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## CONTRACT AS AGREEMENT

*Lawrence M. Solan\**

A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent. If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake, or something else of the sort.

—Judge Learned Hand<sup>1</sup>

### INTRODUCTION

Broad theories of contract law are intentional in nature, whether based upon the rights of the individual as an autonomous actor,<sup>2</sup> the benefits to society of encouraging people to engage in bargained-for transactions,<sup>3</sup> or the justice due those who have relied on the promises and representations of others.<sup>4</sup> No one speaks, for example, of the freedom to be bound by something one did not intend. Bar-

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1 *Hotchkiss v. Nat'l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911).

2 *See, e.g.*, CHARLES FRIED, *CONTRACT AS PROMISE* 2, 83–89 (1981).

3 *See* RESTATEMENT (SECOND) OF CONTRACTS § 71 cmt. c (1981).

4 *See* L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: I*, 46 *YALE L.J.* 52, 53–57 (1936). The seminal work organizing contract law around

gains imply volition. Acts in reliance come only after an understanding that someone has made a commitment. However contract law is constructed, at the very least, one would expect it to take as its point of departure the players' actual intentions.

Yet, for generations law students have been taught that the law governing the formation of contracts is by and large *objective* in nature, although it has some *subjective* elements. It is the appearance of intent that matters most. Many casebooks say so,<sup>5</sup> as do texts<sup>6</sup> and treatises.<sup>7</sup> The Restatement incorporates a largely objective approach to contract formation as well, although its key provision dealing with the interpretation of contracts is both objective and subjective.<sup>8</sup> While it often refers to *mutual assent*, the Restatement makes clear that its concern is only with outward manifestations of mutual assent. Such manifestation occurs through promising or performing,<sup>9</sup> and promising is itself

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reliance issues is GRANT GILMORE, *THE DEATH OF CONTRACT* (Ronald K.L. Collins, 2d ed. 1974).

5 See, e.g., BRUCE W. FRIER & JAMES J. WHITE, *THE MODERN LAW OF CONTRACTS* 9 (2005) ("This theory has dominated American contract law since the late nineteenth century . . ."); CHARLES L. KNAPP, ET AL., *PROBLEMS IN CONTRACT LAW* 34 (5th ed. 2003) ("The substitution of an 'objective' approach for the 'subjective' one previously taken by Anglo-American law in such cases is commonly said to be one of the central tenets of the classical contract law system.").

6 See, e.g., ROBERT A. HILLMAN, *PRINCIPLES OF CONTRACT LAW* 39–40 (2004); JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACT LAW § 2.2, at 26–28 (5th ed. 2003); W. DAVID SLAWSON, *BINDING PROMISES* 20 (1996).

7 See E. ALLAN FARNSWORTH, *CONTRACTS* § 3.6, at 115 (4th ed. 2004) ("By the end of the nineteenth century, the objective theory had become ascendant and courts universally accept it today. In the words of a distinguished federal judge, "intent" does not invite a tour through [the plaintiff's] cranium, with [the plaintiff] as the guide." (quoting *Skycom Corp. v. Telstar Corp.*, 813 F.2d 810, 814 (7th Cir. 1987))); 1 SAMUEL WILLISTON & RICHARD A. LORD, *A TREATISE ON THE LAW OF CONTRACTS* § 4:1, at 241 (4th ed. 1990) ("[A]s a general principle, the inquiry will focus not on the question of whether the subjective minds of the parties have met, but on whether their outward expression of assent is sufficient to form a contract."); see also 1 ARTHUR LINTON CORBIN, *CORBIN ON CONTRACTS* § 4.12, at 628 (Joseph M. Perillo ed., rev. ed. 1993) ("The cases demonstrate plainly enough that a person's expressions as understood by the other party, may bind the person even though the person's own intention and meaning were different."). Corbin, however, expressed doubt about the viability of such a theory, given that the plain meaning of a text is only plain by virtue of its uncontroversially reflecting the intent of the drafter, which, of course, is a subjective matter. See *id.*, § 4.12, at 628.

8 See RESTATEMENT (SECOND) OF CONTRACTS § 201 (1981); see also discussion *infra* notes 196–211 and accompanying text.

9 *Id.* § 18 ("Manifestation of mutual assent to an exchange requires that each party either make a promise or begin or render a performance.").

defined as a manifestation of a commitment.<sup>10</sup> The actual states of mind of the parties are not the subject of legally relevant inquiry.<sup>11</sup> Almost a century after he wrote the opinion in *Hotchkiss v. National City Bank of New York*, Learned Hand's twenty bishops still make their way into discussion, whether through the case law<sup>12</sup> or the scholarly literature.<sup>13</sup> While there is some debate about how and when this state of affairs developed,<sup>14</sup> there is little controversy about its existence.

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10 *Id.* § 2(1) ("A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made.")

11 *Id.* § 21 ("Neither real nor apparent intention that a promise be legally binding is essential to the formation of a contract, but a manifestation of intention that a promise shall not affect legal relations may prevent the formation of a contract.")

12 For recent examples, see *Bock v. Computer Associates International, Inc.*, 257 F.3d 700, 708 (7th Cir. 2001); *Roye Realty & Developing, Inc. v. Arkla, Inc.*, Nos. 94-6218 & 94-6305, 1996 U.S. App. LEXIS 3352, at \*22 n.17 (10th Cir. Feb. 28, 1996); *Ferranti International, PLC v. Jasin*, No. 98-CV-5412, 2000 U.S. Dist. LEXIS 6663, at \*25 n.5 (E.D. Pa. May 5, 2000), *rev'd*, 2001 U.S. App. LEXIS 3691 (3d Cir. Feb. 22, 2001); *Travelers Property & Casualty Co. v. Restortek, Inc.*, No. 98 C 3438, 2000 U.S. Dist. LEXIS 2034, at \*2 (N.D. Ill. Feb. 18, 2000); *Time Warner Sports Merchandising v. Chicagoland Processing Corp.*, No. 95 C 1364, 1998 U.S. Dist. LEXIS 491, at \*5-6 (N.D. Ill. Jan. 9, 1998); *Agroindustria Nacional, S.A. v. Henry Broch & Co.*, 976 F. Supp. 758, 760 n.3 (N.D. Ill. 1997); and *Angelou v. African Overseas Union*, 33 S.W.3d 269, 279 n.6 (Tex. App. 2000).

13 See, e.g., Larry A. DiMatteo, *The Norms of Contract: The Fairness Inquiry and the "Law of Satisfaction"—A Nonunified Theory*, 24 HOFSTRA L. REV. 349, 361 (1995); Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CAL. L. REV. 1743, 1757 (2000); Chad McCracken, *Hegel and the Autonomy of Contract Law*, 77 TEX. L. REV. 719, 737 (1999); Todd Rakoff, *Washington v. Davis and the Objective Theory of Contracts*, 29 HARV. C.R.-C.L. L. REV. 63, 78-79 (1994); G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 431, 440 n.3 (1993); Harvey L. Temkin, *When Does the Fat Lady Sing?: An Analysis of "Agreements in Principle" in Corporate Acquisitions*, 55 FORDHAM L. REV. 125, 132 n.27 (1986).

14 For a historical perspective on the development of the objective theory, see Joseph M. Perillo, *The Origins of the Objective Theory of Contract Formation and Interpretation*, 69 FORDHAM L. REV. 427, 428-29 (2000). There is extensive commentary on this history, with considerable disagreement among scholars as to its course. See GILMORE, *supra* note 4, at 39-59; MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780-1860*, at 180-88 (Stanley N. Katz ed., 1977) (documenting the continued existence of the subjective will theory into the late nineteenth century). For some recent commentary, see Larry A. DiMatteo, *The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment*, 48 S.C. L. REV. 293, 305-16 (1997); Menachem Mautner, *Contract, Culture, Compulsion or: What Is So Problematic in the Application of Objective Standards in Contract Law?*, 3 THEORETICAL INQUIRIES L. 545, 553-59 (2002). All agree that Holmes and Williston played important roles in bringing about the final victory of this approach in American law in the early twentieth century, see GILMORE, *supra* note 4, at 21-30; HORWITZ, *supra*, at 90, 200, 237; DiMatteo, *supra*, at 296-97; Mautner, *supra*, at 551-52 & n.25; Perillo, *supra*, at 443-44, although there is

The objective account relies heavily on cases in which an individual makes a statement that is reasonably construed as a promise, and for which he has bargained for something in exchange. When the time comes for performance, the promisor denies having intended to commit himself to the deal. The cases routinely say that it does not matter what he thought.<sup>15</sup> What matters is whether a reasonable person would understand his statement as a promise. If so, then he is bound—even if twenty bishops vouch for him.

Because the promisor is, naturally enough, also bound by his promise in the routine case in which he *does* intend to be bound, his intent appears to be irrelevant. The law provides the same result regardless of what he was thinking, so long as a reasonable person would construe his statement as a commitment to perform. This confluence has led judges and scholars alike to hypothesize that objective analysis is at the core of contract law.<sup>16</sup>

This Article argues that this objective account emanates from too narrow a vantage point. It ignores certain situations in which it would not be reasonable to construe a statement as a promise, and it fails to take into account the understanding of the promisee, which is an important variable in determining contractual liability. Most problematic for the objective account is that when both parties agree that a commitment has been made, the promisor is bound, and when neither believes that a promise has been made, the promisor is not bound. Objective considerations are irrelevant. Even when a reasonable person would construe the promisor's statement as a commitment, courts will not enforce a statement to which neither party subscribed.<sup>17</sup> By the same token, courts *will* enforce a promise to which both parties agreed, even if a reasonable person would not have understood it as a promise.<sup>18</sup>

When the additional scenarios generated by considering the promisee's state of mind and additional situations in which it is not reasonable to infer a promise are added to the mix, the objective theory has little explanatory power. A theory at the very least should con-

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considerable disagreement about the earlier roots of this approach. I will not recount the different versions of this history here.

15 See, e.g., *Hotchkiss v. Nat'l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911); *NBC Universal, Inc. v. Paxson Commc'ns Corp.*, No. 650-N, 2005 De. Ch. LEXIS 56, at \*14 (Del. Ch. Apr. 29, 2005); *Faulkner v. Am. Cas. Co.*, 584 A.2d 734, 739 (Md. Ct. Spec. App. 1991); *Embry v. Hargadine, McKittrick Dry Goods Co.*, 105 S.W. 777, 778 (Mo. Ct. App. 1907).

16 See *supra* notes 5–7, 15 and accompanying text.

17 See *infra* notes 42–47 and accompanying text.

18 See *infra* notes 36–51 and accompanying text.

tain a set of principles which, when applied to a core set of fact situations, accounts for their distribution of outcomes. The objective account of contract law fails to do this.

Far more descriptive of the actual array of facts are theories of contract formation based upon mutual assent or the reliance of the promisee. Actual agreement matters in the law of contracts. Promises are enforced when the parties have reached an agreement, and are not enforced when the parties have not actually reached an agreement, unless the promisee actually and reasonably believes that a promise was made even though none was intended. By the same token, objective considerations play a role in the decisionmaking process. However, what is called an objective theory is better seen as a rule designed to handle a particular set of cases, embedded in a larger theory whose basic organizing principle is the actual mutual assent of the parties. I argue in this Article that these cases reflect a preference for reliable evidence of actual subjective intent, and act as a species of estoppel, preventing parties from backing away from the predictable reliance upon their acts of speech.

With this reconceptualization comes some positive consequences. For one thing, it allows for added flexibility in the award of contract remedies. While expectation damages may be an appropriate remedy for breaches when the parties have reached agreement, full benefit-of-the-bargain awards may overcompensate promisees, especially when a promisor inadvertently commits himself, and recognizes the fact before there has been substantial reliance.<sup>19</sup> Seventy-five years ago, Professor Whittier made a similar suggestion in his criticism of the first Restatement.<sup>20</sup> Based on a somewhat broader range of data, I argue here that it is time to resuscitate his analysis.

In addition, once we stop speaking of an objective theory of contract formation, various contract doctrines begin to fit more coherently with one another. Among the advantages are the harmonization of rules governing the formation and interpretation of contracts; a significant reduction in the need for peculiar technical definitions of such common terms as *offer*, *acceptance*, *agreement*; reconciliation of the objective approach and the requirement of a bargain, which contains some indispensably subjective elements; and harmonization of the rules governing contract formation and the rules governing incomplete contracts.

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19 For discussion of this potential overcompensation, see Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1494–96 (2004).

20 Clarke B. Whittier, *The Restatement of Contracts and Mutual Assent*, 17 CAL. L. REV. 441, 444–45 (1929).

Part I of this Article fleshes out the problems that arise with the objective theory of contract. The argument is a descriptive one: Once the core scenarios are defined, it quickly becomes clear that the objective approach fails to account for about half of them. A more subjective approach—whether based upon mutual assent or upon reliance—better explains the basic array of facts.

Part II provides two alternative explanations for cases generally used to justify the objective approach, in which a person is bound by a statement that he did not intend as a binding promise. First, the rule serves as a proxy for the actual intent of the parties. Judges articulate this rationale with great frequency. By accepting the ordinary meaning of the words used as the intended meaning, courts are likely to capture the intended meaning most of the time, since that is how the words are most typically used and understood. The second justification for the rule disallowing unexpressed subjective evidence of intent is that such a rule serves as an estoppel to protect reliance interests. If an individual makes a statement that (1) a reasonable person would construe as a promise and (2) the promisee actually understands as a promise in the context of a bargained-for exchange, then the promisor may not assert that he did not intend to bind himself. I call this principle *formation estoppel*.<sup>21</sup>

Part III discusses some of the consequences of a subjective account for contract formation. First, the subjective account permits more flexibility in the conceptualization of contract remedies. Expectation damages may not be appropriate when the promisor did not intend to bind himself and the promisee has not acted in reliance. Second, the subjective account brings the formation of contracts into harmony with the rules governing contract interpretation, consideration, and gap-filling. The result is a far more coherent account of contract law generally. Part IV is a brief conclusion.

## I. APPRECIATING THE SUBJECTIVE NATURE OF CONTRACT FORMATION

### A. *How the Objective Account Does Not Do Enough Work*

Let us develop with more care the scenarios mentioned in the introduction. The objective approach to contract law focuses on the situation in which an individual said something that is most reasonably construed as a promise, but which he did not intend that way. A

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<sup>21</sup> Formation estoppel differs from promissory estoppel in that it does not require that the promisee act or refrain from acting in reliance on the promise. It requires only that the promisee reasonably understood the promisor to have committed himself to his word. For discussion of the differences, see *infra* Part III.A.

classic example is the 1907 case, *Embry v. Hargadine, McKittrick Dry Goods Co.*<sup>22</sup> Embry was in charge of the sample department for a dry goods company.<sup>23</sup> He had been employed pursuant to a series of one-year contracts.<sup>24</sup> During the busy Christmas season, he demanded a renewal and said he would quit if it were not granted.<sup>25</sup> According to Embry, his superior, McKittrick, responded by saying: "Go ahead, you're all right. Get your men out, and don't let that worry you."<sup>26</sup> McKittrick testified that he never intended this statement to be understood as a commitment.<sup>27</sup> The appellate court, following a trial in which a jury was instructed that mutual assent was required for an agreement to be formed, held that mutual assent is not necessary to bind an individual when a reasonable person would understand a statement as a promise:

Judicial opinion and elementary treatises abound in statements of the rule that to constitute a contract there must be a meeting of the minds of the parties, and both must agree to the same thing in the same sense. Generally speaking, this may be true; but it is not literally or universally true. That is to say, the inner intention of parties to a conversation subsequently alleged to create a contract cannot either make a contract of what transpired, or prevent one from arising, if the words used were sufficient to constitute a contract. In so far as their intention is an influential element, it is only such intention as the words or acts of the parties indicate; not one secretly cherished which is inconsistent with those words or acts.<sup>28</sup>

This statement of the law, which is by now standard, is what judges and writers refer to when they speak of the objective theory of contracts.

Such legal characterization is by no means a relic. In providing justification for decisions that employ this rule, judges repeatedly adduce the objective nature of contract formation. For example, in a recent decision upholding an arbitration clause, the Eighth Circuit in a diversity case began its analysis by confirming that "Minnesota follows the objective theory of contract formation, under which an out-

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22 105 S.W. 777 (Mo. Ct. App. 1907).

23 *Id.* at 777.

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.*

28 *Id.* at 778.



ward manifestation of assent is determinative, rather than a party's subjective intent.'"<sup>29</sup> Such statements are easy to find.<sup>30</sup>

In these cases the court assumes, as the court did in *Embry*, that in most instances mutual assent is a sufficient basis for determining that a contract has been formed.<sup>31</sup> Situations like this one, however, demonstrate that our real concern is with the conduct of the parties, not with the inner workings of their minds. The following table displays the array of decisions that generates the objective approach:

TABLE 1.

Would a Reasonable Person Infer a Promise?	Did the Promisor Intend To Make a Promise?	Is There a Binding Promise?
Yes	Yes	Yes
Yes	No	Yes

As the table shows, the law need not concern itself with the actual intent of the promisor, once it is established that a reasonable person would believe that a promise has been made.

Now let us add the remaining two scenarios, in which it is not reasonable to conclude that the promisor has bound himself. An

<sup>29</sup> *Asia Pac. Indus. Corp. v. Rainforest Café, Inc.*, 380 F.3d 383, 387 (8th Cir. 2004) (quoting *TNT Props., Ltd. v. Tri-Star Developers, LLC*, 677 N.W.2d 94, 102 (Minn. Ct. App. 2004)).

<sup>30</sup> *See, e.g.*, *J.F. McKinney & Assocs. v. Gen. Elec. Inv. Corp.*, 183 F.3d 619, 622 (7th Cir. 1999) ("Illinois uses an objective theory of contract under which understandings and beliefs are effective only if *shared*."); *see also* *NBC Universal, Inc. v. Paxon Comm'ns Corp.*, No. 650-N, 2005 Del. Ch. LEXIS 56, at \*14 (Del. Ch. Apr. 29, 2005) ("Delaware adheres to the 'objective' theory of contracts, i.e. a contract's construction should be that which would be understood by an objective, reasonable third party."); *Barchowsky v. Silver Farms, Inc.*, 659 A.2d 347, 355 (Md. Ct. Spec. App. 1995) ("Maryland follows the objective theory of contract interpretation. . . . '[C]ontractual intent is determined in accordance with what a reasonable person in the position of the parties at the time of the agreement would have intended by the language used.'" (quoting *Faulkner v. Am. Cas. Co.*, 584 A.2d 734, 739 (Md. Ct. Spec. App. 1991))); *Mealand v. E.N.M. Med. Ctr.*, 33 P.3d 285, 289 (N.M. Ct. App. 2001) ("New Mexico adheres to the objective theory of contracts."); *Commonwealth v. Stewart*, 66 Va. Cir. 135, 154 (Va. Cir. Ct. 2004) ("[O]bjective theory . . . controls in Virginia . . ."); *Sykes v. Ellenburg Capital Corp.*, No. 22772-0-II, 1999 Wash. App. LEXIS 671, at \*9 (Wash. Ct. App. Apr. 16, 1999) ("Washington adheres to the 'objective theory' of contracts, requiring the court to examine the parties' objective manifestations rather than their subjective intent."); *Givens v. Fowler*, 984 P.2d 1092, 1095 (Wyo. 1999) ("In Wyoming, we examine the objective manifestations of the parties' contractual intent to determine whether a contract was formed.").

<sup>31</sup> *See, e.g.*, *J.F. McKinney & Assocs.*, 183 F.3d at 622-23.

objective approach predicts that there should be no obligation, whether or not the promisor intended the statement as a promise. If all that matters is what a reasonable person would understand, then once the statement is declared not reasonably susceptible to interpretation as a commitment, the person making the statement should not be bound.

But this inference from the objective theory does not accurately describe the facts. At least when the promisor intends the statement as a promise and the promisee understands it that way, a promise will be enforced, notwithstanding objective considerations. To see this, we need to consider not only scenarios in which the intent of the promisor is varied systematically, but also scenarios in which the understanding of the promisee is varied.<sup>32</sup>

Once we take the promisee into account, the array of possible scenarios expands to eight:

TABLE 2.

	Reasonable Inference	Promisor's Intent	Promisee's Understanding	Promisor Bound?
1.	Yes	Yes	Yes	Yes
2.	Yes	Yes	No	No
3.	Yes	No	Yes	Yes ( <i>Hotchkiss</i> )
4.	No	Yes	Yes	No
5.	No	Yes	Yes	Yes
6.	No	Yes	No	No
7.	No	No	Yes	No
8.	No	No	No	No

A purely objective theory would predict that a contract is formed in all of the first four situations, and only in those situations. But this is not the case. Rather, with the exception of the *Hotchkiss/Embry* scenario (Scenario 3), a binding commitment occurs if and only if the parties are in accord. Alternatively, apart from Scenario 7, it is possi-

<sup>32</sup> Speech Act Theory describes these perspectives on the same act of speech as a matter of "illocutionary force" on the one hand, and "perlocutionary effect," on the other. Loosely, the former characterizes the speaker's intent, the latter the hearer's understanding. Many legally relevant speech acts require analysis from both perspectives. For example, fraud requires scienter on behalf of the defendant, and both reasonable and actual reliance on behalf of the plaintiff. The seminal work is J.L. AUSTIN, *HOW TO DO THINGS WITH WORDS* (J.O. Urmson & Marian Sbisà eds., 2d ed. 1975).

ble to say that a promise will be enforced if and only if the promisee actually construes the promisor's statement as a promise.<sup>33</sup> Scenario 7 shows that this reliance must be not only actual, but also reasonable, preventing promisors from being victimized by fraudulent claims of reliance.

As noted in the introduction, these facts are highly consistent with a theory of contract law based on notions of personal autonomy. But it is not the autonomy of the promisor alone that predicts judicial outcomes in a wide range of cases.<sup>34</sup> Rather, courts are concerned with protecting the autonomy of both parties. The exception reflected in Scenario 3 prevents promisors from walking away from actual commitments, and uses "reasonableness" as a tiebreaker when the autonomy interests of the two parties are in actual conflict. Let us look more closely at this array of situations.

#### 1. Cases in Which Both Parties Agree—One Way or the Other

The first scenario describes a situation where both parties reasonably believe the promisor to be bound as part of a bargained-for exchange. And he is. This situation describes the prototypical contract: the parties make a deal, it looks like a deal, and they know that they made a deal. These are the transactions that form the core of contract law. Their formation is typically not the subject of litigation because the formation of a contract is so obvious that it is beyond dispute.

The last scenario describes a situation in which neither party believes the promisor to be bound, and such a belief would be unreasonable. She is not bound. This scenario includes a wide range of situations, including those in which no one would construe a conversation as including a promise (most of everyday life), and cases in which both parties understood agreement-type language not to constitute a deal. Such situations include jokes mutually understood as such, as well as the law professor who hypothetically offers to sell her car to a student to illustrate a principle of law.

The fourth and fifth scenarios make my point most strongly. When two people reach an agreement, it is enforceable, regardless of how a reasonable person would understand the interaction. Learned Hand made this point himself in *Hotchkiss*. Following the language quoted at the beginning of this Article,<sup>35</sup> Hand continued: "Of course, if it appear by other words, or acts, of the parties, that they attribute a

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33 I am grateful to Michael Cahill, who first pointed this possibility out to me.

34 Contrast this position with that of FRIED, *supra* note 2, at 16.

35 See *supra* note 1 and accompanying text.

peculiar meaning to such words as they use in the contract, that meaning will prevail, but only by virtue of the other words, and not because of their unexpressed intent.”<sup>36</sup> Judge Easterbrook stated this proposition colorfully with a watermelon metaphor:

Under the prevailing will theory of contract, parties, like Humpty Dumpty, may use words as they please. If they wish the symbols “one Caterpillar D9G tractor” to mean “500 railroad cars full of watermelons,” that’s fine—provided parties share this weird meaning. A meaning held by one party only may not be invoked to change the ordinary denotation of a word, however. Intent must be mutual to be effective; unilateral intent does not count. Still less may the parties announce that they “share” an unusual meaning to the detriment of strangers, who have no way of finding out what was in the contracting parties’ heads.<sup>37</sup>

Or consider this statement from *Berke Moore Co. v. Phoenix Bridge Co.*,<sup>38</sup> a well-cited New Hampshire case:

The rule which precludes the use of the understanding of one party alone is designed to prevent imposition of his private understanding upon the other party to a bilateral transaction. But when it appears that the understanding of one is the understanding of both, no violation of the rule results from determination of the mutual understanding according to that of one alone.

Where the understanding is mutual, it ceases to be the “private” understanding of one party.<sup>39</sup>

The Supreme Court of Arizona makes this point clearly. After describing various versions of the parol evidence rule, the court made the following observation:

When interpreting a contract . . . it is fundamental that a court attempt to “ascertain and give effect to the intention of the parties at the time the contract was made if at all possible.” If, for example, parties use language that is mutually intended to have a special meaning, and that meaning is proved by credible evidence, a court is obligated to enforce the agreement according to the parties’ intent, even if the language ordinarily might mean something different.<sup>40</sup>

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36 *Hotchkiss v. Nat’l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911).

37 *TKO Equip. Co. v. C & G Coal Co.*, 863 F.2d 541, 545 (7th Cir. 1988) (citation omitted).

38 98 A.2d 150 (N.H. 1953).

39 *Id.* at 156 (citation omitted).

40 *Taylor v. State Farm Mut. Auto. Ins. Co.*, 854 P.2d 1134, 1139 (Ariz. 1993) (quoting *Polk v. Koerner*, 553 P.2d 660, 662 (Ariz. 1975) (citation omitted)).

Scholars who espouse an objective approach recognize that evidence of the parties' actual intent can trump ordinary meaning in the interpretation of contracts. Professor Barnett, for example, notes that when it is clear that the parties actually have their own shared meaning of contractual language, a court should enforce the contract according to that meaning:

[T]he purpose for which we adopt the objective approach—to enable persons to rely on the appearances created by others because subjective intentions are generally inaccessible—is satisfied by actual knowledge that the appearances in this case are deceiving. Therefore, in contract law, we protect a party's reliance on objective appearances, unless it can be shown that the parties shared a common subjective understanding of the term.<sup>41</sup>

Professor Barnett would thus treat ordinary meaning as a default rule for ascertaining the intent of the parties. I agree with this position: the legal system concerns itself principally with the actual intent of the parties and uses ordinary understanding as a surrogate for that intent unless there exists better evidence taken from the transaction itself. But I characterize these facts quite differently. It is not that contract law is about appearances but suspends its concern with the objective just when it happens that the parties have actually agreed. Rather it is the opposite: the business of contract law is to enforce agreements. To prevent people from walking away from their agreements, the law also enforces apparent commitments that a promisee has reasonably taken seriously. Professor Farnsworth also acknowledges that “[i]n the rare cases of a common meaning shared by both parties, the subjectivists have had the better argument,” although he seems to dismiss these cases because of their rarity.<sup>42</sup>

The flip side also holds. If neither the promisor nor the promisee believes that agreement has been reached on terms that a reasonable person may infer from the language of a contract, a court will not impose an agreement simply because the language is subject to such an interpretation.<sup>43</sup> Although the first Restatement suggested that imposing contractual obligations in these circumstances was proper,<sup>44</sup>

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41 Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 858–59 (1992).

42 FARNSWORTH, *supra* note 7, § 7.9, at 448.

43 Actually, I've overstated this point. In cases involving the parol evidence rule, a court may not concern itself with questions of either party's state of mind, which may allow such contracts to be enforced, notwithstanding that neither party had any intent with respect to particular terms. In such cases, it can be said that the parties at the very least intended to be bound by the contract as a whole.

44 RESTATEMENT OF CONTRACTS § 230 cmt. b (1932).

Corbin's position, that to do so would be "to hold justice up to ridicule,"<sup>45</sup> better characterizes actual practice.

Justice Linde makes the point this way: "[T]he staunchest objectivist would not let a jury hold two parties to an apparently manifested agreement if neither thought the other meant to assent."<sup>46</sup> Similarly, the Second Circuit reversed a grant of summary judgment based on language that appeared to show that agreement had been reached on a time limit for bringing a claim but whose meaning was placed in doubt by the circumstances. The court observed: "There is nothing in the law of contracts that prevents the parties from ascribing an uncommon meaning to their words."<sup>47</sup> When it appears that has happened, actual intent trumps ordinary understanding.

Cardozo made a similar observation, in connection with the application of the parol evidence rule.<sup>48</sup> Given a choice between the most natural reading that neither party intended, or the actual meaning to which the parties had subscribed, it is the latter interpretation that courts will impose when a dispute arises:

We may concede that the words, when viewed alone, apart from the setting of the occasion, give support to the defense. . . .

The proper legal meaning, however, is not always the meaning of the parties. Surrounding circumstances may stamp upon a contract a popular or looser meaning. . . . The triers of the facts must fix the sense in which the words were used in the contract now before us. To take the primary or strict meaning is to make the whole transaction futile. To take the secondary or loose meaning, is to give it efficacy and purpose. In such a situation, the genesis and aim of the transaction may rightly guide our choice.<sup>49</sup>

Thus, courts do not regard their function as imposing on parties terms to which neither agreed when the contract was formed. It may, of course, happen from time to time. It happens when the parties did not agree to terms that now appear to be the most reasonable interpretation of a contract, and the party who would be most advantaged by the enforcement of the contract testifies self-servingly that she always intended to gain the advantage that the contract appears to

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45 3 CORBIN, *supra* note 7, § 539, at 81. Corbin also expressed the same idea, "No contract should ever be interpreted and enforced with a meaning that neither party gave it." *Id.* § 572B, at 66.

46 *Kabil Devs. Corp. v. Mignot*, 566 P.2d 505, 509 (Or. 1977).

47 *Garza v. Marine Transp. Lines, Inc.*, 861 F.2d 23, 27 n.4 (2d Cir. 1988).

48 *Utica City Nat'l Bank v. Gunn*, 118 N.E. 607, 608 (N.Y. 1918).

49 *Id.* (citation omitted).

give her.<sup>50</sup> Such a person may be able to benefit from the combination of the rule in *Embry* and the parol evidence rule, if it is applied to preclude the other party from offering evidence to the contrary.<sup>51</sup> But this shows only that evidentiary rules, designed to reduce the overall rate of error in the legal system, do not accomplish this goal in every case. It would be rare indeed, however, for a judge to state, in keeping with the First Restatement,<sup>52</sup> that the objective theory requires the court to thwart the known will of the parties and enforce a deal that both sides concede was never made and that the judge believes was never made. Courts certainly differ as to how to draw the line with respect to the admission of evidence that appears to be at odds with the contract's ordinary meaning. But the overall endeavor is generally seen as intentional in nature.

This is especially true when one party claims that a contract should be reasonably implied from the circumstances, but the facts affirmatively show that no agreement was actually reached. That happened in *Bailey v. West*.<sup>53</sup> West bought a racehorse from a Dr. Strauss.<sup>54</sup> When the horse arrived in Boston, West claimed it was lame, and ordered it returned to Dr. Strauss.<sup>55</sup> But Dr. Strauss would not accept the horse.<sup>56</sup> Ultimately, West's trainer had the horse delivered to Bailey's farm for boarding.<sup>57</sup> When West refused to pay, Bailey sued.<sup>58</sup> Reversing the holding below, the appellate court refused to imply a contract.<sup>59</sup> Even though the circumstances might lead to a

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50 See Melvin Aron Eisenberg, *The Responsive Model of Contract Law*, 36 STAN. L. REV. 1107, 1124–26 (1984), for a discussion. Similarly, Barnett recognizes that under these circumstances, “the objective interpretation of a party’s acts will yield . . . to proof of a different subjective understanding of one or both parties.” Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 307 (1986).

51 The risk of such a result is what has led to a softening of the parol evidence rule over the decades. See, e.g., U.C.C. § 2-202(1)(a) (2004) (stating a relaxed parol evidence rule that generally permits evidence of course of dealing or usage of trade to explain conduct inconsistent with the contract’s clear language); Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 534 (1998). For a good illustration in the context of the UCC, see *American Machine & Tool Co. v. Strite-Anderson Manufacturing Co.*, 353 N.W.2d 592, 596–98 (Minn. Ct. App. 1984).

52 See *supra* note 44 and accompanying text.

53 249 A.2d 414, 416–17 (R.I. 1969). My thanks to Ian Ayres for bringing this case to my attention.

54 *Id.* at 415.

55 *Id.*

56 *Id.*

57 *Id.*

58 *Id.*

59 *Id.* at 416.

reasonable inference that a contract had been formed, the trainer had made it clear to the driver who delivered the horse that West was not going to pay for the boarding, and West had refused to pay any bills in the interim.<sup>60</sup> It made no difference that West had lost his lawsuit with Dr. Strauss and had to pay for the horse.<sup>61</sup> West never agreed to pay for its boarding and maintenance. The court concluded: "From our examination of the record we are constrained to conclude that the trial justice overlooked and misconceived material evidence which establishes beyond question that there never existed between the parties an element essential to the formulation of any true contract, namely, an 'intent to contract.'"<sup>62</sup> Because Bailey was on actual notice right from the beginning that West was not willing to pay for his services, the question of objective consideration never arose.<sup>63</sup>

## 2. When the Promisor Denies Intending To Be Bound

Next, compare the third and seventh scenarios, in which the promisor denies intending to be bound, but the promisee believes that a promise has been made. Scenario three is *Embry* itself. A person who makes a statement that induces a reasonable person to believe that the communicator intended to be bound has bound himself, regardless of his unexpressed intent not to do so.<sup>64</sup> Professor Barnett comments on the risks of relying on subjective intent in such situations:

Such a strategy might create a de facto option in the promisor. The promisor could insist on enforcement if the contract continued to be in her interest, but if it were no longer advantageous, she could avoid the contract, by producing evidence of a differing subjective intent.

Because the subjective approach relies on evidence inaccessible to the promisee, much less to third parties, an inquiry into subjective intent would undermine the security of transactions by greatly reducing the reliability of contractual commitments.<sup>65</sup>

At the extreme, unexpressed intent includes the thoughts of people who privately have the same idea, but have never communicated anything to each other. If you and I both think that it would be a

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60 *Id.* at 415.

61 *Id.* at 415–16.

62 *Id.* at 417.

63 *See id.*

64 *Embry v. Hargadine, McKittrick Dry Goods Co.*, 105 S.W. 777, 778–79 (Mo. Ct. App. 1907).

65 Barnett, *supra* note 50, at 273.



good idea for me to sell you a set of golf clubs for \$100, we share a state of mind, but do not have a contract. As Professor Barnett points out, such cases make a pure will theory of contract untenable.<sup>66</sup>

But these concerns, also expressed by Judge Hand in *Hotchkiss*,<sup>67</sup> and by Holmes in *The Path of the Law*,<sup>68</sup> are really quite limited in their applicability. For contract law typically involves the enforcement of acts that are themselves communicative in nature: offers, acceptances, bargained-for exchanges, and promises (whether for consideration or not). These speech acts, as I argue below, all contain inferences of the speaker's intent.<sup>69</sup> The objective rule in these cases protects against fraudulent conduct and acts as a default when a misunderstanding has occurred. Rules that prefer objective evidence of a party's intent are not motivated by fear that courts will begin enforcing the unexpressed thoughts of people with similar ideas. Rather, the concern is that parties will try to walk away from commitments that they have made, or that they will try to expand the scope of a commitment made by the other party. In both cases, the system benefits by requiring some contemporaneous evidence of what the deal really was at the time it was made.

The seventh scenario differs from *Embry* only in that it was not reasonable for a hearer to construe the promisor's statement as a commitment. This scenario describes cases in which the statement is claimed to be a joke.<sup>70</sup> A well-studied example is *Leonard v. PepsiCo, Inc.*<sup>71</sup> A Pepsi promotional campaign offered various items, such as t-shirts, in exchange for coupons ("Pepsi Points") that could be accumulated by buying Pepsi products. As a joke at the end of a television ad, a jet plane landed in a school yard with a statement that the jet could be purchased for seven million points.<sup>72</sup> A lawyer (Leonard) read the catalogue containing the promotion's rules, and saw that the Pepsi Points program permitted participants to use cash to purchase the items at the price of ten cents for each required point, as long as at least fifteen actual coupon points were submitted as part of the deal. This would mean that the jet could be purchased for \$700,000.

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66 *Id.* at 302–03.

67 *Hotchkiss v. Nat'l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911).

68 O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 464 (1897).

69 *See infra* Part III.D.

70 For discussion of such cases, see Keith A. Rowley, *You Asked for It, You Got It . . . Toy Yoda: Practical Jokes, Prizes and Contract Law*, 3 NEV. L.J. 526, 527–30, 536–38, 546–52, 554 (2003).

71 210 F.3d 88 (2d Cir. 2000) (per curiam).

72 *Id.* at 89.

The retail value of the vehicle was some \$23 million.<sup>73</sup> When Leonard tried to take advantage of the situation, the court held that no reasonable person would take the offer as anything other than a cute joke, and did not enforce the deal as it appeared on television.<sup>74</sup>

*Embry* and *Pepsico* differ in whether it was reasonable for the hearer to take the promisor seriously. In *Pepsico*, the objective rule does not apply to make the promise enforceable, since the promisee cannot have reasonably relied upon the promisor's words in accepting the offer. Yet the state of the promisor's mind is not totally irrelevant. Had the evidence shown that Pepsico was dead serious about this offer (perhaps discovery revealed substantial files planning a ceremony to celebrate the redemption of coupons for the jet), it is likely that a court would have required the company to live up to the promise it made in its advertising campaign.

In fact, a situation very much on point arose in *Newman v. Schiff*,<sup>75</sup> a case decided by the Eighth Circuit in 1985. Schiff was a tax rebel who claimed that the federal income tax is optional as a legal matter.<sup>76</sup> On a CBS news program, he made the following offer: "If anybody calls this show—I have the Code—and cites any section of this Code that says an individual is required to file a tax return, I will pay them \$100,000."<sup>77</sup> Newman, a lawyer, did not see the original broadcast. But he did see the interview—including the offer—when it was rebroadcast on the morning news the next day.<sup>78</sup> Newman found sections of the Internal Revenue Code that appeared to demonstrate that taxes must be paid, and contacted CBS both by phone and in writing the following day.<sup>79</sup> Schiff responded that others had already pointed out the same Code provisions, that they were not adequate to earn the reward, and that Newman had not properly accepted the offer.<sup>80</sup> Newman sued. The district court ruled in favor of Schiff, holding that the offer actually was intended to expire at the end of the original broadcast.<sup>81</sup> Although the offer was later extended to the subsequent

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73 *Leonard v. Pepsico, Inc.*, 88 F. Supp. 2d 116, 119 (S.D.N.Y. 1999).

74 *Leonard*, 210 F.3d at 88–89.

75 778 F.2d 460 (8th Cir. 1985). The case is discussed by Professor Rowley, *supra* note 70, at 549–50.

76 *Newman*, 778 F.2d at 461.

77 *Id.* at 462.

78 *Id.*

79 *Id.* at 462–63.

80 *Id.* at 463 n.6.

81 *Id.* at 463.

broadcast by Schiff's various acts of ratification, the court found that Newman had not accepted that renewed offer in a timely way either.<sup>82</sup>

The Eighth Circuit affirmed on somewhat different grounds. The appellate court first ruled that the key issue was whether a reasonable person in Newman's position would take the next day's rebroadcast of Schiff's offer as a bona fide offer of a reward. The court held that it would not be reasonable to do so.<sup>83</sup> But the court then went on to consider the subsequent correspondence between Schiff and Newman, and how it might impact the status of Schiff's offer. Somewhat inconsistently, the court wrote:

Here, in Schiff's letter, we have a statement indicating that the rebroadcast may have been an offer. If Schiff believed that the rebroadcast was an offer, then that belief would tend to make it appear more reasonable for Newman to have reached the same conclusion. We note, however, that both Schiff's conduct and his letter are indefinite. He still denied the obligation. Schiff's conduct and correspondence do not change the facts that the rebroadcast was merely a newsreport and that it was not reasonable for the hearer to construe the newsreport as a new offer.<sup>84</sup>

Thus, if Schiff had actually admitted with some clarity that he intended the offer to remain open through the rebroadcast, the court would have enforced the parties' mutual intent. For had Schiff made it clear that he intended to extend the offer through the rebroadcast, the deal would have been enforceable precisely because the two parties would have been in accord in their actual interpretation of the events, regardless of the fact that on its face it would not seem reasonable to construe the offer on live television as extended to the next morning's report of it. Such cases are not commonplace, but they occur from time to time.<sup>85</sup>

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82 See *id.* at 461–66.

83 *Id.* at 466 (“A reasonable person listening to the news rebroadcast could not conclude that the above language—‘calls this show’—constituted a new offer; rather than what it actually was, a newsreport of the offer previously made, which had already expired.”).

84 *Id.* at 466–67.

85 For examples, see Rowley, *supra* note 70, at 539–43, 546. The title of Rowley's article refers to *Berry v. Gulf Coast Wings, Inc.*, No. 01-2642 (Fla. 14th Cir. Ct. filed July 24, 2001). In *Berry*, a waitress at a Hooters restaurant alleged that she was promised a new Toyota for job performance, but was given a new “toy Yoda” instead. See Initial Complaint at 1–3, *Berry v. Gulf Coast Wings, Inc.*, No. 01-2642 (Fla. 14th Cir. Ct. July 24, 2001), available at [http://news.corporate.findlaw.com/hdocs/docs/hooters/berry\\_gcw72401cmp.pdf](http://news.corporate.findlaw.com/hdocs/docs/hooters/berry_gcw72401cmp.pdf). The article's title also refers to *Gill v. Cumulus Media, Inc.*, No. 05-CI-2740 (Fayette Cir. Ct. filed June 22, 2005). In *Gill*, the plaintiff alleged that a radio advertisement promised “100 Grand,” but gave her a candy bar with that name

### 3. When the Promisor Intends To Be Bound, but the Promisee Does Not Understand that a Commitment Has Been Made

In two scenarios (two and six), the promisor intends to be bound, but the promisee does not construe the promisor's statement as a binding promise. Consider a variation of the facts in *Embry*, based on a hypothetical by Professor Eisenberg<sup>86</sup>: Assume that McKittrick intended to be bound when he said, "Go ahead, you're all right. Get your men out, and don't let that worry you."<sup>87</sup> Assume further that Embry did not believe that statement to be a real commitment. Perhaps he responded, "Mr. McKittrick, when are you going to give me a direct answer on which I can rely?" He then told a number of witnesses (perhaps twenty bishops) that he would stay for as long as he wished and then leave, since he did not consider McKittrick to have made a real promise. If Embry continued working for the company for a few months and was later dismissed, would the company be bound by McKittrick's statement?

It is difficult to regard such a promise as binding. Most significantly, it cannot be part of a bargained-for exchange,<sup>88</sup> since the party to receive the benefit of the promise did not understand the bargain as including the promise in the first place. Nor can liability be based on promissory estoppel, since there cannot possibly be detrimental reliance on a promise when the recipient does not believe that a promise has been made. Obviously, the situation does not arise often, since a promisee who wishes to enforce a promise is unlikely to acknowledge that he had no idea that there ever was a promise.

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instead of the money she expected. See Complaint at 1–2, *Gill v. Cumulus Media, Inc.*, No. 05-CI-2740 (Fayette Cir. Ct. June 22, 2005), available at <http://www.thesmokinggun.com/archive/0623051grand1.html>. Thanks to Professor Ronald Chen for bringing this matter to my attention through the contract professors listserv. Closer to home for legal academics, Professor Alan Dershowitz raised a stir when he promised on MSNBC's *Scarborough Country*: "Tell you what. I will give \$10,000 to the P.L.O. in your name if you can find a historical fact in my book that you can prove to be false." *Scarborough Country* (MSNBC television broadcast Sept. 8, 2003). On a subsequent radio program, *Democracy Now*, Norman Finkelstein claimed to have found various erroneous statements; Dershowitz claimed that his offer was limited to a "material, willful, distortion." *Democracy Now* (NPR radio broadcast Sept. 24, 2003) (transcript available at <http://www.democracynow.org/static/dershowitzFin.shtml>). To the best of my knowledge, this offer has not resulted in litigation.

<sup>86</sup> Eisenberg, *supra* note 50, at 1124–26.

<sup>87</sup> See *Embry v. Hargadine, McKittrick Dry Goods Co.*, 105 S.W. 777, 777 (Mo. Ct. App. 1907).

<sup>88</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981) (defining consideration).

For our purposes, it is relevant that the reasonableness of the promise does not seem to have anything to do with the analysis. If the purpose of the objective rule is to prevent the promisor from denying intent when his actions appear to speak for themselves, there is no need to apply the rule when he admits his intent to be bound as an initial matter. The analysis is exactly the same regardless of whether the promisor's statement, seen objectively, is reasonably construed by third parties as a commitment.

Moreover, as the hypothetical illustrates, the promisee's state of mind does not mean that she believes in the promisor's sincerity. As discussed below, promises need not be sincere to be enforceable.<sup>89</sup> In fact, insincere promises are not only actionable as a breach of contract if not performed, but are also fraudulent.<sup>90</sup> I may believe that I am dealing with a liar when a car dealer tells me that the car I am interested in buying has only 10,000 miles, but that liar will be bound as long as I understand his statement as a promise.

As for our hypothetical Mr. Embry, courts often reject an employee's effort to enforce an employer's promises when it does not appear that the employee accepted the employer's offer as part of a bargained-for exchange. As the Supreme Court of Maryland has stated,

There is no enforceable contractual obligation created when an employer offers an employee a *bonus* for doing that which the employee is already required to do. Without consideration, in the form of a promise to continue to work, the promise to pay additional fees for sales that previously were required is not part of any valid contract.<sup>91</sup>

Similarly, an employer's request that an employee give up rights—even the rights of an at-will employee—also requires consideration to be enforceable.<sup>92</sup>

Situations in which the promisor intends to bind himself but the promisee does not understand that a commitment has been made are by no means limited to employment situations. The principle applies generally. Consider Professor Farnsworth's hypothetical concerning the enforceability of rewards, based on a 1907 Texas case<sup>93</sup>:

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89 See *infra* notes 215–19 and accompanying text.

90 For detailed analytical discussion, see LAN AYRES & GREGORY KLASS, *INSINCERE PROMISES* 143–45 (2005).

91 *Medex v. McCabe*, 811 A.2d 297, 305–06 (Md. 2002) (citation omitted).

92 See *Poole v. Incentives Unlimited, Inc.*, 525 S.E.2d 898, 900 (S.C. Ct. App. 1999) (holding that a covenant not to compete, signed after employment commenced, but without new consideration, was invalid).

93 *Broadnax v. Ledbetter*, 99 S.W. 1111 (Tex. 1907).

Suppose that an owner advertises a \$100 reward for the return of a lost gold watch. If a finder of the watch, having read the advertisement, returns the watch to the owner, this action is bargained for, and the finder can enforce the owner's promise of a reward. But if the finder, unaware of the promise, notices the owner's name engraved on the watch and returns it, the action could not have been bargained for. Since the finder did not know of the owner's promise, the action could not have been given in exchange for it. The finder cannot, therefore, enforce the owner's promise.<sup>94</sup>

Although bargained-for exchanges surely do not constitute the only enforceable obligations, as critics of the bargain theory of contract have pointed out for many years,<sup>95</sup> in these cases the principle applies well. Most significantly, once the promisor does not deny having made a commitment, objective analysis of her intent becomes irrelevant to the analysis of contract formation, and in fact makes incorrect predictions.

### B. *The Stamina of the Objective Theory*

Whatever the value of the objective account of contract law, it surely does not create a coherent picture of a basic array of cases. It incorrectly predicts the enforceability of statements that neither party would regard as binding, and incorrectly fails to predict the enforceability of statements that both parties would regard as binding. These are more than "subjective elements" of an objective contracts regime. They are core cases. A theory of contract formation should surely be good enough to account for eight basic scenarios. Accepting these failures as "limits" of the prevailing theory is not a very satisfactory solution, not only because the cases are so central, but also because there is nothing about the theory that suggests that such limits should exist.

It is natural enough to discount the reasoning of my argument because so much of it relies upon cases that seldom occur, if at all. However, such an objection does not undermine my point. In fact, it explains why it is that we live so easily with the objective account of contract law notwithstanding its descriptive inadequacy.

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94 FARNSWORTH, *supra* note 7, § 2.10, at 68; *see also* CORBIN, *supra* note 7, § 3.5, at 326–30 ("There is no power of acceptance by one to whom the offer is wholly unknown.").

95 For discussion of the history of the tension between bargain-based theories and reliance-based theories of contract, *see* ROBERT A. HILLMAN, *THE RICHNESS OF CONTRACT LAW* 7–77 (1998); Barnett, *supra* note 50, at 287–89; Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191, 1228–29 (1998).

One reason for the longevity of the objective theory is cognitive in nature. We tend to reason from what we actually notice. Our reliance upon what is actually in front of us is a well-studied phenomenon in the psychology of reasoning. Psychologists speak of an “availability heuristic,” which causes people to overestimate the probability of those events that are salient in their lives.<sup>96</sup> If we regard contract formation as objective, we can describe accurately the few scenarios that recur. With respect to those, it is as if there really is an objective theory. However, application of this strategy leads to errors in predicting the results both in non-salient cases and in the overall structure of our judgments.

This point can be made even more strongly. As the psychologist Philip N. Johnson-Laird has demonstrated, people often draw inferences from what actually occurs, ignoring situations that do not arise.<sup>97</sup> He calls this the “principle of truth.”<sup>98</sup> This principle explains, for example, how it is that people are so prone to infer causation based only on evidence of co-occurrence. Inferences of causation actually require one to consider, hypothetically, situations in which there is no observed co-occurrence.<sup>99</sup> It is difficult for people to remove themselves from the reality they perceive, leading to errors in inference.<sup>100</sup>

Adherence to the objective approach to contract law is a prototypical instance of the application of this strategy. The appeal of the objective approach emanates from its power to explain cases like *Embry*, and to contrast them with cases like *Pepsico*. The focus in all such cases is on the state of mind of the promisor, who has denied that any commitment was intended. Thus, it appears that this is the only relevant consideration. More generally, common law reasoning itself may well increase the likelihood of mischaracterizing the system of contract law, because it has developed from case-by-case decision-making followed by post hoc analysis, rather than as a coherent system ab initio.<sup>101</sup> There is little intellectual pressure to identify the cases

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96 See RICHARD NISBETT & LEE ROSS, HUMAN INFERENCE 18–23 (1980); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY 3, 11–14 (Daniel Kahneman et al. eds., 1982).

97 P.N. Johnson-Laird, *Causation, Mental Models, and the Law*, 65 BROOK. L. REV. 67, 69–80 (1999).

98 *Id.* at 71.

99 *Id.* at 80–83.

100 Others have also noted that the availability of information can lead to errors in judgment about causality. See, e.g., NISBETT & ROSS, *supra* note 96, at 22–23.

101 For recent discussion of such problems, see Frederick Schauer, *Do Cases Make Bad Law?*, 73 U. CHI. L. REV. 883, 890–99 (2006).

that do not arise, but which can teach us a great deal about the structure of our thinking.

Increasing the saliency of cases employing the objective approach are the socio-legal circumstances in which the objective theory gained its prominence. As Professor Rakoff has noted, the rise of the corporation as a contracting party made it more difficult to attribute intent to any individual.<sup>102</sup> Moreover, the standardization of business transactions, often involving the repeated use of forms, made it more attractive to rely upon ordinary interpretations.<sup>103</sup> This approach culminated in the Uniform Commercial Code's focus on such concepts as trade usage and course of dealing.<sup>104</sup> These developments made it intellectually attractive to focus attention on those cases in which courts subordinated a party's intent to the understanding of a reasonable person.

The argument presented here is akin to that of Calabresi and Melamed in their famous study of nuisance law.<sup>105</sup> In describing the possible outcomes of disputes over whether one party may interfere with another in the use of property, they conceptualized the situation in terms of a matrix.<sup>106</sup> The variables are who wins (plaintiff or defendant) and how the winning party wins (enforcement of superior property rights through injunction or the payment of damages, which allows the interference to continue for a price).<sup>107</sup> Among possibilities is a peculiar-looking one: the defendant must stop engaging in the nuisance, but the plaintiff must pay for the cost of the cessation.<sup>108</sup> The scenario makes little sense in our winner-take-all conceptualization of the legal system, but the very year that Calabresi and Melamed published their article, the Supreme Court of Arizona decided *Spur Industries, Inc. v. Del E. Webb Development Co.*<sup>109</sup> A feed lot was creating a nuisance because it was too close to a development.<sup>110</sup> But the feed lot was there first, and the developer had "come to the nuisance."<sup>111</sup> The result was that the court required the feed lot to move (enforcing

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102 Rakoff, *supra* note 13, at 80–81.

103 *Id.* at 81.

104 U.C.C. § 2-202(a) (2006).

105 Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1115–24 (1972). I am very grateful to David Reiss for pointing out the similarities in the structure of the arguments.

106 *Id.* at 1105–15.

107 *Id.* at 1089–93.

108 *Id.* at 1105–10.

109 494 P.2d 700 (Ariz. 1972).

110 *Id.* at 704–05.

111 *Id.* at 707.



the property rights of the development), but also required the developer to pay for the move (imposing a liability rule on the party that seemed to win).<sup>112</sup>

Similarly, our conceptualization of contract formation changes when we look not only at the most recurrent cases, but at how we would resolve the entire matrix of possible scenarios that is generated when we take into account the few variables that seem to influence courts in the recurrent cases. As a descriptive matter, it appears from our eight scenarios that promises are typically enforced when there is mutual assent and they are not enforced when there is not mutual assent. We turn in the next Part to the exceptions to this generalization that have led people to think otherwise.

## II. TWO EXPLANATIONS FOR HOLDING PEOPLE LIABLE FOR PROMISES THEY DID NOT INTEND TO MAKE

I have thus far given reason to question the proposition that we routinely hold promisors accountable for statements that are reasonably construed as promises whether or not they intend them as such. I argue that the basic array of contract law appears to prefer subjective explanation, with the objective principle standing out as an exception that applies in a particular type of scenario. Once the objective approach is rejected as a *theory*, it becomes appropriate to ask whether there exist alternative explanations consistent with my analysis that can explain the exception and its longevity. Below, I propose two: first, the legal system looks at the way a reasonable person would construe a statement as strong evidence of what the speaker intended to say; second, the system holds speakers responsible only when the hearer actually construes the statement as a promise. This creates a choice between protecting the interests of a promisor who has misspoken at best and acted dishonestly at worst, and those of an innocent promisee. The principle, which favors the promisee in these circumstances, protects the autonomy of the party not at fault. This very much resembles other reliance-based doctrines of contract law, such as promissory estoppel, in which the reliance must be both actual and reasonable.

### A. *Objective Evidence of Subjective Intent*

One need not rely upon truth tables to observe that contract law is largely subjective. Even a perfunctory look at cases involving the interpretation of contracts shows them to be replete with rhetoric

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112 See *id.* at 707–08.

about the intent of the parties. Over and over again, courts announce that their job is to determine actual intent.<sup>113</sup> They often make reference to a “meeting of the minds”—a theory of contract that has been declared dead and buried for decades.<sup>114</sup> Thus, while judges announce that they adhere to an objective approach in the cases in which they refuse to take into consideration the unarticulated intent of a party that is at odds with the evidentiary record, much of the rest of the time they speak of intent routinely and without hesitation.

To see what appears to underlie this fact, let us return to Learned Hand’s statement in *Hotchkiss*. What must be rejected, according to Hand, is not the notion of intent, but rather, testimony based upon intent that was unexpressed at the time the contract is alleged to have been formed.<sup>115</sup> This is the rule that has survived for almost a century now. In fact, Hand’s pronouncement is really nothing more than an articulation of the “ordinary meaning rule,” which has dominated the interpretation of both contracts and statutes for decades. In the interpretation of contracts, as in the interpretation of statutes,<sup>116</sup> courts turn to the ordinary meaning of the terms. Although courts sometimes use the rule as a directive without explaining its motivation,<sup>117</sup> often enough a court will note that it is resorting to the ordinary meaning of a document as the best evidence of intent, whether the intent of the contracting parties, or the intent of the enacting legislature.<sup>118</sup> The following statement by the Supreme Court of Colorado is typical:

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113 See discussion *infra* Part III.B.

114 See, e.g., *infra* note 188.

115 *Hotchkiss v. Nat’l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911).

116 Examination of the similarities and differences between the two judicial endeavors can be instructive. See generally Stephen F. Ross & Daniel Tranen, *The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation*, 87 GEO. L.J. 195, 199, 221–42 (1988) (comparing and contrasting “the use of parol evidence in contract interpretation with the use of legislative history in statutory interpretation”); Lawrence M. Solan, *Pernicious Ambiguity in Contracts and Statutes*, 79 CHI.-KENT L. REV. 859, 860, 866–79 (2004) (discussing problems of ambiguity “in both statutory and contractual interpretation”).

117 See, e.g., *DeLoach v. Lorillard Tobacco Co.*, 391 F.3d 551, 558 (4th Cir. 2004) (“Under [North Carolina] law, as under general principles of contract law, our task is to ‘give ordinary words their ordinary meanings.’” (quoting *Internet E., Inc. v. Duro Commc’ns, Inc.*, 553 S.E.2d 84, 87 (N.C. Ct. App. 2001))); *Cantonbury Heights Condo. Ass’n v. Local Land Dev., L.L.C.*, 873 A.2d 898, 904 (Conn. 2005) (“We accord the language employed in the contract a rational construction based on its common, natural and ordinary meaning and usage as applied to the subject matter of the contract.”).

118 As for the ordinary meaning rule reflecting legislative intent in the interpretation of statutes, see *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383 (1992)

A court's primary goal is to implement the intent of the parties as expressed in the language of the decree. To ascertain this intent, the courts turn to the plain and ordinary meaning of its terms. If the terms are clear, a court will neither look outside the four corners of the instrument, nor admit extrinsic evidence to aid in interpretation.<sup>119</sup>

Similar statements are easy enough to find.<sup>120</sup> Perhaps the best illustrations of this approach are cases in which the court simultaneously requires a meeting of the minds and objective evidence, as did the Supreme Court of Arkansas, holding that "in order to make a contract there must be a meeting of the minds as to all terms, using objective indicators."<sup>121</sup>

Much of the time (including the Colorado case quoted above), the analysis relates the intent of the parties, the ordinary meaning rule and the four corners rule, which prohibits a court from looking outside the contract for the intentions of the parties when the lan-

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("The question, at bottom, is one of statutory intent, and we accordingly 'begin with the language employed by CONGRESS and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.'" (quoting *FMC Corp. v. Holliday*, 498 U.S. 54, 57 (1990))); Lawrence M. Solan, *Private Language, Public Laws: The Central Role of Legislative Intent in Statutory Interpretation*, 93 GEO. L.J. 427, 456–57 (2005).

119 *City of Golden v. Simpson*, 83 P.3d 87, 93 (Colo. 2004) (en banc) (citations omitted).

120 See, e.g., *Nat'l Union Fire Ins. Co. v. Dixon*, 112 P.3d 825, 828 (Idaho 2005) ("The meaning of the insurance policy and the intent of the parties must be determined from the plain meaning of the insurance policy's own words."); *ARY Jewelers, L.L.C. v. Krigel*, 82 P.3d 460, 466 (Kan. 2003) ("The cardinal rule in contract interpretation is to ascertain the intention of the parties and to give effect to that intention. . . . The intent of the parties is determined based on the contract alone, not on extrinsic or parol evidence. . . . Words should be given their natural and ordinary meaning." (quoting *Armstrong Bus. Servs. v. H & R Block*, 96 S.W.3d 867, 874 (Mo. Ct. App. 2002) (citations omitted))); *Batshon v. Mar-Que Gen. Contractors, Inc.*, 624 N.W.2d 903, 906 n.4 (Mich. 2001) ("If the language of a release is clear and unambiguous, the intent of the parties is ascertained from the plain and ordinary meaning of the language."); *Motorsports Racing Plus, Inc. v. Arctic Cat Sales, Inc.*, 666 N.W.2d 320, 323 (Minn. 2003) ("[T]he primary goal of contract interpretation is to determine and enforce the intent of the parties. Where the parties express their intent in unambiguous words, those words are to be given their plain and ordinary meaning." (citations omitted)).

121 *Alltel Corp. v. Sumner*, 203 S.W.3d 77, 80 (Ark. 2005); see also *Hill-Shafer P'ship v. Chilson Family Trust*, 799 P.2d 810, 814–15 (Ariz. 1990) (en banc) ("It is well-established that before a binding contract is formed, the parties must mutually consent to all material terms. . . . Importantly, however, mutual assent is based on objective evidence, not on the hidden intent of the parties." (citations omitted)); *Avemco Ins. Co. v. N. Colo. Air Charter*, 38 P.3d 555, 564 (Colo. 2002) (requiring "meeting of the minds through objective manifestation of mutual assent").

guage is clear. Thus, notwithstanding the enormous attention it has received, the “objective theory of contracts” appears to be a simple—and sensible enough—rule of evidence which, like the parol evidence rule and the statute of frauds, is designed to prevent litigating parties from relying upon testimony of an earlier state of mind without corroborating evidence.

Moreover, ordinary meaning is at its core nothing more than a statement about the likely intent of the speaker. We take language to be “plain” just when anyone using that language can mean but one thing by it. We take one sense of language to be the “ordinary” sense, just when anyone using that language is likely to have intended that sense in those circumstances.<sup>122</sup> Courts frequently recognize this fact with statements like: “The intent of the parties is best determined by the plain language of the contract.”<sup>123</sup> These courts are correct in recognizing that plain or ordinary language is nothing more than evidence of a drafter’s intent. That is the only sense in which meaning *can* be plain or ordinary.<sup>124</sup>

Scholars have taken note of these evidentiary arguments. Professor Rakoff explains:

The use of an objective, rather than subjective, approach for contract interpretation can be understood partly in evidentiary terms. Parties often intend the very meaning that would be attributed to their words or acts by an outside observer. It could be argued that the number of cases in which parties do not mean what they seem to mean, is smaller than the number of cases in which the trier of fact will be misled by well rehearsed claims of a spurious subjective intent. Or it could be argued that when the issue is stated in subjective terms, the legal system will focus too much on finding direct evidence—the “smoking gun”—and fail to pay enough attention to the better evidence provided by the terms of the agreement itself. Either of these arguments would tend to the conclusion, that even if the ground of obligation were subjective agreement, the purpose of the law would be better served if stated in objective terms.<sup>125</sup>

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122 See Solan, *supra* note 118, at 456–57.

123 United States v. Donovan, 348 F.3d 509, 512 (6th Cir. 2003); see also Pension Trust Fund for Operating Eng’rs v. Fed. Ins. Co., 307 F.3d 944, 950 (9th Cir. 2002) (“[T]he best evidence of the parties’ intent is the plain language of the policy . . . .”); *In re Osborne*, 763 N.E.2d 855, 857 (Ill. App. Ct. 2002) (“The language of the marital agreement is the best indication of the parties’ intent.”).

124 See NOAM CHOMSKY, *NEW HORIZONS IN THE STUDY OF LANGUAGE AND MIND* 30 (2000). For discussion of this issue in some detail, see Solan, *supra* note 116, at 869–71.

125 Rakoff, *supra* note 13, at 78.

While Rakoff observes that some doctrines, such as reliance on trade usage in the Uniform Commercial Code seem to trump actual intent, such rules may also be seen as default rules that act as proxies for intent when no better evidence exists.

Judge Posner makes this point:

There is a happy medium, and that is to allow extrinsic ambiguity to be shown only by *objective* evidence. By “objective,” I mean to exclude a party’s self-serving testimony that cannot be verified because it concerns his state of mind or a conversation to which the only witness was the other party to the contract, and that party either denies that the conversation took place or disagrees about what was said. That there were two ships Peerless which could have transported the cotton that was the subject of the contract was a readily verifiable fact, in contrast to the unverifiable assertion of an interested party. Similarly, dictionaries, articles, treatises, and evidence of custom or trade usage that gives [sic] special meaning to words that a reader of the contract, ignorant of the trade, might suppose were being used in their everyday sense are objective sources of facts because they are not within the parties’ control. Such evidence is harder to fake than parties’ testimony concerning their intentions and understandings and unrecorded, unwitnessed conversations. The parties’ behavior, as distinct from their assertions, at least when it predates the beginning of the controversy and so is not plausibly regarded as strategic, is also objective in my sense of the term.<sup>126</sup>

The concern of these scholars is the same as that of Judge Hand in *Hotchkiss*: the unreliability of testimony reporting a party’s unexpressed intent. By requiring evidence beyond contested, post hoc descriptions of the parties’ earlier states of mind, the system is able to increase the reliability of its decisionmaking process.

### B. *Objectivity as Formation Estoppel*

Let us return to *Embry*, one of the classic illustrations of the objective approach. A closer look demonstrates that the court concerned itself with more than the ordinary meaning of McKittrick’s words. Below is the actual holding:

[W]e hold that, though McKittrick may not have intended to employ Embry by what transpired between them according to the latter’s testimony, yet if what McKittrick said would have been taken by a reasonable man to be an employment, *and Embry so understood*

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126 Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1598–99 (2005).

*it*, it constituted a valid contract of employment for the ensuing year.<sup>127</sup>

The court specifically relied upon the fact that Embry actually understood McKittrick's words as a commitment in holding that a contract had been formed. That is, the objective meaning trumps the speaker's intent when the hearer actually understood it as an ordinary person would.<sup>128</sup> Were the recipient's understanding not taken into account, courts would be holding people responsible for commitments that they did not intend to make and that the recipient did not regard as a commitment either. Thus the doctrine that a person is bound to a statement reasonably understood to be a commitment also has a subjective element: the actual understanding of the hearer.

Other classic cases often used to illustrate the objective theory of contracts similarly involve actual reliance. Consider *Lucy v. Zehmer*.<sup>129</sup> In that case, W. O. Lucy visited the Zehmers at their restaurant and offered to buy their farm for \$50,000.<sup>130</sup> Having had several drinks and thinking that Lucy was joking (at least so he claimed in litigation), Zehmer wrote up a contract.<sup>131</sup> Lucy then insisted that Mrs. Zehmer, a co-owner of the farm, sign the agreement as well; Zehmer redrafted it, changing references from the singular to the plural.<sup>132</sup> Mr. Zehmer and his wife then both signed the contract of sale.<sup>133</sup> Lucy later claimed that to him it was no joke.<sup>134</sup> He had wanted to buy this farm for a number of years, had made a generous offer, and had actually gone to the restaurant for the purpose of attempting to effect the transaction.<sup>135</sup> The court held that Zehmer was bound, since a reasonable person examining the written document would not conclude that it was a joke.<sup>136</sup> But that is not the only reason the court gave:

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127 *Embry v. Hargadine, McKittrick Dry Goods Co.*, 105 S.W. 777, 779 (Mo. Ct. App. 1907) (emphasis added).

128 Professor Eisenberg notes this aspect of the holding in *Embry*: "The appeals court made clear, however, that the reasonable meaning of McKittrick's expression was determinative only if Embry's subjective understanding coincided with that meaning." Eisenberg, *supra* note 50, at 1125.

129 84 S.E.2d 516 (Va. 1954).

130 *Id.* at 518.

131 *Id.* at 517-518.

132 *Id.* at 518.

133 *Id.* at 519.

134 *Id.* at 518.

135 *Id.*

136 *Id.* at 521 ("In the field of contracts, as generally elsewhere, 'We must look to the outward expression of a person as manifesting his intention rather than to his secret and unexpressed intention.'" (quoting *First Nat'l Exch. Bank v. Roanoke Oil Co.*, 192 S.E. 764, 770 (Va. 1937))).

If it be assumed, contrary to what we think the evidence shows, that Zehmer was jesting about selling his farm to Lucy and that the transaction was intended by him to be a joke, nevertheless the evidence shows that Lucy did not so understand it but considered it to be a serious business transaction and the contract to be binding on the Zehmers as well as on himself. The very next day he arranged with his brother to put up half the money and take a half interest in the land. The day after that he employed an attorney to examine the title. The next night, Tuesday, he was back at Zehmer's place and there Zehmer told him for the first time, Lucy said, that he wasn't going to sell and he told Zehmer, "You know you sold that place fair and square." After receiving the report from his attorney that the title was good he wrote to Zehmer that he was ready to close the deal.<sup>137</sup>

That is, it mattered to the court that Lucy took the offer seriously, and actually acted upon it. Had Lucy, too, considered the matter a joke, it would have made no difference if a reasonable person hearing the story might have taken the contract seriously.

This is not to say that the facts fully support the outcome. For example, the opinion notes that Lucy tried unsuccessfully to give Zehmer five dollars "to bind the bargain."<sup>138</sup> If Lucy really thought Zehmer was serious, he might not have felt the need to do so. And, of course, Lucy may have actually intended the entire episode as a joke, never guessing that a reasonable person would conclude otherwise. Whether it reached the best result, the facts that the court considered relevant are clear enough.

Judges continue to take note of the promisee's state of mind. For example, in *Cobaugh v. Klick-Lewis, Inc.*,<sup>139</sup> a car dealer had posted on a golf course signage promising a new car to a golfer who hit a hole-in-one on the ninth hole during a tournament.<sup>140</sup> The dealer forgot to remove the sign, and when the plaintiff aced the hole the next day, the dealer refused to deliver.<sup>141</sup> The court held that the offer was still valid, employing the classic objective approach.<sup>142</sup> But it also noted that "[t]here is no basis for believing that Cobaugh was aware that the Chevrolet automobile had been intended as a prize only for an earlier tournament."<sup>143</sup> Presumably, had there been a basis for believing that

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137 *Id.*

138 *Id.* at 518. My thanks to Ian Ayres for bringing this fact to my attention.

139 561 A.2d 1248 (Pa. Super. Ct. 1989). I learned of this case from an internet posting by Professor John Gedid.

140 *Id.* at 1249.

141 *Id.*

142 *Id.* at 1251.

143 *Id.* at 1250.

Cobaugh was aware of the dealer's intent to the contrary, the result would have been different.

The Restatement incorporates the understanding of the promisee into its definition of *promise*. Section 2 of the Restatement defines *promise*: "A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."<sup>144</sup> The definition elegantly captures both cases in which the promisor intends to be bound, and those in which he does not intend to be bound. In addition, it at least appears to include only those cases in which the promisee actually and justifiably understands that a commitment has been made.<sup>145</sup> If the promisee does not reasonably understand that a commitment has been made, then there is no promise, no matter what the promisor intended.

Scholars have observed the relationship between reliance interests of promisees and rules requiring objective analysis, sometimes recognizing that the actual state of mind of the promisee cannot be ignored. Professor Barnett extends his analysis to include the requirement that the promisee actually understood the statement as a commitment.<sup>146</sup> As he explains, a core goal of the "objective theory" of contract law is the prevention of fraud.<sup>147</sup> This function is well-served by applying the presumption that the ordinary meaning of a contract's terms was the meaning intended by the parties. However, this presumption is rebuttable: when the promisor can demonstrate that the other party did not understand the alleged promise as an instance of ordinary speech, the likelihood of fraud is reduced, along with the risk that the integrity of the transaction will be compromised.<sup>148</sup> Professor Eisenberg makes a similar point, noting that "the more reasonable meaning will prevail only if it is the meaning that one party has actually attached to the expression."<sup>149</sup> I agree with the conclusions these scholars reach, but not because these scenarios present exceptions to the objective theory of contracts. On the contrary, there is no contract because the parties have not reached an agreement and the

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144 RESTATEMENT (SECOND) OF CONTRACTS § 2(1) (1981).

145 It is possible to read this provision as requiring only that the manifestation be clear enough to allow an inference that a commitment has been made, even if the promisee does not do so, but courts do not appear to adopt this meaning.

146 Barnett, *supra* note 41, at 305.

147 *Id.* at 302.

148 Barnett, *supra* note 50, at 307–308, 321.

149 Melvin Aron Eisenberg, *Expression Rules in Contract Law and Problems of Offer and Acceptance*, 82 CAL. L. REV. 1127, 1132 (1994).



hearer's understanding of the situation is not sufficient to trigger formation estoppel.

Other scholars also note the relationship between the objective approach to contract formation and the significance of reliance interests, although they do not always discuss the significance of the subjective understanding of the hearer.<sup>150</sup> Often, they write about the benefits of the objective theory in protecting the security of transactions.<sup>151</sup> But the only reason for protecting the security of a transaction in this context is to protect the reliance interests of the promisee, and the promisee has no reliance interest if she did not believe that she had received a promise. Implicitly, then, the actual understanding of the promisee plays a role in these analyses as well. Furthermore, by taking the actual goals of both parties seriously, the law recognizes the autonomy of both parties to a transaction.

To summarize, the standard objective approach to contract formation is off-base. The very same facts concerning what does and does not count as a contract can be better handled by a theory based on the parties' actual agreement, with a special rule carved out to bind those who give the impression that they have made a promise, if the hearer actually takes it as such. This misconceptualization of contract law has lasted as long as it has in large part because the crucial cases that display its weaknesses do not occur very often, certainly not as often as those cases that appear to justify the objective approach. In the next Part, I will suggest some changes in the way we conceptualize the law of contracts that may follow from these observations.

### III. SOME CONSEQUENCES OF CONCEPTUALIZING CONTRACT FORMATION AS SUBJECTIVE

Let us now explore what might change once we regard contract formation as a matter of actual agreement rather than as a matter of manifestations of agreement. First, it now becomes possible to look at contractual remedies more flexibly. Courts need not award full expectation damages in cases in which there has been neither mutual assent nor substantial reliance.

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150 See, e.g., FARNSWORTH, *supra* note 7, § 3.6, at 114–17; Russ VerSteeg, *Intent, Originality, Creativity and Joint Ownership*, 68 BROOK. L. REV. 123, 148–49 (2002).

151 See, e.g., Jane B. Baron, *Gifts, Bargains, and Form*, 64 IND. L.J. 155, 156 (1989); James Boyle, *Legal Realism and the Social Contract: Fuller's Public Jurisprudence of Form, Private Jurisprudence of Substance*, 78 CORNELL L. REV. 371, 386 n.67 (1993); Richard A. Epstein, *Reflections on the Historical Origins and Economic Structure of the Law Merchant*, 5 CHI. J. INT'L L. 1, 11 (2004).

Second, legal doctrines governing contract formation and contract interpretation are strangely out of tune with each other. While contract formation is said to be an objective matter, contract interpretation overtly focuses on the intent of the parties, tempered by evidentiary considerations, such as the parol evidence rule. It makes little sense to maintain this duality since the very promises that are construed subjectively, when interpretation is at issue, began as the offer that is supposedly interpreted objectively with respect to the formation process.

Third, there is an embarrassing inconsistency between the objective approach to contract formation and the doctrine of consideration. The courts and the Restatement both regard contracts as bargained-for exchanges.<sup>152</sup> But whether a promise is given in exchange for some benefit has a strong intentional element. The theory espoused here does not eliminate this inconsistency entirely, but relegates it to situations in which evidentiary concerns trump the basic rule of mutual assent.

Fourth, a number of doctrines relate to the problem of incomplete contracts. The doctrine of substantial performance, terms implied by law, default rules, and rules for filling gaps in contracts all concern themselves with situations that arise after the contract has been formed, but which do not seem to be adequately covered by the contract's express terms. Here again, courts frequently (but not always) resort to the intention of the parties. In deciding how to fill gaps, they take into account what parties ordinarily intend as a surrogate for what the parties in the dispute actually intended.

#### A. *Providing Flexibility in Contract Remedies*

I have argued that what is called the objective theory of contracts is better understood as an exception to a system based upon mutual assent. If this is correct, then it does not follow that the full contract remedy of expectation damages should always be awarded when the exception applies. Because the objective theory has become so deeply entrenched, there has been no space in the doctrinal discourse to ask whether such damages are justified in every case. The problem was observed as early as 1929 in Professor Whittier's criticism of the first Restatement.<sup>153</sup> Whittier argued that the ordinary expectation damages that accompany breach of contract were too generous in cases

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152 RESTATEMENT (SECOND) OF CONTRACTS §§ 17, 71 (1981).

153 See Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form,"* 100 COLUM. L. REV. 94, 145 (2000); Whittier, *supra* note 20, at 441-49.

where the promisor did not intend to bind himself and the promisee had not yet acted to his detriment.<sup>154</sup> He would have distinguished cases of innocent mistake from those in which the promisor intended to mislead, and then disingenuously walked away from his commitment by posing a “just kidding” defense.<sup>155</sup> Plaintiffs in the first group would be limited to reliance damages, if any. Those in the second may be eligible to receive the benefit of the bargain that they believed had been made.<sup>156</sup>

This perspective is consistent with Professor Daniel Markovits’ important theory of contract as a collaborative enterprise.<sup>157</sup> Expectation damages, Markovits argues, are justified because, unlike reliance damages, they “underwrite the central moral innovation that contract represents—the collaborative relation of mutual respect that contract involves.”<sup>158</sup> As such, expectation damages “reflect the parties’ . . . forward-looking commitment affirmatively to treat each other as ends in themselves, which lies at the core of the collaborative relation established through the contract.”<sup>159</sup> If the collaborative ideal justifies expectation damages, cases in which there was no collaboration because one party simply misspoke cannot justify the remedy, especially when there has been no reliance. In a similar vein, Professor Wonnell argues that reliance damages are most appropriate when the promisor’s wrong occurs during the formation process, and that expectation damages make more sense when, after agreement has been reached, the promisor thwarts the collaboration by breaching.<sup>160</sup>

An interesting analogy can be made with the history of the remedies called for by the two Restatements in promissory estoppel cases.

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154 Whittier, *supra* note 20, at 442.

155 *Id.* at 445.

156 Put in other terms, Whittier would allow greater damages when the parties did not have common knowledge of second- and third-order information. *See id.* at 444. If one party did not agree to enter into a contract, and knows that the other party thinks that an agreement has been reached, the law treats the situation as though this disparity in knowledge were not the case, and does so to the disadvantage of the party who attempted to take advantage of the situation. *See generally* Ian Ayres and Barry J. Nalebuff, *Common Knowledge as a Barrier to Negotiation*, 44 UCLA L. REV. 1631 (1997) (arguing that in some situations ignorance of higher-order information can preclude strategic bargaining and make negotiations more efficient).

157 Markovits, *supra* note 19, at 1497–514.

158 *Id.* at 1504.

159 *Id.*

160 Christopher T. Wonnell, *Expectation, Reliance, and the Two Contractual Wrongs*, 38 SAN DIEGO L. REV. 53, 68–69 (2001). For an alternative view, which distinguishes between opportunistic and nonopportunistic breaches, see generally George M. Cohen, *Finding Fault with Wonnell’s “Two Contractual Wrongs,”* 38 SAN DIEGO L. REV. 137 (2001).

The first Restatement, which introduced the concept, did not provide for limiting damages in these cases.<sup>161</sup> It is the second Restatement, drafted in 1965, that suggests limiting damages “as justice requires” in promissory estoppel claims.<sup>162</sup> Typically, this limitation is understood to permit courts to award reliance damages in lieu of expectation damages.<sup>163</sup> As Professor Seavey had explained in a 1951 article,

The wrong is not primarily in depriving the plaintiff of the promised reward but in causing the plaintiff to change position to his detriment. It would follow that the damages should not exceed the loss caused by the change of position, which would never be more in amount, but might be less, than the promised reward.<sup>164</sup>

Professor Seavey’s approach later became the basis for the decision of the Supreme Court of Wisconsin in *Hoffman v. Red Owl Stores*,<sup>165</sup> a case still read today to illustrate the proposition that damages for promissory estoppel are generally limited in this way.<sup>166</sup>

How often the courts actually take advantage of this flexibility remains a matter of some debate.<sup>167</sup> Moreover, others have questioned the wisdom of the limitation, arguing that promissory estoppel cases are not a matter of negligent misrepresentation, which might justify reliance damages, but rather intentional statements that should be given the full effect of a binding commitment, including expectation damages.<sup>168</sup>

Notwithstanding these concerns about the limitation of remedies in promissory estoppel cases, there is even more reason to give courts flexibility when the promisor has become bound inadvertently. For one thing, as Gregory Klass has pointed out to me,<sup>169</sup> cases like *Lucy v. Zehmer*, unlike the classic promissory estoppel cases, really are a matter of negligent misrepresentation. The problem in that case is not that the words of the drunken promisor might come back to haunt him, but that he lost his property as a result. Were the system flexible

161 RESTATEMENT OF CONTRACTS § 329 (1932).

162 RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981).

163 See Fuller & Perdue, *supra* note 4, at 52.

164 Warren A. Seavey, *Reliance Upon Gratuitous Promises or Other Conduct*, 64 HARV. L. REV. 913, 926 (1951).

165 133 N.W.2d 267, 277 (Wis. 1965).

166 See, e.g., FARNSWORTH, *supra* note 7, § 3.26, at 196–97.

167 James Gordley, *Enforcing Promises*, 83 CAL. L. REV. 547, 568–70 (1995).

168 Compare W. David Slawson, *The Role of Reliance in Contract Damages*, 76 CORNELL L. REV. 197, 199 (1990) (arguing that “estoppel damages should be limited by the reliance measure”), with Robert A. Hillman, *Questioning the “New Consensus” on Promissory Estoppel: An Empirical and Theoretical Study*, 98 COLUM. L. REV. 580, 604–06 (1998) (demonstrating the crucial importance of reliance in promissory estoppel cases).

169 Gregory Klass brought this point up in a personal communication with me.

enough to limit the award to reliance damages in such situations, the case would be far less memorable.

In addition, cases governing promissory estoppel require that the promisee engage in some significant action or refrain from doing so for the reliance requirement to be met. In contrast, the doctrine of formation estoppel illustrated by *Embry*, *Hotchkiss*, and the like, requires only that the promisor reasonably manifest his intent and that the promisee understand the manifestation in that sense whether or not the promisee has acted or refrained from acting in reliance on this understanding. This means that the recipient of such a statement can take it to the bank even if he has done nothing by the time the misunderstanding is discovered, and whether or not the statement was an inadvertent slip or an effort to mislead.<sup>170</sup>

Expectation damages in these circumstances are hard to justify; yet it is even more difficult to construct a doctrinal justification under the standard objective theory for *not* awarding such damages. Once we recognize, in contrast, that such cases are exceptions to a system of obligation based upon mutual assent, it becomes possible to decide anew what consequences should follow, as suggested some eighty years ago by Professor Whittier.<sup>171</sup>

### B. *Harmonizing Formation and Interpretation*

At the same time as courts profess to commit themselves to an objective approach in their analysis of contract formation, they repeat as a constant refrain in cases involving the interpretation of contracts that their one concern is to discover the intent of the parties, and reach a decision that will vindicate that intent. They say it so often that it cannot be explained by an occasional reversion to a nineteenth century-like slip of the tongue.

In fact, Learned Hand himself routinely invoked the intent of contracting parties. Consider these examples:

It may be well in conclusion to say a word about the finality of the finding which we are reversing. It is true that the contract was not in writing—though a written contract was part of it—and, had the case been tried to a jury, it is they who would have had to find the “intention of the parties,” had the evidence left it in doubt.

That “intent” is indeed a question of fact, though it is a hypothetical question, for its answer demands that the tribunal, judge or jury, declare what the parties would have agreed to, had the occasion for

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170 Professor Rakoff makes note of this difference. See Rakoff, *supra* note 13, at 81.

171 See Whittier, *supra* note 20, at 444–45.

which they had not specifically provided, been presented to them.<sup>172</sup>

The question is how we shall interpret the intent of the parties from these facts . . . .<sup>173</sup>

There are many more.<sup>174</sup>

Nor is the phenomenon of speaking in objective terms about the formation of contracts and subjective terms about their interpretation limited to Judge Hand, or the federal courts in general. In one jurisdiction after another, courts say both that they subscribe to an objective theory, and that their function in resolving disputes is to discern the parties' intent. For example, compare these two judicial statements from Oregon:

Oregon uses an objective theory of contract interpretation. The rule is that "whether the parties entered into an agreement . . . depends on whether the parties agreed to the same, express terms of the agreement."<sup>175</sup>

Oregon subscribes to the objective theory of contracts.<sup>176</sup>

with these:

The court must interpret the wording of a contract to effectuate the intentions of the parties, as those intentions can be determined from that wording and other relevant circumstances.<sup>177</sup>

"If a contract is ambiguous, the trier of fact will ascertain the intent of the parties and construe the contract consistent with" that intent. Specifically, if a term of the contract is ambiguous, the court will "examine extrinsic evidence of the contracting parties' intent," if such evidence is available.<sup>178</sup>

172 *E.F. Drew & Co. v. Reinhard*, 170 F.2d 679, 683–84 (2d Cir. 1948).

173 *In re Walker*, 93 F.2d 281, 283 (2nd Cir. 1937).

174 *See, e.g.*, *Vines v. Gen. Outdoor Adver. Co.*, 171 F.2d 487, 492 (2d Cir. 1948); *Dwyer v. Crosby Co.*, 167 F.2d 567, 569 (2d Cir. 1948); *First Nat'l Bank of Chi. v. Irving Trust Co.*, 74 F.2d 263, 264 (2d Cir. 1934).

175 *Arboireau v. Adidas-Salomon AG*, 347 F.3d 1158, 1162–63 (9th Cir. 2003) (quoting *City of Canby v. Rinkes*, 902 P.2d 605, 610 (Or. Ct. App. 1995)).

176 *Newton v. Newton*, 86 P.3d 49, 52 (Or. Ct. App. 2004).

177 *Care Med. Equip., Inc. v. Baldwin*, 15 P.3d 561, 563 (Or. 2000) (en banc) (citing *Pettigrove v. Corvallis Lumber Mfg. Co.*, 21 P.2d 198, 199–200 (Or. 1933)).

178 *Arlington Educ. Ass'n v. Arlington Sch. Dist. No. 3*, 103 P.3d 1138, 1143 (Or. Ct. App. 2004) (quoting *Or. Sch. Employee Ass'n v. Rainier Sch. Dist. No. 13*, 808 P.2d 83, 87 (Or. 1991); *Yogman v. Parrott*, 937 P.2d 1019, 1022 (Or. 1997)).

I picked Oregon out of a hat. It is easy to find just this array of decisions in states around the country, from Minnesota<sup>179</sup> to Alabama,<sup>180</sup> Alaska,<sup>181</sup> and Wyoming.<sup>182</sup>

In principle, there is no reason why the law governing contracts must use the same theoretical orientation for both formation and interpretation questions, if the realities of commercial life suggest that they be treated differently. Yet in practice, such a dual system would be almost impossible to implement because the subjective aspect of the interpretive process concerns itself with the parties' states of mind during the formation process, which is exactly what has been declared irrelevant by the objective theory of contract formation. There is no two-step process in which a court first ignores the parties' intent to determine if a contract was formed, and immediately thereafter relies on the parties' intent with respect to the same events to determine what the contract means. Such a regime would force courts to say that they should care about intent and should not care about intent in

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179 *Compare* *Asia Pac. Indus. Corp. v. Rainforest Café, Inc.*, 380 F.3d 383, 385 (8th Cir. 2004) (“Minnesota follows the objective theory of contract formation, under which an outward manifestation of assent is determinative, rather than a party’s subjective intent.” (quoting *TNT Props., Ltd. v. Tri-Star Developers, LLC*, 677 N.W.2d 94, 102 (Minn. Ct. App. 2004))), *with* *Webb Bus. Promotions, Inc. v. Am. Elecs. & Entm’t Corp.*, 617 N.W.2d 67, 75 (Minn. 2000) (“The agreement necessary to form a contract need not be express, but may be implied from circumstances that clearly and unequivocally indicate the intention of the parties to enter into a contract.”).

180 *Compare* *Quality Truck & Auto Sales, Inc. v. Yassine*, 730 So. 2d 1164, 1168 (Ala. 1999) (“Courts generally accept the ‘objective theory’ of contracts, which determines the existence of a contract based on ‘the external or objective appearance of the parties’ intentions as manifested by their actions.’” (quoting FARNSWORTH, *supra* note 7, § 3.6, at 114)), *with* *FabArc Steel Supply, Inc. v. Composite Constr. Sys.*, 914 So. 2d 344, 358 (Ala. 2005) (“[T]he intention of the party to a contract controls its interpretation and . . . to ascertain such intention, regard must be had to the subject matter, the relationship of the parties at the time of the contract, and the law which it is justly inferable they had in view while contracting.” (quoting *G.F.A. Peanut Ass’n v. W.F. Covington Planter Co.*, 192 So. 502, 506 (Ala. 1939))).

181 *Compare* *Hendricks v. Knik Supply, Inc.*, 522 P.2d 543, 548 (Alaska 1974) (Erwin, J., dissenting) (“We purport to follow the objective theory of contract interpretation . . .”), *with* *Betz v. Chena Hot Springs Group*, 657 P.2d 831, 835 (Alaska 1982) (“Given such an ambiguity in the agreement, the primary function of judicial interpretation should be to ascertain and give effect to the intent of the parties.”).

182 *Compare* *Bouwens v. Centrilift*, 974 P.2d 941, 947 (Wyo. 1999) (“Under the objective theory of assent, which courts, including this one, generally accept today, one looks ‘to the external objective appearance of the parties’ intentions as manifested by their actions.’” (quoting FARNSWORTH, *supra* note 7, §3.6 at 114)), *with* *Hutchison v. Hill*, 3 P.3d 242, 245 (Wyo. 2000) (“Most importantly, ‘[w]e seek to determine and effectuate the intention of the parties . . .’” (quoting *Anderson v. Bommer*, 926 P.2d 959, 961 (Wyo. 1996))).

connection with the same event. When the actual intent is *not* to incur some obligation, then a court might be forced first to hold that a contract has been formed, and then to interpret that contract as not containing the very obligation that comprised the contract. Again, courts do not engage in such self-contradictory analysis.

Part of the problem is explained by observations made by Professor Eisenberg: offers are nothing more than conditional promises, which mature into unconditional promises upon acceptance.<sup>183</sup> As he points out, “[W]hen an offer is understood as a promise there is no need to explain why the offeror cannot walk away if his offer is accepted. He cannot walk away because by making his offer he promised to perform on stated terms if his offer was properly accepted.”<sup>184</sup>

Thus, when I offer to sell you my car for \$5000, I am saying that I promise to sell you my car for \$5000 if you accept my offer within the period that the offer stays alive. Once you accept it, the offer matures into an unconditional promise, and you can count on having your expectations met, whether I perform or not. Crucially, what we call the offer during the formation process and the promise once a contract has been formed is a single act of speech. There *is* no promise apart from my offer that you accepted. We did not say later: “Now that you’ve made an offer and I’ve accepted it, let’s promise each other to perform.” Why should we? We had already made those promises once my offer became unconditional.<sup>185</sup>

This contradiction between formation and interpretation evaporates, however, if we look at the formation rules as concerning themselves with intent as much as the interpretation rules do. Contracts are formed when the parties reach an agreement. Contracts are construed by discovering and enforcing the agreement that the parties reached. In determining whether an agreement was reached and, if so, what that agreement was, courts typically prefer objective evidence over unexpressed intentions, unless the parties are in accord as to what their unexpressed intent was.<sup>186</sup> At various points in the inquiry,

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183 Melvin A. Eisenberg, *The Revocation of Offers*, 2004 Wis. L. Rev. 271, 275.

184 *Id.* at 276.

185 I put aside here issues such as letters of intent and agreements to agree, where it is not clear whether the original discussions actually constituted an enforceable promise.

186 See, e.g., *Lucy v. Zehmer*, 84 S.E.2d 516, 522 (1954) (“If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial . . . . ‘The law, therefore, judges of an agreement between two persons exclusively from those expressions of their intentions which are communicated between them.’” (quoting WILLIAM LAWRENCE CLARK ET AL., *HANDBOOK OF THE LAW OF CONTRACTS* § 3, at 4 (4th ed. 1931))).



these evidentiary concerns are expressed alternatively in terms of the objective theory of contracts, the four corners rule,<sup>187</sup> and the parol evidence rule. But the goal is to determine actual intent to the extent feasible.

This concern is ubiquitous and is expressed frequently and unselfconsciously. Take the expression, “meeting of the minds,” which scholars and treatises have declared legally defunct.<sup>188</sup> No one, however, has told the judges, lawyers, and parties to contract disputes, who use the expression constantly.<sup>189</sup> Both federal and state courts use the expression hundreds of times each year, sometimes as part of their own analysis, at other times, making reference to the arguments used by lawyers.<sup>190</sup>

Or consider basic legal doctrine concerning the interpretation of contracts. For the most part, it is subjective. Courts over and over again claim that their principal goal in interpreting contractual language is to enforce the will of the parties.<sup>191</sup> Even the parol evidence

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187 For a recent illustration of that rule, see *Davis v. G.N. Mortgage Corp.*, 396 F.3d 869, 878 (7th Cir. 2005) (“Illinois adheres to a ‘four corners rule’ of contract interpretation, which provides that ‘an agreement, when reduced to writing, must be presumed to speak the intention of the parties who signed it. It speaks for itself, and the intention with which it was executed must be determined from the language used.’” (quoting *Air Safety, Inc. v. Teachers Realty Corp.*, 706 N.E.2d 882, 884 (Ill. 1999))).

188 See, e.g., LAWRENCE M. FRIEDMAN, *CONTRACT LAW IN AMERICA* 87 (1965) (noting that the objective theory “insisted that the law enforce only the objective manifestations of agreement and rejected the notion that the essence of an enforceable contract was a subjective ‘meeting of the minds’ of the parties”); Russ VerSteeg, *Rethinking Originality*, 34 WM. & MARY L. REV. 801, 841 (1993) (“[T]he so-called ‘objective theory of contract’ has almost universally replaced the ‘meeting of the minds’ standard.”).

189 For some recent examples, see *Newsome v. Protective Industrial Insurance Co.*, 890 So. 2d 81, 87 (Ala. 2003) (“Like any other contract, a valid accord and satisfaction requires consideration and a meeting of the minds regarding the subject matter.”); *Janusauskas v. Fichman*, 793 A.2d 1109, 1114 (Conn. App. Ct. 2002) (“[T]here must be a meeting of the minds between the parties . . . .” (quoting *Burnham v. Karl & Gelb, P.C.*, 717 A.2d 811, 813 (Conn. App. Ct. 1998))); and *Potts Construction Co. v. North Kootenai Water District*, 116 P.3d 8, 11 (Idaho 2005) (“The minds of the parties must meet as to all the terms before a contract is formed.” (citation omitted)).

190 For example, a Lexis search (“meeting w/3 mind”) yielded 948 hits for the year 2006 over state and federal court decisions, and exceeded the maximum of 3,000 hits for the first seven years of the decade.

191 See, e.g., *Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co.*, 375 F.3d 168, 177 (2d Cir. 2004) (“Under New York law, ‘[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties’ intent.” (quoting *Greenfield v. Phillis Records, Inc.*, 780 N.E.2d 166, 170 (2002) (footnote omitted))); *MPACT Constr. Group, LLC v. Superior Concrete Constructors, Inc.*, 802 N.E.2d 901, 906 (Ind. 2004) (“Whether the parties agreed to arbitrate

rule, in both its strict traditional form and its more liberal modern form, has as its goal the prevention of post hoc fabrication of negotiating history in the interest of increasing the likelihood that parties' intent will be vindicated more often than not.<sup>192</sup> This statement from the United States Court of Appeals for the Third Circuit articulates Pennsylvania's liberal version of the rule:

Pennsylvania contract law begins with the "firmly settled" point that the intent of the parties to a written contract is contained in the writing itself. Where the intention of the parties is clear, there is no need to resort to extrinsic aids or evidence . . . . [W]here the contract terms are ambiguous and susceptible of more than one reasonable interpretation . . . the court is free to receive extrinsic evidence, i.e., parol evidence, to resolve the ambiguity. . . . To determine whether ambiguity exists in a contract, the court may consider "the words of the contract, the alternative meaning suggested by counsel, and the nature of the objective evidence to be offered in support of that meaning."<sup>193</sup>

The stronger, traditional version is similarly justified by a quest for intent.<sup>194</sup> As a federal court recently explained:

Under Kansas law, the construction of a written contract is a matter of law for the court. "The cardinal rule of contract interpretation is that the court must ascertain the parties' intention and give effect to that intention when legal principles so allow." Where a contract is complete and unambiguous on its face, the court must

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any disputes is a matter of contract interpretation, and most importantly, a matter of the parties' intent."); *Hartig Drug Co. v. Hartig*, 602 N.W.2d 794, 797 (Iowa 1999) ("A cardinal rule of contract construction or interpretation is the intent of the parties must control."); *ARY Jewelers, L.L.C. v. Krigel*, 82 P.3d 460, 466 (Kan. 2003) ("The cardinal rule in contract interpretation is to ascertain the intention of the parties and to give effect to that intention." (quoting *Armstrong Bus. Servs. V. H & R Block*, 96 S.W.3d 867, 874 (Mo. Ct. App. 2002))), *rev'd on other grounds*, 85 P.3d 1151 (Kan. 2004).

192 See *Golden Pac. Bancorp v. FDIC*, 273 F.3d 509, 517 (2d Cir. 2001); *Bohler-Uddeholm Am., Inc. v. Ellwood Group, Inc.*, 247 F.3d 79, 93 (3d Cir. 2001); *Bass v. Parsons (In re Parsons)*, 272 B.R. 735, 753 (D. Colo. 2001); see also *Poole v. City of Waterbury*, 831 A.2d 211, 224 (Conn. 2003) ("[A] contract must be constructed to effectuate the intent of the parties, which is determined . . . in the light of the situation . . . and the circumstances connected with the transaction.").

193 *Bohler-Uddeholm*, 247 F.3d at 92-93 (quoting *Krizovensky v. Krizovensky*, 624 A.2d 638, 642 (Pa. Super. Ct. 1993)); see *Mellon Bank, N.A. v. Aetna Bus. Credit, Inc.*, 619 F.2d 1001, 1011 (3d Cir. 1980).

194 See *Thatcher v. Kohl's Dep't Stores, Inc.*, 397 F.3d 1370, 1374 (Fed. Cir. 2005); *Webb v. Nat'l Union Fire Ins. Co.*, 207 F.3d 579, 582 (9th Cir. 2000); *LDCircuit, LLC v. Sprint Commc'ns Co.*, 364 F. Supp. 2d 1246, 1255-56 (D. Kan. 2005); *Beattie v. State ex rel. Grand River Dam Auth.*, 41 P.3d 377, 382 (Okla. 2002).

determine the parties' intent from the four corners of the document, without regard to extrinsic or parol evidence.<sup>195</sup>

At least as far as contract interpretation is concerned, the goal of the analysis is the determination of subjective intent, with jurisdictions differing as to how much to require objective evidence of the parties' earlier intentions. By looking at contract formation similarly, subject to evidentiary rules to deter fraud, the law of contracts gains coherence as a whole.

### C. *Objectivity and Definitions in the Law of Contracts*

Much of the law governing the interpretation of contracts defers to ordinary business practice. Karl Llewellyn's role in focusing the Uniform Commercial Code on course of dealing, trade usage, and the like has been a well-studied phenomenon.<sup>196</sup> At the same time, however, there are some striking disconnects between the commercial world, on the one hand, and the concepts of contract law on the other. In particular, definitions contained in the Restatement tend to be devoid of intent, focusing instead on "manifestations of intent," in order to keep them in line with the objective approach to contract law. These definitions are inconsistent with ordinary usage, placing them at odds with the law's goal of codifying everyday commercial experience. Chief among these conceptual difficulties is the requirement of a bargain. For the most part, enforceable contracts are exchange transactions. The Restatement puts it this way in section 17: "Except as stated in Subsection (2), the formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration."<sup>197</sup>

The exceptions in subsection (2) refer to doctrines that permit enforcement without consideration, including promises to meet prior legal duties, option contracts, and promissory estoppel. It is not my goal here to argue one way or the other about the viability of the exchange requirement as a motivating theory of contract law given these many exceptions.<sup>198</sup> At the very least, it is beyond controversy

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195 *LDCircuit*, 364 F. Supp. 2d at 1255–56 (quoting *Ryco Packaging Corp. v. Chappelle Int'l, Ltd.*, 926 P.2d 669, 674 (Kan. Ct. App. 1996)) (citations omitted).

196 See WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 302–40 (1973).

197 RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981).

198 This has been the subject of a great deal of scholarly literature over the decades. See, e.g., GILMORE, *supra* note 4, at 95–112; Peter A. Alces, *Contract Reconceived*, 96 NW. U. L. REV. 39 (2001); Barnett, *supra* note 50; Daniel A. Farber & John H. Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake,"* 52 U. CHI. L. REV. 903, 925–45 (1985); Lon L. Fuller, *Consideration and Form*, 41 COLUM.

that exchange transactions are one way to form a binding contract, and an important way at that. My focus here is on the inconsistency between an objective approach to contract formation on the one hand, and the consideration requirement on the other.

The bargain requirement of section 17 has two elements: manifestation of mutual assent and consideration. The mutual assent requirement can be expressed in objective terms, as it is in the sections defining *promise*<sup>199</sup> and *offer*,<sup>200</sup> discussed in the previous Part.<sup>201</sup> But the exchange requirement cannot be stated in terms that ignore the participants' actual states of mind. On the contrary, the consideration requirement is expressed and defined in section 71 using explicitly intentionalist language: It must be part of a bargain, which itself is "sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise."<sup>202</sup>

What is the state of mind of a person seeking to enter into a bargain? Seeking is an intentional act. It is at best a strained use of language to say, for example, *I unintentionally looked for a service contract for my new computer*. Looking for a service contract is something that I can only do on purpose. That is part of the meaning of "looking for" or "seeking." But if I cannot seek a bargain without doing so on purpose, then I cannot enter into an agreement for consideration without doing so on purpose either.

Courts routinely note that contracts are exchanges for consideration, and they do so in intentionalist terms. For example, the United States Court of Appeals for the Seventh Circuit notes:

Contract law rests on obligations imposed by bargain. The law of contracts is designed to effectuate exchanges and to protect the expectancy interests of parties to private bargained-for agreements. Contract law, therefore, seeks to hold commercial parties to their promises, ensuring that each party receives the benefit of their bargain.<sup>203</sup>

Thus, there appears to be some inconsistency between the bargain requirement, on the one hand, and the objective approach to contract formation on the other. The Restatement attempts to

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L. REV. 799, 815–19 (1941); Fuller & Perdue, *supra* note 4, at 46; Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form"*, 100 COLUM. L. REV. 94, 169–75 (2000); Roy Kreitner, *The Gift Beyond the Grave: Revisiting the Question of Consideration*, 101 COLUM. L. REV. 1876, 1950 (2001).

199 RESTATEMENT (SECOND) OF CONTRACTS § 2 (1981).

200 *Id.* § 24.

201 *See supra* Part II.B.

202 RESTATEMENT (SECOND) OF CONTRACTS § 71(2).

203 *Rich Prods. Corp. v. Kemutec Inc.*, 241 F.3d 915, 918 (7th Cir. 2001).

address this problem by expanding the objective nature of contract law to include not only the promise requirement, but also the exchange requirement: "§ 3. Agreement Defined; Bargain Defined: An agreement is a manifestation of mutual assent on the part of two or more persons. A bargain is an agreement to exchange promises or to exchange a promise for a performance or to exchange performances."<sup>204</sup> Since *bargain* is defined in terms of *agreement* and *agreement* is defined in terms of a *manifestation of mutual assent*, it is possible to understand a bargain as a *manifestation of mutual assent to exchange promises*, etc.

This approach, however, is problematic. For one thing, it is inconsistent with the subjective nature of bargaining as that term is defined in section 71. While bargains may typically leave evidence of an intent to enter into an exchange transaction, exchange transactions themselves are those in which the parties reached agreement after "seeking" to enter into an exchange, as the Restatement puts it, and *seeking* cannot be reduced to manifestations without regard to the parties' intentions.

The most obvious solution to this incoherence is to declare the bargain requirement to be objective, just as the promise requirement purports to be objective. Thus, courts might say that they are not concerned with whether the parties actually entered into a bargained-for exchange, but only with whether they appear to have done so. But courts do not routinely do this. It is one thing to estop a party from relying on an unexpressed intent not to live up to a commitment that the promisee actually and reasonably understood him to make. It is quite another to hold irrelevant undisputed facts about what the parties intended to accomplish in favor of a theory based only on appearances.

When courts concern themselves with bargained-for exchanges, they really do care about what bargain was reached between the parties, and they say so. For example, in *United States v. Robison*,<sup>205</sup> the issue before the Sixth Circuit was the scope of a plea bargain agreement.<sup>206</sup> The defendant argued that an agreement reached in one case precluded subsequent prosecutions in others.<sup>207</sup> The court rejected this argument in the strongest intentionalist terms.<sup>208</sup> After

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204 RESTATEMENT (SECOND) OF CONTRACTS § 3 (1981).

205 924 F.2d 612 (6th Cir. 1991).

206 *Id.* at 614.

207 *Id.* at 613.

208 *Id.* at 614.

emphasizing that traditional contract doctrine applies to the interpretation of plea bargains,<sup>209</sup> the court held:

There can be no contract without a “meeting of the minds.” Whether or not there was a “meeting of the minds” depends, of course, on what the parties to the plea agreement intended. The district court found that the parties to the North Carolina agreement never intended to limit prosecution in other districts. This determination is not clearly erroneous. In fact, the circumstances of this case strongly support the result reached by the district court.<sup>210</sup>

The court concluded, “The circumstances of this case disclose that it was intended by neither the United States Attorney for the Eastern District of North Carolina nor Robison that the North Carolina plea agreement have any effect on the prosecution in the Eastern District of Michigan.”<sup>211</sup> The court earnestly engaged in an effort to identify the bargain that the parties reached, and enforce it. Courts often speak in such terms.<sup>212</sup>

This is not to say that one cannot speak of the bargain requirement in objective terms and demand objective evidence of the bargain. It is not unreasonable for courts to insist upon objective evidence, rather than permitting self-serving statements of the unexpressed desires of the parties, and they do.<sup>213</sup> Unlike the concept of assent, which is wholly cognitive, bargaining requires interaction between the bargainers, which means that there almost always will be objective evidence when a bargain has occurred.

As they do when they discuss *offering* and *promising*, courts do indeed bring objective considerations into an analysis of whether a bargained-for exchange is alleged. At times, they deny a party relief for failure to produce objective evidence of a bargain, and at other times they employ an objective rule and dispense with the bargained-for exchange requirement altogether. But when courts do actually write about bargains, they write about them the way people would do so in everyday life. They include an element of intent, and discuss the

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209 *Id.* at 613.

210 *Id.* at 614 (citation omitted).

211 *Id.*

212 *See, e.g.*, *Trans-Orient Marine Corp. v. Star Trading Marine, Inc.*, 925 F.2d 566, 573 (2d Cir. 1991) (“[F]orbearance to assert a valid claim, if bargained for, is sufficient consideration to support a contract.”); *Romero v. Earl*, 810 P.2d 808, 810 (N.M. 1991) (“Consideration adequate to support a promise is essential to enforcement of the contract and must be bargained for by the parties.”).

213 *See, e.g.*, *Bennett v. Emerson Elec. Co.*, 186 F. Supp. 2d 1168, 1171 (D. Kan. 2002); *Standard Mgmt., Inc. v. Kekona*, 53 P.3d 264, 275 (Haw. Ct. App. 2001).

parties' states of mind naturally, as though they had never heard of an objective theory of contracts.

What about the definitions of terms such as *offer* and *promise*, which are stated in objective terms? To the extent that I am correct in my analysis of contract formation, it should be possible to dispense with them for the most part. An *offer* is an offer. A *promise* is a promise. A *bargain* is a bargain. The law prefers objective evidence of these concepts, and estops parties from denying the consequences of their actions with respect to them.

The Restatement defines *offer* as follows: "§ 24. Offer Defined: An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it."<sup>214</sup> Missing from the definition is any state of mind with respect to the manifestation. But state of mind is very much part of our ordinary understanding of offers.

Consider what we think of as an offer, using the following vignette. You arrive at a cocktail party. The host approaches you with a tray of drinks. You say "thank you" and reach for one. The host laughs and says, "Not so fast. These are for Mario and Adela. You haven't even told me what you want yet." You smile, and ask for a gin and tonic, which your host brings you soon.

Would you say—outside of any legal context—that the host offered you a drink? I doubt it. You would say that you reasonably thought from the physical circumstances that he had offered you a drink, but that you were wrong. And the reason you were wrong is that the host never intended to offer you a drink, and intent is part of your concept of offering.

This analysis of natural language leads to several legally relevant points. First, to the extent that unintentional manifestations of willingness to enter into a transaction are enforced, they are not enforced because they are offers in the everyday sense, since they are not offers at all. Rather, they are enforced because the law does not permit individuals to walk away from the reasonable understanding of their words, given that the other party actually understood them in their ordinary sense. Thus, when McKittrick told Embry not to worry in response to Embry's inquiry about whether his employment would be renewed for another year, McKittrick did not make an offer if he was trying only to put off an irritating employee. Nonetheless, he was appropriately bound by the commitment that he expressed.

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214 RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981).

Second, the intent required for an offer is not the intent to perform the act being offered, as Peter Tiersma points out.<sup>215</sup> The intent is merely an intent to make an offer. Put in the language of the Restatement, an offer in the context of a contract is an *intentional* “manifestation of willingness to enter into a bargain.”<sup>216</sup> If the host says that he’ll bring you your gin and tonic, but does not—perhaps because he knows that you are today’s designated driver—he has still made an offer, but has not honored it. He had the requisite intent.

Finally, both offers and promises are typically understood as containing at least some level of sincerity, although we regard them as binding even when insincere. That is, while intent to manifest commitment is part of what it means to make a promise or offer, intent to do what one actually offers or promises is not required for us to regard the statement as an offer or promise, but it is routinely inferred. In their thoughtful book, Ian Ayres and Gregory Klass write about the law governing promissory fraud in just these terms: “In most cases, a promisor’s representation that she intends to perform does not require a separate utterance . . . but it is understood to be part of the meaning of the very act of promising.”<sup>217</sup> Promises, they argue, contain at least some implication that the speaker does not intend not to perform, even if the promisor does not have a strong intention actually to perform.<sup>218</sup> Thus, while Holmes’ statement, “[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else,”<sup>219</sup> may characterize contract law in a narrow sense, it certainly does not preclude the availability of fraud as a claim against those who are insincere in their promises. And insincerity is a matter of intent: saying that you will do something when you had no intention of carrying out your commitment.

Although this Article might not trigger a broad movement to correct these definitions, my analysis of contract law as based largely on the actual agreements of the parties explains why it is that courts are willing at the same time to pronounce the triumph of objectivism on the one hand, and to talk incessantly about the parties’ states of mind on the other. The law of contracts contains primitives that are highly intentional concepts. Legal actors are not sufficiently adept at sus-

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215 Peter Meijes Tiersma, Comment, *The Language of Offer and Acceptance: Speech Acts and the Question of Intent*, 74 CAL. L. REV. 189, 224 (1986). Tiersma uses the expression “illocutionary intent” to describe this fact. *Id.*

216 See RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981).

217 AYRES & KLASS, *supra* note 90, at 202.

218 See *id.* at 21–26.

219 Holmes, *supra* note 68, at 462.



pending their understanding of the world to avoid speaking of intent no matter how the Restatement defines these terms.

*D. Incomplete Contracts: Gap-Filling, Default Rules and Implied Terms*

The account of contract formation based upon mutual assent espoused in this Article also reduces the conceptual gap between doctrines addressing incomplete contracts on the one hand, and contract formation on the other. Judicial implication of contractual terms, the doctrine of substantial performance, default rules, and gap-filling are frequently based upon estimations of what the parties would have intended had they thought through the details that are currently under dispute. Such analyses have their limits, as a prolific literature points out.<sup>220</sup> But they would make no sense whatsoever if contract formation were objective in nature. It would be difficult to justify a theory that did not concern itself with what the parties intended when they formed an incomplete contract, but then went to great lengths to estimate how these same people would have filled in missing terms based on their actual states of mind.

Consider the doctrine of substantial performance. The classic statement of its rationale is contained in Cardozo's opinion in *Jacob & Youngs, Inc. v. Kent*,<sup>221</sup> decided in 1921. A contractor agreed to build a house for \$77,000.<sup>222</sup> The contract called for the last payment to be made only after the architect certified that the house had been built to specification.<sup>223</sup> Instead of using Reading pipe, as called for in the contract, the plumbing subcontractor had used some Reading pipe, and some pipe that appeared to be equivalent to Reading pipe, but manufactured by a different company.<sup>224</sup> Based on this discrepancy, the architect refused to sign the certification releasing the final payment, and the contractor sued.<sup>225</sup> The case made its way to the New York Court of Appeals. In a 4–3 decision Cardozo framed the issue as whether payment of the last installment should be conditioned on completing the building exactly as designed, or whether payment and completion should be seen as independent promises, allowing the owner to claim damages if the house is worth less than the one he ordered, but otherwise requiring the owner to pay.<sup>226</sup> Because the

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220 See HILLMAN, *supra* note 95, at 224–36; *see also infra* note 261.

221 129 N.E. 889 (N.Y. 1921).

222 *Id.* at 890.

223 *Id.*

224 *Id.*

225 *Id.*

226 *Id.* at 891.

building had been substantially completed as designed, Cardozo chose the latter option.<sup>227</sup> To rule otherwise would result in an unduly harsh (and inefficient) outcome since the contractor would forfeit a great deal more than the owner would realize.<sup>228</sup> Cardozo explained this in intentionalist terms:

From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.<sup>229</sup>

More contemporary courts argue similarly.<sup>230</sup> By the same token, courts holding that substantial performance is not adequate to meet contractual obligations often do so by ascribing a contrary intent to the parties.<sup>231</sup>

Cardozo's argument is precisely the one used to justify the ordinary meaning rule in the interpretation of contracts and statutes. We privilege the ordinary meaning because, by doing so we are more likely to enforce the *ex ante* intent of the contracting parties. Similarly, we infer that, if asked in advance, most reasonable people would understand their obligations as consistent with the substantial performance doctrine, at least as applied to constructive conditions.

A second well-studied Cardozo opinion, which deals with implied terms in contracts relies on similar argumentation. In *Wood v. Lucy, Lady Duff-Gordon*,<sup>232</sup> a designer of clothing who had given Wood an exclusive right to sell her designs, went off on her own and bypassed Wood, depriving him of his commission.<sup>233</sup> When he sued, she argued that the contract failed for lack of consideration since Wood never had an obligation to sell anything.<sup>234</sup> Had he moved to Tahiti without selling a single design, the only consequence would have been

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227 *Id.*

228 *Id.*

229 *Id.*

230 *See, e.g., Phoenix Office Sys., Inc. v. Kopp*, No. 92-1877, 1993 Wisc. App. LEXIS 425, at \*7-10 (Wisc. Ct. App. Apr. 14, 1993).

231 *See Am. Cont'l Life Ins. Co. v. Ranier Constr. Co.*, 607 P.2d 372, 375 (Ariz. 1980); *Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 418 (N.Y. 1995).

232 118 N.E. 214 (N.Y. 1917).

233 *Id.* at 214.

234 *Id.*

that he would earn no commissions.<sup>235</sup> A unanimous court rejected this argument, basing its holding on the implied intent of the parties:

The implication is that the plaintiff's business organization will be used for the purpose for which it is adapted. But the terms of the defendant's compensation are even more significant. Her sole compensation for the grant of an exclusive agency is to be one-half of all the profits resulting from the plaintiff's efforts. Unless he gave his efforts, she could never get anything. Without an implied promise, the transaction cannot have such business "efficacy as both parties must have intended that at all events it should have."<sup>236</sup>

The implied covenant of good faith is similarly justified by courts that resolve cases based on its presence.<sup>237</sup>

Judges often justify gap-filling the same way. Courts fill gaps in contracts in order to effectuate the intent of the parties when they failed to state all of the contract's details in advance.<sup>238</sup> This perspective on gap-filling and implied terms has also been prominent in the academic literature. For example, Judge Posner remarks:

Filling potential gaps in contracts should be distinguished from disambiguating specific terms, which is the heart of the problem of contract interpretation. A contract might contain an explicit best-efforts clause, yet the wording of the clause might leave a doubt as to what exactly it required of the dealer. Gap filling and disambiguating are both, however, "interpretive" in the sense that they are efforts to determine how the parties would have resolved the issue that has arisen had they foreseen it when they negotiated their contract.<sup>239</sup>

This intentionalist perspective is consistent with the economic approach to gap-filling as well, since economists assume that the participants to a transaction are more likely to understand their best interests than do academic legal theorists. Thus, the intent of the par-

<sup>235</sup> *Id.*

<sup>236</sup> *Id.* at 214–15 (citation omitted).

<sup>237</sup> *See, e.g.*, *R.I. Charities Trust v. Engelhard Corp.*, 109 F. Supp. 2d 66, 78 (D.R.I. 2000) (implying good faith in order to effectuate the intent of the parties).

<sup>238</sup> *See, e.g.*, *Hold Bros. v. Hartford Cas. Ins. Co.*, 357 F. Supp. 2d 651, 657 (S.D.N.Y. 2005) ("[U]nder New York law, a court may fill the gap in order to effectuate the intent of the parties."); *State Farm Fire & Cas. Co. v. Tan*, 691 F. Supp. 1271, 1273 (S.D. Cal. 1988) ("[T]he court has a duty to fill in the gaps of the contract to preserve and effectuate the overall intentions of the contracting parties.").

<sup>239</sup> Posner, *supra* note 126, at 1586; *see also* Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983) ("Ideally, the preformulated rules supplied by the state should mimic the agreements contracting parties would reach were they costlessly to bargain out each detail of the transaction.").

ties serves as a proxy for efficient decision making in contract formation.<sup>240</sup> Professor Goldberg makes a similar point, using as illustrations the two Cardozo opinions discussed above.<sup>241</sup>

Default rules are treated similarly, at least in many instances. Often, the default rules are themselves “majoritarian,” as law and economics analysts point out.<sup>242</sup> That is, the rules are designed to simulate what most contracting parties would have agreed upon had they addressed the issue. The goal, according to this perspective, is efficiency.<sup>243</sup> The transaction costs in reaching agreement are reduced when the law already contains the provisions that parties would have accepted anyway, thereby permitting more productive activity at less cost.<sup>244</sup> The goal is not to simulate the intent of the parties because intent is a core value in its own right, but rather to simulate the intent of the parties in the majority of cases to produce a more efficient system in the aggregate. The literature contains a number of creative suggestions for accomplishing this task, largely by evaluating various considerations that lead parties to accept default rules of one sort or another notwithstanding efficiency concerns.<sup>245</sup>

Some default rules, however, have as their direct goal increasing the likelihood that a court will reach the result that the parties would have intended had their contract not been incomplete. Among these are the reliance on trade usage and prior dealings in the Uniform Commercial Code.<sup>246</sup> Courts frequently adduce trade usage as evi-

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240 See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 96–98 (7th ed. 2007).

241 VICTOR P. GOLDBERG, *Reading Wood v. Lucy, Lady Duff-Gordon with Help from the Kewpie Dolls*, in *FRAMING CONTRACT LAW* 43, 62–67 (2006). Professor Goldberg also argues that Cardozo may have gotten the case wrong. Extrinsic evidence suggests that the parties may well have intentionally left open the extent of any efforts due in light of another agency contract of Wood’s that had resulted in litigation. *Id.* at 50.

242 See, e.g., Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Analysis of Default Rules*, 99 *YALE L.J.* 87, 93 (1989); Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 *STAN. L. REV.* 1591, 1591 (1999) [hereinafter Ayres & Gertner, *Majoritarian*]; Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 *CORNELL L. REV.* 608, 614 (1998).

243 See, e.g., Goetz & Scott, *supra* note 239, at 971 (arguing that default rules promote efficiency by “eliminating the cost of negotiating every detail of the proposed argument”).

244 Other legal systems appear to be more successful at reducing the burden on contracting parties through the codification of standard terms. See Claire A. Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 79 *CHI-KENT L. REV.* 889, 912–14 (2004).

245 See, e.g., Ayres & Gertner, *Majoritarian*, *supra* note 242, at 1606.

246 U.C.C. § 2-206 (2006).

dence of actual intent, the enforcement of which is a goal in itself.<sup>247</sup> While some commentators argue rather persuasively that ordinary trade usage is a poor substitute for the actual wishes of the parties in many instances,<sup>248</sup> courts continue to employ the standard and to associate it with the parties' intent.<sup>249</sup>

Here again, my argument is not that the "incorporation"<sup>250</sup> of trade practice into the law of contracts is a good idea on either economic or intentionalist grounds. Rather, my point is that the intentionalist rhetoric that so frequently surrounds its use makes sense only to the extent that contract formation is itself a function of the parties' mutual assent. Its use is further consistent with the general approach of seeking objective evidence of actual intent. One can argue about how well resort to trade usage actually approximates the actual expectations of the parties, but it would be hard to justify reference to trade usage at all if unexpressed intent were so wholly irrelevant to the formation process.

Not all gap-filling, however, proceeds along these lines. Implied warranties<sup>251</sup> and default damages rules,<sup>252</sup> for example, to which the system defaults in the absence of agreement to the contrary, need not reflect the decisions that sellers or buyers would make on their own.<sup>253</sup> Such rules may be justified on either efficiency or paternalis-

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247 See, e.g., *Elda Arnhold & Byzantio, L.L.C. v. Ocean Atl. Woodland Corp.*, 284 F.3d 693, 701 (7th Cir. 2002) (explaining that trade usage is helpful in coming to an understanding of the parties' intent); *Den Norske Bank AS v. First Nat'l Bank of Boston*, 75 F.3d 49, 58 (1st Cir. 1996) ("The precise function of 'usage of trade' evidence is to provide *circumstantial* proof of the contracting parties' intent."); *Precision Steel Warehouse, Inc. v. Anderson-Martin Mach. Co.*, 854 S.W.2d 321, 325 (Ark. 1993) (suggesting that usage of trade is competent evidence of parties' intent); *Buchholz Mortuaries, Inc. v. Dir. of Revenue*, 113 S.W.3d 192, 194 (Mo. 2003) (explaining that trade usage is a relevant fact in determining the intent of parties).

248 See, e.g., Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 750-51 (1999).

249 See, e.g., *Maverick Oil & Gas, Inc. v. Barburton City Sch. Dist. Bd. of Educ.*, 872 N.E.2d 322, 328 (Ohio Ct. App. 2007); *Adler v. Fred Lind Manor*, 103 P.3d 773, 784-85 (Wash. 2004).

250 The term "incorporation" is frequently used in the literature to describe the practice of absorbing trade practice into the constellation of contractual rights and obligations. See Bernstein, *supra* note 248, at 746-60; Jody S. Kraus, *Legal Design and the Evolution of Social Norms*, 26 J. LEGAL STUD. 377, 377 (1997).

251 See U.C.C. § 2-314 (2006) (outlining implied warranty of merchantability); *id.* § 2-315 (outlining implied warranty of fitness for a particular purpose).

252 See *id.* § 2-715(2) (consequential damages).

253 See *id.* § 2-207 (calling for such rules to supplement the actual agreement of the parties when they have agreed that a contract exists, but disagree on its terms); *id.* § 2-316 (exclusion or modification of warranties); *id.* § 2-719(3) (permitting parties to limit or exclude consequential damages).

tic grounds. My point is not that mutual assent is the only concept needed to explain the law of contracts. Rather, it is that the law governing contract formation is organized around the concept of mutual assent, and that the recognition of its central role will help to harmonize our understanding of the formation process with numerous other doctrines. That is true with respect to a host of situations involving default rules, although it is not universally the case with respect to default rules.

#### CONCLUSION: THE SUBJECTIVE THEORY AND ITS LIMITATIONS

I have argued in this Article that for a century judges and academics alike have mistakenly referenced an objective theory of contracts that does not exist and has never existed. Dispensing with the fiction of an objective theory of contract in favor of a theory based upon mutual intent has a number of theory-internal benefits:

- It is more directly consistent with justificatory theories of contract law, in particular, the vindication of the autonomous decisions of the parties.
- It is descriptively more adequate.
- It licenses a more flexible approach to contract remedies when there has been neither mutual assent nor substantial reliance.
- It allows the rules governing contract formation and contract interpretation to be harmonized—an important result because contract interpretation is conducted with respect to the same events that constitute contract formation.
- Because consideration doctrine relies upon the concept of a bargained-for exchange, and because bargaining has an indispensable subjective element, it adds coherence to the rules of contract formation.
- It eliminates a peculiar incoherence concerning gap-filling and related doctrines concerning incomplete contracts, which are frequently based upon the intent of the parties, which, according to the objective approach is irrelevant to the formation of those parts of the contract that actually exist.

All of these contributions improve our conceptualization of contract law by making it more coherent and better able to explain core cases. In contrast, nothing in my analysis necessitates change in the substance of contract law other than a more flexible approach to damages when a party is being held to a bargain he did not intend to make. I conclude, then, with some thoughts about why I believe the observations in this Article to be of some importance, and about some of the limitations of this analysis.

First, the law of contracts has a great deal to say about how business is conducted. Since Karl Llewellyn's drafting of the Uniform Commercial Code,<sup>254</sup> it has been widely accepted that contract law itself must be responsive to normal business practices. Were it not, it would not have remained relatively stable to the extent that the same doctrines are taught to law students from one generation to the next. This suggests, perhaps ironically for an academic paper, that the validity of my argument rests in part on it not disturbing the status quo significantly. For if what has been called the objective theory had been causing havoc, then the business community whose conduct is governed by these rules would surely have advocated for change over the decades. Thus, for the most part, the strength of my argument is that it adds coherence and consistency to our conceptualization of contract law.<sup>255</sup> It is entirely appropriate to suggest that we should prefer one theory over another based on questions of descriptive adequacy and coherence.

Second, this project was motivated by difficulty in teaching contract law given some of the problems with conventional contract theory described in this Article. Right from the beginning, it is possible to tell students that the law of contracts is about mutual assent, and favors objective evidence of that assent in various ways that will come out as they learn the various doctrines.

At the same time, any legitimate critique of contract law's reliance on mutual assent surely applies to my account. For example, in an interesting article and exchange, Omri Ben-Shahar has argued that mutual assent should be replaced by a no-retraction principle that allows one party to bind the other with progressively increasing firmness as negotiations proceed, even in the absence of actual mutual assent.<sup>256</sup> The notion is that parties who commit themselves to aspects

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254 For discussion, see generally TWINING, *supra* note 196 (detailing in depth Karl Llewellyn's and the Realist Movement's contextual approach to contract law); Eugene F. Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213, 214 (1966) ("Professor Karl Llewellyn implemented his ideas on the law of contract by imbedding them into the Uniform Commercial Code in such a manner that they are now virtually inextricable."). For recent developments to the contrary, see Gregory E. Maggs, *Karl Llewellyn's Fading Imprint on the Jurisprudence of the Uniform Commercial Code*, 71 U. COLO. L. REV. 541, 584 (2000).

255 See generally Dan Simon, *A Third View of the Black Box: Cognitive Coherence in Legal Decision Making*, 71 U. CHI. L. REV. 511, 520–83 (2004) (presenting research on the cognitive psychology topic of "coherence-based reasoning" and applying it to the legal world).

256 Omri Ben-Shahar, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*, 152 U. PA. L. REV. 1829, 1848–50 (2004).

of a transaction during negotiations should not be free to walk away from the deal prior to full agreement being reached. Rather, the law should recognize the reality of the fact that contractual commitments are frequently made incrementally. By eliminating the “all-or-nothing” rule of mutual assent, Ben-Shahar argues, among other things, that the problem of one party holding up the other as a result of information disclosed during negotiations will be reduced.<sup>257</sup> Liability and damages proceed along a continuum, with the measure of damages changing as a deal becomes more and more settled.

Ben-Shahar’s proposal has triggered debate. Ronald Mann argues that some of Ben-Shahar’s assumptions about the economic consequences of the bargaining process are questionable.<sup>258</sup> Daniel Markovits argues that Ben-Shahar’s notion of obligation arising from the negotiation process is not always appropriately grounded in the morals of obligation.<sup>259</sup> I tend to agree with these critical assessments. However, as Ben-Shahar points out, the all-or-nothing problem with conventional contract theory exists regardless of whether one adopts a subjective or objective approach to contract formation.<sup>260</sup> If Ben-Shahar is right, then the theory of contracts should be adjusted whether or not the approach to contract espoused in this article is more convincing than the standard objective account.

Similar points have been made for years by those who espouse a relational approach to the law of contracts. Their argument focuses more on the changing nature of business relations after the legally-relevant formation process has been completed.<sup>261</sup> In fact, those performing contracts on behalf of firms have probably never even read the document, relying instead on business norms and the develop-

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257 *Id.* at 1867.

258 Ronald J. Mann, Commentary, *Contracts—Only with Consent*, 152 U. PA. L. REV. 1873, 1876 (2004).

259 Daniel Markovits, Commentary, *The No-Retraction Principle and the Morality of Negotiations*, 152 U. PA. L. REV. 1903, 1921 (2004).

260 See Ben-Shahar, *supra* note 256, at 1835.

261 For discussion of relational contract theory, see generally Symposium, *Relational Contract Theory: Unanswered Questions*, 94 NW. U. L. REV. 737 (2000) (discussing various aspects of relational contract theory); Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465 (examining the “gap between the academic model of contract law and the system as it works” and calling for the establishment of a more complex model); Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271 (1992) (discussing the relational theory of contract law as it applies to judicial gap-filling of incomplete contracts). For a helpful summary of this literature, see HILLMAN, *supra* note 95, at 241–66.



ment of the relationship with the other contracting party.<sup>262</sup> To the extent that these observations are accurate, they raise a question of whether a theory of contract formation based on mutual assent is relevant to a system of transactions based on business norms, and if so, whether its relevance is positive or leads to unwanted distortions in business practice.<sup>263</sup> Similarly, those who criticize resort to intent because the parties most likely had no intent with respect to many litigated issues may find this analysis unable to present a realistic picture of business engagement.<sup>264</sup>

These concerns are legitimate. The question of the appropriate role of business norms in the law of contracts has received a great deal of attention. However, its resolution is well outside the scope of this project. The argument here is that the law governing contract formation is organized largely around the notion of actual mutual assent. If it turns out that as a normative matter mutual assent plays too great a role in the law governing contracts, then the positions taken in this Article are surely as vulnerable as any other account. For at least the time being, though, I have set as a goal the task of laying out an account of contract formation that is both more true to the outcomes of legal disputes and more in keeping with other legal doctrines.

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262 See Claire A. Hill, *A Comment on Language and Norms in Complex Business Contracting*, 77 CHI.-KENT L. REV. 29, 34 (2001).

263 See, e.g., Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1787-95 (1996).

264 See Jeffrey M. Lipshaw, *The Bewitchment of Intelligence: Language and Ex Post Illusions of Intention*, 78 TEMP. L. REV. 99, 116-40 (2005).