. When he buys a drink in a bar, he may be seeking relaxation, joy, or oblivion. In such cases, a party may also be seeking fellowship or community with others. But he is entering into an exchange of one sort or another: for example, a sale, a lease, or a contract for services. We agree that the terms the law reads into such contracts must be explained in terms of some value other than autonomy. We do not see how that value can be utility or efficiency. We propose that it is economic fairness.

Dagan and Heller claim, however, that "autonomy . . . is still the ultimate value of contract."[58] Dagan discussed economic fairness in a recently published book with Michael Heller and an article with Avihay Dorfman.[59] Their explanation concerns autonomy, not utility or efficiency. Autonomy implies that the parties can "relate in a contract as equals either by assuming co-authorship of determining, or influencing the determination of, the terms of the interaction, or by satisfying reasonable expectations of typical term-takers."[60] Relief for unconscionability "most dramatically" "exemplifies [a] concern" "that one of the parties is not sufficiently competent to make and

55. *Id.* at 16.

56. *Id.* at 51.

57. *Id.* at 52–56 (discussing that it is not distributive justice which they regard as a value "external" to a concern for autonomy, utility, and community). In our view, set out below, labor contracts are special because they concern both commutative and distributive justice.

58. *Id.* at 16.

59. *See generally id.*; *see also* HANOCH DAGAN & AVIHAY DORFMAN, JUSTICE FOR CONTRACTS 47 (2020).

60. DAGAN & DORFMAN, *supra* note 59, at 48 (internal emphasis omitted).

accept contractual promises."[61] Terms are "substantive[ly] unconscionable" when they are "unreasonably favorable to the other party."[62] They are "procedural[ly] . . . unconscionab[le]" when they reflect an absence of "self-determination"[63] or "meaningful choice"[64] because "the weaker party suffers from 'physical or mental infirmities, ignorance, illiteracy or inability to understand the language of the agreement.'"[65] As we will see later on, however, no matter how vulnerable a party may be, he is bound to a contract as long as the terms do not unreasonably favor the other party.[66] Otherwise, vulnerable people could not contract. Moreover, it is strange to think that whether terms unreasonably favor the other party depends upon whether the disadvantaged party played a role in shaping them or expected them to be otherwise. If the parties contract at a market price determined by supply and demand, neither influences the price. If they sign a contract with fair terms, the terms will be enforced against a party who could not have influenced them and did not understand them, let alone expect them. The economic unfairness of a contract does not depend on the autonomy of the parties.

B. Efficiency

Modern economic theory explains contracts in terms of efficiency. Pareto efficiency is a state in which one party cannot be made better off without making another worse off. Economists do not speak of fairness. Yet without the concept of fairness, they cannot explain why efficiency is a goal worth pursuing. The difficulty, as Guido Calabresi notes in his article *The Pointlessness of Pareto: Carrying Coase Further*, is that a contract that makes both parties better off ex ante does not always make them better off ex post.[67] Ex ante, when they enter into a contract, both parties hope to be better off. Ex post, there will be winners, who are better off, and losers, who are not. As Calabresi noted, "all alleged improvements," that is, all changes that are allegedly Pareto optimal, "entail, at least ex ante, the

61. DAGAN & HELLER, *supra* note 5, at 86.
62. DAGAN & DORFMAN, *supra* note 59, at 47.
63. *Id.*
64. DAGAN & HELLER, *supra* note 5, at 87 (internal quotation marks omitted).
65. DAGAN & DORFMAN, *supra* note 59, at 47 (quoting RESTATEMENT (SECOND) OF CONTS. § 208 cmt. d (AM. L. INST. 1981)).
66. *See infra* Subsection II.C.1.
67. *See generally* Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211 (1991).

possibility of losers."[68] Any time the law enforces a contract, it is against someone who made a bargain and lost, at least compared with some other bargain he can make. To say that contracts are binding is to say that a party cannot escape merely because he finds the contract disadvantageous. Melvin Eisenberg made the same point:

> The expressed preference of a promisor when he makes the contract is to keep his promise. The expressed preference of the promisor when the contract is sought to be enforced is to not keep his promise; otherwise, there would be no reason for the promisee to seek legal enforcement. Nothing in revealed-preference theory alone can tell us which of these two preferences the law [ought to] respect.[69]

As we will see, our answer is that some risks must be borne by one party or another, and that a fair contract allocates these risks between the parties so that each is compensated for the risk that he bears. A party who refuses to perform has reneged. He is worse off, but it is fair that he should be held liable.

A second question is why the law reads terms into a contract to which the parties themselves never agreed. As discussed below, economists have correctly observed that the terms the parties would draft for themselves are those that place the risks and burdens of an exchange on the party that can bear them at the lowest cost. The parties would adjust the price so that the party who bears this risk or burden is compensated for doing so. When the law places a risk or burden on the party who can bear it most easily, although the parties may not adjust the price to reflect that specific risk, they can do so to take account of their general expectations as to the risks they will bear. From the standpoint of efficiency, however, it does not matter whether the terms are fair. Indeed, from the standpoint of efficiency, it really does not matter what terms the law reads in unless they are so repugnant as to induce the parties to draft terms of their own. The gain in efficiency is merely that the parties will not incur the expense of doing so. Such an explanation is likely to appeal only to someone who believes an explanation in terms of fairness is impossible and is looking for an alternative.

A third question is why the law sometimes gives relief when a contract is unfair. A contract can be efficient even in the clearest cases in which the law gives relief for unfairness. If a ship is sinking and only one other ship can rescue it, any price for performing the rescue

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68. *Id.* at 1227.

69. Eisenberg, *supra* note 16, at 239; *see also* MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 244 (1993).

is "efficient" as long as it is higher than the cost of doing so and lower than the value of the ship, its cargo, and the lives of the crew and passengers. At any price within that range, each party is better off than with no contract at all. Yet a contract at any price the rescuer can exact is a paradigm example of one that courts will not enforce. As Eisenberg noted, a contract would not be enforced if a geologist studying rock formations happened upon a traveler, stranded without food and water after his car had broken down, and charged him a fortune for a ride to the nearest town.[70] Such a price is efficient, but it is not fair. It is not fair, we would say, because the rescuer is not being compensated for any risk that he assumed. But economists speak of efficiency, not of fairness.

According to Richard Posner, a leader of the law and economics movement, the reason for giving relief in such a case is not the unfairness of the contract. In an article with William Landes, Posner explained that if relief were denied, ship owners would overinvest in safety equipment to reduce the chance that their ships will need to be rescued.[71] Again, that sort of explanation will be satisfying only to a person who doubts that there is any such thing as an unfair contract, and therefore believes we must look elsewhere for an explanation. Posner suggested another explanation in his seminal treatise *Economic Analysis of Law*. Although any price higher than the cost of rescue and lower than the value of the ship and its cargo will make both parties better off, "[a]scertaining this range may be costly, and the parties may consume much time and resources in bargaining within the range. Indeed, each party may be so determined to engross the greater part of the potential profits from the transaction that the parties never succeed in coming to terms."[72] Suppose, however, that the parties waste little time negotiating while the ship is sinking and that neither is so blind to self-interest as to let it sink rather than agree. Should the agreement be enforced when, to give Posner's example, they agreed on "a price equal to 99 percent of the value of the ship and its cargo"?[73]

Moreover, what about the traveler stranded in the desert who promises a fortune in return for a short ride to the nearest town? Is that agreement unenforceable because, otherwise, travelers to remote

70. *See* Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 755 (1982) [hereinafter *The Bargain Principle*].

71. *See* William M. Landes & Richard A. Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83, 92–93 (1978).

72. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 62 (7th ed. 2007).

73. *Id.* at 118.

places will overinvest in automobile maintenance and bottled water? Or because the parties in the desert might waste valuable time in discussion? Or because negotiations might fail because the traveler would rather die than agree?

C. Voluntary Commutative Justice

Though it may seem odd, modern contract law is better explained using the ancient idea of contract as voluntary commutative justice. In principle, a contract of exchange should be enforced when it is both voluntary and economically fair. It is voluntary so long as a party puts a higher value on what he is to receive than on what he is to give. It is economically fair when the performance that each party makes is equivalent in economic value to the one that he receives.[74] Performances are equivalent in economic value when each party is compensated for the risks that the contract places on him.

This approach can answer the questions that stymy theories based on the will of the parties or on efficiency. A contract is binding when the terms are fair because to permit him to back out is like allowing him to renege on fair bet. The law reads terms into the contract to which the parties never expressly assented because they are fair. When a contract is economically unfair, it should not be enforced because the disadvantaged party was not compensated for a risk it placed on him. The contract is unfair in the same way a bet is unfair.

The Aristotelian idea of a just price or equality in exchange has often been misunderstood. To see why, we can consult the work of sixteenth and seventeenth century jurists already mentioned as the originators of "transfer theory." They used the idea of equality in exchange to build the first systematic theory of contract law. Historians refer to them as the "late scholastics." Leaders were Domenico de Soto (1494–1560), Molina, and Lessius. Their conclusions, including those that concern the just price, were borrowed by leading continental jurists including Grotius and Pufendorf in the seventeenth and eighteenth centuries and were not discarded until the rise of will theories in the nineteenth century. These writers did not regard economic value as a stable characteristic of an object like its color. Instead, they were among the first to recognize that the economic value of any asset at any moment in time depends on its value in the future.[75] Its value in the present is the sum of the

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74. *See* ARISTOTLE, *supra* note 3, at V.iv 1132^{a}–32^{b}.
75. *See infra* notes 77–78.

values it may have in the future discounted by the probability that it will have these values. Modern economists express this idea mathematically. Assign each set of circumstances a probability, and the expected value of the performance (V_e) is the value it will have under each set of circumstances ($V_1, V_2, \ldots V_n$) discounted by the probability that each will occur ($p_1, p_2, \ldots p_n$). So, $V_e = p_1V_1 + p_2V_2 + \ldots + p_nV_n$. In a coin flip, if I win $100 if the coin comes up heads, and lose $100 if it comes up tails, the expected value to me is $.5 \times \$100 + .5 \times -\$100 = 0$. These writers were the first to formulate the concept of expected value.[76] They used that concept to determine damages for breach of contract.[77] They used it to define a fair bet: The potential gains and losses for one bettor, discounted by the probability that they will occur, are equal to those of the other. According to historian of mathematics James Franklin, that formulation was a landmark in the development of probability theory.[78]

The late scholastics identified the fair price of an object with its market price.[79] They knew that this price varied from day to day and from region to region. They believed that it must do so to respond to factors which they called need, scarcity, and cost.[80] These factors are like the ones that modern economists take into account by drawing supply and demand curves. Unlike modern economists, they did not understand supply and demand as distinct schedules that intersect to determine the market price.[81] Rather, they believed that the market price was determined by the common judgment, *communis aestimatio*, of those trading on the market as to the price that most accurately reflected need, scarcity, and cost.[82]

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76. *See infra* notes 77–78.

77. *See* MOLINA, *supra* note 40, at disp. 736.

78. *See* JAMES FRANKLIN, THE SCIENCE OF CONJECTURE: EVIDENCE AND PROBABILITY BEFORE PASCAL 286–88 (2001) (citing Soto and Lessius on wagers and insurance).

79. *See* PHILOSOPHICAL ORIGINS, *supra* note 22, at 94–97.

80. *See* DOMENICUS SOTO, DE IUSTITIA ET IURE LIBRI DECEM lib. 6, q. 2, a. 3 (1553); MOLINA, *supra* note 40, at disp. 348; LESSIUS, *supra* note 41, at lib. 2, cap. 21, dub. 4. The same view was held by members of the northern natural law school. *E.g.*, GROTIUS, *supra* note 43, at II.xii.14; PUFENDORF, *supra* note 43, at V.i.6.

81. *See* ODD LANGHOLM, PRICE AND VALUE IN THE ARISTOTELIAN TRADITION 116 (1979).

82. *See* SOTO, *supra* note 80, at lib. 6, q. 2, a. 3; MOLINA, *supra* note 40, at disp. 348; LESSIUS, *supra* note 41, at lib. 2, cap. 2, dub. 2. For the northern natural lawyers, see GROTIUS, *supra* note 43, at II.xii.14, II.xii.23 (stating that prices are determined by "taking account" of these factors and explaining that the phase *communis aestimatio* describes how a risk is priced in an insurance contract); PUFENDORF, *supra* note 43, at V.i.8.

They regarded the risk that market price will change as an inherent risk of owning property, such as the risk that it will be destroyed. It is a risk the parties assume when they exchange. A party who loses if prices fall would have gained if prices had risen. As Soto said, a merchant must bear his losses if "bad fortune buffets him, for example, because an unexpected abundance of goods mounts up," and he may sell for more if "fortune smiles on him and later there is an unexpected scarcity of goods, . . . [f]or as the business of buying and selling is subject to fortuitous events of many kinds, merchants ought to bear risks at their own expense, and, on the other hand, they may wait for good fortune."[83] Similarly, Lessius noted, "[T]his is the condition of merchants, that as they may gain if they receive goods at small expense, so they lose if the expense was disproportionate or extraordinary."[84] A party who was unwilling to bear the losses he had sustained because the market price had fallen is like a party who tries to repudiate a contract because the property he purchased has since been destroyed. He assumed a risk and is trying to escape its consequences.

The risk that prices will change later is thus one that parties must assume if prices are to fluctuate to reflect need, scarcity, and cost. Since the risk is reflected in the price, neither party becomes richer or poorer at the time of the transaction. In contrast, a party is enriched at another's expense if he takes advantage of what Lessius called that party's ignorance or necessity to charge more than the market price.[85] Charging a high price for a rescue at sea is an example of taking advantage of his necessity. Selling above or below the market price to someone who does not know that price is an example of taking advantage of his ignorance.

Roman law, as interpreted by the medieval jurists, gave a remedy for what was called *laesio enormis*, a deviation of more than half from the just price, which the medieval jurists, like the late scholastics, identified with the market price. The reason for the remedy, the late scholastics explained, was that such a price grossly violated the principle of equality in exchange.[86] A remedy was given only for gross

83. SOTO, *supra* note 80, at lib. 6 q. 2 a. 3.
84. LESSIUS, *supra* note 41, at lib. 2, cap. 21, dub. 4.
85. *See id.*
86. *See, e.g.*, GLOSSA ORDINARIA to CORPUS IURIS CIVILIS to C 4.44.2 to *auctoritate iudicis* (Venice, 1581).

violations for pragmatic reasons that concerned the stability of commerce.[87]

Other terms of a contract were fair as long as they preserved equality. An example was the seller's warranty that goods are free from defects. The seller could disclaim the warranty, but only if he charged the buyer a lower price to compensate him for assuming that risk.[88]

II. FAIRNESS IN CONTRACTS OF EXCHANGE

This Part discusses the fairness of the price term and the fairness of the auxiliary terms. It then turns to how these concerns about fairness are or should be reflected in common law doctrine.

A. The Fairness of the Price

Modern economists explain contracts in terms of efficiency, not fairness. Yet the tools of modern economics can be used to make the Aristotelian idea of a fair price more precise. As we have seen, writers in the Aristotelian tradition identified the just price with the market price. They believed that an exchange at the market price would make neither party richer nor poorer at the time the parties entered into their contract. The risk that prices would change thereafter, and that consequently a party would become richer or poorer, was one that the parties had to assume because prices had to fluctuate to reflect the factors which they called need, scarcity, and cost.

Modern economists explain more clearly why prices must fluctuate to reflect what they call supply and demand. If prices were frozen, the supply for a good or service would no longer equal the demand for it. At a price below the one that the market would set, goods and services will not go to those who are willing to pay the most for them. They will go to whoever happens to be first in a line of would-be purchasers or has friends who can make sure he gets them. At a higher price, goods and services will go unsold. One function of a competitive market, then, is to price ration goods and services. They go to whoever will pay most for them. Another function is to channel resources into the production of goods whose price rises and away from the production of goods whose price falls. To perform these

87. *See* SOTO, *supra* note 80, at lib. 6, q. 2, a. 3; MOLINA, *supra* note 40, at disp. 348; LESSIUS, *supra* note 41, at lib. 2, cap. 21, dub. 2.

88. *See* MOLINA, *supra* note 40, at V, disp. 353.

functions, market prices must be allowed to change. Economists have given a clearer explanation, then, of why each party must assume the risk that he will lose by contracting rather than waiting to contract.

By assuming that risk, each party is making a bet that he may win or lose: He will be better off having contracted if the market price moves in one direction and worse off if it moves in the other. That bet, however, is not like the ones that gamblers make in a casino. They are creating a risk that a person will win or lose that exists only because of the rules of the game that they play. They are not allocating a risk, like the risk that the market price will change, that must be borne by someone. As economists say, most people are risk averse. Risk averse parties will not gamble. But they will allocate between them the risks that one party or the other must bear.

For writers in the Aristotelian tradition, an exchange at the market price is like a fair bet. It makes neither party richer nor poorer at the time they contract because, although the market price may fall thereafter, it might rise as easily.[89] Modern economists have given a clearer explanation of why. Suppose that persons of superior insight could tell whether the market price at present is too low and will rise in the future. If there are a sufficient number of such persons, and they command enough money, the market price will constantly be corrected as they bid against each other. It cannot long remain above or below the level at which it is as likely to move up as it is to move down.

That, at least, is what economists call the "efficient market hypothesis."[90] One might draw an analogy to players in a game of darts. The best player in the world could not beat the average of a thousand mediocre players if the thousand were given a single score computed by taking the average distance from the bullseye. For example, a miss by one player a foot to the left, and a miss by another player a foot to the right, are counted as two bullseyes. Similarly, among buyers and sellers trying to predict how the market price will change, some will guess high, some will guess low, but the average of their predictions should be on target.

Consequently, we can see why, when the parties are trading on competitive markets, their contract should be binding. In entering into a contract, they allocated the risk that prices would change in the

89. *See supra* p. 743, para. 1.

90. Eugene F. Fama first proposed the hypothesis. *See* Eugene F. Fama, *The Behavior of Stock-Market Prices*, 38 J. BUS. 34, 94 (1965); *see also generally* Paul A. Samuelson, *Proof That Properly Anticipated Prices Fluctuate Randomly*, 6 INDUS. MGMT. REV. 41 (1965).

future. At the time they did so, neither party was enriched at the other's expense, or, to put it another way, each party was compensated for the risk that he assumed. To allow a party to renege on a risk that he has been compensated to assume would be unfair. The tools of modern economics enable us to see more clearly why it would be unfair.

Indeed, when we recognize why the market price is normally fair, we can see why, in the vast majority of cases, the law enforces a contract of exchange without any special examination of whether it is fair. Neither party may have given a thought to fairness but yet, although each person "intends only his own gain," to quote Adam Smith, "he is . . . led by an invisible hand to promote an end which was no part of his intention"—in this instance, to contract at a price that is fair to the other party.[91]

Nevertheless, it may be that one party is better able than the other to predict in which direction the market may change, and yet it is still fair to enforce the contract. One possibility is that one party has information that others trading on the market do not. In that event, even according to the efficient market hypothesis, he will be better able to make such a prediction. There are two reasons why a contract he enters into at the market price should be enforced even though he is more likely to win than to lose.

First, if he spent time or money acquiring the information, he was making a different bet: a bet that to do so would be worth the cost. If that bet pays off, it is fair that he should profit from it. Such efforts allow the current market price to reflect accurately the chances that it will change in the future. Consequently, such efforts should be rewarded.

In *Laidlaw v. Organ*, one party had learned of the signing of the Treaty of Ghent, ending the War of 1812, early on a Sunday morning.[92] Soon after sunrise, he called on the defendant with whom he had been negotiating and bought 111 hogsheads of tobacco. The defendant did not know about the treaty and had asked the plaintiff if he knew of any news that would affect its value, but the plaintiff remained silent. The news drove up the price of tobacco 30–50%. The United States Supreme Court refused to give relief.

As plaintiff's counsel argued, there was "no circumvention or manoeuver by the vendee, unless rising earlier in the morning, and obtaining by superior diligence and alertness that intelligence by

91. *See* ADAM SMITH, THE WEALTH OF NATIONS bk. IV, ch. ii (1776).
92. *See* 15 U.S. 178, 182–83 (1817).

which the price of commodities was regulated, be such."[93] Thomas Aquinas, explaining Aristotle's idea of commutative justice, said that a merchant who has found that goods can be bought cheaply in one place and sold for more in another should receive the difference as a "payment for his labor."[94]

There is another reason why it is fair to allow a person with such information to profit by it. Regardless of how he acquired it, either he or someone else will benefit from having that information. To require him to disclose it to the person with whom he is trading merely transfers the benefit to that person, who receives a more favorable price than everyone else because he happened to be trading with a person who happened to have that information. There is no injustice allowing the person with advance information to keep the benefit for himself. According to Aquinas and the late scholastics, it is not unjust for a merchant who arrives in a famine-stricken city with a shipload of grain to sell at the prevailing market price even though he knows that enough ships are on the way to relieve the famine.[95]

A second possibility is that the efficient market hypothesis is not true. If it is not, then some people, who have only the information generally available to other traders, have a skill that enables them to predict more accurately whether the market price will rise or fall. An exchange at the market price is still fair for the same two reasons. The party who profits has spent time and money acquiring this skill himself or purchasing the advice of someone who has. He has bet that the time and money he spent acquiring that skill or advice is worth the cost. If he wins the bet, he should be allowed to profit. The efforts of skilled traders will lead the current market price to more accurately reflect the risks that it will rise or fall in the future. Moreover, as before, it would be absurd to require him to buy or sell at a less favorable price than others. The benefit of skill would then go to the person with whom he happens to trade.

Yet another possibility is that there is no definite and easily ascertainable market price because the commodity traded is not fungible but unique. An example is the housing market. A house cannot be shown to all possible buyers all at once, nor can a buyer see, all at once, all of the houses that he might wish to buy. The risk that

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93. *Id.* at 193.

94. THOMAS AQUINAS, SUMMA THEOLOGIAE II-II, Q. 77 a. 4.

95. *See id.* at art. 3; SOTO, *supra* note 80, at lib. 6, q. 3, art. 2; LESSIUS, *supra* note 41, at lib. 2, cap. 21, dub. 5. *See also* WIM DECOCK. LE MARCHÉ DU MÉRITE PENSER LE DROIT ET L'ÉCONOMIE AVEC LÉONARD LESSIUS 88–89 (2019) (speaking of Vitoria, Molina, and Lessius).

each party takes is not simply that the housing market might rise or fall after he contracts. The risk, for the seller, is that if he had waited longer he could have obtained a higher price, and, for the buyer, that if he had looked longer he could have found a better house for the same price or as good a house for a lower price. A party who does not wait longer or look longer assumes that risk.

If both parties were equally informed about risk of committing themselves at once, rather than waiting, their contract would still be fair in the same way as a fair bet. Nevertheless, for the reasons just discussed, the contract may still be fair if they are not equally well informed. When a party does not seek further information concerning the chances of obtaining a better offer, he is taking the further risk that the information is not worth the cost of seeking it. If he seeks further information, he is betting that to do so is worth the cost. If his bet pays off, again, it is fair that he should profit from it. Indeed, it is through this process that the prices of unique commodities adjust to supply and demand.

Lessius said that the two circumstances in which a price might be unfair are when the contract was made out of necessity or in ignorance.[96] Indeed, if a party contracts at a price that is less favorable than the market price, the reason must be either that he is unable to use the market, or that he does not know what the market price is.

In cases of necessity, a party does not receive the market price because he is unable to use the market. An example is Posner's hypothetical case of a rescue at sea in which the rescuer charged "a price equal to 99 percent of the value of the ship and its cargo."[97] Another example is Eisenberg's case in which a rescuer found a traveler stranded in the desert without food and water and charged him a fortune for a ride to the nearest town.[98]

In these cases, if the rescuer were allowed to profit, it would not be because the parties allocated a risk between themselves, and he happened to win. It would not be because he spent extra time or money acquiring information that enabled him to profit—information, for example, about where a party in need of a rescue might be. Indeed, the

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96. *See* LESSIUS, *supra* note 41, at lib. 2, cap. 21, dub. 4. Theorists who do not recognize that the market price is fair have no standard for determining when one party has gone too far in exploiting another's vulnerabilities. Lacking such a standard, Dagan and Dorfman argue that the contracting parties are not in principle required to take account of each other's vulnerabilities. *See* DAGAN & DORFMAN, *supra* note 59, at 46.

97. POSNER, *supra* note 72, at 118.

98. *See The Bargain Principle*, *supra* note 70, at 755.

risk in question is not one, like the risk that the market price will change, that must be borne by one party or the other. The high price of a rescue, unlike a high market price, neither rations goods or services to those willing to pay the most for them, nor increases the supply of would-be rescuers searching the sea or the desert for people in need of rescue. Indeed, if each ship, or each traveler in the desert, were equally likely to sink or die without the other's help, and they could negotiate in advance, they would each agree not to take advantage of the other's need to extract a high price. Otherwise they would be gambling on a chance event, and risk averse people do not gamble.

The other reason that one party may contract at a price that is less favorable than the market price, is that he does not know what the market price is at the moment he contracts. In such cases, courts of equity gave relief for unconscionability even before the doctrine was recognized in the Uniform Commercial Code and the Second Restatement of Contracts. A Kentucky court did so in 1892 in *Wollums v. Horsley*. A man who was sixty-four years old, disabled, living on a 200-acre isolated mountain farm, and out of touch with the world, sold the mineral rights to his land to a sophisticated businessman who was buying up mineral rights on thousands of acres in the locality. The mineral rights were then worth over thirty times the price to be paid.[99] Sellers in general knew the market price but not the old man.

In *Wollums*, the seller was ignorant of the market price of his land. Under the unconscionability doctrine, courts give relief to buyers who do not know the retail price of goods which they bought for several times that price from a door-to-door salesman.[100]

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99. *See* Wollums v. Horsley, 20 S.W. 781, 781–82 (Ky. 1892). Similarly, a court of equity refused to enforce an exchange of land in Michigan worth $15,000 and subject to no mortgage for a parcel of land in Florida worth $25,000 but subject to a $25,000 mortgage. The owner of the Michigan parcel had not heard that the "Great (Florida) Boom" had collapsed and believed Florida parcel to be worth $40,000. *See* Johnston Realty & Inv. Co. v. Grosvenor, 217 N.W. 20, 21 (Mich. 1928).

100. *See* Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 266–67 (Sup. Ct. 1969); Frostifresh Corp. v. Reynoso, 274 N.Y.S.2d 757, 759 (Sup. Ct. 1966), *rev'd on other grounds*, 281 N.Y.S.2d 964 (App. Div. 1967); Toker v. Westerman, 274 A.2d 78, 81 (N.J. Dist. Ct. 1970); Am. Home Improvement, Inc. v. MacIver, 201 A.2d 886, 889 (N.H. 1964) (discussing an instance of extravagant prices for windows and sidewalls); UNIF. CONSUMER CREDIT CODE § 5.108 cmt. 4 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1974) ("[A] home solicitation sale of a set of cookware . . . for $375 in an area where a set of comparable quality is readily available . . . for $125 or less.").

In such cases, the contract price was not a fair bet as to what the market price will be. They are not cases in which a party was able to charge more by exploiting knowledge or skill in predicting market prices that he spent time or money to acquire. They are not sales of a unique commodity in which each party knew that he might receive a better offer if he waited. The advantaged party was able to charge a higher price because he met someone who did not know the market price, and, indeed, in these cases, sought out such a person. The price he charged was not fair. It did not reflect any expenditure of time or money for which the advantaged party should be rewarded or any risk the disadvantaged party had assumed for which he had been compensated.

In all of these cases, there was a reason why the disadvantaged party did not receive the market price. In cases of necessity, there was no other party with whom he could contract. In cases of ignorance, there was some reason why he did not know the market price. In *Wollums*, he was old, disabled, solitary, and living on an isolated mountain farm. In the cases of the door-to-door sales, the salesman made his pitch in that party's home, which made it more difficult to do comparative shopping, and, for some people, more difficult to tell the salesman to leave. Some scholars use the term "procedural unconscionability" to describe difficulties like these. They believe that both procedural and substantive unconscionability are necessary for courts to give relief. We discuss that claim later when we consider the doctrine of unconscionability.[101] All we need to note here is that whether it is true or not, the evil remedied is substantive unfairness: a failure to receive the market price. Whatever their disadvantages in protecting themselves, if the old man in *Wollums* had been paid the market price of his land, or the customers of the door-to-door salesmen the market price of the goods, there would have been no wrong done for the courts to set right.

B. The Fairness of Auxiliary Terms

The performance terms of a contract specify what each party is to give and to receive. In a sale, they are the object and the price. Some auxiliary terms allocate the risks and burdens of the exchange specified by the performance terms. Other auxiliary terms specify the procedure by which the rights of the parties are to be determined.

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101. *See infra* Subsection II.C.1.

Economists do not speak of fairness but, again, their account of exchange helps to explain when both types of auxiliary terms are fair.

1. *Auxiliary Terms That Allocate Risks and Burdens*

According to writers in the Aristotelian tradition, these terms maintain equality. If the seller does not warrant his goods against defects, the unwary buyer will pay a sound price for an unsound commodity. The seller can waive the warranty but only if he reduces the price to reflect the risk that the goods are defective.[102] An exchange is unfair if it imposes a risk on a party for which he is not compensated.

Again, the tools of economics can make this answer more precise. Economists explain that while parties do not wish to gamble, they do wish to allocate risks that must fall to one party or the other. Economists describe most parties as "risk averse." A risk averse party will not bet $100 that a coin will come up heads unless he will win more than $100 if it comes up tails. Thus, a risk averse party will not enter into a contract like the coin flip, which creates a risk that otherwise will not exist. Rather, they will allocate risks that one party or the other must bear by placing them on the party who can bear them at the lowest cost and adjust the contract price to compensate him for doing so.[103]

They will do so, according to Posner, provided that the seller does not have a monopoly.[104] Actually, it should not matter if the seller has a monopoly as long as both parties fully understand the cost of bearing the risk. Suppose the seller would be willing to assume a risk for $100 that the buyer would not be willing to assume for less than $500. If the seller is a monopolist, he will be able to force the buyer to pay more than the competitive market price for his product. Yet the seller's liability for this risk is like any other amenity that is sold along with the product. If the seller were the sole producer of all the automobiles in the world, he would charge a high price for them. But he would still put in leather seats if buyers were willing to pay an additional amount that exceeds the cost of installing them. Similarly, the seller would assume a risk if buyers were willing to pay more than his cost of doing so.

Therefore, if the parties fully understand the cost of a risk imposed by a term of their contract, the terms will be fair in the same

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102. *See* MOLINA, *supra* note 40, at disp. 353.
103. *See* POSNER, *supra* note 72, at 116.
104. *See id.*

way as a fair bet. A party may lose, but he will have been compensated for taking the risk that he might lose. A contract is not fair if it places a risk or burden on a party without compensating him.

Even if a contract placed a risk on the party who could not bear it most cheaply, the contract would be economically fair if that party were compensated for bearing that risk. In that event, however, the other party would rather bear the risk himself than compensate him. If it is clear that the terms of a contract placed a risk on the party who could not bear the risk most cheaply, it is unlikely that the other party compensated him for doing so.

An illustration is the well-known case of *Weaver v. American Oil Co*.[105] A poorly educated man leased a filling station from an oil company. The lease contained a clause that he would hold harmless the oil company for any damage done by the negligence of its employees. The clause was buried among others in a form contract, and no one pointed out its significance to the lessee. The driver of one of the oil company's trucks negligently set the lessee and the filling station on fire. Applying the unconscionability doctrine, the court refused to enforce the clause.

Which party is best able to bear a risk, according to economic theory, depends on three factors. In this case, each of them indicates that the oil company could bear the risk most cheaply. One factor is who can best foresee the magnitude of the risk. A risk is lower for the party who can best foresee it for roughly the same reason that the risk of playing poker is lower for someone who can peek at the other players' cards. Another factor is who can best control the risk. If the party who can do so must bear the cost if the risk eventuates, then the further risk is eliminated that he may omit the precautions he ought to take to control it. A third factor is who can best spread the risk over similar transactions, whether by buying insurance or by self-insuring. The risk of a house catching fire is less for an insurance company than for a homeowner because it can spread that risk over the many houses it insures. The risk of a streak of bad luck is less for a casino than for an individual gambler.[106]

Here, the oil company could best foresee the probability that one of its drivers would be negligent, and it could best control that risk by taking care who it hires. It could best spread the risk that its drivers

105. *See* 276 N.E.2d 144, 145, 147 (Ind. 1971).

106. On the first and last of these factors, see Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 90–91 (1977). On the second, see GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 135 (1970).

would cause harm to a lessee over its many leases. Yet the contract placed this risk on the lessee. Therefore, it is unlikely that the oil company fully compensated the lessee for bearing this risk. If the oil company could bear the risk more cheaply than the lessee, it would rather do so itself than fully compensate him. If, for example, Amoco would have been willing to bear the risk for $100 and Weaver for $500, Amoco would not have placed the risk on Weaver and also lowered his rent by $500. Since he was not compensated, to place the risk on him was unfair.[107]

It is also possible that even though a contract places the risk on the party who can most easily bear it, the contract is unfair because that party was not compensated for doing so. An example may be another well-known case, *Williams v. Walker-Thomas Furniture Co*.[108] A woman on welfare made a series of purchases from a store. The contract provided that all payments she made would be applied proportionately to all the items that she purchased, so that no item would be completely paid for until all were paid for. When she defaulted on a payment, the store sought to repossess everything she had purchased, although she had already paid an amount greater than the price of her earlier purchases.

Posner and Richard Epstein both noted that these terms may have been of net benefit to the store's customers.[109] Because the store could repossess everything a customer had ever purchased, it ran less of a risk selling these customers new items on credit. Therefore, it could have charged a lower price or a lower rate of interest. The difficulty with their argument is that there is no evidence that the store did so for Ms. Williams. If there were evidence, the store surely would have introduced it. So far as one can tell, she paid the same price and was charged the same rate of interest as a new customer with the same credit rating. Thus, even if the contract placed a risk on her that she could bear more easily, the store did not compensate her for bearing it. Again, the contract was not fair in the same way as a fair bet.

In *Weaver* and in *Williams*, the courts stressed that the disadvantaged parties were unable to understand the terms to which they agreed. As mentioned earlier, according to some scholars, that inability made the agreement "procedurally unconscionable," which, in their view, is a prerequisite for relief. We will discuss that view

107. *See Weaver*, 276 N.E.2d at 145.

108. *See* 350 F.2d 445, 449 (D.C. Cir. 1965).

109. *See* POSNER, *supra* note 72, at 117; Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 U. CHI. J.L. & ECON. 293, 306–08 (1975).

later.[110] Here again, all that needs to be noted is that relief would not have been given if the term in question had not been substantively unfair despite of the inability to understand the terms. We have now seen why that was.

2. *Auxiliary Terms That Modify Procedural Rights*

Sometimes the auxiliary terms of a contract specify the procedure by which the rights of the parties are to be determined. For example, they provide for arbitration or, as is often the case with an employment contract, an internal procedure for determining questions that would otherwise be decided by a court. These terms affect the burdens of determining what the parties' rights are and the risks of making an inaccurate determination.

The fairness of these terms depends on the considerations that have already been described. They are fair if they do not increase the burdens or risks that fall on one party as compared with the other. An example would be a procedure that is cheaper for both parties and more likely to be accurate than litigation before a court. The terms are also fair if the procedure they create is more burdensome or risky for one party than for another provided that the disadvantaged party is compensated for bearing it.

The procedure may be more burdensome for one party even though it increases the cost to both parties of determining their rights by the same amount. One of the parties may be less likely to have the financial resources to bear the increased cost. The other party can then force him to accept an unfair settlement in order to avoid them.

The procedure may be riskier for one party even though it decreases the accuracy of the procedure in a manner that is unbiased so that either party is as likely to prevail as if the case went to court. As mentioned earlier, a party can better bear a risk if he faces it many times in similar transactions. A party who is frequently involved in similar disputes might prefer a less expensive but less accurate procedure because his wins and losses will average out. The risk of inaccuracy will weigh more heavily on a party who may suffer greatly if he loses and who may never be involved in a similar dispute.

The procedure provided by an auxiliary term will always be unfair if it is more expensive without any increase in accuracy, or less accurate but with no decrease in cost. The only reason a party would insert an auxiliary term in a contract that provided for such a procedure

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110. *See infra* pp. 764–67.

is that the burden of the increased cost or the risk of decreased accuracy will weigh more lightly on him than on the other party for the reasons just described. The purpose of such a term would be to induce the other party to settle in order to escape the increased cost or to avoid the risk of losing. To compensate the other party fairly for assuming that burden and risk would defeat the very purpose of imposing it on him. One can safely assume that he was not fairly compensated.

Another possibility is that the procedure is not only less accurate but biased, so that one party is more likely to win and the other to lose than if a court were to determine their rights. Here, again, one can safely assume that the disadvantaged party was not fairly compensated for exposing himself to the risk of a procedure biased against him. To do so would defeat the purpose of inserting a term that provided for a biased procedure.

C. Reappraising Common Law Doctrine

This Section illustrates how these concerns about fairness are reflected in the doctrines of unconscionability, consideration, and impracticability.

1. *The Doctrine of Unconscionability*

In the eighteenth century, courts of equity refused to enforce contracts that they deemed to be "unconscionable."[111] The nineteenth century was the age of will theories. The will of the parties was regarded as the source of all their contractual obligations. Relief for unfairness would set aside the express will of the parties. One might have expected courts to stop giving relief from "unconscionable" bargains. Instead, as A.W.B. Simpson noted, they continued to give relief, but the rationale changed. The courts claimed that they were refusing to enforce an "unconscionable" contract, not because the terms were unfair, but "because the harshness of the terms was evidence of fraud, not as an independent ground for relief . . . ."[112]

Some contemporary scholars have taken the claim that these courts made at face value. They say that the contracts "vaguely condemned as unconscionable were almost invariably associated with some species of fraud, mistake, incapacity, or inadequacy of

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111. *See* PHILOSOPHICAL ORIGINS, *supra* note 22, at 147–51.
112. Simpson, *supra* note 6, at 269.

consideration."[113] Yet as the senior author of this Article has shown elsewhere, if one reads the nineteenth and early twentieth century cases, it is hard to find any in which the party who obtained relief alleged that the other party had lied to him.[114] Courts were giving relief because the terms were harsh while denying that they did so.

In 1952, § 2-302 of Uniform Commercial Code permitted relief for unconscionability in both law and equity.[115] In 1981, an equivalent provision was adopted in § 208 of the Second Restatement of Contracts.[116] Although most scholars have accepted the unconscionability doctrine, they have not left the will theories behind. Rather, they have modernized the will theories.

Some scholars have followed in the same path as the nineteenth century courts of equity. They have suggested that the unconscionability doctrine does not really allow courts to decide when a contract is substantively unfair, or, at least, that it should not. The evil is not the unfairness of the terms, but the process by which a contract was formed. According to Epstein, the doctrine of unconscionability "should be used only . . . to police the process whereby private agreements are formed."[117]

Similarly, Stephen Smith observed, correctly, that when relief is given, there is usually present what he calls "cognitive asymmetry" between the parties. One party had "little education, low intelligence, lack of knowledge, [or] lack of independence." Or, "the contract was difficult to understand, was in fine print, or dealt with difficult-to-estimate probabilities."[118] Smith concluded, incorrectly, that relief is not given because of substantive unfairness. It is true that contracts are more likely to be substantively unfair when there is cognitive asymmetry. According to Smith, however, cases of "cognitive asymmetry . . . are cases . . . in which courts have good reason to be concerned about fraud, undue influence, duress, or a simple failure to agree, but in which they lack direct evidence of the defect."[119] Fraud, duress, and undue influence are independent reasons for refusing to enforce a contract. But they are not cases of mere "cognitive

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113. 1 HOWARD J. ALPERIN & ROLAND F. CHASE, CONSUMER LAW: SALES PRACTICES AND CREDIT REGULATION 245 (1986); Note, *Unconscionable Contracts: The Uniform Commercial Code*, 45 IOWA L. REV. 843, 846 (1960).

114. *See Equality in Exchange*, *supra* note 24, at 1650–55.

115. U.C.C. § 2-302 (AM. L. INST. & UNIF. L. COMM'N 1952).

116. Restatement (Second) of Conts. § 208 (Am. L. Inst. 1981).

117. Epstein, *supra* note 109, at 294–95, 315.

118. STEPHEN A. SMITH, CONTRACT THEORY 344 (Peter Birks ed., 2004).

119. *Id.* at 364.

asymmetry." They are cases in which one party lied to the other, threatened the other party, or trusted the other party's judgment. Cases of "a simple failure to agree" are cases of mistake, which we will discuss later. Often, a party's ignorance of the harshness of the bargain may be due to lack of education, intelligence, or knowledge. But in these cases, relief is only given when the terms are economically unfair. Otherwise, a large number of people would be unable to enter into binding contracts.

The in-between position, taken by most scholars, is that although substantive unfairness does matter, a contract must be both "substantively" and "procedurally" unconscionable for a court to give relief.[120] It is substantively unconscionable when the terms are unfair. Any sort of a "bargaining disadvantage" can constitute procedural unconscionability. The Uniform Consumer Credit Code lists examples like those mentioned by Smith: "inability . . . [to] reasonably [] protect his interests by reason of physical or mental infirmities, ignorance, illiteracy."[121]

We saw the difficulty of requiring procedural as well as substantive unconscionability when we discussed Dagan's view that the law should require both.[122] As we saw, for Dagan, procedural unconscionability means an absence of "self-determination"[123] or "meaningful choice."[124] "[T]he weaker party suffers from 'physical or mental infirmities, ignorance, illiteracy or inability to understand the language of the agreement.'"[125] The vulnerable are often the "poor or

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120. *See* Melissa T. Lonegrass, *Finding Room for Fairness in Formalism—the Sliding Scale Approach to Unconscionability*, 44 LOY. U. CHI. L.J. 1, 8–12 (2012) (describing the consideration of these two factors as the "conventional approach" and contrasting the "sliding scale approach" in "*strong* evidence of both prongs is no longer required to justify relief"); *see also* RESTATEMENT OF CONSUMER CONTS. § 5 (AM. L. INST., Tentative Draft, Apr. 18, 2019) ("In determining that a contract or a term is unconscionable, a greater degree of one [form of unconscionability may offset] a lesser degree of the other element," but "in appropriate circumstances a high degree of substantive unconscionability is sufficient to find that a standard contract term . . . is unconscionable."). Our point is not only that substantive unconscionability is sufficient. It is that procedural unconscionability should be relevant only as evidence of substantive unconscionability.

121. *See* UNIF. CONSUMER CREDIT CODE § 5.108(e) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1974).

122. *See supra* pp. 739–43.

123. *See* DAGAN & DORFMAN, *supra* note 59, at 47.

124. *See* DAGAN & HELLER, *supra* note 5, at 86–87 (internal quotation marks omitted).

125. *See* DAGAN & DORFMAN, *supra* note 59, at 48 (quoting RESTATEMENT (SECOND) OF CONTS. § 208 cmt. d (AM. L. INST. 1981)).

the weak, the foolish, and thoughtless."[126] If the terms are unreasonable, however, why does it matter that the disadvantaged party accepted them because he was vulnerable? If he was vulnerable, surely he would not receive relief if the terms were reasonable. The evil to be remedied, then, must be the unreasonableness of the terms. His vulnerability merely explains why he accepted them.

If the evil to be remedied is substantive unfairness, one might well ask why procedural unconscionability should matter at all. One reason—though not a good one—is a belief that parties who can protect themselves should do so or suffer the consequences. But why deny relief because a party who could have protected himself from an unfair contract failed to do so?

The only good reason for denying relief when a party can protect himself is that there is more room for doubt as to whether the contract is truly unfair. If an experienced businessman or businesswoman, familiar with an industry and the terms of contracts typically in use, were to negotiate a contract and later protest that the price or the terms were unfair, that claim is unlikely to be true. "Procedural unconscionability" should matter, but only because it is more likely that the terms of a contract are substantively unfair.

Consequently, when the terms are clearly unfair, courts should give relief even if there is no sign of procedural unconscionability. As one might suspect, such cases will be rare. Nevertheless, sometimes, even before the doctrine of unconscionability was recognized by Uniform Commercial Code and the Second Restatement of Contracts, courts of equity gave relief despite little or no evidence of procedural unconscionability. Relief was given to a physician who had exchanged property worth $11,800 for property worth $15,000 but subject to a $15,000 mortgage which he had agreed to pay;[127] to the operator of an automobile repair shop who acquired a house valued at $12,000 and sold it twelve days later to a machinist with a sixth grade education who had never owned property before;[128] when a trustee sold land for one-tenth of its value;[129] when the owner of a fruit farm parted with it for property worth little more than its mortgage, which he also assumed;[130] and when owner of a four-family flat exchanged it for a

126. *See* DAGAN & HELLER, *supra* note 5, at 86–87 (internal quotation marks omitted).

127. *See* State Sec. & Realty Co. v. Shaffer, 142 N.W. 1058, 1060 (Mich. 1913).

128. *See* Miller v. Coffeen, 280 S.W.2d 100, 104 (Mo. 1955).

129. *See* Wright v. Wilson, 10 Tenn. 294, 295 (Ct. Err. & App. 1829).

130. *See* Koch v. Streuter, 83 N.E. 1072, 1077 (Ill. 1908).

vacant lot in which he would have an equity worth less than half the equity he had given up.[131] Suppose that a used car dealer offered a customer a price for a used 2015 Mustang that he knew to be three times the *Kelley Blue Book* value for a car of that year and model. The customer agreed without consulting the *Blue Book*, which is an easily available listing of the price for which used cars are typically sold. The contract was economically unfair. The customer was careless, as the salesman knew, but it is hard to see why the salesman should be able to profit from the customer's carelessness.

2. *The Doctrine of Consideration*

The common law will not examine the adequacy of consideration. Thus, a contract has consideration even if the price is unfair although relief may be given under the doctrine of unconscionability.

As Simpson pointed out, however, the judges who fashioned the rule that the adequacy of consideration does not matter were not confronting the problem of what to do with hard bargains.[132] They were deciding what promises to enforce. Some limit had to be placed on the enforcement of promises through an action in assumpsit, and the English courts imposed one by requiring that the promise have consideration. In a two-party exchange, that requirement was rather straightforward. The consideration for a promise was found in what the promisor was to receive in return. Had these exchanges been the only promises that the common law judges wished to enforce, the rules about consideration might have developed quite differently. Instead, they chose to enforce some promises involving three parties or detrimental reliance as well as certain gratuitous arrangements such as promises to sons-in-law and gratuitous loans and bailments.[133] Although the judges often found consideration in these cases by drawing far-fetched analogies to contracts of exchange, the consideration was not a recompense in any ordinary sense of the word. In these cases, to demand that the consideration be adequate would have defeated the very purpose that the judges were trying to achieve, which was to enforce promises in which the consideration was not a recompense. Thus, it came to be said, in the famous words of *Sturlyn*

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131. *See* Linsell v. Halicki, 215 N.W. 315, 316 (Mich. 1927).

132. *See* A.W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT 445–49 (1975).

133. *See id.* at 416–52.

v. Albany, that "when a thing is . . . done . . . be it never so small, this is a sufficient consideration to ground an action."[134]

In *Sturlyn*, the plaintiff leased to a third party who had granted his estate to the defendant. The plaintiff demanded the rent from the defendant who promised to pay if the plaintiff would show him a deed proving that the rent was due. The showing of the deed was said to be consideration. As Simpson has pointed out, the case has nothing to do with the enforcement of hard bargains.[135] As the senior author of this Article has shown elsewhere, the enforcement of hard bargains was an unusual and occasional consequence of the rule against examining the adequacy of consideration.[136] Neither the judges who developed the rule nor those who applied it were confronting the problem of what to do about economic unfairness.[137] The rule, however, has been preserved. As § 79 of the Second Restatement of Contracts notes, "If the requirement of consideration is met, there is no additional requirement of . . . equivalence in the values exchanged."

The consequence is that contracts of exchange are normally enforced without any special examination of whether the contract is fair. We have seen why that is as it should be. The price at which the parties exchange normally will be fair. Each party takes the risk that the market price will change or that he may be offered a more favorable price if he waits to lock in a bargain. The terms will be fair as long as risks are placed on the party who can most easily bear them, and that party is compensated for doing so. Cases in which the exchange is unfair are exceptional, and to deal with them we have the doctrine of unconscionability.

Nevertheless, the doctrine of consideration has been used to prevent unfairness in three situations. First, only one of the parties is legally committed, as in an option contract. Second, one party is permitted to buy or sell as much or as little of a commodity as he chooses at a fixed price. Third, one party has been promised more money for a performance that he was already obligated to make. In all three situations, courts have held that contracts lack consideration. The difficulty is that the doctrine of consideration is a crude tool for distinguishing agreements which are unfair from those that are not. Consequently, in each of the three, courts have modified the doctrine or established exceptions that discriminate between fair and unfair

134. *See* Sturlyn v. Albany (1587) 78 Eng. Rep. 327, 328 (KB).
135. *See* SIMPSON, *supra* note 132, at 447.
136. *See generally Equality in Exchange*, *supra* note 24.
137. *See id.* at 1595–98.

contracts more accurately. Therefore, it is not true that, so far as the doctrine of consideration is concerned, the fairness of an exchange does not matter. Rather, unless one believes that the fairness of an exchange does matter, one cannot understand the doctrine of consideration.

a. Options

In an option, the parties agree on certain terms which will be binding only if one of the parties so chooses. Under the traditional doctrine, an option lacks consideration because the party with the right to choose has not given up a legal right or promised to do so.

An option may be economically unfair. Suppose, for example, that Arthur promises to sell Belle his house for $500,000 at any point within the next five years if Belle chooses to buy it. The house is now worth $300,000. If its value goes above $500,000, Belle can choose to buy; if it stays below $500,000, she can choose not to do so. The contract allows one party to speculate at the other's expense. It is unfair in the same way as an unfair bet. Similarly, it would be unfair to allow Belle to decide at the end of an evening of poker whether the participants were playing for money.[138]

Sometimes, however, an option is fair and serves a practical purpose. Suppose, for example, that Arthur promises Belle that she can buy his house any time in the next week for $500,000. The current value of the house and the amount for which Belle would be willing to buy it for right now is $500,000. She is unwilling to commit herself, however, until she finds out whether she can raise the money from a lender or from her rich aunt. It is unlikely that Belle will take advantage of a fluctuation in the market price of houses to speculate at Arthur's expense. Moreover, in such cases, as the Second Restatement of Contracts notes, "The fact that the option is an appropriate preliminary step in the conclusion of a socially useful transaction provides a sufficient substantive basis for enforcement."[139]

The doctrine of consideration cannot accurately discriminate between options that are fair and those that are not because it does not examine fairness directly. The response of some courts and of the Second Restatement of Contracts is to enforce an option which has

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138. Civil law jurisdictions do not have a doctrine of consideration. *See* JAMES GORDLEY, THE ENFORCEABILITY OF PROMISES IN EUROPEAN CONTRACT LAW 293 (2001) [hereinafter ENFORCEABILITY]. Yet they will often refuse to enforce a severely unfair option. *See id.* at 279–99.

139. RESTATEMENT (SECOND) OF CONTS. § 87 cmt. b (AM. L. INST. 1981).

nominal consideration when the option is likely to be fair.[140] The Second Restatement recognizes that nominal consideration is not genuine consideration. In the case of genuine consideration, a promise is made, at least in part, to induce the promisee to give up a legal right. In the case of nominal consideration, the promisee gives up a legal right—for example, $1—but the reason is not to induce the promisor to commit himself but to make his commitment legally binding. Although nominal consideration will not generally make a contract enforceable, the Second Restatement makes an exception for options if they are fair. It provides that an option is binding if it "is in writing and signed by the offeror, recites a purported consideration for the making of the offer, and proposes an exchange on fair terms within a reasonable time."[141] To enable the doctrine to discriminate between fair and unfair options, the Second Restatement recognized that it is necessary to take direct account of fairness.

The trouble with the way it did so is that whether a fair option is binding depends upon whether the parties use the magic words. As long as a written document recites a purported consideration, the option is binding whether or not the purported consideration is ever actually paid. A fair option is unenforceable if the document states that "the offeror promises not to revoke this offer for a period of one week," but enforceable if it adds "in return for one dollar." Such a requirement is most likely to protect those who are least likely to need protection—parties who hire lawyers who know the magic words.

The "firm offer" rule of the Uniform Commercial Code eliminates the need to use magic words. It provides that, among merchants, a short-term option to buy or sell goods in a signed writing which is stated to be irrevocable does not require consideration. "[I]n no event may such period of irrevocability exceed three months . . . ."[142] The provision does not require the option to be on fair terms, but it is intended to prevent the unfairness that is most likely to arise with longer term options. Although it makes no mention of fairness, "[e]very contract or duty within [the Uniform Commercial Code]

140. *See* 1464-Eight, Ltd. v. Joppich, 154 S.W.3d 101, 110 (Tex. 2004) (adopting the rule of the Second Restatement of Contracts § 87(a)). *But cf.* Bd. of Control of E. Mich. Univ. v. Burgess, 206 N.W.2d 256, 257–58 (Mich. Ct. App. 1973) (holding that a sixty-day option to purchase a house, which was supported only by nominal consideration, was not enforceable as an option).

141. RESTATEMENT (SECOND) OF CONTS. § 87(1)(a) (AM. L. INST. 1981).

142. U.C.C. § 2-205 (AM. L. INST. & UNIF. L. COMM'N 1977).

imposes an obligation of good faith in its performance and enforcement."[143]

b. Requirements and Output Contracts

A contract may leave the quantity of goods that one party is to buy or sell unspecified. In a "requirements contract," the quantity is the amount a party chooses to buy; in an "output contract," it is the amount he chooses to sell.[144] The enforceability of these contracts is another instance in which the traditional doctrine of consideration proved to be a crude tool for preventing economic unfairness and consequently has been modified.

By the traditional rule, such contracts lack consideration because one party has not given up a legal right.[145] He or she may buy or sell nothing, or he or she may buy from or sell to someone else instead. That rule did prevent the enforcement of some contracts that are severely unfair. For example, in *Wickham & Burton Coal Co. v. Farmers' Lumber Co*., one party promised to sell to the other all the coal that he ordered over the next year for $1.50 a ton to be increased to $l.65 a ton.[146] The contract is unfair because it allows the buyer to speculate at the seller's expense. If the market price of coal falls below the contract price, the buyer will purchase his coal elsewhere. If the market price rises above the contract price, he will continue to buy coal and to resell it at a profit until the other party becomes bankrupt. It is unfair in the same way a coin flip is unfair when one party pays nothing if the coin comes up heads but is paid a dollar if it comes up tails.[147]

The trouble with the traditional rule is that one could draft an equally unfair contract that does have consideration. One party might agree to buy at least one ton from the other party, and, at the same price, all the coal that he orders over the next year. Or he might promise that if he does buy coal, he will not buy it from anyone else. The Uniform Commercial Code came to the rescue with a rule that takes fairness into account. According to § 2-306, in an output or requirements contract, the quantity to be supplied or ordered must be

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143. *Id.* § 1-304.

144. *See* U.C.C. §2-306 (AM. L. INST. & UNIF. L. COMM'N 1977).

145. *See* RESTATEMENT (SECOND) OF CONTS. § 17 (AM. L. INST. 1981).

146. *See* 179 N.W. 417, 418–19 (Iowa 1920).

147. Civil law jurisdictions do not have a doctrine of consideration, yet they will often refuse to enforce a severely unfair requirements contract. *See* ENFORCEABILITY, *supra* note 138, at 193–218.

"such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded."[148]

c. Preexisting Duties

According to traditional doctrine, performance of a preexisting duty could not serve as consideration for a promise. It did not matter whether the promise was made to a government official, a third party, or to the other party to a contract.

The modern approach is to distinguish these three situations. In the case of promises to a government official, the evil to be remedied is corruption. As the Second Restatement of Contracts observed, "There is often no direct sanction available to a member of the public to compel performance of the duty, and the danger of express or implied threats to withhold performance affects public as well as private interests." Such a promise "is therefore unenforceable as against public policy."[149]

In the case of a third party, there is rarely any evil to be remedied. The Second Restatement concluded that the promise should be enforced because "there is less likelihood of economic coercion or other unfair pressure . . . ." Therefore, "the tendency of the law has been simply to hold that performance of contractual duty can be consideration."[150]

The third case is where a promise was made in return for a performance already promised to the promisor. According to the Second Restatement, the purpose served by refusing to enforce the promise is to prevent economic unfairness. "[A]n unscrupulous promisor may threaten breach in order to obtain such a bonus."[151] By contracting, as described earlier, each party has taken the risk that the terms of the contract were at least as good as the terms he could have received by looking for a better deal with someone else. Consequently, a party who asks more than the contract price is behaving unfairly in the same way as a person who reneges on a bet. He may be able to take advantage of the other party because that party is no longer in as

148. *See* U.C.C. §2-306 (AM. L. INST. & UNIF. L. COMM'N 1977).
149. RESTATEMENT (SECOND) OF CONTS. § 73 cmt. b (AM. L. INST. 1981).
150. *Id.* § 73 cmt. d.
151. *Id.* § 73 cmt. c.

good a position to find someone who can make the same performance at the same price. In *Lingenfelder v. Wainwright Brewing Co.*, for example, a builder demanded a higher price for finishing a brewery.[152] The other party could not have hired a different builder to complete the job and still have the brewery finished on time.[153]

Nevertheless, the traditional doctrine of consideration is a crude way to prevent economic unfairness. As we will see, the modification of the original terms might be fair because circumstances have changed. Consequently, § 89(a) of the Second Restatement provides that a promise modifying a duty is binding "if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made."[154] An example is the result in *Angel v. Murray*.[155] A garbage collector had contracted to pick up all the town's garbage for a fixed yearly fee. Unexpectedly, a developer built a new tract of houses in the town, adding greatly to the garbage collector's expenses. The court enforced the town's promise to pay him an additional amount as compensation for his extra expenses.

3. *The Doctrine of Impracticability*

The doctrine of unconscionability and even the doctrine of consideration are concerned with whether an exchange is economically unfair at the time the parties contract.[156] The doctrine of impracticability, we will now see, is concerned with whether an exchange became economically unfair after the parties contracted. The criterion for whether an exchange is fair is the same: whether each party was compensated for the risks that the contract places on him. For that reason, the doctrine of impracticability rests on a different foundation than the doctrine of frustration of purpose which, we will see, is concerned not with the economic fairness, but with the voluntariness of an exchange.[157]

Chapter 11 of the Second Restatement of Contracts treats the two doctrines together. Both are said to give relief for "changed and unforeseen circumstances." According to the Second Restatement and

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152. *See* 15 S.W. 844, 847 (Mo. 1891).

153. Civil law jurisdictions do not have a doctrine of consideration, yet they will often refuse to enforce an unfair promise to pay more for a performance than was originally agreed. *See e.g.*, ENFORCEABILITY, *supra* note 138, at 219–38.

154. *See* RESTATEMENT (SECOND) OF CONTS. § 89(a) (AM. L. INST. 1981).

155. *See* 322 A.2d 630, 632–38 (R.I. 1974).

156. *See* RESTATEMENT (SECOND) OF CONTS. §§ 71, 208 (AM. L. INST. 1981).

157. *See infra* Subsection III.B.1.

the Uniform Commercial Code, relief for impracticability depends on the "non-occurrence" of the event that made performance more difficult was "a basic assumption on which the contract was made."[158] That rule is not helpful. It is not at all clear what is meant by a "basic assumption." According to the Official Comments to the Second Restatement, the parties need not consciously have assumed anything. "The parties may have had such a 'basic assumption,' even though they were not conscious of alternatives."[159] Moreover, an "assumption" may be critical to the decision to contract and still not be "basic." "[M]arket conditions and the financial situation of the parties are ordinarily not such assumptions . . . ."[160] So we arrive at the curious rule that the parties must have made an assumption, whether or not they consciously assumed anything, and that the assumption must be basic, whether or not it is of great importance to the parties. One gets the impression that the drafters of the Restatement were not sure what the rule should be but could not think of a better one.

The doctrine of impracticability gives relief in situations in which a performance has become more costly. It may have become more costly because it has become physically more difficult, or because market prices have changed. We take each situation in turn.

a. Hardship Due to Increased Physical Difficulty

In a classic California case, *Mineral Park Land Co. v. Howard*, the defendants agreed to take all the gravel and earth from plaintiff's land that they needed to build a bridge.[161] Much of it proved to be under water, and it would have cost ten to twelve times the normal amount to excavate. The court held that the defendants were not bound.

The result was fair even though to give relief seems to contradict the very purpose of the kind of contract into which the parties entered. The contract was fixed-price rather than cost-plus. In a fixed-price contract, a party agrees to perform for a price set in advance. If his cost of performance is less than that price, he makes a profit. If his cost is greater, he suffers a loss. In a cost-plus contract, the party to

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158. U.C.C. § 2-615(a) (AM. L. INST. & UNIF. L. COMM'N 1977); RESTATEMENT (SECOND) OF CONTS. § 261 (AM. L. INST. 1981).

159. RESTATEMENT (SECOND) OF CONTS. § 152 cmt. b (AM. L. INST. 1981). Section 152 deals with mistake, but, according to the Second Restatement, the term "basic assumption" has the same meaning in the rules governing that doctrine as in those governing changed circumstances. *See id.*

160. *Id.*

161. *See* 156 P. 458, 458–60 (Cal. 1916).

perform receives the amount of his costs plus an added amount, usually a percentage, as his profit. By making one kind of contract rather than the other, the parties allocate the risk that a performance will be more expensive than anticipated. A fixed-price contract allocates that risk to the party who is to make a performance. A cost-plus contract allocates that risk to the party who is to receive it. Provided that the price is adjusted to reflect that risk, either kind of contract can be fair in the way that a fair bet is fair.

In cost-plus contracts, there is no need for a special doctrine of impracticability to protect the party whose costs have risen. He was not hurt and may have profited. The doctrine protects a party to a fixed-price contract. The question is: How can it be fair to give a party to a fixed-price contract relief because his costs were unexpectedly high? It would seem that he assumed that risk and was compensated for bearing it.

We can see an answer if we consider why the parties would enter into a fixed-price contract rather than one that is cost-plus. When a risk must be borne by either party, the parties will place it on whoever can bear it most cheaply. As noted earlier, there are three reasons why one party might be more easily able to bear a risk. First, he might be best able to foresee the magnitude of the risk. Second, he might be best able to control the risk. And third, he might be best able to spread the risk over similar transactions. The party performing a service, whether it is collecting garbage or constructing a building or shipping goods, is often in a better position to foresee and control the cost and, if the costs are unexpectedly high, to offset his loss by his gain on other jobs in which costs are unexpectedly low.[162]

Accordingly, the reason for making a fixed-price contract is not that the performing party is better able to assume all risks. Rather, he is better able to assume certain risks: those he can better foresee, control, and spread across the other jobs he undertakes. Rightly, then, the law grants relief when the risk is one that he did not assume. As Judge Skelly Wright said in *Transatlantic Financing Corp. v. United States*, for relief to be given, "a contingency—something unexpected—must have occurred," and that "the risk of the unexpected occurrence must not have been allocated either by agreement or by custom."[163] "Proof that the risk of a contingency's occurrence has been allocated may be expressed in or implied from

162. *See* discussion *supra* Subsection II.B.1.
163. 363 F.2d 312, 315 (D.C. Cir. 1966).

the agreement."[164] In *Transatlantic*, a shipper, who contracted for a fixed price to carry a full cargo of wheat from Galveston, Texas, to Iran, was forced to sail around Africa at a considerably increased cost because the Suez Canal had been closed due to a political crisis. While neither party could have controlled such an event, Skelly Wright said that the shipper could more easily have foreseen and insured against it. Although the nationalization of the Suez Canal "did not necessarily indicate that the Canal would be blocked," "[t]he surrounding circumstances do indicate . . . a willingness by Transatlantic to assume abnormal risks."[165]

> If anything, it is more reasonable to expect owner-operators of vessels to insure against the hazards of war. They are in the best position to calculate the cost to performance by alternative routes (and therefore to estimate the amount of insurance required), and are undoubtedly sensitive to international troubles which uniquely affect the demand for and cost of their services.[166]

b. Hardship Due to a Change in Market Price

A performance may become more costly, not because it is physically more difficult to perform, but because market prices have changed. There is an ongoing debate over whether relief should be given in that situation.

An American court has not yet done so. An Official Comment to the Uniform Commercial Code implies that a court should.

> Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance is within the contemplation of this section.[167]

According to this Comment, relief may be given when "a marked increase in cost" is caused by "a severe shortage of . . . supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like." One reason for

164. *Id.* at 316.
165. *Id.* at 318–19.
166. *Id.* at 319.
167. *See* U.C.C. § 2-615 cmt. 4 (AM. L. INST. & UNIF. LAW COMM'N 1977).

thinking that the Comment means what it says is because the drafter was Karl Llewellyn who studied law in Switzerland and was thoroughly familiar with German law. It is hard for someone familiar with German law to read this Comment without thinking of the earliest cases in which the highest German court for civil matters gave relief for severe and unexpected changes in the market price. In one case, the outbreak of World War I caused the price of steam to soar.[168] In another, the German collapse in 1918 caused a huge increase in the price of iron wire.[169]

Much of the debate in the United States over whether relief should be given has focused on the *Westinghouse* litigation.[170] Westinghouse agreed to provide a continuing supply of uranium at a fixed price to fuel nuclear generators. The price of uranium then skyrocketed due to the Arab oil crisis. The parties settled the case before appeal.

As the Comment to § 2-615 itself suggests, relief should not be given when the change in market prices "is exactly the type of business risk which business contracts made at fixed prices are intended to cover." It does not follow that such a contract is made to allocate any risk that arises from a change in the market price.

When a party sells goods that he already owns, he bears the risk that the market price will change simply because he owns them. When he sells in advance of delivery, he transfers that risk to the buyer. In a generic sale, however, the seller is obligated to deliver, not specific goods, but any goods that fit a particular description, such as copper wire or uranium. Typically, the seller neither owns nor manufactures the goods that he sells. The buyer anticipates that he will need goods of a certain kind in the future and will be hurt if the price of them rises. As Paul Joskow noted, the seller insures himself against that risk.[171] The contract is one of insurance against price changes cast in the form of a contract of sale.

It does not follow, as Joskow thought, that the seller assumes the risk of a rise in price, however drastic. In a conventional insurance policy, the amount the insurer can lose will be no greater than the loss that the insured could suffer. As noted earlier, if the parties are risk

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168. *See* Reichsgericht [RGZ] [Federal Court of Justice] Sept. 21, 1920, Entscheidungen des Reichsgerichts in Zivilsachen [RGZ] 100, 129 (Ger.).

169. *See* Reichsgericht [RGZ] [Federal Court of Justice] Nov. 29, 1921, Entscheidungen des Reichsgerichts in Zivilsachen [RGZ] 103, 177 (Ger.).

170. *See generally* Paul L. Joskow, *Commercial Impossibility, the Uranium Market and the Westinghouse Case*, 6 J. LEGAL STUD. 119 (1977).

171. *See id.* at 162.

averse, there is no price for the extra insurance that is acceptable both to the owner and to the insurance company. In a generic sale, if the market price of the goods changes sufficiently, the difference between the market and the contract price may exceed any loss that the buyer may suffer, and consequently, it may exceed any loss against which he would have been willing to insure.[172] The buyer's recovery should be limited to what we would call, in a normal insurance contract, his "insurable interest"—the amount of the loss he might have suffered had he been forced to buy the goods for his own use on the open market. If the price rose to the point that he would make more by reselling the goods on the open market than by using them himself, he should not recover the excess.[173]

D. Rakoff's Thesis

In a recent and welcome break with prevailing contract theory, Todd Rakoff criticized attempts to explain contract law "entirely in terms of standards of freedom, or of efficiency."[174] "In fact, the law—both the judge-made law and the statutory law—cares a lot—not exclusively, but a lot—about the justice of exchanges, and this attention affects both the statement of rules and the decision of individual cases."[175] He was speaking of economic unfairness: "I mean justice in its core transactional sense as regards trades and deals: Does what is given stand in a just relationship to what is gotten?"[176] We believe he was right, although, in our view, a theory based on justice is not an alternative to theories based on efficiency or autonomy but can incorporate their insights.

Rakoff quoted Aristotle who "distinguished between rectifying transactions person to person—commutative justice—and the division among all members of society of the wealth or honor of the society—distributive justice."[177] According to Rakoff we are "blinded by presuming that contract law, as 'private' law, ought to concern itself only with commutative principles."[178] Unlike Rakoff, we believe that

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172. *See* JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW: PROPERTY, TORT, CONTRACT, UNJUST ENRICHMENT 350 (2006).

173. *See id.* at 350–51.

174. Todd D. Rakoff, *The Five Justices of Contract Law*, 2016 WIS. L. REV. 733, 734 (2016).

175. *Id.*

176. *Id.*

177. *Id.* at 737.

178. *Id.*

contract is typically concerned with commutative, not distributive justice. In Part V of this Article, we explain why.

Rakoff also distinguished five different forms of economic fairness.[179] One of them is "commutative justice" or "equal exchange."[180] Rakoff identified this form with "Aristotle's conception" and added that it "is nicely set out" in one of the senior author's earlier articles, *Equality in Exchange*.[181]

Where we differ is that Rakoff claimed that there are four other forms of economic fairness.[182] Each form is a "distinctive way[]" "of thinking about the justice of contracts . . . , often justifying different outcomes."[183] He concluded that, "we approach the matter with analytical blinders [when] [w]e presume that if the law paid attention to the fairness of exchanges, the only possible standard of justice would be equality."[184]

According to Rakoff, the second form is "[j]ustice as the honest wager."[185] The exchange is fair in the same way as a fair bet, so that whichever party takes a risk is compensated for taking it.[186] The third is "[j]ustice as the term that fits."[187] It "seek[s] to specify a particular term" within "the basic structure of a relationship" and "tr[ies] to find the term that best fits the relationship the parties have otherwise entered."[188] The fourth is "[j]ustice as the deserved return."[189] It "reward[s] the proper use of the institution of contracting."[190] "[B]eing a good dealmaker, making a good bargain, is itself to be viewed as a merit deserving reward."[191] "'[A]n agent's voluntarily undertaking a valuable activity" is "deserving [of] benefits."[192] The fifth form is

179. *See id.* at 739.
180. *Id.* at 737, 739.
181. *Id.* at 737 n.24; *Equality in Exchange*, *supra* note 24, at 1588–90.
182. *See* Rakoff, *supra* note 174, at 739.
183. *Id.* at 790.
184. *Id.* at 737.
185. *Id.* at 739.
186. *See id.* at 749.
187. *Id.* at 739.
188. *Id.* at 756.
189. *Id.* at 739.
190. *Id.* at 765.
191. *Id.* at 769.
192. *Id.* at 768 (quoting DAVID MILLER, PRINCIPLES OF SOCIAL JUSTICE 149 (1999)).

"[j]ustice as the advantage not to be taken."[193] Among his examples is charging a high price to rescue a ship in distress.[194]

We can now see that these other four forms of justice fit easily within our theory of fairness as equality in exchange. As we have seen, his second form, "[j]ustice as the honest wager," is a form of the first. Indeed, to explain how performance can be equal in value, one must rely on the ideas of expected value and justice in the sense of a fair bet.

His third form of justice is also a form of the first. As he describes it, "Justice [is] the term that fits."[195] We have seen why a fair auxiliary term fits: A party is compensated for the risk or burden it places on him so that, again, the contract is fair in the same sense as a fair bet.

We have also shown how our theory includes rewarding "the proper use of the institution of contracting" by "a good dealmaker, making a good bargain," which is Rakoff's fourth form.[196] If a party can outguess the market by superior skill or the acquisition of information of the market that other traders do not have, the exchange may still be fair. He bet, when he acquired this skill or information, or purchased it from someone who had, that the skill or information was worth the cost. A party who failed to do so bet that it is not. The exchange is still fair in the same way as a fair bet. Moreover, the reason that the current market price accurately reflects the chances it will change in the future is that traders try to exercise the skill and acquire the information which, they believe, will help to predict future prices. Their efforts should be rewarded if market prices are to be fair.

The fifth form is "[j]ustice as the advantage not to be taken."[197] We have shown that advantage is taken precisely when the contract is unequal. It is unfair when, through necessity or ignorance, a party cannot contract at the market price. That is the case in Rakoff's example of the rescue of a ship in distress.[198]

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193. *Id.* at 739.

194. *See id.* at 786. His other examples are taking advantage of a party with whom one has a long-term cooperative relationship and underpaying one's workers. *See id.* at 780–82. The first seems to be an example of the third form of justice since it violates an obligation that is implicit in the larger relationship. The second, as we will see, concerns the relationship of commutative to distributive justice.

195. *Id.* at 739.

196. *Id.* at 765, 769.

197. *Id.* at 739.

198. *See id.* at 786–87.

III. VOLUNTARINESS IN CONTRACTS OF EXCHANGE

According to Aristotle, as a matter of commutative justice, a contract must not enrich either party at the other's expense.[199] We have seen that, ex ante, a contract that is economically fair does not do so any more than a fair bet. According to Aristotle, such a transaction must also be voluntary. It is voluntary if a party receives something that he values more than what he gives in return.

To enable a party to do so is the purpose of a contract of exchange. We conclude that if a party does not receive something that he values more than what he gives because of a mistake or a change of circumstances or even a change of mind, the contract should not be enforced unless to fail to do so is economically unfair to the other party.

A. A Common-Sense Idea

We have presented a common-sense notion of what it means for an exchange to be voluntary. It differs from the more elaborate ideas of those who build within a contract theory the idea of will of autonomy. It is much the same as that of economists in practice, though not in theory.

1. *Voluntary Exchange and Autonomy*

The builders of will theories, old and new, need a more complex idea of voluntariness. If a person chooses to buy a car or a refrigerator, it is not enough for them simply to say that at the time he contracts he wants that item more than the price. They must say that his choice is a manifestation of his will or an exercise of his autonomy. For will or autonomy to serve as the foundation of a theory of contract these concepts must mean more than simply that a party chose to buy a refrigerator or car.

In such theories, a party's will or autonomy is supposed to explain why a contract is binding, so that he cannot later change his mind. It is supposed to explain why he is bound by some terms to which he never agreed, but which the law reads into his agreement. It is supposed to explain why he is not bound by other terms which the law will not enforce because they are unfair. As we have explained, theories based on autonomy can do none of these things.

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199. *See* ARISTOTLE, *supra* note 3, at V.iv 1132^a–32^b.

Dagan and Heller have tried to base a theory of contract on autonomy even though they have acknowledged that theories that turn on what constitutes freedom "have reached a dead end."[200] They have noted, correctly, that "[e]ven 'voluntariness,' the most trans-substantive concern, should be safeguarded with divergent and better[contractual] tools that vary among contract types and spheres."[201] Voluntariness, indeed, has a different meaning in contracts of exchange than, for example, in contracts to make gifts or contracts of marriage. In contracts of exchange, however, it has the simple meaning we have described. One advantage of that simple idea of voluntariness in exchange is that it avoids the plethora of meanings the term might have in other voluntary arrangements, or whatever meaning it supposedly has when one describes autonomy, in some larger sense, as "the ultimate value of contract."[202]

Another advantage is that this simple idea avoids confusing the question of whether an exchange is voluntary with whether the terms of exchange are fair. Whether the terms are fair depends upon what risks the parties have assumed and whether they have been compensated for assuming them. As long as a contract is fair, a party does not need to understand the significance of these risks and the manner in which he has been compensated.

In reality, it is impossible for the parties to understand all the terms by which they are bound. Some terms appear in boilerplate contracts that no one is expected to read. Some terms would be impossible for parties to understand without a legal education. The most ambitious recent attempt to deal with the problem of lack of consent is *Pseudo-Contract and Shared Meaning Analysis* by Robin Kar and Margaret Radin.[203] They use linguistic analysis to identify those non-dickered auxiliary terms on which the parties have actually agreed. They try to identify these terms by a sophisticated analysis of language, drawing especially on the distinction between speaker meaning and sentence meaning. They propose analytical tools to distinguish pseudo-contracts from contracts. Their goal is to preserve freedom of contract by determining the terms on which the parties have actually agreed given the linguistic context. Their analysis, however, is concerned with the procedural difficulties in arriving at genuine consent. It still leaves us with the problem of how to explain

200. DAGAN & HELLER, *supra* note 5, at 10.

201. *Id.* at 136.

202. *Id.* at 16.

203. *See generally* Robin Bradley Kar & Margaret Jane Radin, *Pseudo-Contract and Shared Meaning Analysis*, 132 HARV. L. REV. 1138 (2019).

why the parties are bound by many terms of which they were unaware and to which they could not have given meaningful consent by any standards.

By our approach, a party who signs a fair contract to buy a home or a car need not understand the meaning of every term. If he were required to do so, most people could not buy homes or cars. By separating the question of whether terms are voluntary from whether they are fair, we avoid the problems of imagining that all the terms that bind the parties are in some way voluntary.

2. *Voluntary Exchange and Revealed Preferences*

Unlike Aristotle, economists explain choice in terms of "revealed preferences." Despite the difference, the practical consequences are much the same.

As we have seen, economists define Pareto efficiency as a state in which one party cannot be made better off without making another worse off. They define what makes a party better off in terms of his revealed preferences. Sometimes, they say that when a party reveals his preferences, he is maximizing utility. At one time, they thought of "utility" in the same way as a classical utilitarian such as Jeremy Bentham: It was an amount of pleasure. As Paul Samuelson observed, economists have "ceased to believe in the existence of any introspective magnitude or quantity of a cardinal, numerical kind."[204] They define utility in terms of preference satisfaction. A person's utility increases when he is able to satisfy more of his preferences. As Samuelson noted, economists define "preferences" as what a person actually chooses, regardless of why he chooses it.[205] "Thus, the consumer's market behavior is explained in terms of preferences, which are in turn defined only by behavior. The result can very easily be circular . . . ."[206] Circular or not, economists claim that they are assuming only that people do prefer some courses of action to others.

Writers in the Aristotelian tradition would have agreed. They claimed, however, that whether a person's choice contributes to his well-being depends on whether or not the choice is wise. Nevertheless,

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204. PAUL ANTHONY SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS 91 (7th prtg. 1963) (appearing in the first edition of 1947).

205. *See id.*

206. *Id.* Similarly, Arthur Leff said that it is "definitionally circular" to say "what people do is good, and its goodness can be determined by . . . what . . . they do." Arthur Allen Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV 451, 458 (1974).

they believed that a contract should be enforced whether a person acted wisely or foolishly.[207] Later, we will take the same position. Thus, in practice, according to both approaches, a party enters into a contract of exchange voluntarily if he regards what he receives as of greater in value than what he gives. That understanding of voluntariness accords with common sense. I choose to buy a car or a refrigerator because it is worth more to me than the price I must pay.

The problem with explaining contract law in terms of efficiency is not with the economists' idea of when an exchange is voluntary. The problem, as we have seen, is to explain why a contract is binding when one party has changed his mind so that what he is to receive is no longer worth more to him than what he is to give. As Calabresi observed, ex ante, the contract is expected to make each party better off but ex post it may not.[208] Our answer is, in that event, there is no reason for the contract to be enforced unless releasing one party from the contract would be unfair to the other party. Economists cannot give that answer because they do not speak of fairness, but of efficiency.

B. Reappraising Common Law Doctrine

This Section discusses the doctrines of mistake, frustration of purpose, and unconscionability.

1. *The Doctrines of Mistake and Frustration of Purpose*

The doctrines of mistake and frustration of purpose concern involuntariness. They have the same relationship to each other as the doctrines of unconscionability and consideration have to the doctrine of impracticability. As we have seen, the former concern whether a contract is economically unfair when it was made; the latter concerns when it has become so thereafter. Similarly, the doctrine of mistake concerns whether a contract was involuntary when it was made, and frustration of purpose concerns whether it has become so.

As the Second Restatement of Contracts recognizes, these two doctrines are closely related.[209] It fails to recognize, however, that

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207. *Compare* LESSIUS, *supra* note 41, at lib. 2, cap. 18, dub. 1, no. 10, *and* MOLINA, *supra* note 40, at disp. 271, no. 4, *with* SOTO, *supra* note 80, at lib. 4, q. 7, a. 1 (arguing that a sufficiently imprudent promise was not binding, at least in conscience).

208. *See* Calabresi, *supra* note 67, at 1226–27.

209. *See* RESTATEMENT (SECOND) OF CONTS. § 152(1)–(2) cmts. a–b (AM. L. INST. 1981).

mistake and frustration of purpose concern involuntariness, unlike impracticability which concerns economic unfairness. According to the Restatement Second, relief for mistake should be given when the mistake concerns "a basic assumption" which had "a material effect on the agreed exchange of performances."[210] One problem with this formulation, as we saw in discussing impracticability, is that the expression "basic assumption" has no clear meaning. But another is the requirement that the mistake must have a "material effect" on the agreed exchange. What matters is whether the transaction was involuntary because of the mistake even if it had no such effect. Suppose a party agrees to buy item 699 in a catalog, believing it to be a lawn mower, when it turns out to be a set of golf clubs. The reason for giving relief is that performance called for by the contract is one to which the buyer never agreed. It has nothing to do with the relative value of the lawn mower and the golf clubs.

A contract does not accomplish its purpose unless it is voluntary in the sense that each party receives something of greater value to him than what he gives in return. Consequently, the only reason a party should be bound involuntarily is if to give relief would be economically unfair to the other party.

A contract is involuntary, in this sense, when the goods or services in question do not serve the purposes of the buyer. Whether it is economically fair to give relief normally depends on a distinction that is implicit in the decided cases but which courts have not drawn explicitly. The goods or services may be unsuitable for the purposes of buyers in general, or they may be unsuitable only for the purposes of the particular buyer. Normally, in the first case, to give relief is not economically unfair to the seller; in the second case, it is economically unfair.

A contract of exchange normally compensates each party for the risk of receiving a less favorable price if he waits to contract. Each party gives up the chance of receiving a more favorable offer from another party to avoid the risk of receiving a less favorable one from someone else. If the goods or services would be unsuitable to the purposes of other buyers, the seller has not given up the opportunity of entering into a voluntary exchange with someone else. The contract no longer allocates the risk of obtaining a less favorable price. To enforce it would be economically fair only if the parties were attempting to allocate a quite different risk—the risk that arises if it is uncertain what purposes the goods or services in question will serve.

210. *Id.* § 152(1).

In contrast, if the goods or services are unsuitable to the purposes of a particular buyer, but not to those of buyers in general, normally, it would be economically unfair to give relief. The seller would then lose the guarantee against receiving a less favorable price that he would have received had he dealt with another buyer. To give relief would be economically fair only if the actual buyer had paid an extra amount to the seller for assuming a risk that the seller would not bear had he contracted with someone else. This distinction explains how courts have applied both the doctrines of mistake and that of frustration of purpose.

a. A Performance Unsuited for the Purposes of Buyers in General

One reason that goods or services may be unsuitable for the purposes of buyers in general is they cannot be used to accomplish it. In such cases, courts have given relief. A contract to sell land was set aside for mistake when "the sole purpose of the contract was to enable respondents to grow jojoba," and there was insufficient water to do so.[211] So was a contract to sell land when the parties believed that land was suitable for a building site, and legal restrictions prevented the buyer from building.[212] So was a contract to sell a rare coin which was of interest to collectors only if it is genuine when it turned out to be a fake.[213] Similarly, in *Griffith v. Brymer*, a contract was set aside for mistake when the defendants rented flats at a suitably enhanced price to view the coronation procession of King Edward VII.[214]

In *Griffith*, the parties contracted an hour after the decision had been made to operate on the king, which made the procession impossible. In *Krell v. Henry*, the parties entered into a similar contract before that decision to cancel the procession had been made.[215] The court gave relief for frustration of purpose. In a classic New York case, *Alfred Marks Realty Co. v. Hotel Hermitage Co.*, the court gave relief for frustration of purpose when the defendant agreed to place an advertisement in the program to be printed for an international yacht

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211. Renner v. Kehl, 722 P.2d 262, 265 (Ariz. 1986).

212. *See* Rancourt v. Verba, 678 A.2d 886, 886–87 (Vt. 1996); Gartner v. Eikill, 319 N.W.2d 397, 398, 400 (Minn. 1982).

213. *See* Beachcomber Coins, Inc. v. Boskett, 400 A.2d 78, 78–79 (N.J. App. Div. 1979).

214. *See generally* (1903) 19 T.L.R. 434 (KB Div.).

215. *See* Krell v. Henry (1903) 2 KB 740.

race to take place in September 1914.[216] The ad would have been useless because the races were cancelled due to the outbreak of World War I.

A second reason that goods or services may be unsuitable for the buyer's purposes is that, though they could be used to accomplish it, no buyer with only those purposes in mind would have purchased them had they known the truth. They are valuable because they serve some other purpose. If the contract stands, the buyer who only wished to accomplish his original purpose would resell them and buy something cheaper that would be equally acceptable for his own purposes. Unless they are uncertain about the purposes that the goods or services in question may serve, the parties do not enter into a contract to allocate this risk. Each party does so to avoid the risk that otherwise, he will have to accept a less favorable price. In such case courts have given relief. In the famous case of *Sherwood v. Walker*, a cow of distinguished lineage, worth a large amount if she could breed, was sold for a small amount because she was thought to be sterile.[217] According to the majority opinion, the buyer wanted to butcher the cow for its meat. The cow was pregnant at the moment of sale. It would have been physically possible to butcher the cow, but no buyer would have purchased a fertile prize breeding cow for that purpose. The court gave relief for mistake.

It is the same when the parties were mistaken as to whether a jewel, an antique, a work of art, or a musical instrument is genuine. Physically, one can wear a ring, sit in a chair, decorate a wall with a painting, or play a piano whether or not the diamond in the ring is real, the chair is a Sheraton, the painting is a Rembrandt, or the piano is a Steinway. But if one's purpose could be served by an imitation, one would not pay the price of the genuine article. Courts have given relief when, for example, violins sold as a Stradivarius, a Guernerius, and a Bernardel were imitations.[218]

In contrast, it is economically fair to enforce a contract when the parties were uncertain about the purposes that the goods or services in question would serve. Courts have denied relief for mistake when the parties entered into the contract despite that risk.[219] *Sherwood* was such

216. *See* 156 N.Y.S. 179, 179–80 (N.Y. App. Div. 1915).

217. *See* 33 N.W. 919, 923 (Mich.1887).

218. *See* Smith v. Zimbalist, 38 P.2d 170, 171 (Cal. App. 1934); Bentley v. Slavik, 663 F. Supp. 736, 742 (S.D. Ill. 1987).

219. RESTATEMENT (SECOND) OF CONTS. § 154(b) (AM. L. INST. 1981) ("A party bears the risk of a mistake when . . . (b) he is aware, at the time the contract is

a case according to a minority opinion, which said that the buyer understood that the cow might be sterile but bought it to see if it could be made to breed.[220] If so, the sale should have been upheld. Similarly, relief was denied when land was sold as is, when a rock of unknown composition turned out to be an uncut diamond, and when a locked safe was sold and later proved to contain cash.[221] Relief was denied when the parties did not know who painted two works of art and chose not to have them appraised, and when an appraiser expressed doubts as to the authenticity of an antique Parker A-1 shotgun, but the parties went ahead with the sale anyway.[222] Relief was also denied when a painting, which critics generally believed to have been the work of Albert Bierstadt, later proved to be the work of John Ross Key.[223] Parties who buy and sell art should recognize that attributions of art critics, even when widely accepted, are inherently uncertain. A party who buys or sells art assumes that risk.

b. A Performance Unsuited to the Purpose of a Particular Buyer

When goods or services are only unsuitable to the purposes of a particular buyer, the seller could have sold them to other buyers who do want them. If the buyer could upset the bargain because he cannot use the performance for his particular purposes, he could deprive the seller of his guarantee against accepting a less favorable price that someone else might pay. Consequently, such a buyer should either take his chances or ask the seller for a guarantee that the performance can be used for his particular purposes. Since he is then asking the seller to assume an additional risk, the seller will charge him an additional amount. If he is unwilling to obtain such a guarantee, or the seller is unwilling to give him one, it is not unfair to him that he must take the chance that he will find the performance unsuitable.

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made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient . . . .”).

220. 33 N.W. at 924 (Sherwood, J., dissenting).

221. *See* Lewanee Cnty. Bd. of Health v. Messerly, 331 N.W.2d 203, 210 (Mich. 1982); Wood v. Boynton, 25 N.W. 42, 44 (Wis. 1885); City of Everett v. Estate of Sumstad, 631 P.2d 366, 368 (Wash. 1981).

222. *See* Estate of Nelson v. Rice, 12 P.3d 238, 241 (Ariz. Ct. App. 2000); Cydrus v. Houser, No. 98CA2425, 1999 Ohio App. LEXIS 5746, at *9 (Ohio Ct. App. Nov. 29, 1999).

223. *See* Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987).

It is not surprising, then, that often relief for mistake has been denied when goods or services were suitable for the purposes of buyers in general but not for those of a particular buyer. A contract was upheld when a seller sold an antique armoire which the buyer discovered he could not use because it was too large to fit with his other furniture, and when a seller sold a dredge designed to lay pipelines which the buyer later discovered could not be used for sweep dredging without modifications.[224] In the case of the dredge, the court denied relief because the plaintiff "alone was mistaken in assuming that the dredge was adapted, without modification, to the use he had in mind."[225]

The same is true of the doctrine of frustration of purpose. Relief was denied when an American buyer of lamb pelts from a Canadian seller could not ship them to the United States for resale, as he had planned, because of stricter import regulations. As the court noted, "the rest of the world was free to the buyer . . . as destination for the shipment."[226] The goods did not serve the purposes of this buyer, but they would have served the purposes of others. In these cases, to give relief would deprive the seller of a benefit he would have had if he had been dealing with buyers for whom the goods would have been suitable because they did not have a special purpose in mind.

Sometimes, however, the seller does not contract in order to avoid the risk of having to sell the same performance to someone else at a lower price. In such cases, courts have given relief for frustration of purpose even when the purpose frustrated was that of a single buyer, not that of buyers in general. In *La Cumbre Golf & Country Club v. Santa Barbara Hotel*, the hotel company entered into a contract with the golf and country club that allowed its guests to play on the club's golf course.[227] The hotel company did not have to pay when the hotel burned down, and there were no more guests. In *Chase Precast Corp. v. John J. Paonessa Co.*, the state of Massachusetts contracted with a construction firm to replace a grass median strip on a street with concrete barriers.[228] The contractor hired a subcontractor to produce the barriers. The project was cancelled after the protests of angry residents. The contractor paid for all the barriers that the subcontractor had already produced. The court held that it did not have to pay for

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224. *See* Valiulis v. L'Atelier Wholesale Antiques, 519 So. 2d 312, 313 (La. Ct. App. 1988); Anderson Bros. v. O'Meara, 306 F.2d 672, 673 (5th Cir. 1962).

225. *Anderson Bros.*, 306 F.2d at 675.

226. Swift Canadian Co. v. Banet, 224 F.2d 36, 38 (3d Cir. 1955).

227. 271 P. 476, 476 (Cal. 1928).

228. 566 N.E.2d 603, 605 (Mass. 1991).

lost profits on those still to be produced under its contract. Neither the golf club nor the contractor was selling a performance which it now had to resell to someone else who might pay a lower price. Consequently, to give relief was not economically unfair to either of them.

2. *The Doctrine of Unconscionability*

We have said that a contract of exchange is voluntary when a party values what he will receive more than what he will give in return. Sometimes when a party voluntarily enters into an exchange, he is foolishly mistaken about the value to himself of what he will receive. We believe that such a contract should be enforced anyway.

Nevertheless, in rare cases, such a contract has been held to be unconscionable when the seller knew that the buyer would not benefit. Such a rule was adopted by the Uniform Consumer Credit Code, which states that relief will be given for "unconscionability" when there was "knowledge by the seller . . . at the time of the sale . . . of the inability of the consumer to receive substantial benefits from the property or services sold or leased."[229]

The Uniform Consumer Credit Code gave two illustrations of when relief should be given.[230] In one, a door-to-door salesman sold a vacuum cleaner to each of two poor people sharing the same apartment and the same rug. In the other, a door-to-door salesman sold a Hispanic laborer an English language encyclopedia. He was a bachelor and only spoke Spanish.

According to another provision of the Uniform Consumer Credit Code, a contract may be held unconscionable when there was a "belief by the seller, lessor, or lender at the time a transaction is entered into that there is no reasonable probability of payment in full of the obligation by the consumer or debtor."[231] Mortgage loans have violated both provisions when, as the lender knew, the borrower would have to pay a high fraction of a small income.[232] After the crash of

229. UNIF. CONSUMER CREDIT CODE § 5.108(4)(b) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1974).

230. *See id.* § 5.108(4)(b) cmt. 4.

231. *Id.* § 5.108(4)(a).

232. *See* Hughes v. Abell, 867 F. Supp. 2d 76, 82 (D.C. Cir. 2012) (explaining the borrower's monthly payment "amounted to approximately 46% of [his] monthly income of $3,511.83"); *see also* Williams v. First Gov't Mortg. & Invs., 225 F.3d 738, 743 (D.C. Cir. 2000) (stating the borrower had a seven-person household and "roughly $1,200 a month in disposable income, over half of which went to First Government to cover his $686 monthly payments").

2008, many home owners claimed that mortgage companies had lured them into taking loans they could not afford. In *Commonwealth v. Fremont Investment and Loan*, the Attorney General of Massachusetts brought an action claiming a number of subprime loans were "unfair" within the meaning of the Consumer Protection Act because the interest rate would jump within three years to more than 50% of the borrowers' income.[233] The lender argued that the loans made "in the expectation, reasonable at the time," that they could be refinanced because "housing prices would improve during the introductory loan term."[234] The Massachusetts Supreme Judicial Court said that "it was unreasonable, and unfair to the borrower, for [the lender] to structure its loans on such unsupportable optimism."[235]

One can sympathize with courts that give relief. In these cases, however, the exchange was voluntary in that the party who later repudiated the contract thought when he entered into it that the performance was worth more to him than what he was to give in return. He was under no mistake as to the performance or the price. He was foolish to have agreed. An Aristotelian would say he chose, but he chose imprudently.

To give relief in such a case is dangerous. Sellers would not want to deal with anyone who could later claim that they acted foolishly. Moreover, courts would then substitute their own judgment of the value a party should have placed on a performance for that of the party himself. A court does not do so when it gives relief for economic unfairness. Anyone will benefit from a more favorable price. Rather, a court does so when it decides that a party was foolish to value the object he paid for so highly.

It seems obvious that two poor people sharing one rug do not need two vacuum cleaners to keep it clean. Is it obvious that the Spanish speaking laborer–bachelor cannot use the encyclopedia? If so, the court is telling him, "This encyclopedia is not for you. Whatever makes you think you can learn English well enough to read it?" It may seem obvious that the borrowers in *Hughes*, *Williams*, and *Fremont* would default. To give relief, however, is to say, "No matter how valuable owning your own home may seem to be to you, it is foolish of you to try when the odds are so much against your keeping it." All investors sometimes experience "unsupportable optimism." So do the students who enroll in four-year colleges and universities. An

233. *See* 897 N.E.2d 548, 550–51 (Mass. 2008).
234. *Id.* at 558.
235. *Id.*

estimated 40% of them do not graduate within six years. "Even [ten] years after graduation, 32% of college graduates end up with jobs that [do not] require a college degree . . . ."[236] Should a court say, "Investing your own funds in the way you have chosen is too dangerous"? or "College is not for you. We do not think you can benefit from it"? There are occasions—drug laws are an example—when a person's right to choose is replaced by a right to act only as someone else thinks best. But to do so as a general principle of contract law is to infringe a freedom that is quite valuable: the freedom to bear the responsibility for one's own decisions, wise or foolish.[237]

3. *Offensive Auxiliary Terms*

A contract of exchange is voluntary when a party values what he will receive more than what he will give in return. Consequently, in order to enter into such a contract voluntarily, a party must understand what he is to get and what he is to give.

Generally, it is enough for a party to understand the performance terms of the contract: the price and the object. It does not matter if he understands the auxiliary terms of a contract as long as they are economically fair. Sometimes, however, an auxiliary term is so offensive to him as to affect the value of what he is to give or receive. Then, the exchange may be involuntary.

The law dealing with terms that are unwanted because they are offensive is poorly developed. Except for unconscionability, there is no general doctrine that can be used to give relief, and the doctrine of unconscionability is rarely applied

Some situations are dealt with by special statutes. For example, some types of offensive behavior may violate statutory prohibitions on discrimination according to race or gender. One cannot include a term in a contract that violates these provisions. The difficulty is that an offensive term may not happen to violate a statute.

Other situations are dealt with as violations of public policy. The difficulty is that this approach only protects against terms that offend a person's dignity or moral principles when they also offend public policy. As the Illinois Supreme Court said, "[P]ublic policy concerns what is right and just and what affects the citizens of the State

236. Douglas Belkin, *Making the College Bet Pay Off*, WALL ST. J. A3, Dec. 11, 2018.

237. *See* James Gordley, *Morality and Contract: The Question of Paternalism*, 48 WM. & MARY L. REV. 1733, 1758 (2007).

collectively. It is to be found in the State's constitution and statutes and, when they are silent, in its judicial decisions."[238] "[M]atters that are the subject of public polic[y]" are distinct "from matters purely personal."[239] An offense to a person's sense of dignity or moral standards may be purely personal and may not affect the citizens of the state collectively.

Typically, violations of public policy are found when a party is penalized for refusing to violate a statute enacted for the benefit or others or to renounce the benefit of a statute enacted for his own benefit. For example, it is a violation of public policy to require an employee to commit perjury,[240] to engage in price-fixing,[241] to alter state mandated pollution control reports,[242] to perform a medical procedure for which she was not licensed,[243] to violate consumer protection law,[244] or to conceal a violation of a statute prohibiting theft.[245] No doubt, the violation of public policy would violate the moral standards of a law-abiding citizen, and perhaps his sense of dignity as well, but only because his moral standards require him to be law-abiding and therefore obey statutes that are concerned with the welfare of others. It is also a violation of public policy to require him to renounce the benefit of laws that are intended to promote his own welfare. For example, an employer cannot prohibit him from joining a union or filing a claim for workers' compensation.[246] In such cases, his moral standards and sense of dignity are violated only because he may regard it as immoral or servile to circumvent legislation designed for his own protection.

In other cases, a party to a contract must argue that a term that offends his sense of dignity or moral standards also happens to violate a public policy expressed in statutes or judicial decisions.[247] Some

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238. Palmateer v. Int'l Harvester Co., 421 N.E.2d 876, 878 (Ill. 1981).

239. *Id.*

240. *See* Petermann v. Int'l Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of Am., Local 396, 344 P.2d 25, 27 (Cal. Ct. App. 1959).

241. *See* Tameny v. Atl. Richfield Co., 610 P.2d 1330, 1331, 1334 (Cal. 1980).

242. *See* Trombetta v. Detroit, Toledo & Ironton R.R., 265 N.W.2d 385, 388 (Mich. Ct. App. 1978).

243. *See* O'Sullivan v. Mallon, 390 A.2d 149, 149–50 (N.J. Super. Ct. 1978).

244. *See* Harless v. First Nat'l Bank, 246 S.E.2d 270, 276 (W. Va. 1978).

245. *See* Vermillion v. AAA Pro Moving & Storage, 704 P.2d 1360, 1361 (Ariz. Ct. App. 1985).

246. *See* Glenn v. Clearman's Golden Cock Inn, 13 Cal. Rptr. 769, 771 (Ct. App. 1961); Frampton v. Cent. Ind. Gas Co., 297 N.E.2d 425, 427 (Ind. 1973).

247. *See* Wagenseller v. Scottsdale Mem'l Hosp., 710 P.2d 1025, 1031 (Ariz. 1985).

parties have succeeded, but the difficulties are illustrated by an Arizona case, *Wagenseller v. Scottsdale Memorial Hospital.*[248] A female hospital employee alleged that she had been fired because she offended her female supervisor by refusing to participate in a skit parodying the song *Moon River* that concluded with members of the group "mooning" the audience. The court held that to require her to expose her buttocks was a violation of public policy because a state statute prohibiting indecent exposure "establishes a clear policy that public exposure of one's anus or genitals is contrary to public standards of morality."[249]

By this reasoning, however, the limits of her employer's contractual right to fire her depend on the legislature's decision about what conduct to criminalize. The court gave itself some wiggle room by saying that it would reach the same result even if the employer had not violated the statute provided that he had violated the policy behind it.[250] Even this flexibility was taken away from the court by a subsequent Arizona law that provided that a violation of public policy must be a violation of statute.[251]

Suppose there had been no law prohibiting indecent exposure in Arizona. Suppose the skit required the plaintiff to strip down to whatever constituted the legal minimum of clothing that must be worn without violating the statute. Suppose that the plaintiff had been told to appear at a company beach event wearing a bikini or a two-piece bathing suit and had refused to do so, although other female employees might not have objected. The employer should not have the contractual right to require any type of behavior an employee regards as demeaning or morally offensive simply because the legislature failed to criminalize it. Moreover, as the example of the bikini illustrates, an employee's personal standard of dignity and morality may be violated even when those of other people would not be.

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248. *See id.* at 1035 (stating that "all of the onlookers were voyeurs and would not be offended").

249. *Id.*

250. *See id.*

251. ARIZ. REV. STAT. ANN. § 23-1501(A)(3) (2018) ("An employee has a claim against an employer for termination of employment only if one or more of the following circumstances have occurred: . . . (b) The employer has terminated the employment relationship of an employee in violation of a statute of this state."). According to one Arizona court, "[t]he legislature in enacting took express exception to the court's indication [in *Wagenseller*] that it rather than the legislature had the authority to define public policy." Galati v. Am. W. Airlines, Inc., 69 P.3d 1011, 1013 n.2 (Ariz. Ct. App. 2003).

A better approach would be to face the question squarely: When do incursions on personal standards of dignity or morality warrant relief on that ground alone? In such cases, a court might give relief because the term is unconscionable even though it is not economically unfair. It is helpful to distinguish cases in which an incursion on those standards advances the interests of the other contracting party and cases, such as *Wagenseller*, in which it does not.

If the terms of the contract do advance the interests of the other party, the party who finds them offensive should not receive relief if he should have known of them when he entered into the contract, unless he had no reasonable alternative but to accept. A sound general principle is provided by the Second Restatement of Contracts: "Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."[252] Conversely, if the party manifesting assent has reason to believe that the other party would not know a certain term is offensive to him, he should ask whether the contract contains such a term.

Suppose a woman is hired to work in a jewelry store and signs a contract in which she agrees to comply with security procedures. Suppose one of the procedures requires her to walk through a metal detector that takes nude photographs that will be seen by a female employee. Few enough women would object that the employer should not be required to draw her attention to that procedure before she is hired. If the photographs would be seen by male and female employees, enough women would object, and the employer should be required to bring this provision to a future employee's attention.

As a further example, Stephen Curry, a star player of the 2017 NBA champion team Golden State Warriors, refused to visit the White House and meet with President Donald Trump on account of their political differences. Suppose that Curry, in his employment agreement with Warriors, was required to visit the White House and meet with the president. Suppose that term was buried among other terms, and so he would be unlikely to know of it unless it was explicitly pointed out. Had it been customary for NBA champions to visit the White House regardless of who was president, a professional basketball player such as Curry either should have known of the term or should have known enough to ask whether he would be obligated to do so. Had it not been customary, then if his employer knew that

252. RESTATEMENT (SECOND) OF CONTS. § 211(3) (AM. L. INST. 1981).

Curry might object, his employer should have told him that he would have to make the visit.

A person who knows of an offensive term may nevertheless have no reasonable alternative but to agree. He may be acting in an emergency. Suppose a pregnant woman's water broke unexpectedly at 4:00 AM, and when she was rushed to the nearest hospital to have a Caesarean section, she signed an agreement which would allow the hospital to film the entire operation and show it to medical students for educational purposes. Because enough women would object to it, the hospital should call the term to her attention. Even if it did so, however, the term should not be binding. The reason is not only that the woman found it offensive and had no reasonable alternative, but also that the hospital can adequately educate medical students by filming the childbirth of women who do not object.

Suppose an employee was informed when he was hired that he will be bound by a dress code that is established and periodically modified by an executive committee. Suppose that he is Jewish, and the committee forbids him to wear a yarmulke. If the job is in the service industry and requires daily contact with customers by employees wearing a uniform with uniform headgear, the term serves an interest of the employer, who should be able to require him to dress like the other employees.[253] If the employer had reason to believe the employee would object, the employee should have been notified of this requirement in advance. If forbidding him to wear a yarmulke contributes nothing to his employer's business, the employer should not be able to forbid it.

This distinction was ignored in *Pierce v. Ortho Pharmaceutical Corp*.[254] The plaintiff, Dr. Grace Pierce, "was the only medical doctor on a project team developing loperamide, a liquid drug for treatment of diarrhea in infants, children, and elderly persons. The proposed formulation contained saccharin."[255] The "team agreed that the formula was unsuitable for children."[256] Dr. Pierce refused to work on

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253. The Supreme Court drew a similar distinction in *Goldman v. Weinberger*, 475 U.S. 503 (1986), holding that the first amendment guarantee of freedom of religion was not violated when a rabbi serving in the Air Force was prohibited from wearing a yarmulke. The provision was not arbitrary, according to the court, because, in "[t]he considered professional judgment of the Air Force[,] . . . the traditional outfitting of personnel in standardized uniforms encourages the subordination of personal preferences and identities in favor of the overall group mission." *Id.* at 508.

254. 417 A.2d 505, 513 (N.J. 1980).

255. *Id.* at 506–07.

256. *Id.* at 507.

the project when, in response to a directive from the company's marketing division, the decision was made to continue to develop the drug anyway. Although the company invited her to choose to work on another project, she resigned on the grounds that the new assignment amounted to a demotion and that she had been told that she would never be promoted because of an "inability to relate to the Marketing Personnel."[257] The court granted the company's motion for summary judgment.

By the approach we are suggesting, that motion should have been denied, and Dr. Pierce should have prevailed at trial if she could prove that the company could have assigned her to another project, without impairing its interests, and without demoting her or diminishing her responsibilities or prospects of a promotion. Instead, the court dismissed her complaint on the grounds that since she had not been asked to violate a statute, her belief that she was violating her Hippocratic oath did not matter. Discharging her was not "contrary to a clear mandate of public policy."[258]

Thus far, we have been discussing situations in which the term that one party finds offensive serves some interest of the other party. However, some terms do not. To require compliance with such terms is arbitrary. In that event, the term should not be binding regardless of whether the party who finds it offensive could have expected it.

An example is *Wagenseller*. The term at issue in that case in no way advanced the interest of the hospital to have its employees expose their buttocks. As another example, suppose that employees are required to attend an annual office event at which the CEO expresses himself or herself in terms that are needlessly offensive. For example, the CEO habitually makes crude racial or sexual jokes. Those who find them offensive should not be required to attend. That is so even if those who do not attend are not members of the race or gender that is ridiculed, and so cannot claim discrimination against themselves on the basis of race or sex.

Such terms should not be enforced because the performance required by the contract was unwanted. Although they are auxiliary terms, the performance they require should consciously be understood and accepted by the employees. Otherwise the contract is involuntary. In contrast, if terms are economically fair, as we have seen, they should be binding even if a party is not consciously aware of the terms.

257. *Id.*
258. *Id.* at 513–14.

IV. REMEDIES FOR BREACH OF CONTRACT

In what has been called the most influential law review article ever written, Lon Fuller and William Perdue said that the normal remedy for breach of contract protected a party's "expectation interest," which is one's interest "being put in as good a position as [it] would have been in had the contract been performed."[259] They began their article by saying that "legal rules can be understood only with reference to the purposes they serve."[260] We have seen why a contract of exchange is binding. If the contract is economically fair, each party is compensated for assuming the risk that the contract will be disadvantageous. To permit him to back out is like allowing him to renege on a fair bet. If so, then Fuller and Perdue were wrong to conclude that the purpose of the normal remedy is to protect a party's expectation interest. The proper remedy will do so only by coincidence. The proper remedy should be to award the value of the bet; it should compensate the nonbreaching party for the risks which the breaching party assumed.

In speaking of the expectation interest, Fuller and Perdue noted, "It is . . . no easy thing to explain why the normal rule" puts the party in as good a position as if the contract had been performed. Although some say to do so compensates the nonbreaching party, "in this case we 'compensate' the plaintiff by giving him something he never had."[261] To do so, they suggested, is an indirect way of protecting a party's reliance on a contract. Some losses due to reliance are hard to prove. For example, the "'gains prevented' by reliance, that is, losses involved in foregoing the opportunity to enter other contracts."[262] Putting the plaintiff where he would have been if the contract were performed "is a cure . . . in the sense that it offers the measure of recovery most likely to reimburse the plaintiff for the (often very numerous and very difficult to prove) individual acts and forbearances which make up his total reliance on the contract."[263]

If they were correct, then the reason for enforcing a contract is to protect a party who relies on another's promise. The normal remedy, in principle, would be compensation for the loss he suffered

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259. L.L. Fuller & William Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 54 (1936) (emphasis omitted). This position has been accepted by RESTATEMENT (SECOND) OF CONTRACTS § 344 (AM. L. INST. 1981).

260. Fuller & Perdue, *supra* note 259, at 52.

261. *Id.* at 52–53.

262. *Id.* at 60.

263. *Id.*

by reliance. Grant Gilmore's prediction would have come true—the *Death of Contract* would have led to the emergence of a different law that looks much like tort.[264]

But that cannot be. Contracts are binding even when parties do not expect to change their position before performance. Reliance damages are not the normal remedy. Each party contracts to lock in a favorable bargain, one in which each party assumes certain risks and is compensated for the risks he assumes. It would be circular to say that in doing so, the parties rely on each other because they forgo the opportunity to contract on similar terms with someone else. The reason that each party wishes to contract with anyone is to lock in a favorable bargain.

Consequently, the purpose of giving a party something he never had is the same as allowing the insured to collect the amount due under a fire insurance policy when his house burns down. The insurance company was paid to assume that risk, and it should not be allowed to renege when the risk materializes.

A. The Risk of Receiving a Less Favorable Price

As we have seen, when the parties to an exchange agree upon a price, they are protecting themselves against the risk of receiving a less favorable price. Once a party has done so, as in the case of the insurance policy, he should have the benefit of the price that he was guaranteed.

Consequently, the typical remedy is and should be to allow the nonbreaching party to obtain that benefit. Coincidentally, that remedy often places a party in as good a position as if the contract had been performed. Specific performance allows a party to receive the performance that he was promised at the contract price. Damages should award him the difference between the less advantageous price now available to him and the contract price. The formulas are well known. In a contract to buy or sell goods, the buyer receives the difference between the higher market price and the contract price. The seller receives the difference between the contract price and the lower market or resale price. The party who contracted to perform services receives the difference between the contract price and the costs saved because of the breach. The party for whom the service was to be performed receives the cost of completing it minus the contract price.

264. *See generally* GILMORE, *supra* note 1.

These remedies happen to protect what Fuller and Purdue called the plaintiff's "expectation interest."[265] But doing so is not an end in itself. The end is to hold each party to the allocation of risks to which each of them agreed when they contracted. Sometimes that end is achieved by putting a party in as good a position as he would have been in had the contract been performed, but sometimes it is not. We will examine two situations in which it is not.

1. *The Nonbreaching Party Is Worse off: The Lost-Volume Seller*

The nonbreaching party may be worse off because of the breach, not because he was forced to accept a less favorable price, but because he lost an extra sale. Orthodox doctrine allows him to recover the extra amount he would have made on the sale had the buyer not breached the contract. That would be the proper result if protecting the "expectation interest" were an end in itself. By our approach, it is not, since the nonbreaching party was not deprived of his guarantee that he would not have to sell at a less favorable price.

Section 2-708(2) of the Uniform Commercial Code allows recovery of "the profit (including reasonable overhead) which the seller would have made from full performance by the buyer."[266] An example is *Neri v. Retail Marine Corp*.[267] The buyer contracted to purchase a new boat of a specified model from a boat dealer. Six days later, the buyer notified the seller that he wished to rescind the contract because he was about to undergo hospitalization and surgery. Four months later, the boat ordered for the buyer and received by the dealer was sold to another buyer for the price that the first buyer had agreed to pay. The first buyer as held liable for the contract price minus the costs that the dealer saved because he did not have to purchase another boat. The dealer was worse off than he would have been if the contract with the first buyer had been performed.

In this situation, because of his medical problems, the boat was no longer worth more to the buyer than the money he was to pay for it. The exchange had become involuntary in the sense we described earlier. We have maintained that when it does so, even if the reason is that one of the parties changed his mind, the contract should not be

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265. Fuller & Perdue, *supra* note 259, at 54 (emphasis omitted).

266. U.C.C. § 2-708(2) (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2017).

267. *See generally* 285 N.E.2d 311 (N.Y. 1972).

enforced unless it is economically unfair to the other party to fail to do so.

In the case of a lost-volume seller, it is not economically unfair. The parties to an exchange contract at a certain price to avoid the risk of receiving a price that is less favorable. In *Neri*, the seller did not receive a less favorable price. Had the contract not been enforced, he would not have been harmed. If the contract was enforced, he would be protected against the risk that the buyer would have to pay for merchandise he did not want. That risk is like the one that gamblers create when they bet on a coin flip. If neither party were bound by the terms of the wager, neither would be harmed. When there is a risk of harm that one party or the other must bear, risk-averse parties will place it on the party that can bear it most easily. But risk-averse parties will not enter into a contract that creates a risk of harm that exists only if the contract is binding.

Suppose there were two competing boat dealers located next door to each other, and a would-be buyer went first to one, then to the other, and then back again, seeking the most favorable terms. He negotiated over how much extra he would be charged if he were given the privilege of backing out, and thereby costing the dealer an extra customer. The pressure of competition would lead each dealer to give him that privilege at no extra charge. Each dealer would realize that if the buyer did not back out, he would sell an extra boat. If the buyer did, he would lose nothing.

2. *When the Nonbreaching Party Is No Worse off*

In the cases we have just discussed, the nonbreaching party was worse off than if the contract had been enforced but not because he had to accept a price less favorable than the one guaranteed him by the contract. In rare situations, the nonbreaching party may be no worse off, even though he had to do so.

An example is *KGM Harvesting Co. v. Fresh Network*.[268] The defendant contracted to sell lettuce to the plaintiff at $0.09 per pound. When the price rose, the defendant breached the contract and sold the lettuce to a third party at the higher price. The plaintiff recovered by buying lettuce at the higher price, which it processed and resold to third parties. The plaintiff was no worse off, however, because its contracts to resell the lettuce were not fixed-price but cost-plus. Consequently, it was able to pass along the higher price that it paid to

268. *See generally* 42 Cal. Rptr. 2d 286 (Ct. App. 1995).

its customers. The court awarded the plaintiff the difference between the higher price it paid for the lettuce and the contract price. That result would be wrong if the purpose of giving a remedy is to put the plaintiff in as good a position as he would have been in had the contract been performed. Nevertheless, the court reached the right result. The parties bet on whether the price of lettuce would rise or fall, and the nonbreaching party won the bet. Because he hedged his bets, he received a windfall. If he were not allowed to recover, however, the windfall would go to the breaching party—the party who lost the bet. Moreover, the contract guaranteed the breaching party that he would receive the contract price even if the market price of lettuce fell. The nonbreaching party provided that guarantee. It should not matter that under the special circumstances of the case, the nonbreaching party provided that guarantee at no risk to himself.

B. The Risk of Consequential Damages

One consequence of a breach of contract is that the nonbreaching party may be forced to accept a price less favorable than the one that he was guaranteed. But there also may be other adverse consequences for the nonbreaching party. If our approach is correct, whether the nonbreaching party can recover for them should depend on whether they are among the risks that the breaching party assumed. To say that his expectation interest should be protected obscures that question. It suggests that he would be put in as good a position as if the contract had not been breached without any analysis of what risks the breaching party assumed and was compensated for assuming.

If the adverse consequences of a breach will be much the same for any customer or client of the breaching party, normally that party can bear the risk of the consequences at the lowest cost, and he will be compensated for bearing it by charging each customer or client a bit more. The seller is in the best position to foresee and control the risk that he will breach and to spread that risk among similar transactions. If the adverse consequences differ from one customer or client to the next, the seller will still be compensated if he charges a higher price to those customers for whom the adverse consequences are likely to be abnormally large. But the seller will not have been compensated if he charges all his customers or clients the same price even though, for some of them, the adverse consequences of a breach are likely to be much higher than for others. The seller should not be liable to a party who suffers an abnormally large amount for a harm unless that party paid an extra amount for him to assume the extra risk.

The common law often protects the seller against liability for such harm by invoking the rule in *Hadley v. Baxendale*.[269] In that case, the plaintiff's mill had stopped because a shaft broke. The plaintiff hired the defendant to transport the shaft to a manufacturer so that it could serve as a model for a new one. The defendant's breach of contract delayed transportation, and the plaintiff sued for the profits he lost because the mill was stopped for a longer period of time. The court denied recovery on the grounds that this harm was not foreseeable at the time that the contract was made.

If our approach is correct, it should not matter whether the harm was foreseeable at the time the contract was made. What should matter is whether the defendant was compensated for assuming the risk that the harm would occur. In *Hadley*, the transportation company was not compensated for assuming such a risk. Presumably, the transportation company charged the same amount for transporting the shaft as it would have for transporting anything else of the same weight and volume the same distance. It could have included an extra amount to cover the risk of liability for the harm that a breach of its contract might cause a typical customer. But there is no evidence that it charged the plaintiff an extra amount to run the risk that it would be liable if the plaintiff's mill was stopped. A contract is economically fair when each party is compensated for the risks that the contract places on him. It would have been unfair to hold the defendant liable.

Courts have often applied the rule in *Hadley* even though the harm to the plaintiff was foreseeable when the harm was abnormally large, and the contract price was not adjusted to reflect the risk the plaintiff would assume if he were liable for it. *Hadley* itself may have been such a case. According to the headnote, "the plaintiff told the defendant that the mill was stopped."[270] Victor Goldberg has shown that the headnote was not in error.[271] Two years after the decision, John William Smith and Sir Henry Singer Keating, counsel for Baxendale and Hadley respectively, co-authored a selection of leading cases in which they noted that the plaintiff told the shipper that the mill was stopped.[272]

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269. (1854) 9 Exch. 341.

270. *Id.* at 341.

271. *See* VICTOR P. GOLDBERG, RETHINKING THE LAW OF CONTRACT DAMAGES 166–67 (2019). *See* Venkatesan Niranjan, *The Contract Remoteness Rule: Exclusion, Not Assumption of Responsibility* (2017), *in* ANDREW DYSON, JAMES GOUDKAMP & FREDERICK WILMOT-SMITH, DEFENCES IN CONTRACT 187, 198–99 (2017).

272. *See* JOHN WILLIAM SMITH & SIR HENRY SINGER KEATING, A SELECTION OF LEADING CASES ON VARIOUS BRANCHES OF THE LAW: WITH NOTES 431 (1856).

The Second Restatement of Contracts accepts the rule of *Hadley* that "[d]amages are not recoverable for loss that the party in breach did not have reason to foresee . . . when the contract was made."[273] Yet, in an illustration based on *Hadley*, the Restatement explained that the reason a court may deny recovery is that damages are disproportionately high.

> A, a private trucker, contracts with B to deliver to B's factory a machine that has just been repaired and without which B's factory, as A knows, cannot reopen. Delivery is delayed because A's truck breaks down. In an action by B against A for breach of contract the court may, after taking into consideration such factors as the absence of an elaborate written contract and the extreme disproportion between B's loss of profits during the delay and the price of the trucker's services, exclude recovery for loss of profits.[274]

Indeed, there is a line of cases stretching back almost to *Hadley* that deny recovery when damages were disproportionate but seem to be foreseeable.[275]

The rule in *Hadley* was the result of a quirk in legal history in which it replaced an earlier rule limiting recovery for damages that are disproportionately high. The court in *Hadley* adopted a rule proposed by Robert Pothier, an eighteenth-century French jurist, proposed,

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273. RESTATEMENT (SECOND) OF CONTS. § 351(1) (AM. L. INST. 1981).

274. *Id.* § 351 illus. 17.

275. *See* Postal Instant Press, Inc. v. Sealy, 51 Cal. Rptr. 2d 365, 373–75 (Ct. App. 1996) (ruling no recovery by franchisor of future royalties from a franchisee); Sundance Cruises Corp. v. Am. Bureau of Shipping, 7 F.3d 1077, 1084 (2d Cir. 1993) (holding no recovery for loss caused by defects in a ship that the defendant had certified to have no defects); Armstrong Rubber Co. v. Griffith, 43 F.2d 689, 691 (2d Cir. 1930) (giving no recovery for injury to plaintiff's business caused by defendant's delivery of defective tires); McEwen v. McKinnon, 11 N.W. 828, 830 (Mich. 1882) (giving no recovery for profits lost on a steam mill and "salt block" when the defendant failed to provide boilers on time); Snell v. Cottingham, 72 Ill. 161, 170 (1874) (holding no recovery against a defendant who failed to finish building a railroad for profits lost when the road could not be used); Moulthrop v. Hyett, 17 So. 32, 33–34 (Ala. 1895) (giving no recovery of profits lost when defendant failed to furnish a machine for drying bricks with as much capacity as promised, although the court added that damages were remote and speculative); Fleming v. Beck, 48 Pa. 309, 312 (1864) (giving no recovery of profits lost by a miller when defendant breached a contract to dress stones for his mill); Armstrong & Latta v. City of Philadelphia, 94 A. 455, 458 (Pa. 1915) (giving no recovery by the owner of machinery of the profit he would have made had it been returned to him on time). For other cases, see Larry T. Garvin, *Disproportionality and the Law of Consequential Damages: Default Theory and Cognitive Reality*, 59 OHIO ST. L.J. 339, 345–60 (1998).

whence it passed into the French Civil Code.[276] Pothier followed the suggestion of a sixteenth century French jurist, Charles du Moulin.[277] Du Moulin was perplexed by a Roman rule that limited the damages the plaintiff could recover in some contracts to twice the contract price.[278] He suggested that its rationale "is that most likely it was not foreseen or thought that greater damage would be suffered or that there was a risk beyond the principal object than the principal object itself."[279] Pothier ignored the Roman rule and restated du Moulin's rationale so that it became a rule in its own right: "The person who owes a performance is only liable for the damages that one could have foreseen at the time of the contract that the party owed a performance would suffer."[280] If our approach is correct, the Romans were right. Damages should be limited when they are disproportionately high. Our current law is the product of two mistakes: one by Du Moulin as to the rationale of the rule, and the other by Pothier in substituting the rationale for the rule itself.

The rationale for the rule, according to Baron Alderson. in his opinion in *Hadley* is that "had the special circumstances [leading to unforeseen injury] been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case."[281] That may be, but why assume that the breaching party is willing to be liable for the damages he does foresee unless he agrees to bear such risk? Why would he have agreed unless he charges an extra amount?

Sophisticated economic defenses of the rule have been based on the same assumption. According to Posner, the foreseeability rule "induces the party with knowledge of the risk either to take appropriate precautions himself or, if he believes the other party might be the more efficient preventer or spreader (insurer) of the loss, to reveal the risk to that party and pay him to assume it."[282] According to Ian Ayres and Robert Gertner, the foreseeability rule will force the party who knows that harm may occur to accept liability for it or to

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276. *See* REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 830 (1990).

277. *See id.* at 829.

278. *See id.* (discussing Du Moulin's attempt to rationalize C. 7.47.1).

279. CAROLUS MOLINAEUS, TRACTATUS DE EO QUOD INTEREST no. 60 (1574).

280. Robert Pothier, *Traité des obligations*, *in* 2 OEUVRES DE POTHIER 497 (Bugnet ed., 2d ed. 1861).

281. Hadley v. Baxendale, (1854) 9 Exch. 341, 355.

282. POSNER, *supra* note 72, at 141.

convey that information to who may be best able to prevent it.[283] If not, presumably, he will refuse to accept liability. If the party receiving the information agreed to assume liability and charge extra for that assumption, he ought to be liable. The trouble is that the foreseeability rule does not require that this party agree, but merely that he be informed and, having been informed, can foresee the loss that might occur.

V. UNJUST DISTRIBUTION OF WEALTH: INJUSTICES THAT CONTRACT LAW CANNOT REMEDY

There are other cases in which a contract is unfair, and yet contract law cannot provide an appropriate remedy. As noted earlier, one function of the market is to price ration goods to those who are willing to pay the most for them. At any price below that set on a competitive market, there would be queues of people wishing to buy. Goods would go to whomever happens to be first in line or has friends who can make sure he gets them.

Whether it is fair to price ration goods depends on the fairness of the distribution of purchasing power in society. These are matters that Aristotle would say concern distributive rather than commutative justice.[284] Distributive justice ensures, so far as feasible, that each citizen has a fair share of resources. Commutative justice preserves that share. Contracts are a matter of commutative justice. They enable each party to receive something he wants more than what he gives in return without enriching either party at the other's expense. If people are too poor to afford basic medical care and decent housing, the unconscionability doctrine will not help.

Contract prices—for example, the wages paid for labor—affect the amount that people can afford. Rakoff is correct in claiming:

> [I]f we are going to be realistic about the law of contracts at the present time, statutes establishing minimum wages, for example, are as much a part of the law of contracts as is the traditionally considered Statute of Frauds . . . [W]e live in a market society, where to survive one has to participate in the market over and over and where the basic distribution of wealth takes place through the very mechanism of the deal.[285]

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283. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules,* 99 YALE L.J. 87, 101 (1989).

284. Rakoff, *supra* note 174, at 737.

285. *Id.* at 736–37.

For the same reason, Dagan and Heller are correct that a contract for labor is a different type of contract from an ordinary exchange.[286] We would describe it as a mixed type of contract. The wages paid, the conditions of work, and the type of work should reflect both the voluntary commutative justice of exchange and the standard of living that distributive justice should promote. For us, that is an illustration of the value of distinguishing between distributive and commutative justice. If the distribution of wealth is unfair, the contracts people enter into will be unfair, and yet courts will face a dilemma. It will seem wrong to both uphold such contracts and to strike them down.

In *Carboni v. Arrospide*, a poor person borrowed a large sum of money at 200% interest to pay for the medical expenses of relatives in Peru.[287] The court held that the contract was unconscionable and gave an inconsistent explanation. According to the court, it was substantively unconscionable because the borrower could easily have obtained more favorable terms. It was procedurally unconscionable because he could not obtain a better rate because of his poor credit, and no one would lend to him for less. If the court was right when it discussed procedural unconscionability, then the borrower may well have received the interest rate on a competitive market for a person with his credit borrowing a large sum of money. The interest rate reflected the dim prospects that he would be able to pay the lender back. If a court refuses to enforce such a contract, then other people in his position will have to leave their relatives without medical care rather than borrow. Yet to enforce a loan at a 200% rate of interest seems outrageous.

In nearly all states, leases contain an implied warranty of habitability, which means that the premises must be fit for human habitation.[288] Suppose a poor person inspects a run-down apartment, observes rats and cockroaches, and is informed by the landlord that the heating will go off periodically in the winter, the plumbing will sometimes fail, the roof leaks, and the landlord has no intention of fixing these conditions. The landlord will rent it to the prospective tenant for $100 a month, which is all the tenant can afford, provided the tenant agrees to take the premises as is, with no warranty of habitability. In most states, that warranty cannot be waived.[289] In the language of contract law, the waiver would be unconscionable. Yet it

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286. *See* DAGAN & HELLER, *supra* note 5, at 96.
287. 2 Cal. Rptr. 2d 845, 846 (Ct. App. 1991).
288. *See* 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES app. at 10A-2 (5th ed., 2005).
289. *See* JESSE DUKEMINIER ET AL., PROPERTY: CONCISE EDITION 325 (2014).

may be that if the landlord fixed these conditions without charging more rent, he would operate at a loss. If a court holds that the waiver is unconscionable, the prospective tenant may have no place to live that he can afford. If the court does find the waiver to be unconscionable, the landlord can rent premises unfit for human habitation. This is not a problem that the law of contracts can solve. It can only be solved by ensuring that people can afford adequate medical care and housing.

A similar dilemma can arise in conditions of short-term scarcity. A Texas case, decided in 1960 without any reference to the doctrine of unconscionability, upheld a loan of $29 worth of Greek drachmas to a woman in Nazi occupied Greece.[290] In return, she agreed to pay the lender $2,000. Had the court applied the doctrine of unconscionability, it is hard to say whether it should have upheld the contract or not. During the Nazi occupation, many Greeks died of starvation. To that woman, $29 may have meant the difference between life and death. The competitive market price of a loan of that amount may have been enormous for the same reason that a canteen of water can command an enormous price among people in a lifeboat with very little to drink. Life and death should not be price rationed. It seems outrageous for the lender to charge her so much for survival. Yet it is paradoxical to refuse to enforce the contract. She is the one who survived and benefited from the very system of price rationing of which she complains.

One problem with the Pareto optimality, as we have seen, is that a contract can make both parties better off ex ante and leave one of them worse off ex post. Another problem is that it ignores the unfairness that results from the distribution of purchasing power. According to Calabresi, by "the Pareto test," a change is desirable if it "would make someone in that society better off and no one in it worse off."[291] Supposedly, that change is desirable "however bizarre or nefarious the original starting points and the tastes they defined, and however outrageous the wealth and power distributions that our law created or took for granted."[292] Maldistribution of wealth and power have nothing to do with efficiency, which is the goal of economists. They have a great deal to do with justice, which is the goal of the legal system. Yet that injustice is not one that the law of contracts can correct.

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290. *See* Batsakis v. Demotsis, 226 S.W.2d 673, 675 (Tex. Civ. App. 1949).

291. Calabresi, *supra* note 67, at 1215.

292. *Id.* at 1216.

CONCLUSION

As we have seen, autonomy alone does not explain contract law. Neither does efficiency.

We have tried to show that a theory of contract law cannot do without the principle of commutative justice or economic fairness. A contract of exchange is economically fair when each party is compensated for the risks that he assumed. If he is not fairly compensated, the evil to be remedied is the unfairness, not a lack of autonomy, and not the bargaining disadvantages or personal weaknesses that explain why the other party was able to treat him unfairly. This theory does not contradict modern economics. The tools of modern economics enable us to better explain when a party is fairly compensated. They explain why normally, he is fairly compensated when he contracts at the market price for the risk that prices will change. If he disavows the contract when the market price fluctuates, he is like a person who reneges after losing a fair bet.

To serve its purpose, a contract must be voluntary. It is voluntary when each party receives something that he values more than what he is to give in return. If he does not, the contract should not be enforced except when to fail to do so would be economically unfair to the other party.

We hope that our theory explains not only why contracts of exchange are enforced, but also the principal doctrines governing when they are enforced and the remedies available to enforce them.