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Reasonableness and Responsibility: A Theory of Contract Law

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Chapter 1
Introduction

Justice is the first virtue of social institutions, as truth is of systems of thought. A theory however elegant and economical must be rejected or revised if it is untrue; likewise laws and institutions no matter how efficient and well-arranged must be reformed or abolished if they are unjust.[1]
[...It is] by the reasonable that we enter as equals the public world of others and stand ready to propose, or to accept, as the case may be, fair terms of cooperation with them.[2]

John Rawls

Rational individuals have their own purposes. They can pursue these purposes in many different ways. Quite often, individuals pursue their plans by exchanging with others whatever goods they happen to have, that is, by concluding contracts with others. The institution of contract, then, is a tool that individuals can use to make of their lives whatever they see fit; it is a tool that they can use to exercise their moral power to set and pursue their own conception of the good. Now, in this book, I address the following question: if, as John Rawls famously suggests, justice is the first virtue of social institutions, how are we to understand the institution of contract law? I argue that justice requires that we understand contract rules in relation to the idea of fair terms of interaction. The underlying idea is that of reciprocity, the idea that individuals should not set the terms of their interactions with others unilaterally. Fair terms of interaction should be *reasonable* terms.[3] They are standards that, by their very nature, are public and interpersonal. This means that the particular idiosyncrasies of individuals are not supposed to unilaterally set the conditions of people's *private* interactions with one another. That's why, when individuals interact on fair

[1] John Rawls, *A Theory of Justice*, rev. ed. (Cambridge: Harvard University Press, 1999), 3.

[2] John Rawls, *Political Liberalism* (New York: Columbia University Press, 1993), 53.

[3] Arthur Ripstein, *Equality, Responsibility, and the Law* (Cambridge: Cambridge University Press, 1999), 206.

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terms, they do so *as equals*. Treating parties as equals demands that we adopt objective, public standards that both parties can be assumed to understand. Thus, my claim is that contractual interactions are about what is fair for individuals *in interactions with others*.

In Rawls' view, individuals have a capacity to form, to revise, and to rationally pursue a conception of the good. Because they're free in this sense, individuals can be held responsible for what they do or say while they pursue their life plans.[4] In the Rawlsian scheme, people are not only rational, but *reasonable* as well. Reasonable individuals "are ready to work out the framework for the public social world, a framework it is reasonable to expect everyone to endorse and act on, provided others can be relied on to do the same."[5] As Rawls says, "reasonableness takes agents to the world of the others, where they become equals that are ready to propose or accept fair terms of interaction."[6] The reasonable has a public character that the rational does not have.[7] For this reason, the idea of fair terms of interaction is based on the Rawlsian idea that legal responsibility is a "political" rather than a metaphysical question.[8] Fair terms of interaction are terms that agents share and publicly recognize mutually. This suggests that even though we're free to adopt whatever ends we prefer, our ends are always filtered through the lens of the reasonable. In some sense, this is the public aspect of private interactions.

My suggestion in this book will be that this account of contract law is mandated by the Rawlsian notion that individuals have a special responsibility for how their life goes. This idea is embedded in what he calls "the social division of responsibility." In "Social Unity and Primary Goods," Rawls claims that society has a duty to provide individuals with a fair share of resources and opportunities, things that Rawls calls "all-purpose means." At the same time, individuals can be asked to sustain fair institutions. They are assumed to be able to moderate the claims they make on their social institutions in accordance with the fair share of primary goods that they can *reasonably* expect to receive. Once individuals receive those means, they can use them as they see fit. Precisely because of that freedom, individuals have

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[4] Under this conception of persons, people also have the capacity for a sense of justice, that is, the capacity to understand, to apply, and to act from the public conception of justice. See *idem* at 233.

[5] Rawls, *supra* note 2 at 54. Rawls points out that the distinction was discussed earlier by W. M. Sibley, "The Rational Versus the Reasonable," in *Philosophical Review* 62: 554 at 560. For Sibley, "knowing that people are rational we do not know what ends they will pursue only that they will pursue them intelligently. Knowing that people are reasonable where others are concerned, we know that they are willing to govern their conduct by a principle from which they and others can reason in common; and reasonable persons take into account the consequences of their actions on others' well-being. The disposition to be reasonable is neither derived from nor opposed to the rational but it is incompatible with egoism, as it is related to the disposition to act morally."

[6] Rawls, *supra* note 2 at 50.

[7] *Idem* at 53.

[8] See, in general, Rawls, "Justice as Fairness: Political but Not Metaphysical," in *John Rawls: Collected Papers*, ed. Samuel Freeman (Cambridge: Harvard University Press, 1999).

a special responsibility for how their own lives go. Private ordering, then, acquires its normative claim against fair background conditions that guarantee equal freedom for all, that is, provided that people have a chance to lead their lives as they wish. Now, people may pursue their plans by entering into arrangements with others. In order to do so, they must be able to exchange the goods they have or to perform services for others. The ability to subordinate people's goods to their own conception of the good, then, *requires* a system of contract rules. Now, once fair background conditions are in place, the relative position in the overall distribution of either party to a contract—the fact that one of them may have "deep pockets," or the virtues or needs of each of the parties—becomes absolutely irrelevant in the context of contractual interactions. This is why, framing the issue in light of Aristotle's famous dichotomy, I argue that contract rules should be understood in terms of corrective justice, that is, as justice in interpersonal relations, and not in terms of distributive justice, that is, as issues that arise because of the allocation of burdens and benefits in each society.

This account of contract law is dependent on a broader Kantian account of the legitimate use of coercion. In this view, the use of coercion to enforce a contract is not about the enforcement of moral obligations by the state, whenever doing so would prevent harm to others.[9] In contrast, the bindingness of contracts is required by norms of equal freedom. People have different purposes. The pursuit of those different purposes, whatever they are, has to be made congruous. This requires reciprocal limits on freedom. Such limits have to be binding for all, that is, in Kantian terms, they need to be general.[10] As people pursue their purposes, they can transfer the use of their powers to one another through a contract. When there is a breach of contract, the victim is deprived of one of the means that she has to pursue her plans—to wit, the promisor's performance. Because individuals have to take responsibility for what they do, the breaching party cannot just walk away without paying any sort of compensation. If that were allowed, then the breacher would be allowed to set the terms of the contractual interaction unilaterally. In light of this, the idea of fair terms of interaction requires that contracts be binding.

The aim of this book, then, is to explain some of the main doctrines of contract law in the common law by using the notion of fair terms of interaction.[11] I will claim that most of the issues that come up with contractual interactions should be understood in light of the reasonable person standard.

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[9] The best example of this position is John Stuart Mill's famous "harm principle": "The only purpose for which power can be rightly exercised over any member of a civilized community against his will, is to prevent harm to others."

[10] I borrow this explanation from Arthur Ripstein, "Authority and Coercion" (2004), 32 Phil. & Pub. Aff. 2 at 10.

[11] Although most of my examples will come from the common law, my argument may be extended to civil law doctrines. In Chap. 9, for instance, my discussion of the doctrines of responsibility for economic loss and the doctrine of contracts for the benefit of third parties will also make reference to civil case law.

I have said that this book presents a Rawlsian account of contract law. John Rawls is well known as one of the most influential political philosophers ever. Rawls was mainly concerned with what he calls "constitutional essentials" (perhaps that's why he did not say much about the principles that would animate private law). Even so, some passages in *A Theory of Justice* are devoted to explaining the institution of promises. Rawls explains that "[p]romising is an action defined by a public system of rules" which are like the "rules of games." Moral philosophers can explain why, if someone voluntarily takes advantage of a *fair* institution, he or she has to abide by its rules. In this view, the reason why we have to keep our promises is that the social institution of promise is valuable for society. If we don't abide by our promises, we do something wrong, namely, we undermine a socially valuable practice.[12] In this book, however, I offer reasons to explain why the promissory account does not help us to understand contract law at all: *approaching contract law from the perspective of promises is the wrong starting point.* "Promissory approaches" do not help us to see why, when I breach my contract with you, I am not, say, merely free-riding on a socially valuable convention, but *wronging you:* by breaching the agreement, I am depriving you of something that is already yours.[13] Because Rawls' concern was not, however, the law of contracts, he was also not looking for a justification for the use of coercion to enforce agreements. In contrast, I use the idea of a division of responsibility between society and individuals to offer a normative *Rawlsian* account of contract law and corrective justice and its connection to distributive justice. In the framework of the division of responsibility, justice requires that we use coercion only to enforce fair terms of interaction. As a consequence, contractual interactions are reasonable interactions, that is, public and interpersonal terms of interaction. In some sense, then, this book is an attempt to complete Rawls' work.

The plan of the book is as follows. In Chap. 2, I introduce the notions, first developed by Aristotle, of distributive and corrective justice. Then, I relate the distinction between them to a view referred to as "monism" in political philosophy and contract law. Monists reject the distinction between distributive and corrective justice. I will introduce the basic tenets of the two different monist positions that I will discuss. On the one hand, those ascribing to what I will call "the distributive approach" hold the view that there is no such thing as "private ordering"; on the other hand, libertarians argue that there is never anything else. This should work as a preliminary basis for the discussion in the following two chapters, where I discuss each monist account of the foundations of contract law separately.

In Chap. 3, I examine Anthony Kronman's seminal idea that the voluntary basis of contracts should be conceived wholly through the lens of distributive justice. For Kronman, voluntariness cannot be understood simply in terms of the idea of individual freedom; for him, in order to determine whether the parties voluntarily consented to a particular contract or not, we have to determine whether they have

[12] Rawls, *supra* note 1 at 344–348.

[13] See my discussion of Charles Fried's *Contract as Promise* (Cambridge: Harvard University Press, 1981) in Chap. 8.

taken advantage of one another in an impermissible way. I argue that this way of looking at private transactions is problematic. I will claim that the main problem with Kronman's approach is that he cannot at all explain the sense in which contract law is about private interactions: his focus on distributive justice inhibits him from explaining the private nature of contractual transactions. In particular, I argue that Kronman's distributive approach explains neither the privity rule, which is a central doctrine in contract law, nor the role of consent.

Chapter 4 discusses Robert Nozick's libertarianism and its account of contract law. I explain Nozick's account of liberty as self-ownership and the three principles of his entitlement theory of justice. Also, I introduce Nozick's argument against—what he calls—"patterned theories of justice" and the famous example of Wilt Chamberlain, which purports to show that theories of justice other than the entitlement theory require constant interferences with liberty. This discussion is relevant in a book about the foundations of contract law because it is often argued that liberal theories of justice such as Rawls' theory of justice are incompatible with freedom of/to contract. Against that view, my conclusion in the chapter will be that, although Nozick claims that patterned theories of distributive justice are necessarily upset by the exercise of freedom, his argument actually doesn't work against dynamic theories of distributive justice—such as Rawls' theory. My point will be that, even though libertarianism is free from the objections that I raise against Kronman's distributivism in the previous chapter, libertarians are wrong to claim that they can monopolize the idea that a particular distribution of resources may change without raising issues of justice.

In Chap. 5, I introduce the notion of the "reasonable person," which is central to the argument in the book. I start by introducing Rawls' idea of society as a fair system of social cooperation from generation to generation. Then, I explain that this idea has to be understood in terms of two companion ideas: the notion of a well-ordered society (in which individuals are ready to act on the basis of public principles of justice, provided that others are also willing to do so) and the idea of persons as free and equal citizens who are not only rational, but reasonable as well (meaning that they can act on the basis of the public principles of justice). The distinction between the complementary ideas of the reasonable and the rational is crucial to my argument. The reasonable connects with the capacity that citizens have for a sense of justice; the rational, in turn, is related to the capacity to have a conception of the good, whatsoever particular conception is adopted. The Rawlsian notion of the person includes the idea of a division of responsibility, which allows for a powerful account of the relationship between distributive and corrective justice, and locates contract rules within that distinction. I will argue that contract law can be understood in terms of what I call relational duties, that is, duties that, within the division of responsibility, we owe to one another when we voluntarily decide to cooperate through personal agreements. Then, I pose the following discussion: if people are to be left free to conclude contracts as they see fit, what happens when a contract results in a redistribution of goods from one party to another and the resulting distribution is unjust? In order to answer this concern, I introduce what Rawls calls the "institutional division of labor" between the principles that concern basic structure

and the rules applying these principles to individuals and associations that must be followed in particular transactions, namely, when concluding agreements. I explain how this division can be explained in terms of the two different dimensions of the division of responsibility. Finally, in the last section of the chapter, I explain the importance of "primary goods" for freedom.

In Chap. 6, I start to deal with contractual doctrines more directly. First, against the idea that attempting to look at private law obligations as a coherent unit is worthless, I argue that because the use of coercion is at stake, any legal system should aspire to justify the imposition of obligations in a legitimate way. As an alternative to that concern, I present a Kantian account of private law obligations. The foundational idea is that of personal independence. Then, I explain how this idea, in conjunction with the distinction between persons and things, explains the sense in which tort, contractual, and fiduciary duties are different from one another. These distinctions are the basis for the idea that a contract gives rise to a personal right—that is, a right *in personam*—against the promisor for the performance of the contractual duties. I make my point by explaining that before actual performance, the promisee acquires something through the contract: the right to the promisor's performance. I continue to explain the standard remedy for breach of contract in the common law, that is, expectation damages. Also, I discuss why, although once we have a contractual agreement, I own your action and your action is a means to my plans, I am not entitled to the specific performance of your promised action but to expectation damages. I go on to explain the principle of no liability for mere nonfeasance in terms of the division of responsibility: in its scheme, people are free to use the means at their disposal to set and pursue their own conception of good, which means that nobody can be forced to use his or her means in pursuit of someone else's purposes. I will argue that this explains why, as a rule, a breach of contract gives rise to a claim for expectation damages (as well as to a claim for consequential damages, when appropriate). Otherwise, if the courts would ask the defendant to give to the plaintiff something to which she is not entitled, the rule would compel the defendant to confer a benefit on the plaintiff for free. This result would be inconsistent with the idea that individuals cannot be forced to use their means for purposes they do not share.

In Chap. 7, I focus on the Rawlsian foundations of the reasonable person standard. I argue that a consequence of this conception of the person is that the particular idiosyncrasies of individuals are not supposed to unilaterally set the conditions of people's private interactions with one another. I compare the resulting objective test for contract formation with the subjective account of contract rules that characterizes the French approach to private law. In the end of the chapter, against both communitarians and feminists, I argue that this Rawlsian idea provides a better justification for the legitimate use of state coercion than that offered by those alternative accounts.

Chapter 8 is a discussion of what I take to be two of the most prominent alternative influential accounts of contract law. First, I discuss Fuller and Perdue's idea that from the perspective of corrective justice the expectation remedy cannot be justified. Against that view, I'll argue that if a contract gives the plaintiff an entitlement against the defendant, then the expectation remedy makes sense. Then, I discuss

Charles Fried's idea that contracts are a special case of promises. Although I'll introduce several objections to Fried's position, my main claim is that his account cannot explain the sense in which contractual rights and duties are personal and correlative.

In Chap. 9, I outline an account of the rights and duties that, within the Rawlsian framework of the division of responsibility, a contract may create for third parties. As we know, people do not enter contracts in isolation from others. Sometimes, contracts can affect the way in which third parties pursue their plans; there are also different ways in which third parties may intervene with an agreement between the parties. In this chapter, I suggest that, from a Rawlsian perspective, the issue should not be approached from a concern for the welfare of any of the parties involved; instead, my general point is that this issue should be broached starting from an idea animating my entire approach to private interactions: reciprocal limits on freedom. In particular, I analyze the following doctrines in detail: the privity of contract rule, responsibility for economic loss, and contracts benefiting of third parties.

Chapter 10 is about the law of material nondisclosure in the law of contracts. I discuss what a corrective justice account of contract law would say with regard to whether a party to a contract has an obligation to reveal all the information which may be relevant to his counterpart—in that it may influence his decision to celebrate or not to celebrate a contractual agreement—and under which conditions he must do so. Following a proposal by Marc Ramsay, I will differentiate between "robust corrective justice" and "nonrobust corrective justice" accounts of contract law. Proponents of robust corrective justice such as Charles Fried claim that parties to a contract have a duty to respect one another, which means that they have an obligation to disclose. In contrast, although they share the view that we all have a duty to respect one another, proponents of nonrobust corrective justice argue that bargaining scenarios do not necessarily require us to disclose. Instead, the parties' obligations relative to material disclosure must be understood on the basis of two principles, namely, the "bargaining principle" and the "reasonable transparency principle." The first principle establishes that the parties are under no obligation to reveal information for free; the second states that each party does have the obligation to alert his counterpart to the false, yet reasonable, beliefs about the quality of goods that each party brings to the bargaining table. In this chapter, my aim is to defend the view held by proponents of nonrobust corrective justice by offering the division of responsibility as a background theory of justice that explains why their position is satisfactory.

Chapter 2
Setting the Scene: Distributive Justice, Corrective Justice, and Monism in Political Philosophy and Contract Law

My aim in this brief and introductory chapter is twofold. First, I'd like to introduce the Aristotelian notions of distributive and corrective justice. My other aim is to connect the distinction between these two notions with a view referred to as "monism" in political philosophy and contract law. Monists reject the distinction between distributive and corrective justice. I will introduce the basic tenets of the two monist positions that I will discuss. On the one hand, those subscribing to "the distributive approach" hold the view that there is no such thing as "private ordering"; on the other hand, libertarians argue that there is never anything else. This chapter should provide the groundwork for the discussion in Chaps. 3 and 4, in which I reject monism by saying that, for different reasons, holders of each position make the same mistake: they think that the principles that govern the creation and behavior of the state are the same as those that govern private interactions. I will begin by introducing the notions of distributive and corrective justice.

2.1 Distributive and Corrective Justice

Let me start by a brief explanation of what I mean by distributive justice and corrective justice and how they relate to contractual interactions between persons. The most famous and earliest formulation of both these ideas was provided by Aristotle in Book V of the *Nicomachean Ethics*. Most scholars that discussed the topic after him start their discussion by making some kind of reference to the Aristotelian formulation. Aristotle presented them as two contrasting *forms* of justice.[1] In a nutshell, under distributive justice, something is distributed to persons on the basis of a particular criterion that the distribution is intended to realize: in accordance with the criterion, every citizen receives a portion of whatever there is to be divided.[2]

[1] John Gardner, "The Purity and Priority of Private Law" (1996), 46 U. Toronto L. J. 459 at 468.

[2] Peter Benson, "The Basis of Corrective Justice and Its Relation to Distributive Justice" (1992), 77 Iowa L. Rev. 515 at 535.

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By contrast, corrective justice deals with justice in interpersonal relations, such as contractual relations; it does not deal with society in general.[3] As I believe John Gardner correctly explains, Aristotle's point about justice is often misunderstood. Aristotelian "principles of formal justice" are often contrasted with "principles of substantive justice" as though he preferred "formal" justice to "substantive justice."[4] But Aristotle was only analyzing the different *forms* that justice can adopt (distributive, corrective, etc.) As Gardner explains, in fact,

> [n]o principle of justice is or could be identical with its form, since its form is, by definition, what is left of it once its substance is removed. Thus the idea of 'a principle of formal justice' is unintelligible and cannot be contrasted with any other kind of principle of justice.[5]

In a similar vein, Hans Kelsen was also mistaken in thinking that Aristotle had only elaborated on the tautology that justice consists in giving to each his or her due. Kelsen thought that Aristotle should have provided a criterion for determining what is each one's due. But Kelsen misunderstood the Aristotelian project in this regard: in the *Nicomachean Ethics*, Aristotle was interested only in pointing out the different forms that justice may take, nothing more. As Weinrib explains, perhaps Aristotle's contribution to the discussion on the meaning of justice was to show that if, as Kelsen argued, a form of justice was merely a way of presenting the problem of just return, then Aristotle had shown that there is not just one problem of just return, but two.[6]

Let me develop the contrast between the two Aristotelian forms of justice further. For Aristotle, distributive justice "is manifested in distributions of honour or money or other things that fall to be divided among those who have a share in the constitution."[7] Now, as he explains, each particular society decides which principle of distributive justice is consistent with its political regime. Thus, for example, he argues that democracies will favor a principle according to which each citizen should receive an equal share; aristocracies, by contrast, will choose to divide goods on the basis of "excellence," and in an oligarchy, the mere fact of having power and wealth would be seen as a reason to receive more of that power and wealth.[8] Under distributive justice, then, people are treated equally if the allocation of goods is made according to same relevant criterion.[9] If people receive different shares then, it must be because—according to the chosen distributive criterion—there are differences

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[3] Aquinas, for example, describes distributive justice as "the order of the whole towards the parts, to which corresponds that which belongs to the community in relation to each single person," that is, the relationship between the whole and the part, and corrective justice as the "order of one part to another." See Thomas Aquinas, *Summa Theologica*, trans., *Fathers of the Dominican English Province* (Westminster: Christian Classics, 1981), vol. 3, II-II, Q. 61, Art. 1.

[4] Gardner, *supra* note 1.

[5] *Ibid.*

[6] For an explanation of Kelsen's objections, see Ernest Weinrib, *The Idea of Private Law* (Cambridge: Harvard University Press, 1995), 66–68.

[7] *Nicomachean Ethics*, cited in James Gordley, "Equality in Exchange" (1981), 69 Cal. L. Rev. 1587 at 1589.

[8] Here I'm following James Gordley's reading of Aristotle. *Ibid.*

[9] Benson, *supra* note 2 at 535.

between them. The idea is that something will be divided on the basis of some specified characteristic shared by those among whom it is being divided. Aristotle calls this kind of equality "geometric." Distributive justice is "the mathematics of dividing a pie."[10] Once they receive what they deserve, people are said to have "their due," and, therefore, "their own."[11] For distributive justice, the way in which people in the relevant group interact with one another is irrelevant: their distributive claims do not depend on how they relate to each other.[12]

Now, my presentation of the Aristotelian explanation of distributive justice may lead to the mistaken conclusion that conceptions of distributive justice can only be "static." In other words, the reader may be tempted to draw one of two conclusions: on the one hand, it may be thought that once we determine the ideal distribution—in accordance with our preferred distributive criterion—and once we distribute the goods in question, all the relevant work is done. Or, on the other hand, "static" may be taken to mean that the chosen ideal distribution has to be kept all the time, perhaps at any cost. Now, for both understandings of "static" conceptions of distributive justice, the problem is the same: what happens to the distribution as people use their shares? This problem does not manifest itself under Aristotle's central example of a distributive criterion, which deals with the distribution of power to rule (power is not something that can be used in the sense of "use" that I am employing). However, Aristotle's general account of distributive justice, as I present it, allows for static accounts of distributive justice that may need to confront the problem of shifting allotments that alter the original distribution through use. Now, under the first understanding of static conceptions of distributive justice, once we have distributed all there is to be distributed, the fact that people exchange their shares or destroy them is completely irrelevant because our duty to distribute shares fairly (according to the chosen criterion) has already been fulfilled. Conversely, under the second understanding, if the proper distribution is to be maintained forever, the problem is more pressing. Suppose that I am owed a particular piece of the "whole pie." Let's also suppose that I am the only one who eats his pie. Since everyone has pie and I don't, should I get a portion of everyone else's pie in order to maintain the ideal distribution? Or, suppose I give you my pie as a gift, should you be forced to give it back to me? Should I be forced to accept it? Or, perhaps, again, should everyone be required to forfeit a small part of his or her pie in order for me to get back my fair share.[13]

Most contemporary theories of distributive justice are, however, "dynamic" rather than "static"; that is, they advocate neither for one particular "fair" distribution nor for an ideal distribution that should always be maintained at any cost. Most

[10] Gordley, *supra* note 7.

[11] Benson, *supra* note 2 at 536.

[12] Though how I behave with regards to the others may be important in several ways: for example, if our distributive scheme were based upon the principle of assigning claims "to each according to how she relates to other individuals."

[13] Robert Nozick famously referred to these theories of distributive justice as "patterned theories." I will address Nozick's claims on distributive justice later in this book. See Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974) and my analysis in Chap. 4 of this book.