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Freedom of Contract and Fundamental Fairness for Individual Parties: The Tug of War Continues

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FREEDOM OF CONTRACT AND FUNDAMENTAL FAIRNESS FOR INDIVIDUAL PARTIES: THE TUG OF WAR CONTINUES

Carolyn Edwards*

I. INTRODUCTION

Classical contract theory emerged in the late nineteenth century to provide the foundation for the principles that govern the formation, performance, and enforcement of the bargain contract.[1] The theory insists that the unrestricted exercise of freedom of contract[2] between parties who possess equal bargaining power, equal skill, and perfect knowledge of relevant market conditions maximizes individual welfare and promotes the most efficient allocation of resources in the marketplace.[3] But contract theory did not reflect the harsh

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[1] Numbers of scholars have discussed the origins of classical contract theory. *See, e.g.*, LAWRENCE M. FRIEDMAN, CONTRACT LAW IN AMERICA: A SOCIAL AND ECONOMIC CASE STUDY (1965); *see also* GRANT GILMORE, THE DEATH OF CONTRACT 13 (1974) (crediting Christopher Langdell, who was appointed Dean of the Harvard Law School in 1870, with "the almost inadvertent discovery of the general theory of Contract".); E. Alan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576 (1969); Samuel Williston, *Freedom of Contract*, 6 CORN. L. Q. 365, 367 (1921) ("It was comparatively easy . . . to adopt a new theory of contract, since any inconsistency with earlier notions was not obvious enough to be disturbing.").

[2] The classic statement of freedom of contract is found in Printing & Numerical Registering Co. v. Sampson, 19 L. R.-EQ. 462, 465 (M.R. 1875):

> It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when freely and voluntarily entered into shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider – that you are not to lightly interfere with this freedom of contract.

Classical contract theory's emphasis on unrestricted freedom of contract had its roots in nineteenth century political philosophy, which declared "the end of man is freedom." Roscoe Pound, *The End of Law as Developed in Juristic Thought II*, 30 HARV. L. REV 201, 204 (1917). For an analysis of the doctrine of freedom of contract, *see generally* Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933); Roscoe Pound, *Liberty of Contract*, 18 YALE L. J. 454 (1909); Williston, *supra* note 1.

[3] This notion that the exercise of freedom of contract contributes to both individual and community welfare continues to influence contemporary legal thinking.

> Bargains are widely believed to be beneficial to the community in the provision of opportunities for freedom of individual action and exercise of judgment and as a means by which productive energy and product are apportioned in the economy. The enforcement of bargains rests in part on the common belief that enforcement enhances that utility.

RESTATEMENT (SECOND) OF CONTRACTS § 72 cmt. b (1981). Classical contract theory mirrors Adam Smith's laissez faire economic theory that the pursuit of self-interest, guided by an "invisible hand," promotes the good of society as a whole. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 423 (Richard Cannan ed., 1937). For a discussion of Adam Smith's moral philosophy, *see* Larry A. DiMatteo, *The History of Natural Law Theory;*

realities of the marketplace in the late nineteenth century. Equal parties did not exist and strong parties were able to impose unfair and oppressive bargains upon those who were weak and vulnerable.[4] Both legislatures and courts acknowledged that state action was necessary to ensure fundamental fairness for those who could not protect themselves.[5] However, legislative enactments and common law principles provided relief to those victimized by irresponsible and unscrupulous contract behavior only in limited and extraordinary circumstances.[6] "As we look back on the nineteenth century theories, we are struck most of all, I think, by the narrow scope of social duty which they implicitly assumed. No man is his brother's keeper; the race is to the swift; let the devil take the hindmost."[7]

During the early 1900s, abuses in market transactions multiplied. Legislatures enacted measures to curb some of these abuses, including the sale of adulterated food and drugs[8] and the exploitation of workers who labored in mills, mines, and factories.[9] But most contract transactions were not subject to government regulation and dishonest and greedy parties flooded the marketplace with defective merchandise and unfinished services.[10] Numbers of scholars

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Transforming Embedded Influences Into a Fuller Understanding of Modern Contract Law, 60 U. PITT. L. REV. 839, 879 (2006) ("Smith's capitalistic contractor was not one blinded by the passion of self-interest and financial greed. The capitalist of Smith's moral philosophy was one who entered just and equitable contracts.").

[4] *See* GILMORE, *supra* note 1, at 104 ("It seems apparent to the twentieth century mind, as perhaps it did not to the nineteenth century mind, that a system in which everybody is invited to do his own thing, at whatever cost to his neighbor, must ultimately work to the benefit of the rich and powerful").

[5] For discussion of legislative measures and judicial decisions that shaped the institution of contract during the early 1900s, *see* FRIEDMAN, *supra* note 1, at 140–54; Williston, *supra* note 1, at 374-380. Market realities prompted many scholars to support greater government intervention. *See* BARBARA H. FRIED, THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE, ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT, 38-42 (1998); MELVIN I. UROFSKY, A MIND OF ONE PIECE, BRANDEIS AND AMERICAN REFORM, 51 (1971) ("But if many people were willing to admit some form of government intervention in the economy, there was still a great debate over what form that intervention should take.").

[6] *See* Friedrich Kessler, *Contracts of Adhesion – Some Thought About Freedom of Contract*, 43 COLUM. L. REV. 629, 629 (1943) ("Rational behavior within the context of our culture is only possible if agreements are respected.").

[7] GILMORE, *supra* note 1, at 104. *See also* Kessler, *supra* note 6, at 640 ("Society, by proclaiming freedom of contract, guarantees that it will not interfere with the exercise of freedom of contract.").

[8] *See, e.g.*, Richard J. Barber, *Government and the Consumer*, 64 MICH. L. REV. 1203, 1205-17 (discussing legislative efforts to protect the health, safety, and economic welfare of consumers in the early 1900s).

[9] *See* Richard G. BOYER & HERBERT M. MORAIS, LABOR'S UNTOLD STORY (3d.ed. 1994) (providing an exhaustive analysis of workers' demands for better working conditions and the measures enacted by state legislatures to meet these demands).

[10] The market conditions that triggered demands for reforms in the law are outlined in a number of scholarly articles. *See, e.g.*, Allen R. Kamp, *Between-the-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context*, 59 ALB. L. REV. 325, 365-66 (1995) ("The pre-Keynesian macro-economists believed that business was caught in a vicious cycle. They thought that overproduction led to lower prices and 'chiseling,' the lessening of the quality of

warned that the economic order was in peril and that the health and safety of scores of consumers had been put at risk. Freedom of contract, they claimed, could only survive in an economy where trust and good will existed between parties who did business. Comprehensive reforms in the law were necessary, they insisted, to channel the exercise of liberty toward cooperation and decency, and, thus, to preserve the bargain contract as the vehicle to facilitate the most efficient distribution of resources in the economy.[11] In the early 1940s, the American Law Institute and the National Conference of Commissioners on Uniform State Laws[12] responded to the warnings and began the process of modernizing the law of commercial transactions.[13] The product of their efforts, the Uniform Commercial Code ("Code"), was enacted into law by state legislatures during the 1950s and 1960s.[14]

The Code grants express recognition to the doctrines of good faith[15] and unconscionability.[16] These doctrines, which had existed on the periphery of the

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goods and cheating, which further caused lower wages, decreased demand, overproduction, and, finally, lower prices and chiseling again.").

[11] *See* E. Merrick Dodd, *From Maximum Wages to Minimum Wages: Six Centuries of Regulation of Employment Contracts*, 43 COLUM. L. REV. 643 (1942). The modern period has been one in which a new impulse towards regulation has gathered strength as a result of our experience of the evils to which unlimited freedom of contract gives rise in an industrial society characterized by extreme inequalities of wealth and bargaining power and by sudden oscillations between booms and depressions. *Id.* at 643. Grant Gilmore, *On the Difficulties of Codifying Commercial Law*, 57 YALE L.J. 1341, 1358 (1948) ("Although the political weather is doubtful, nothing is less likely than that the future will see a protracted period of unregulated private agreement.").

[12] *See* A. Brooke Overby, *Modeling UCC Drafting*, 29 LOY. L.A. L. REV. 645, 650-56 (providing a history of the two organizations).

[13] For a detailed history of the drafting process, with an emphasis on the contributions made by Karl Llewellyn, *see* Allen R. Kamp, *Downtown Code: A History of the Uniform Commercial Code: 1949–54*, 49 BUFF. L. REV. 359 (2001) [hereinafter Kamp, *Downtown Code*]; Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code: 1940 – 49*, 51 SMU L. REV. 275 (1998) [hereinafter Kamp, *Uptown Act*].

[14] The Code has been enacted in all fifty states as well as Puerto Rico, the U. S. Virgin Islands, and the District of Columbia. Louisiana and Puerto Rico have enacted only parts of the Code. Unless otherwise indicated, citations are to the 2008 Official Text.

[15] The original version of Article 1 contained two sections on good faith. U.C.C. § 1-203 stated: "Every contract or duty within this Act imposes an obligation of good faith in its performance and enforcement." U.C.C. § 1-201(19) defined good faith as "honesty in fact in the conduct or transaction concerned". Revised Article 1 also contains two sections on good faith. U.C.C. § 1-304 provides: "Every contract of duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement." U.C.C. § 1-304 states that "good faith" means "honesty in fact and the observance of reasonable commercial standards of fair dealing." There is extensive literature on the doctrine of good faith. Recent articles include: Robert C. Bird, *An Employment Contract "Instinct With an Obligation": Good Faith Costs and Contexts*, 28 PACE L. REV. 409 (2008); Mariana Pargendler, *Modes of Gap Filling: Good Faith and Fiduciary Duties Reconsidered*, 82 TUL. L. REV. 1315 (2008); Luigi Russi, *Can Good Faith Performance be Unfair? An Economic Framework for Understanding the Problem*, 29 WHITTIER L. REV. 565 (2008); Emily Gold Waldman, *Fulfilling Lucy's Legacy: Recognizing Implied Good Faith Obligations within Explicit Job Duties*, 28 PACE L. REV. 429 (2008). For a list of additional

law until they were incorporated into Code articles,[17] provide the heart of a complex and expansive concept of social duty. This concept signaled the intent of legislators to transform community norms of honesty and decency into legal obligations and to create a market climate that discourages irresponsible contract behavior.[18] Once again, legislatures had departed from the classical vision of the institution of contract in an effort to foster fundamental fairness between parties who engage in transactions that are governed by Code articles.[19] But legislatures

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articles, *see* Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 ST. JOHN'S L. REV. 559, 560 n.4 (2006).

[16] U.C.C. § 2-302 provides:

> (1) If a court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
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> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded the opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

The drafters of the Code limited the scope of the doctrine of unconscionability to transactions in the sales of goods. However, Section 208 of the Restatement (Second) of Contracts (1981) expanded the scope of the doctrine to include contracts of all subject matters. There are numbers of articles that discuss the doctrine. Recent articles include: Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139, 156 (2005) (noting that "[c]ourts rarely overturn contracts for unconscionability."); Larry A. DiMatteo & Bruce Louis Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law In Action*, 33 FLA. ST. U. L. REV. 1067, 1100 (2006) (stating that "unconscionability claims are hard to win"); James F. Hopgg, *Consumer Beware: The Varied Application of Unconscionability Doctrine to Exculpation and Indemnification Clauses Michigan, Minnesota, and Washington*, 2006 MICH. ST. L. REV. 1011 (2006); Edith R. Warkentine, *Beyond Unconscionability: The Case For Using "Knowing Assent" as the Basis for Analyzing Unbargained-For Terms in Standard Form Contracts*, 31 SEATTLE U. L. REV. 469 (2008). For a list of articles that focus on the use of the doctrine to police terms contained in standard form contracts, *see* Larry Bates, *Administrative Regulation of Terms in Form Contracts: A Comparative Analysis of Consumer Protection*, 16 EMORY INT'L L. REV. 1, 2, n.2 (2002).

[17] *See* Dubroff, *supra* note 15, at 564-71 (tracing the development of the doctrine of good faith from the mid-1800s to the present); Arthur Allen Leff, *Unconscionability and the Code – The Emperor's New Clause*, 115 U. PIT. L. REV. 485, 489–546 (1967) (outlining in detail the difficulties encountered by the drafters in crafting Section 2-302).

[18] Numbers of scholars have discussed the Code's introduction of market norms, including good faith, reasonablness and diligence, into the laws that govern commercial transactions. *See, e.g.*, Kamp, *supra* note 10; John E. Murray, Jr., *The Article 2 Prism: The Underlying Philosophy of Article 2 of the Uniform Commercial Code*, 21 WASHBURN L. J. 1 (1981); Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465 (1987). For an analysis of the notion of equitable contracting as found in the works of philosophers, including Aristotle, Saint Thomas Aquinas, and Immanuel Kant, *see generally* DiMatteo, *supra* note 3.

[19] Professor Murray has observed, "The overriding standards of commercial reasonableness, honesty-in-fact, conscionability and, yes, decency, are the ultimate principles which may not be overcome in any application of Article . . . Article 2 not only enables but directs courts to impose their understanding of commercial reality on the marketplace." Murray, *supra* note 18, at 19-20.

had not established the scope of either doctrine and the task of providing appropriate limits on their use fell to the courts. There was reason to believe that courts were eager to take a more active role in matters of private bargaining and to expand their efforts to provide relief to parties who claimed to be the victims of selfish contract behavior. By the mid-1960s, courts had invoked the doctrine of promissory estoppel[20] in bargain transactions to avoid injustice to promisees who had relied to their detriment on unaccepted offers[21] as well as on promises made during the course of negotiations.[22] For decades, the doctrine, expressed in Section 90 of the Restatement of Contracts,[23] had been limited in scope to gratuitous transactions and its application in the bargain context suggested that courts were willing to displace classical contract principles, which protected freedom of contract, in order to provide relief to aggrieved parties.[24] Moreover,

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[20] The doctrine of promissory estoppel was granted express recognition in Section 90 of the Restatement of Contracts, published in 1932. The Section provided: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." For discussion of the origins of the doctrine, *see* Eric Mills Holmes, *Restatement of Promissory Estoppel*, 32 WILLAMETTE L. REV. 263, 265-97 (1996); Joel M. Ngugi, *Promissory Estoppel: The Life History of an Ideal Legal Transplant*, 41 U. RICH. L. REV. 425 (2007). The drafters of the Restatement (Second) of Contracts (1981) amended Section 90. It provides:

> (1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.
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> (2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

Several new sections have been added to accommodate use of the theory in particular fact situations. *See, e.g.*, §§ 87 (2) (offer which induces foreseeable and substantial reliance before acceptance is binding as an option contract to the extent necessary to avoid injustice); 89 (c) (promise modifying a duty is binding to the extent that justice requires enforcement where there is material change in position in reliance on the promise). For analysis of the changes made by the Restatement (Second), *see* Edward Yorio & Steven Thel, *The Promissory Basis of Section 90*, 101 YALE L. J. 111, 115-29 (1991).

[21] *See e.g.*, Drennan v. Star Paving Co., 333 P. 2d 757 (1958) (invoking the doctrine of promissory estoppel to avoid injustice suffered by an offeree who had relied on an unaccepted offer).

[22] *See, e.g.*, Hoffman v. Red Owl Stores, Inc., 133 N.W.2d 267 (1965) (granting damages to Hoffman, the promisee, who relied on assurances made by Red Owl during negotiations that he would be awarded a store franchise). For criticism of the court's decision to provide relief to Hoffman, *see* John J. Chung, *Promissory Estoppel and the Protection of Interpersonal Trust*, 56 Clev. ST. L. REV. 37, 74-75 (2008) (stating that "Hoffman bears a great deal of the responsibility for the failed outcome of his efforts" and "that the court should not have protected Hoffman's trust and reliance").

[23] RESTATEMENT OF CONTRACTS § 90 (1932).

[24] *See generally* Stanley D. Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, 78 YALE L. J. 343 (1969) (remarking on the significance of the doctrine's introduction into the bargain transaction).

courts had begun to incorporate the doctrines of good faith[25] and unconscionablity[26] into the common law. A new vision of the contract relationship seemed inevitable.

Within less than two decades, however, most courts had concluded that the doctrines of promissory estoppel and unconscionability must be applied with extreme caution in order to protect the benefits that unfettered freedom of contract was believed to produce in the marketplace.[27] But consensus that social obligation should play only a modest role in the bargain context was more fragile than it appeared. During the 1980s, some courts displaced traditional contract principles and used the implied covenant of good faith as a tool to mold the performance of express contract terms in accordance with the reasonable expectations of the parties.[28] Scholars applauded this development, declaring that courts had embarked on a course that reconciled the need to curb abuses in contract conduct with the demands of the marketplace that bargains be enforced as made.[29] Within the span of one decade, however, numbers of courts concluded that robust application of the covenant was not acceptable. They imposed severe restrictions on the doctrine's use,[30] insisting that the institution of

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[25] *See, e.g.*, Monge v. Beebe Rubber Co., 316 A.2d 549 (1974) ("We hold that a termination of a contract of employment at will which is motivated by bad faith, malice or based on retaliation is not in the best interest of the economic system or the public good and constitutes a breach of the employment contract."). In *Porter v. City of Manchester*, 849 A.2d 103, 114 (2004) the court stated that the law also requires that the at will employee demonstrate that he was discharged "because he performed an act that public policy would encourage, or refused to do that which public policy would condemn." Section 205 of the Restatement (Second) of Contracts (1981) states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement."

[26] *See, e.g.*, Ryan v. Weiner, 610 A.2d 1377 (1992) (applying the doctrine of unconscionability to a contract for the sale of an interest in land). Section 208 of the Restatement (Second) of Contracts (1981) provides:

> If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.

[27] *Infra* notes 142-61 and accompanying text.

[28] *See, e.g.*, K.M.C. Co., Inc. v. Irving Trust Company, 757 F.2d 752 (6th Cir. 1985) (holding that the lender was required to give the debtor notice before refusing to loan additional funds pursuant to a financing agreement which provided that all advances were discretionary and that all loans were payable on demand); Fortune v. National Cash Register Co., 364 N.E.2d 1251 (1977) (holding that the reasons for which an at-will employee may be terminated are shaped by the covenant of good faith).

[29] Professor Patterson has been a leading advocate of expansive use of the doctrine. *See, e.g.*, Dennis M. Patterson, *Good Faith, Lender Liability and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEX. L. REV. 169 (1989) [hereinafter Patterson, *Good Faith*]; Dennis M. Patterson, *A Fable From the Seventh Circuit: Judge Easterbrook on Good Faith*, 76 IOWA L. REV. 503 (1991) [hereinafter Patterson, *A Fable*].

[30] *Infra* notes 208-21 and accompanying text.

contract was at risk if the law[31] required that parties enter into equitable contracts.[32] Tension among the courts intensified. Different visions of the contract relationship and of the role of courts in contract affairs existed in the case law. Despite the passing of time and the publication of scores of judicial decisions and scholarly articles, controversy lingers.

This article outlines the controversy that surrounds the incorporation of community norms into the contract relationship and the role that courts should play in matters of private bargaining. Part II discusses the vision of the institution of contract that prevailed in America at the close of the nineteenth century. Except in extraordinary circumstances, this vision reflected the fundamental propositions of classical theory. Accordingly, courts and legislatures exercised restraint in order to preserve the power of parties to structure their own affairs.[33] Part III explores the market conditions that triggered legislative intrusion into matters of private bargaining and outlines the debate that emerged in the early 1900s when the United States Supreme Court declared statutory measures that addressed the plight of the American worker to be unconstitutional and foolhardy restrictions upon the exercise of liberty of contract.[34] The controversy over the relative merits of freedom of contract and social control created tension between courts and legislatures until well into the 1930s. But the Great Depression silenced the debate and it slumbered peacefully for more than three decades. However, formal recognition of the doctrines of unconscionability, good faith, and promissory estoppel rekindled the debate, "with the courts themselves very much in the fray."[35] Part IV reviews the efforts that have been made to establish the limits of permissible contract conduct and identifies the reasons why judges and scholars have failed to reach agreement on what combination of freedom of contract and social duty best serves individual welfare and community progress.

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[31] *See, e.g.*, Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd., 970 F.2d 273, 282 (7th Cir. 1992) (remarking on the economic injury that flows to individual parties from judicial oversight of contract terms).

[32] *See, e.g.*, Industrial Representatives, Inc. v. CP Clare Corp., 74 F.3d 128, 132 (7th Cir. 1996) ("Contract law does not require parties to be fair, or kind, or reasonable, or to share gains or losses equitably.").

[33] *Infra* notes 45-59 and accompanying text.

[34] For a history of the constitutional doctrine of "liberty of contract" as envisioned by the United States Supreme Court in the early 1900s, *see* FRIED, *supra* note 5, at 32-33. Scholars were critical of judicial decisions that struck down reform measures designed to address the plight of the wage earner. *See, e.g.*, Learned Hand, *Due Process and the Eight-Hour Day*, 21 HARV. L. REV. 495, 500 (1908) (stating that "with the expediency of the statute the court has no concern, but only with the power of the legislature").

[35] Patterson, *Good Faith*, *supra* note 29, at 173.

II. THE INSTITUTION OF CONTRACT

A. The Fundamental Propositions of Classical Theory

Classical contract theory rests upon three fundamental propositions.[36] First, the exercise of freedom of contract between equal parties in markets of perfect competition is the key to individual welfare and the common good.[37] Freedom of contract is defined as the power to decide whether to contract and to establish the terms of the bargain.[38] "We have been proud of our 'freedom of contract,' confident that the maximum of social progress will result from encouragement of each man's initiative and ambition by giving him the right to use his economic power to the full."[39] Second, enforcement of bargains as made protects the reasonable expectations of the parties that promises will be performed and contributes to certainty and stability in the marketplace.[40] "It is a presupposition

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[36] For an outline of the propositions that support classical contract theory, *see* Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 211-12 (1995).

[37] *See, e.g.*, Ryan v. Weiner, 610 A.2d 1377, 1380 (Del.1992) ("The right of competent persons to make contract and thus privately to acquire rights and obligations is a basic part of our general liberty. This ability to enter and enforce contracts is universally of thought not only to reflect and promote liberty, but as well to promote the production of wealth."). Scholars have also remarked on the view that the unfettered exercise of market liberty benefits the economic order. *See, e.g.*, HENRY SIDGWICK, THE ELEMENTS OF POLITICS (1908).

> Withdraw contract – suppose that no one can count upon the fulfillment of any engagement – and the members of a human community are atoms that cannot effectively combine; the complex cooperation and division of employments that are essential characteristics of modern industry cannot be introduced among such beings. Suppose contracts freely made and effectively sanctioned, and the most elaborate social organization becomes possible, at least in a society of such human beings as the individualistic theory contemplates – gifted with mature reason, and governed by enlightened self-interest.

Id. at 82. *See also* Cohen, *supra* note 2, at 588 (stating that contract theory "is connected with the classical economic optimism that there is a sort of pre-established harmony between the good of all and the pursuit by each of his own selfish economic gain."); Kessler, *supra* note 6, at 640 ("The 'pre-established harmony' of a social system based on freedom of enterprise and perfect competition sees to it that the 'private autonomy' of contracting parties will be kept within bounds and will work out to the benefit of the whole."); Williston, *supra* note 1, at 366 (noting that economic writers, including Adam Smith and John Stuart Mill, insisted on "freedom of bargaining as the fundamental and indispensable requisite of progress."). The notion that parties must be free to structure their own affairs is expressed in the principle that courts will not inquire into the adequacy of consideration. *See* RESTATEMENT (SECOND) OF CONTRACTS § 79 cmt. c (1981).

[38] *See* Roscoe Pound, *Liberty of Contract*, *supra* note 2, at 455 (observing that the first exhaustive treatment of freedom of contract as a fundamental natural right did not occur until the early 1890s).

[39] John Dalzell, *Duress by Economic Pressure I*, 20 N.C. L. REV. 237, 237 (1942).

[40] *See* Dubroff, *supra* note 15, at 567 (remarking on the "belief that strict formalism led to consistency and predictability—a desirable attribute in the administration of contract law that permitted parties to arrange their affairs with clear and certain expectations of legal consequences").

of the whole economic order that promises will be kept. Indeed, the whole matter goes deeper. The social order rests upon stability and predictability of conduct, of which keeping promises is a large item."[41] Thus, the bargain contract is the manifestation of liberty in the marketplace and the vehicle to facilitate the most efficient allocation of resources in the economic order. "Contract thus became the indispensable instrument of the enterpriser, enabling him to go about his affairs in a rational way."[42] Finally, state action "is an evil, for it can only have for its object the regulation of the exercise of rights, and to regulate the exercise of a right is inevitably to limit it."[43] Accordingly, it is the duty of government to exercise restraint and to protect the right of the individual to contract freely.[44]

B. The Role of the Courts in Contract Affairs

By the mid-1800s, courts[45] had established the fundamental principles that govern the formation, performance, and enforcement of the bargain contract.[46] They created a complex system of universal rules that mirrored the propositions of classical contract theory.[47] This system assumed that equal parties exist in the marketplace and that each party is competent to choose the terms upon which he is willing to be bound.

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[41] ROSCOE POUND, III JURISPRUDENCE 162-63 (1959).

[42] Kessler, *supra* note 6, at 629.

[43] Pound, *The End of Law*, *supra* note 2, 205 n.16 (1917) (quoting CHARLES BEUDANT, LE DROIT INDIVIDUEL ET L'ETAT 148 (1891)).

[44] *See* Fried, *supra* note 5, at 29–37 (analyzing the views of scholars who supported limited state action).

[45] "[I]t was commonly accepted that proper division of labor between court and legislature gave contracts to the court. Legal theory assigned to the court the exclusive power of declaring "law" in the sense of basic, universal, underlying principles." FRIEDMAN, *supra* note 1, at 25. For an extensive analysis of the institutional differences between courts and legislatures, *see* David L. Shapiro, *Courts, Legislatures and Paternalism*, 74 VA. L. REV. 519, 551-558 (1988).

[46] *See* FRIEDMAN, *supra* note 1, at 194-95 (discussing the reasons why courts "were apparently free to invent such legal rules as they deemed most just and suitable to fit the cases and classes of cases before them.").

[47] Professor Friedman has offered the following description of the system of common law rules that courts established to preserve unfettered liberty in the marketplace:

> The "pure" law of contract is an area of what we call abstract relationships. "Pure" contract doctrine is blind to details of subject matter and person. It does not ask who buys and who sells, and what is bought and sold . . . . Contract law is an abstraction – what is left in the law relating to agreements when all particularities of person and subject-matter are removed.

Id. at 20-21. This abstraction is not what people think of when they criticize the law as being too abstract, implying that the law is hyper-technical or unrealistic. The abstraction of classical contract law is not unrealistic; it is a deliberate renunciation of the particular, a deliberate relinquishment of the temptation to restrict untrammeled individual autonomy or the completely free market in the name of social policy.

> [E]very person who is not from his peculiar condition or circumstances under disability is entitled to dispose of his property in such a manner and upon such terms as he chooses; and whether his bargains are wise and discreet, or profitable or unprofitable or otherwise, are considerations not for courts of justice but for the party himself to deliberate upon.[48]

The presumption of party competence led to the conclusion that courts were not to inquire into the fairness of contracts or contract content, but to exercise restraint and to enforce bargains as made.[49] Their role was to act as "detached umpires or referees, doing no more than to see that the rules of the game were observed and refusing to intervene affirmatively to see that justice or anything of that sort was done."[50]

But courts were not indifferent to the realities of contract practice. Common law doctrines granted the power to avoid contract obligations to minors as well as to those victimized by fraud, duress, and undue influence.[51] These doctrines were narrowly defined and limited in number in order to avoid the adverse consequences that were believed to flow to the economic order from state regulation of private contracting. Except in extraordinary circumstances, courts avoided scrutiny of contract equities on the grounds that efforts to achieve justice in individual cases limited freedom of contract and fostered uncertainty that promises would be kept.[52] Commercial life in this country could ill-afford a

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[48] I JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA 337 (14th ed. 1918). *See* Eisenberg, *supra* note 36, at 211-12 (discussing classical contract theory's reliance on the notion that "parties are normally the best judges of their own utility, and normally reveal their determinations of utility in their promises . . . .").

[49] The notion that bargains should be enforced as made continues to influence contemporary legal theory. *See generally* ALAN SCHWARTZ, KARL LLEWELLYN AND THE ORIGINS OF CONTRACT THEORY, IN THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 12 (Jody S. Kraus & Steven D. Walt eds., 2000) [hereinafter SCHWARTZ]. The notion is expressed in the common law rule that a party is bound to a contract whether the contract is read or its contents understood. "[I]t is as much the duty of a person who cannot read the language in which a contract is written to have someone read it to him before he signs it, as it is the duty of one who can read to peruse it himself before signing it." Stern v. Moneyweight Scale Co., 42 App. D.C. 162, 165 (D.C. Cir. 1914) (citation omitted).

[50] GILMORE, *supra* note 1, at 15. *See also* DiMatteo, *supra* note 3, at 884 ("Traditional contract law placed a premium upon the sanctity of promise or sanctity of contract. This sanctity underlies the strict application of contract rules and the strict enforcement of contractual terms.").

[51] For a discussion of these doctrines, *see* E. ALLAN FARNSWORTH, I FARNSWORTH ON CONTRACTS 442-520 (Aspen Publishers 2004).

[52] For more than a century, courts have acknowledged that tension exists between the need to ensure fairness for parties who are weak and vulnerable and the demands of the marketplace for certainty and stability in contract affairs. In the classic case of Henry v. Root, 33 N.Y. 526 (1865) the court observed:

> A protracted struggle has been maintained in the courts, on the one hand to protect infants and minors from their own improvidence and folly, and to save them from the depredations and frauds practiced upon them by the designing and unprincipled, and on the other to protect the rights of those dealing with them in good faith and on the assumption that they could lawfully make contracts.

system of principles that restricted private autonomy and threatened efficiency in the exchange of goods and services.[53] Thus, the responsibility of the courts to protect those who were weak and vulnerable did not extend to parties who suffered hardships simply because they failed to protect themselves.[54]

> Contract – the language of the cases tells us – is a private affair and not a social institution. The judicial system . . . cannot make contracts for the parties. . . . Either party is supposed to look out for his own interests and for his own protection. Oppressive bargains can be avoided by careful shopping around. . . . Since a contract is the result of free bargaining of parties who are brought together by the play of the market and who meet each other on a footing of social and approximate economic equality, there is no danger that freedom of contract will be a threat to the social order as a whole.[55]

C. The Role of Legislatures in Contract Affairs

During the nineteenth century, legislatures also assumed power to shape the institution of contract.[56] They exercised this power in order to deal with market particularities and with "expedient, temporary, local, or specialized variations. . . . Legislative change in the fundamentals of the common law was thus 'in derogation' of what was regarded as the main body of law; judge-made law was

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Id. at 535.

Scholars have also remarked on the tension that exists between liberty and fundamental fairness. Professor DiMatteo has noted:

> The norms of justice and fairness are seen as competitors to the formalistic use of contract rules to promote certainty in contractual transactions. The latter is individualistic in its perspective and incorporates notions of freedom, security, and efficiency. The former is communitarian centered in its focus. The central issue for the law of contracts is how best to balance these norms. How much should community based norms limit the free rein of the individuality of contracting.

DiMatteo, *supra* note 3, at 884.

[53] *See, e.g.*, Katherine M. Apps, *Good Faith Performance in Employment Contracts: A "Comparative Conversation" Between the U.S. and England*, 8 U. PA. J. LAB. & EMP. L., 883, 888 (2006) (noting "the discord between the court's function as an arbiter of individual disputes and its role of setting out legal principle for the settlement of future disputes."); Lawrence M. Friedman, *Legal Rules and the Process of Social Change*, 19 STAN. L. REV. 786, 792 (1967) (stating that rules, which demand consideration of good faith and equity "are tolerable as operational realities only in those areas of law where the social order or the economy can afford the luxury of slow, individuated justice. If there is a social interest in mass handling of transactions, a clear-cut framework of nondiscretionary rules is vital."). This view continues to influence contemporary judicial thinking. *See, e.g.*, Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1357 (7th Cir. 1990).

[54] *See e.g.*, James Baird Co. v. Gimbel Bros., 64 F.2d 344, 346 (2d Cir. 1933) (holding "[I]n commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves.").

[55] Kessler, *supra* note 6, at 630.

[56] FRIEDMAN, *supra* note 1, at 25 (outlining "the division of labor" that existed between courts and legislatures in the nineteenth century).

the norm, statutes the exceptions."[57] Although legislatures had authority to create reasonable exceptions to common law rules "where it is conceived that public policy requires it,"[58] they were no more inclined than the courts to restrict the exercise of freedom of contract. Prohibitions against lotteries, Sunday laws, and usury statutes[59] made only limited inroads into the power of parties to conduct business in a manner and upon such terms as they might choose.

By the late 1800s, the gap between classical theory's vision of the marketplace and the realities of contract practice widened, exposing an economic order dominated by large and powerful corporations. "The darker side of their success – the shady dealings, the squalid slums spawned by factories, the cruel working conditions – frightened many people"[60] and fueled unrest among workers.[61] By the early 1900s, workers, "trampled to death beneath an iron heel,"[62] had organized strikes in small towns and large cities, demanding higher wages, safer working conditions, and an eight-hour day. On numerous occasions, government officials, who were anxious to end the chaos, ordered state and federal troops to arrest, even fire upon, those who engaged in protests.[63] The country was in plunged into an economic and social crisis that pitted the American worker against the industrial capitalist. As the crisis deepened, government action to address workers' grievances and to restore order in the country became inevitable. Courts were virtually powerless to act. Common law rules, which rested upon nineteenth century radical individualism, were indifferent to abuses in bargaining power that did not rise to the level of fraud, duress, or undue influence. Moreover, the court "by law and by custom . . . lacked any authority to initiate action. It had no authority to stretch out its hand and gather in questions that urgently needed deciding. The court had to sit passively waiting for the cases to come."[64] Legislatures, on the other hand, were not bound by a system of principles that discouraged examination of market realities. Moreover, they had assumed power to set their own agenda and to initiate action for the public good.[65] By 1915, many state legislatures had chosen

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[57] *Id.* at 25.

[58] Williston, *supra* note 1, at 378.

[59] *Id.* at 373-74. For an interesting discussion of the controversy that continues to surround government regulations that are intended to protect the health, safety, and economic welfare of citizens, *see generally* Shapiro, *supra* note 45.

[60] UROFSKY, *supra* note 5, at 48.

[61] For a detailed history of labor's struggle for justice in the workplace, *see* BOYER & MORAIS, *supra* note 9; ALAN DAWLEY, STRUGGLES FOR JUSTICE: SOCIAL RESPONSIBILITY AND THE LIBERAL STATE (1991).

[62] BOYER & MORAIS, *supra* note 9, at 65 (quoting President Grover Cleveland, Annual Message to Congress (Dec. 3, 1888)).

[63] *See* DAWLEY, *supra* note 61, at 27-37 (describing the violence that erupted during the late 1800s between striking workers and government officials).

[64] FRIEDMAN, *supra* note 1, at 198.

[65] Shapiro, *supra* note 45, at 552-55 (outlining the reasons why courts and legislatures serve different functions in shaping the institution of contract).

to exercise this power, enacting laws that regulate child labor and that set maximum hours and minimum wages for thousands of American workers.[66]

Legislative measures that established limits on the exercise of freedom of contract in the workplace marked a significant departure from classical contract propositions. These laws intruded directly into contract content, displacing the classical notion that parties, not government, are better suited to determine the wisdom and fairness of their bargains. The sanctity of the bargain contract had been deliberately violated in an effort to provide justice in the workplace. Legislatures had rejected the theory that championed minimal state action and redefined the contract relationship that exists between scores of American wage earners and their employers

III. THE DEBATE OVER THE MERITS OF SOCIAL DUTY

A. The United States Supreme Court Responds to Labor Legislation

The plight of the American worker failed to persuade the United States Supreme Court to deviate from nineteenth century radical jurisprudence. Scores of legislative enactments that addressed workplace abuses were declared to be unconstitutional infringements of liberty of contract, a fundamental property right protected under the Due Process Clause of the Fourteenth Amendment.[67] In *Lochner v. New York*,[68] for example, the Court struck down as unconstitutional a New York law that prohibited the employment of bakery workers for more than ten hours per day or sixty hours per week.[69] But the Court was not content to rely only upon the notion that liberty of contract is entitled to constitutional protection to support its conclusion that that law must fail. In a vigorous defense

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[66] BOYER & MORAIS, *supra* note 9, at 180.

[67] *See* Jessica E. Hacker, Comment, *The Return to Lochnerism? The Revival of Economic Liberties from David to Goliath*, 52 DEPAUL L. REV. 675, 686 (stating that during the early 1900s, the Supreme Court struck down more than two hundred state statutes designed to protect American workers).

[68] Lochner v. New York, 198 U.S. 45 (1905). The decision continues to prompt scholarly comment. *See, e.g.*, Daniel A. Farber, *Who Killed Lochner?*, 90 GEO. L. J. 985 (2002); Hacker, *supra* note 67; Anthony S. McCaskey, *Thesis and Antithesis of Liberty of Contract: Excess in Lochner and Johnson Controls*, 3 SETON HALL CONS. L. J. 409 (1993). Professor McAffee has noted:

> Lochner remains troubling to modern thinkers precisely because if there remains a rough consensus . . . that something went wrong during the Lochner era, there is no such consensus about exactly what went wrong and its implications for contemporary constitutional adjudication. Nevertheless, in the most recent era, the Supreme Court has returned to its practice, going back to at least the turn of the twentieth century, of imposing unenumerated fundamental rights as limitations on the powers of government.

Thomas B. McAffee, *Overcoming Lochner in the Twenty-First Century: Taking Both Rights and Popular Sovereignty Seriously As We Seek to Secure Equal Citizenship and Promote the Public Good*, 42 U. RICH. L. REV. 597, 600-01 (2008).

[69] *Lochner*, 198 U.S. at 53.

of unfettered freedom of contract, the Court declared the law to be an unnecessary and undesirable interference with the power of bakery workers to choose the terms of their employment.

> There is no contention that bakers are as a class not equal in intelligence and capacity to men in other trades or manual occupations, or that they are not able to assert their rights and care for themselves without the protecting arm of the State, interfering with their independence of judgment and of action. They are in no sense wards of the state. . . . Not only the hours of employees, but the hours of employers, could be regulated, and doctors, lawyers, scientists, all professional men, as well as athletes and artisans, could be forbidden to fatigue their brains and bodies by prolonged hours of exercise, lest the fighting strength of the state be impaired.[70]

The Court did not stand alone in its refusal to abandon the notion that state action, which transforms community norms of honesty and decency into legal obligations, constitutes unwarranted regulation of market liberty. Advocates of limited state intervention continued to insist that government regulation, which establishes the boundary between the use and misuse of bargaining power, is detrimental to individual and community prosperity.[71] Laws that set maximum hours of work, for example, were condemned on the grounds that they reduce productivity, requiring employers to accept lower profits or to raise prices on their products. "But so far as the admitted effect of the measure is to diminish the amount of daily service rendered by the labourer to society, I think that no government ought to take the responsibility of causing the consequent loss of wealth to individuals and to the community as a whole."[72]

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[70] *Id.* at 57, 60-61. The refusal of the Court to acknowledge that legislatures have power to impose reasonable restrictions upon the exercise of liberty of contract prompted one scholar to observe:

> Political as well as economic and social sciences noted these revolutionary changes. But legal science – the unwritten or judge-made laws as distinguished from legislation – was largely deaf and blind to them. Courts continued to ignore newly arisen social needs. They applied complacently 18th century conceptions of the liberty of the individual and of the sacredness of private property. Early 19th century scientific half-truths like "The survival of the fittest," which, translated into practice, meant "The devil take the hindmost" were erected by judicial sanction into a moral law. Where statutes giving expression to the new social spirit were clearly constitutional, judges, imbued with the relentless spirit of individualism, often construed them away.

Louis D. Brandeis, *The Living Law*, 10 U. ILL. L. REV. 461, 463-64 (1916). See also UROFSKY, *supra* note 5, at 24 ("Judicial conservatism erected a wall of precedents to block future legislative reforms and to protect laissez faire. Thus, at the same time that lawyers were forced into a greater awareness of social and economic change, the law itself was being locked into a one-dimensional view of reality.").

[71] *See* Hand, *supra* note 34 (discussing the controversy that surrounded legislative measures intended to provide justice in the workplace).

[72] SIDGWICK, *supra* note 37, at 162 n.1.

Other scholars[73] praised the efforts of legislatures to "make more just and equal the relative strategic advantages of the two parties to the contract, of whom one is under the pressure of absolute want, while the other is not."[74] They claimed that the greatest threat to free contract came not from state action, but from individual coercion.[75] The business of the state, they declared, is to "override individual coercion,"[76] whether such coercion takes the form of fraud, duress, or abuse in the exercise of superior bargaining power and skill.[77] "To uphold the sanctity of the bargain contract is doubtless a prime business of government, but it is no less its business to provide against contracts being made, which, from the helplessness of one of the parties to them, instead of being a security for freedom, become an instrument of disguised oppression."[78] Thus, government is obligated to take action, scholars declared, to control the exercise of market power and to restore harmony and equality in the economic order.[79]

B. Warnings Are Issued

The debate over the appropriate limits of government control had been set in motion, pitting legislatures against courts. Different visions of the contract relationship and of the role that government should play in defining this relationship had emerged. Would legislatures and courts resolve the debate or would the tug of war continue? There was little reason to be optimistic that agreement could be reached on what combination of freedom of contract and social control protects and enhances contract objectives. A few scholars resisted the temptation to be drawn into the debate.[80] They warned that the benefits and burdens of government regulation cannot be identified and measured with certainty at the time government chooses to take action.[81] They cautioned that

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[73] *See, e.g.*, Hand, *supra* note 34, at 506; Williston, *supra* note 1, at 378.

[74] Hand, *supra* note 34, at 506.

[75] *See* FRIED, *supra* note 5, at 42-47 (discussing the development of the theory that individual coercion was believed to be a greater threat to liberty than state action); Robert Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 625 (stating that coercive bargaining power enables strong parties to impose "restrictions" upon those who are "economically weak").

[76] FRIED, supra note 5, at 42 (quoting L. T. HOBHOUSE, LIBERALISM 71 (1911)).

[77] Hand, *supra* note 34, at 90.

[78] FRIED, *supra* note 5, at 42 (quoting T.H. GREEN, LECTURES ON THE PHILOSOPHY OF KANT: LIBERAL LEGISLATION AND FREEDOM OF CONTRACT 67-68 (1881)).

[79] *See* FRIED, *supra* note 5, at 40–44 (discussing the transition in scholarly thinking from a negative definition of liberty, which focused on the need for government restraint, to a positive definition that required government to take action to serve the public good); Nathan Issacs, *The Standardizing of Contracts*, 27 YALE L. J. 34, 47 (1917) ("The movement toward status law clashes, of course, with the ideal of individual freedom in the negative sense of 'absence of restraint' of laissez faire. Yet, freedom in the positive sense of opportunity is being served by social interference with contract.").

[80] Hand, *supra* note 34, at 503.

[81] In commenting on the New York statute that the United States Supreme Court struck down in *Lochner*, Learned Hand noted:

the debate over the wisdom of limiting freedom of contract is resolved only by experience.[82] In the absence of such experience, scholars, legislators, and jurists must resist the temptation to draw any conclusions about the relative merits of unfettered freedom of contract and state intervention that is intended to end the evils that exist in the marketplace.[83] Thus, in their zeal to end injustices in the workplace, legislatures had engaged in experimentation and only time would reveal whether their decision to intervene produced benefits for some without imposing injury upon others.

In short, the whole matter is yet to such an extent experimental that no one can with justice apply to the concrete problems the yardstick of abstract economic theory. We do not know, and we cannot for a long time learn, what are the total results of such "meddlesome interference with the rights of the individual." He would be as rash a theorist who should assert with certainty their beneficence, as he would sweep them all aside by virtue of some pragmatic theory of "natural rights". The only way in which the right, or the wrong, of the matter may be shown is by experiment.[84]

Thus, theories about the wisdom of state action are unproven and "that throws the whole matter open for exclusive consideration, and for exclusive determination, by the legislature."[85] The legislature, "with its paraphernalia of committee and commission"[86] was declared to be "the only public representative really fitted to experiment."[87] This declaration reaffirmed the nineteenth century view that legislatures and courts served different functions in shaping the institution of contract.[88] Legislatures were believed to be well-equipped to examine market particularities and to experiment with social controls. They could rely on committees and commissions to gather evidence that identified and measured the benefits and burdens of measures that were intended to curb market abuses. If experience established that certain measures were unnecessary or undesirable, reforms could be made without encroaching upon an inherited system of common law principles and precedents. Courts did not have resources to determine the consequences of judicial decisions, which set limits on contract conduct, and thus, they were declared unfit to engage in experimentation.[89]

> That is, there can be no question that such a regulation actually "affects" the welfare of the persons within its terms; but there may well be a question whether, all things considered, it affects them beneficially, or, if beneficially, whether it does not do so at a corresponding expense arbitrarily imposed upon other persons."

Hand, *supra* note 34, at 503.

[82] Williston, *supra* note 1, at 374 (observing that "unlimited freedom of contract does not necessarily lead to public or individual welfare and that the only ultimate test of proper limitations is that provided by experience.").

[83] Hand, *supra* note 34, at 507-08.

[84] Hand, *supra* note 34, at 507-08.

[85] Hand, *supra* note 34, at 507.

[86] Hand, *supra* note 34, at 508.

[87] Hand, *supra* note 34, at 508.

[88] FRIEDMAN, *supra* note 1, at 25.

[89] *See* Shapiro, *supra* note 45, at 552-55 (discussing why institutional differences between legislatures and courts lead to the conclusion that legislatures are better suited to experiment with social controls); *see also* Bushwick-Decatur Motors v. Ford Motor Co., 116 F.2d 675, 677 (2d Cir.

Accordingly, it was the duty of courts to exercise restraint and to avoid "the temptation to restrict untrammeled individual autonomy or the completely free market in the name of social policy."[90]

C. Market Conditions Continue to Deteriorate

The warnings that the wisdom of state action to ensure fundamental fairness is a matter of pure speculation and that legislatures are better suited than courts to engage in experimentation did not bring an end to the tension that existed between state legislatures and the United States Supreme Court. Indeed, the Court continued to strike down labor legislation until well into the 1930s.[91] But the debate finally faded into the background as the country entered the Great Depression. During the first one hundred days of his administration, President Franklin Roosevelt proposed a number of ambitious programs to address the economic and social crisis that gripped the nation.[92] The voices of those who opposed government intrusion into the economic order were powerless against "the dark realities of the moment."[93] Within just seven months of his election, Roosevelt was declared to have saved the nation.[94]

> Millions of Americans would still despair in the eight long years of Depression that still lay ahead and many of their individual dreams would be dashed on the rocks of economic hardship. But collectively, the country was in a new place, with a new confidence that government would actively try to solve problems rather than fiddle or cater to the rich.[95]

This "new confidence"[96] led to the proliferation of social and economic programs that shifted power to Congress and to a vast array of administrative agencies.

> Whether one looked at managerial institutions, such as the National Recovery Administration, or social reforms, such as the Social Security system, it was clear that a new liberalism had come into being. Extensive government regulation of the market and the coming of the welfare state marked a permanent turn away from laissez faire.[97]

1940) (noting that courts do not have the resources to determine the economic factors that lead one party to demand "seemingly harsh bargains").

[90] FRIEDMAN, *supra* note 1, at 21.

[91] Hacker, *supra* note 67, at 686.

[92] *See* JONATHAN ALTER, THE DEFINING MOMENT: FDR'S HUNDRED DAYS AND THE TRIUMPH OF HOPE (2006) (discussing the social and economic crisis that gripped the nation during the 1930s and outlining the programs that were intended to restore individual and community prosperity).

[93] ALTER, *supra* note 92, at 339 (quoting President Franklin D. Roosevelt, Inaugural Address (Mar. 4, 1933)).

[94] ALTER, *supra* note 92, at 306.

[95] ALTER, *supra* note 92, at 306-07.

[96] ALTER, *supra* note 92, at 307.

[97] DAWLEY, *supra* note 61, at 409.

But greater government regulation of the economic order did not disturb the principles that governed the formation, performance, and enforcement of most goods and service contracts nor did it create equality between parties who met in the marketplace.[98] Opportunities for strong parties to impose harsh and oppressive terms upon weak and unsuspecting parties multiplied as the standard form contract became the principal vehicle to facilitate the distribution of goods and services.[99] The standard form contract provided the most effective and efficient means of doing business[100] in an economic order where "that precious commodity Justice must be viewed as being as scarce as the scarcer economic goods."[101]

During the 1940s and 1950s, consumers as well as commercial parties asked courts to provide them with relief from unfair terms contained in form contracts. However, tools that allowed courts to inquire into the fairness of contract terms did not exist in the common law or in statutory measures and most judges were reluctant to abandon abstract contract principles in order to develop such tools.[102] In *Bushwick-Decatur Motors v. Ford Motor Co.*,[103] for example,

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[98] *See* Gilmore, *supra* note 11, at 1358 ("American lawyers have traditionally thought of private commercial law as being in one watertight compartment and public control of business in another. The separation of two halves of an indivisible whole has never been logically sound; it is rapidly becoming manifestly untenable.").

[99] Scholars were troubled by the use of the standard form contract to impose harsh bargains on those who were weak and vulnerable. Karl N. Llewellyn, who served as principal drafter of U.C.C. Article 2 (Sales), referred to standard form contracts as "lopsided bargains." Karl N. Llewellyn, *On Warranty of Quality and Society: II*, 37 COLUM. L. REV. 341, 402 (1937) [hereinafter Llewllyn, *On Warranty of Quality and Society: II*]; *see also* Kessler, *supra* note 6, at 640 (stating that form contracts enable "powerful industrial and commercial overlords . . . to impose a new feudal order of their own making upon a vast host of vassals"); KARL N. LLEWELLYN, THE COMMON LAW TRADITION: DECIDING APPEALS 362 (1960) (stating that he knew of no other legal problem that "has either been as disturbing in life or more baffling to lawyers" than the standard form contract). Scholars continue to remark on the hardships that standard form contracts may impose upon unsuspecting consumers. Bates, *supra* note 16, at 2 (remarking on "the inability of the law to develop an approach to standardized contracts that provides adequate protection to consumers against the reshaping of the law by powerful market entities."); *see* Michael M. Greenfield & Linda J. Rusch, *Limits on Standard-Form Contracting in Revised Article 2*, 32 UCC L.J. 115 (1999); Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429 (2002).

[100] *See generally* W. David Slawson, *Standard Form Contracts and Democratic Control of Law Making Power*, 84 HARV. L. REV. 529, 529-33 (1971) (outlining the reasons why the standard from contract provides the most efficient means of doing business in an economy of mass production and mass distribution).

[101] Karl N. Llewellyn, *On Warranty of Quality*, *supra* note 99, at 401.

[102] *See, e.g.*, Nat'l Bank of Washington v. Equity Investors, 506 P.2d 20, 36 (Wash. 1973) ("The whole panoply of contract law rests on the principle that one is bound by the contract which he voluntarily and knowingly signs."). Courts of equity were not reluctant to inquire into the fairness of contract content and they refused to grant equitable remedies when the contract was one that "no man in his senses and not under delusion would make on the one hand, and . . . no honest and fair man would accept on the other." Earl of Chesterfield v. Janssen, 28 Eng. Rep. 82 100 (Ch. 1750).

the manufacturer, which had been granted express power to terminate the contract "at any time,"[104] ceased doing business with the dealer. The dealer argued that the termination "was malicious, in bad faith, and contrary to the custom of the trade, and therefore wrongful."[105] The court refused to incorporate the covenant of good faith into the agreement to limit performance of the power to terminate. It acknowledged that its refusal flowed directly from legal theory and from the belief that courts were not equipped to engage in experimentation that restricts the exercise of freedom of contract.[106]

> With a power of termination at will here so unmistakably expressed, we certainly cannot assert that a limitation of good faith was anything that the parties had in mind. Such a limitation can be read into the agreement only as an overriding requirement of public policy. This seems an extreme step for judges to take. . . . But, generally, speaking, the situation arises from the strong bargaining position which economic factors give the great automobile manufacturing companies: the dealers are not misled or imposed upon, but accept as nonetheless advantageous an agreement in form bilateral, in fact one-sided. To attempt to redress this balance by judicial action without legislative authority appears to us to be a doubtful policy. We have not proper facilities to weigh economic factors, nor have we before us a showing of the supposed needs which may lead the manufacturer to require these seemingly harsh bargains.[107]

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[103] 116 F.2d 675 (2d Cir. 1940). Criticism of classical contract theory began in earnest in the 1930s. *See, e.g.*, Cohen, *supra* note 2, at 559 (stating that freedom of contract is "one of the most pervasive and persistent vices of reasoning on practical affairs, to wit the setting up of premises that are too wide for our purpose and indefensible on their own account.").

[104] *Bushwick-Decatur Motors*, 116 F.2d at 676.

[105] *Id.*

[106] *Id.* at 677.

[107] *Id.* Other courts expressed similar views. *See, e.g.*, Capital Options Investments, Inc. v Goldberg BES Commodities, Inc., 958 F.2d 186, 191 (7th Cir. 1992) ("Courts are not equipped to second-guess the business judgment of professional traders and brokers when it comes to risk assessments."). Commentators were also skeptical that courts alone could set the limits of permissible contract conduct. *See e.g.*, John P. Dawson, *Economic Duress – An Essay in Perspective,* 45 MICH. L. REV. 253, 289 (1947) (stating that "the courts have neither the equipment nor the materials for resolving the basic conflicts of modern society over . . . the limits to be set to the use, or misuse, of economic power."); FARNSWORTH, *supra* note 51, at 585 (observing that "courts are ill-equipped to deal with problems of unequal distribution of wealth in society."). Scholars concluded that legislatures must act to address evils in the marketplace. Robert Hale noted:

> But because courts can do nothing to revise the underlying pattern of market relationships, it does not follow that other organs of government should make no attempt to accord greater freedom to the economically weak from the restrictions which stronger individuals place upon them by means of coercive bargaining power which the law now permits or enables them to exert.

Hale, *supra* note 75, at 625.

A few courts were persuaded to ignore legal and institutional barriers to experimentation.[108] They granted relief to aggrieved parties, "showing more and more willingness to examine common law doctrines in the light of 'justice' or 'common sense' or 'public policy.' Precedent and legal reasoning were not always enough."[109] But decisions that responded to the realities of contract practice were limited in number and they remained on the margins of the law. Except in extraordinary circumstances, courts refused to use legal norms to set the outer limits of unfettered freedom of contract. The presumption that parties are competent to structure their own affairs remained intact. "After all, the general responsibility to fend for one's self still lies with one's self."[110] Thus, the propositions of nineteenth century classical contract theory continued to shape judicial decision-making and to define the role of the courts until well into the twentieth century.

D. Efforts to Expand Social Duty Begin

The use of unfair and oppressive terms was not the only form of contract behavior that caused hardship to parties who did business in the marketplace.[111] Economists and legal theorists expressed concern that selfish and greedy contract conduct occurred in all phases of the bargain transaction, triggering a decline in community prosperity.[112] They believed that a new model of the institution of contract, which established the boundary between the use and misuse of bargaining power, was necessary to restore economic stability and security in the marketplace.[113]

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[108] The classic case is Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69 (1960) (holding that a disclaimer of an automobile warranty by a dealer violated public policy and was void).

[109] FRIEDMAN, *supra* note 1, at 191. Most courts that granted relief to aggrieved parties relied on manipulation of common law rules to achieve just results. For a discussion of this technique, *see* FARNSWORTH, *supra* note 51, at 556-72. Scholars criticized this practice. *See, e.g.*, Karl. N. Llewellyn, *Book Review*, 52 HARV. L. REV. 700, 703 (1939) ("The net effect is unnecessary confusion and unpredictability, together with inadequate remedy, and evils persisting that call or remedy. Covert tools are never reliable tools.").

[110] El Paso Natural Gas Co. v. Minco Oil & Gas Co., 964 S.W.2d 54, 62 (Tex. 1997).

[111] *See* Douglas G. Baird, *Llewellyn's Heirs*, 62 LA. L. REV. 1287, 1288-89 (2002) ("Robber barons and itinerant peddlers dotted the landscape. Sinclair Lewis' *The Jungle*, an expose of Chicago meatpackers, had just appeared. Snake oil salesmen still provided doctors decent competition. The great con men were in their prime.").

[112] Professor Baird has observed that:

> Llewellyn lacked the tools in empirical methods and economic analysis that are second nature to us" and that his "account of the commercial world overemphasizes . . . primitive forms of mischief. We should not, however, let any of these flaws obscure Llewellyn's great strengths and his ability to harness them in the name of law reform.

Id.

[113] Karl N. Llewellyn, who served as principal drafter of Article 2, was one of the first scholars to write about the state of the economy and the need for change in the law governing commercial transactions. *See e.g.*, Karl N. Llewellyn, *The Needed Federal Sales Act*, 26 VA. L. REV. 558 (1940).

> As welcome fiction is slowly displaced by sober act, the regime of "freedom" . . . can be visualized as merely another system, more elaborate and more highly organized, for the exercise of economic pressure. With new vision has come a more conscious and sustained effort to select the forms of permissible pressure and to control the manner of its exercise. In law, as in politics, the control of economic power has emerged as the central problem of modern times.[114]

Laws that governed commercial transactions were particularly troublesome. The Uniform Sales Act, for example, had been enacted by most state legislatures in the early 1900s.[115] Its provisions, which rested on the classical contract vision of unfettered freedom of contract, were indifferent to the realities of the marketplace[116] where bargains did "outrageous work."[117] In the early 1940s, the members of the American Law Institute and the National Conference of Commissioners on Uniform State Laws acknowledged the need for reforms in the law to capture the injustices that flourished in the marketplace[118] and to "target . . . the worst of the sharpers."[119]

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[114] *See* DAWLEY, *supra* note 61, at 345.

[115] The Uniform Sales Act was enacted into law in 36 states.

[116] Professor Gilmore noted:

> It is entirely possible that, had the judicial process been allowed to continue, sales law would have been readjusted to the facts of economic life in a fresh burst of legal creativeness. The success of our courts in the last generation of scrapping tort law which proved unsuited to an industrialized society suggests what the same courts might have done on the commercial side. Judicial discretion was, however, replaced by a codifying statute. The Uniform Sales Act, promulgated in 1906 . . . largely reproduced the outdated patterns and simple generalizations of a hundred years earlier.

Gilmore, *supra* note 11, at 1347.

[117] Llewellyn, *On Warranty of Quality and Society: II*, *supra* note 99, at 394. *See* Kamp, *supra* note 10, at 335 ("The common law and the traditional constitutional system were not only inefficient, but were also incapable of protecting individuals.").

[118] Professor Kamp has provided the most exhaustive analysis of the drafters' efforts to address marketplace abuses, *see* Kamp, *Downtown Code*, *supra* note 13; Kamp, *Uptown Act*, *supra* note 13. Courts appeared persuaded that the Code had charted a new course for commercial law. *See, e.g.*, Jones v. Start Credit Corp., 298 N.Y.S.2d 264, 266 (1969) ("Section 2-302 of the Uniform Commercial Code enacts the moral sense of the community into the law of commercial transactions."). Although scholars concede that the drafters intended to address market evils, they acknowledge that the principal purpose of Code provisions is to enhance the exercise of freedom of contract and to ensure efficiency in the distribution of resources. *See, e.g.*, Baird, *supra* note 111, at 1292 ("Llewellyn's commercial law had modest ambitions. It sought to work within an existing landscape, rather than transform it (which it had no power to do) or pretend that it did not exist. The problem is one of ensuring that commerce flourishes among honest merchants."); SCHWARTZ, *supra* note 49, at 31 (noting that "Llewellyn paid considerable attention to freedom of contract issues . . . because of the epistemological role that actual contracting played in his theory. When parties contracted under ideal conditions, the deal would maximize the utility of both.").

[119] Wiseman, *supra* note 18, at 506.

The question that confronted the drafters of the Code was clear. Could social obligation be expanded beyond its existing boundaries without undermining the expectation of the marketplace that bargains are enforced as made?[120] The drafters worked for almost two decades and compromise between those who favored free markets and those who insisted upon greater state action was inevitable.[121] In the end, the Code's vision of the institution of contract rests on the classical notion that the sanctity of the bargain maximizes individual utilities and promotes efficiency in commercial markets.[122] But the drafters did reject the nineteenth century vision that parties are "individual economic units" who possess "complete mobility and freedom of decision."[123] They created a complex system of community norms that rise to the level of legal obligations.[124] The purpose of these norms, which are reflected, at least in part, in the doctrines of good faith[125] and unconscionability,[126] is to guide the exercise of freedom of contract toward trust and good will and to establish the outer limits of permissible contract behavior.[127] Thus, the "individual will . . . is a social product, unique in its particular needs and desires, but fundamentally constituted according to communal norms."[128] The fate of nineteenth century radical individualism, which had provided the foundation for the laws governing commercial transactions, had been sealed.[129]

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[120] *See* DiMatteo, *supra* note 3 at 913 ("The evolution of Anglo-American contract law has been a general attempt to mesh individualistic and communitarian concepts of justice.").

[121] Karl Llewellyn expressed disappointment that some of his proposals, including the merchant jury system and strict liability for dangerous products, were not included in the final version of Article 2 (Sales). Karl Llewellyn, *Why A Commercial Code*, 22 TENN. L. REV. 779, 784 (1953) ("I am ashamed of it in some ways; there are so many pieces that I could have made a little better; there are so many beautiful ideas I tried to get in that would have been good for the law, but I was voted down.").

[122] U.C.C. § 1-302(a) provides in part that "the effect of provisions of [the Uniform Commercial Code] may be varied by agreement." For discussion of the role that freedom of contract plays in Code articles, including Article 2, *see generally* Kamp, *supra* note 10; John E. Murray, Jr., *The Revision of Article 2: Romancing the Prism*, 35 WM. & MARY L. REV. 1447 (1994); SCHWARTZ, *supra* note 49; Robert E. Scott, *The Rise and Fall of Article 2*, 62 LA. L. REV. 1009 (2002).

[123] FRIEDMAN, *supra* note 1, at 21.

[124] *See, e.g.*, U.C.C. § 1-302(b), which provides in part: "The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement." *See* Robert S. Summers, *The General Duty of Good Faith - Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 834 (1982) (noting that legal norms are "not identical with" moral norms).

[125] U.C.C. § 1-304.

[126] U.C.C. § 2-302.

[127] *See* Kamp, *supra* note 10.

[128] Amy H. Kastely, *Stock Equipment for the Bargain in Fact: Trade Usage, "Express Terms" and Consistency Under Section 1-205 of the Uniform Commercial Code*, 64 N.C. L. REV. 777, 814-15 (1986).

[129] Freedom of contract is also guided in the marketplace by merchant rules, trade usage, and the standard of reasonableness. Article 2 contains 13 merchant rules. *See, e.g.*, U.C.C. §§ 2-201(2) (merchant exception to the Statute of Frauds); 2-314(1) (warranty of merchantability is implied in

IV. SOCIAL DUTY AND THE ROLE OF COURTS IN CONTRACT AFFAIRS

A. The Work Begins

By the mid-1960s, most state legislatures had enacted the Code into law. Social duty was mandated by Code provisions for contract content[130] and contract performance.[131] Consensus emerged that the doctrines of good faith and unconscionability provided the fundamental, and most rigorous, components of this duty.[132] But legislatures had not established guidelines for use of either doctrine.[133] They had thrust the task of providing the details on the courts.[134]

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contracts when the seller is "a merchant with respect to goods of that kind"). For an extensive discussion of the reasons why Karl Llewellyn insisted on including merchant rules in Article 2, *see generally* Wiseman, *supra* note 18.

U.C.C. § 1-303 (c) defines usage of trade as "any practice or method of dealing having such regularity of observance in place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question". U.C.C. § 1-303, cmt. 4 provides in part that "full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree." Trade usages are generated in the marketplace and, therefore, do not encroach upon the notion that parties are better suited than government to determine the terms of their bargains. *See* Kamp, *supra* note 10, at 347-60 (discussing Karl Llewellyn's view of how trade usage is generated in the market by members of trade groups and how it functions to channel conduct towards honesty and decency); David Ray Papke, *How the Cheyenne Indians Wrote Article 2 of the Uniform Commercial Code*, 47 BUFF. L. REV. 1457 (1999). A number of Code sections require that contract conduct be reasonable. *See, e.g.*, U.C.C. § 2-706(1) (providing that a seller may recover the difference between the contract price and the resale price in the event of buyer's breach if the sale is made in a commercially reasonable manner); 2-603(1) (requiring a merchant buyer who has rejected goods to follow reasonable instructions from the seller); 4-204(a) (providing that a collecting bank must send items to the payor bank by a reasonably prompt method); 4-403(a) (stating that a bank customer may stop payment on an item by describing the item with reasonable certainty); 9-607(c) (imposing the requirement that a secured party enforce a security interest in a commercially reasonable manner). Professor Kamp has noted that the standard of reasonableness "gives courts the power to regulate the bargain and the behavior of parties to sales contracts." Kamp, *supra* note 10, at 384. For a discussion of other tools that enable courts to reach just results, *see* DiMatteo, *supra* note 3, at 893-99.

[130] *See* U.C.C. § 2-302; *see also* U.C.C. § 2-719 (3), which states: "Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not."

[131] *See* U.C.C. § 1-304.

[132] *See, e.g.*, John S. Sebert, *Rejection, Revocation, and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals*, 84 NW. L. REV. 375, 383 (1990) (commenting on the significance of the drafters' decision to codify the doctrine of good faith); Carol B. Swanson, *Unconscionable Quandry: UCC Article 2 and the Unconscionability Doctrine*, 31 N.M. L. REV. 359, 361-62 (2001) (stating that many legal theorists, including Karl Llewellyn, believed that the doctrine of unconscionability was one of the most important changes in contract law).

[133] *See, e.g.*, Clayton P. Gillette, *Limitations on the Obligation of Good Faith*, 1981 DUKE L.J. 619, 621-26 (remarking on the confusion that surrounded the intent of the drafters and the legislators

Karl Llewellyn, who served as principal drafter of Article 2, expressed confidence that courts were prepared to assume this new role. "Courts' business," he declared, "is not the making of detailed contracts for parties; but courts' business is eminently the making out the limits of the permissible."[135] This declaration swept away the proposition that courts must not engage in experimentation because they do not have the resources to determine the consequences of judicial decisions that intrude upon the sanctity of the bargain contract. Institutional barriers, which courts had relied upon to safeguard their role as guardians of freedom of contract, were to be ignored in the struggle to curb the evils that existed in the marketplace.

Change in the contract relationship and in the role of the courts in contract affairs was inevitable. But questions remained unanswered. Could courts chart a course that minimized tension between the demands for fundamental fairness and the need of the marketplace for certainty and predictability in the performance of contract rights and obligations?[136] Were courts eager to engage in experimentation and to develop a vision of the contract relationship that requires each party to act as his brother's keeper?[137] The view that favored more comprehensive and consistent use of legal norms in private bargaining had gained momentum, but its power to bring about significant change in the classical vision of the contract relationship was uncertain. It was certain, however, that courts were entering uncharted waters with tools of almost unlimited flexibility and that their allegiance to the nineteenth century vision of the institution of contract and to their role as guardians of freedom of contract would be tested. It was also certain that courts would play a critical role in determining the nature of the modern contract relationship. By the early 1950s, legislatures and administrative agencies had assumed significant control over

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regarding the meaning and scope of the doctrine of good faith); Leff, *supra* note at 17, 488 (noting "section 2-302's final amorphous unintelligibility and its accompanying commentary's final irrelevance").

[134] *See* John P. Dawson, *Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041, 1043 (1976) (discussing the doctrine of unconscionability and noting that "initial leadership is clearly cast on judges . . . because judges have the first opportunity, through the reasons they give, to provide a good start in perceiving and defining the new elements.").

[135] Llewellyn, *supra* note 109, at 704. The Code's concept of agreement provides the cornerstone for the courts' obligation to examine the totality of circumstances in which parties conduct business. U.C.C. § 1-201(b)(3) provides in part that "'Agreement' . . . means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303." U.C.C. § 1-201(b)(12) states in part: "'Contract' . . . means the total legal obligation that results from the parties' agreement."

[136] *See* Apps, *supra* note 53, at 941(noting that tension exists between "the need to decide the individual case and the need to ensure coherence in the law. Yet it is recognized that it is the courts continuing duty to make its way through this treacherously difficult territory . . . in order to demarcate the permissible from the impermissible.").

[137] *See* Gillette, *supra* note 133, at 620 ("An expansive good faith obligation is appealing. It suggests that commercial law be guided by ethical considerations such as promise-keeping, benevolence, and equality of interested parties in addition to traditional prohibitions of fraud or deceit.").

economic life in this country. Pure contract law had declined in importance as an organizing principle for the marketplace and for the resolution of disputes.[138] But the refusal of the legislature to provide the details of their new vision of the marketplace shifted extraordinary power to the courts to create a model of the bargain contract that meets the needs and demands of the modern economic order. Judicial efforts to establish "the limits of the permissible"[139] began in earnest in the late 1960s.

B. The Doctrine of Unconscionability

Scholarly writings, which focused on the doctrines of good faith and unconscionability, created a sense of pessimism that the need to protect parties who are vulnerable to unfair contract conduct could be reconciled with the tradition of judicial restraint. Numbers of writers declared that these doctrines are a form of state action and they warned that adverse consequences would flow from their use. They repeated the age-old concern that laws, which allow courts to scrutinize contract particularities for the purpose of achieving just results, restrict the exercise of freedom of contract and undermine certainty and predictability in the marketplace. These doctrines must be used with extreme caution, they reasoned, in order to protect private autonomy and to preserve market efficiency.[140] Other scholars praised the decision of legislatures to incorporate doctrines that provide courts with tools to address the evils of contract practice. Vigorous application of these tools promised to discourage abuses in economic power and to foster cooperation and trust between those who meet in the marketplace. The institution of contract, they concluded, would surely benefit.[141] The debate over the wisdom of social controls in contract

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[138] FRIEDMAN, *supra* note 1, at 198-210 (discussing the factors which narrowed the courts' role in contract affairs).

[139] Llewellyn, *supra* note 109, at 704.

[140] Professor Richard Danzig was one of the first scholars to charge that doctrines such as good faith and unconscionability are simply tools that enable courts to rewrite contracts and to impose their own vision of fairness on the parties. Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 STAN. L. REV. 621, 629-30 (1975). Criticism of the doctrine of good faith reached its highwater mark in the 1980s as lender liability cases flooded the courts. *See, e.g.*, Mark Snyderman, Comment, *What's So Good About Good Faith? The Good Faith Performance Obligation in Commercial Lending*, 55 U.CHI. L.REV. 1335 (1988). For a list of additional articles in which the authors outlined the burdens that the doctrine might impose on both lenders and borrowers, *see* Patterson, *Good Faith*, *supra* note 29, at 173 n.23. The doctrine of unconscionability was also criticized. *See, e.g.*, Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 396 (1988) (stating that the doctrine is too vague to provide effective relief to consumers); DONALD A. FARBER, ECONOMIC EFFICIENCY AND THE EXANTE PERSPECTIVE, IN THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 54, 57-58 (Jody S. Kraus & Steven D. Walt eds.) (2000) (examining the view that the doctrine harms the consumer class).

[141] Numbers of scholars applauded the movement toward fairness in contracting. *See* DiMatteo, *supra* note 3, at 912 ("It is this just or equitable contract notion that allows long-term contractual relations to flourish. Once an equitable relationship is established, parties will continue to interact

relationships had been refueled, triggering the exchange of familiar, but unproven, claims and counterclaims about the merits of unfettered freedom of contract.[142]

During the 1960s and 1970s, courts resisted being drawn into the debate that occupied the attention of commentators. Judicial decisions, which provided a roadmap for use of the doctrine of unconscionability, suggested that judges continued to believe that state action to ensure fundamental fairness always restricts the right of parties to contract freely.[143] The doctrine of unconscionability, judges declared, is state regulation that collides directly with the sanctity of the bargain and with the presumption that parties are competent to determine the terms upon which they are willing to be bound.[144]

> On the one hand, it is necessary to recognize the importance of preserving the integrity of agreements and the fundamental right of parties to deal, trade, bargain, and contract. On the other hand, there is concern for the uneducated and often illiterate individual who is the victim of gross inequality of bargaining power, usually the poorest members of the community.[145]

Thus, courts believed that they had to choose between liberty, which demands judicial restraint, and fairness, which limits the exercise of freedom of contract. Consensus emerged that the doctrine of unconscionability should be

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in an efficient and just manner . . . . The act of contracting is most efficient when based upon virtues of honesty, fairness, and justice."). *See also* John J. Murray, Jr., *"Basis of the Bargain", Transcending Classical Concepts*, 66 MINN. L. REV. 283, 320 (1982) ("The need for 'good faith' is clear. If it was not present, commercial transactions would be seriously impeded by the resulting lack of trust."); Sebert, *supra* note 132, at 383. ("The recognition and expansion of a pervasive duty of good faith has been possibly the single most significant doctrinal development in American contract law over the past fifty years."); Summers, *supra* note 124, at 811 (stating that recognition of doctrines such as good faith and unconscionability is "one of the hallmarks of our time").

[142] Professor Danzig has observed:

> It is interesting that in his academic writings Llewellyn claimed that he shared a concern for the effects of transactions on those other than the parties to the transaction, but, as in his response to Pound about goal orientation, he pleaded that for the moment he lacked the time or knowledge to deal with that dimension.

Danzig, *supra* note 140, at 630 n.33. Professor Schwartz has noted that Llewellyn did not have "the concepts and tools of modern economic analysis. Llewellyn could not understand how market power is acquired and exercised, and so his unconscionability theories are too primitive." SCHWARTZ, *supra* note 49, at 18.

[143] *See, e.g.*, Rowe v. Great Atlantic & Pacific Tea Co., 385 N.E.2d 566, 569 (N.Y. 1978) ("There exists an unavoidable tension between the concept of freedom of contract, which has long been basic to our socioeconomic system, and the equally fundamental belief that an enlightened society must to some extent protect its members from the potentially harsh effects of an unchecked free market system."); Ortelere v. Teachers' Retirement Bd. of City of New York, 250 N.E.2d 460, 465 (N.Y.1969) ("There must be stability in contractual relations and protection of the expectations of parties who bargain in good faith. On the other hand, it is also desirable to protect persons who may understand the nature of the transaction but who, due to mental illness, cannot control their conduct.").

[144] Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 265 (N.Y. Sup. Ct. 1969).

[145] *Id.*

invoked only when "lopsidedness begins to scream."[146] Courts embraced the two-prong test, which provides that the doctrine is to be used only to protect those who are the victims of both procedural and substantive unconscionability.[147] These victims, the courts declared, are usually poor, illiterate, and uneducated.[148] In other words, the presumption of party competence was to be displaced only in circumstances where parties were unable to protect themselves. Within less than a decade after the Code had been adopted by state legislatures, the doctrine of unconscionability had simply become a tool, like that of fraud, duress, and undue influence, that exists on the margins of the law.[149] Except where legislative mandate or extraordinary circumstances demanded otherwise, the sanctity of the bargain, and the rights and obligations stated therein, continued to escape judicial tampering.

> Our court system cannot act as the mother hen watching over its chicks, standing ready to ameliorate every unpleasant circumstance which might befall them. One's right to negotiate a bargain, to exercise free will, to choose a path, and to even make a bad deal must be admitted and respected.[150]

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[146] *See* Karl N. Llewellyn, *supra* note 99, at 402 (stating that a bargain "shows itself not to be a bargain, when lopsidedness begins to scream"). U.C.C. § 2-302, cmt. 1 states that the doctrine is "one of prevention of oppression and unfair surprise."

[147] Professor Arthur A. Leff developed the two-prong test that requires procedural unconscionability ("bargaining naughtiness") and substantive unconscionability ("evils in the resulting contract"). Leff, *supra* note 17, at 487. The test mirrored guidelines that courts had begun to formulate for use of the doctrine. *See, e.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965) ("Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."). Most courts continue to insist that both elements of the test be satisfied. *See e.g.*, El Paso Natural Gas Co. v. Minco Oil & Gas Co., 964 S.W.2d 54, 61 (Tex. 1997). However, courts do use a sliding scale approach. *See* DiMatteo & Rich, *supra* note 16, at 1074 (stating that "greater levels of one form lowers the threshold of evidence needed for the other form of unconscionability"). A few courts have granted relief on the grounds of substantive unconscionability alone. The classic case is Brower v. Gateway 2000, Inc. 246 A.D.2d 246, 254 (N.Y. App. Div. 1998) (concluding that an arbitration provision contained in a consumer contract for the sale of a computer was unconscionable).

[148] *See, e.g.*, Kugler v. Romain, 279 A.2d 640, 652 (N.J. 1971) (stating that "the uneducated, the inexperienced, and the people of low incomes" are the most vulnerable to oppressive bargains).

[149] *See, e.g.*, Ryan v. Weiner, 610 A.2d 1377 (1992) (stating that "[t]he notion that a court can and will review contracts for fairness is apt to strike us as dangerous, subjecting negotiated bargains to the loosely constrained review of the judicial process. Perhaps for this reason, courts have evoked this doctrine with extreme reluctance and then only when all of the facts suggest a level of unfairness that is unconscionable.").

[150] El Paso Natural Gas Co. v. Minco Oil & Gas Co., 964 S.W.2d 54, 62 (Tex. App. 1997) (internal citations omitted).

C. The Doctrine of Promissory Estoppel

But in the early 1970s, court decisions appeared to signal a change in juristic thinking. Courts introduced the doctrine of unconscionability into the common law, and, thus, contracts of all subject matters became susceptible to scrutiny for unfair surprise and oppression.[151] On rare occasions, courts invoked the doctrine to provide relief to business parties who satisfied the elements of the two-prong test.[152] Moreover, use of the doctrine of promissory estoppel to avoid injustice in bargain transactions exploded, prompting one scholar to declare that Section 90 "has become perhaps the most radical and expansive development of this century in the law of promissory liability."[153] Courts set aside common law principles that protected freedom of contract in order to avoid injustice to promisees who had relied to their detriment upon promises that were not supported by consideration.[154] Indeed, courts embraced the doctrine as "an attempt . . . to keep remedies abreast of increased moral consciousness of honesty and fair representations in all business dealings."[155] Opposition from advocates of free markets was rare,[156] fueling the perception that traditional barriers to

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[151] *See, e.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965) (stating that the doctrine of unconscionability is part of the common law of contracts). For a discussion of the influence that equitable principles play in provisions of Restatement (Second) of Contracts (1981), *see* DiMatteo, *supra* note 3, at 894-99.

[152] For discussions of cases in which courts have invoked the doctrine to provide relief to business parties, *see, e.g.*, DiMatteo & Rich, *supra* note 16, at 1077–78; Edith Resnick Warkentine, *Article 2 Revisions: An Opportunity to Protect Consumers and "Merchant/Consumers" Through Default Provisions*, 30 J. MARSHALL L. REV. 39, 53-56 (1996). Criticism of the doctrine of unconscionability continues. Many commentators have claimed that it does not provide an effective remedy for consumers. *See, e.g.*, Bates, *supra* note 16, at 20 (stating that the doctrine does not provide effective protection to the consumer because it not only "requires that the consumer initiate and finance litigation to challenge terms but also assume the burden of establishing that terms are unconscionable"); Philip Bridwell, *The Philosophical Dimensions of the Doctrine of Unconscionability*, 70 U. CHI. L. REV. 1513, 1514 (2003) (suggesting that the courts have failed to "elucidate what is and is not unconscionability"); Evelyn Brown, *The Uncertainty of U.C.C. Section 2-302: Why Unconscionability Has Become a Relic*, 105 COM. L. J. 287 (2000).

[153] Charles L. Knapp, *Reliance in the Revised Restatement: The Proliferation of Promissory Estoppel*, 81 COLUM. L. REV. 52, 53 (1981).

[154] The classic case is Drennan v. Star Paving Co., 333 P.2d 757 (Cal. 1958) (invoking promissory estoppel to provide relief to an offeree who had relied upon an unaccepted offer to contract). *Compare* Citiroof Corp. v. Tech Contracting Co., 860 A.2d 425 (Md. Ct. Spec. App. 2004), *with* Pickus Const. and Equipment v. American Overhead Door, 761 N.E. 2d 356 (Ill. App. Ct. 2001) (holding that contractor's reliance on supplier's bid was not reasonable and that its claim of promissory estoppel failed). "An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice." RESTATEMENT (SECOND) OF CONTRACTS § 87(2) (1981).

[155] Rosnick v. Dinsmore, 457 N.W.2d 793, 801 (Neb. 1990).

[156] *See* GILMORE, *supra* note 1, at 79 (stating that reliance theory "has, in effect, swallowed up the bargain principle"). Professor Kostritsky has stated "scholars of all persuasions found something to applaud in promissory estoppel." Juliet P. Kostritsky, *The Rise and Fall of Promissory Estoppel,*

judicial examination of contract equities were crumbling. The concept of social duty in contract affairs appeared to be on the verge of unprecedented expansion and growth.[157]

But optimism that the doctrine of promissory estoppel would provide relief in a vast array of transactions, such as employment relationships,[158] was premature. During the 1960s and 1970s, promissory estoppel had been applied to enforce promises only in transactions where the parties had failed to execute an enforceable bargain contract. As cases multiplied in number, it was inevitable that the doctrine would collide with the enforceable bargain. In many of these cases, the aggrieved promisee could not obtain relief based on a claim for breach of the bargain contract. The promisee turned to the doctrine of promissory estoppel to recover for losses suffered from reliance on a promise that was not contained in the contract but which related to the same subject matter. In these circumstances, courts refused to grant relief, declaring that the doctrine is not intended "to give a party to a negotiated commercial bargain a second bite at the apple in the event it fails to prove a breach of contract."[159]

Or Is Promissory Estoppel Really as Unsuccessful as Scholars Say It is: A New Look At the Data, 37 WAKE FOREST L. REV. 531, n.31 (2002).

[157] By the early 1980s, the doctrine had been invoked in a variety of commercial contexts where the parties had not executed an enforceable bargain. *See* Michael B. Metzger & Michael J.Phillips, *The Emergence of Promissory Estoppel as an Independent Theory of Recovery*, 35 RUTGERS L. REV. 472 (1983) (discussing commercial cases including subcontractor bid cases and promises by franchisors, employers, and lending institutions).

[158] *See* Robert A. Hillman, *The Unfulfilled Promise of Promissory Estoppel In the Employment Setting*, 31 RUTGERS L. J. 1, 2 (1999) (noting "the startling lack of success of promissory estoppel in employment litigation"). The question of whether promissory estoppel may be invoked to provide relief for reliance on a promise of at-will employment continues to divide the courts. The classic case is Grouse v. Group Health Plan, Inc., 306 N.W.2d 114, 116 (Minn. 1981) ("[A]ppellant had a right to assume he would be given a good faith opportunity to perform his duties to the satisfaction of respondent once he was on the job. He was not only denied that opportunity, but resigned the position he already had in reliance on the firm offer which respondent tendered him."). *See also* Gorham v. Benson Optical, 539 N.W.2d 798, 801 (Minn. Ct. App. 1995) (stating that "when the contract is of a type that provides no basis for a contract recovery, i.e. an at-will employment contract . . . [t]hen there is no bar to a promissory estoppel claim") *Contra* Slate v. Saxon, 999 P.2d 1152, 1155 (Or. Ct. App. 2000) (stating that the promise of employment was terminable at-will and, therefore, "there could have been no reasonable basis for reliance on and no substantial change of position that was attributable to the promise per se"). *See* Kostritsky, *supra* note 156, at 585 (observing that "courts are still struggling with the question that has troubled scholars from the beginning: what role does/should promissory estoppel play in the landscape of contract law? There has been a lack of consensus . . . on this difficult issue of how reliance and bargain theory should fit together in one theory of promissory liability.").

[159] Walker v. KFC Corp., 728 F.2d 1215, 1220 (9th Cir. 1984). *See also* Ruiz v. A.B. Chance Co., 234 F.3d 654 (Fed. Cir. 2000) (promissory estoppel not available when unambiguous contract exists); Building Serv. Co. v. Nat'l R.R. Passenger Corp., 305 F.Supp.2d 85, 89 (D.D.C. 2004) (stating that promissory estoppel is applicable only if an express, enforceable bargain contract is absent). For a list of other cases in which the existence of a bargain contract barred a promissory estoppel claim, *see* Sidney W. DeLong, *The New Requirement of Enforcement Reliance in Commercial Promissory Estoppel: Section 90 as Catch-22*, 1997 WIS. L. REV. 943, 974 n.108

The refusal to grant relief is not surprising. The net effect of invoking Section 90 to enforce a promise, which is not expressed in the parties' contract but which relates to the same subject matter, is to add to or vary bargained-for rights and obligations and to provide an avenue for relief that is created, not by the parties' agreement, but by the court. The sanctity of the bargain contract is in jeopardy whether courts intrude directly into contract content by invoking the doctrine of unconscionability or interfere indirectly by applying promissory estoppel to promises that are not included in the parties' agreement.

Promissory estoppel is meant for cases in which a promise, not being supported by consideration, would be unenforceable under conventional principles of contract law.

> When there is an express contract governing the relationship out of which the promise emerged, and no issue of consideration, there is no gap in the remedial system for promissory estoppel to fill. To allow it to be invoked becomes in those circumstances gratuitous duplication or, worse, circumvention of carefully designed rules of contract law.[160]

The sanctity of the bargain had trumped the avoidance of injustice. Once again, courts had issued the warning that they were reluctant to displace classical contract propositions and to scrutinize market particularities for the purpose of protecting parties who failed to protect themselves.

By the early 1980s, the doctrines of unconscionability[161] and promissory estoppel[162] had been deliberately tailored to discourage judicial meddling with

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(1997). Professor Kostritsky has offered the following explanation for the reluctance of courts to invoke promissory estoppel in transactions where an enforceable bargain exists:

> Where the parties have reached a bargained-for exchange, intervention in the form of a law-supplied rule could be counterproductive and inefficient. It would introduce uncertainty by displacing bargained for terms and rewriting contracts entered into by the parties. It would be inefficient because it would actually increase transaction costs by creating reversal costs as future parties must undertake extra precautionary measures to ensure that courts did not apply promissory estoppel in cases where a completed bargain existed.

Kostritsky, *supra* note 156, at 577.

[160] All-Tech Telecom, Inc. v. Amway Corp., 174 F.3d 862, 869 (7th 1999) (internal citations omitted). Some courts have carved out an exception to the rule that an enforceable bargain bars the use of promissory estoppel. *See, e.g.*, Kramer v. Alpine Valley Resort, Inc., 321 N.W.2d 293, 295 (1982) (stating that "where the contract fails to embody essential elements of the total business relationship of the parties . . . the existence of a bargain contract does not bar recovery under promissory estoppel"). *See also* DeLong, *supra* note 159, at 979 ("The subordination of promissory estoppel to formal, bargain contract reflects the preference of commercial promisors and promisees for certainty and flexibility.").

[161] *See* Harry G. Prince, *Unconscionability in California: A Need for Restraint and Consistency*, 46 HAST. L. J. 459, 463 (1995) ("Since the promulgation of Section 2-302, the fears of its detractors have proved to be largely unwarranted. Generally, the courts in most states have shown restraint in examining contracts or clauses for unconscionability."); Shapiro, *supra* note 45, at 535-36 (noting the reluctance of courts to strike down contract terms and observing that "decisions like Henningson v. Bloomfield Motors, Inc. and Williams v. Walker-Thomas Furniture Co. are beginning to stand out in the casebooks as curiosities.").

rights and obligations expressed by the parties in their agreement. Social duty, as reflected in these doctrines, imposed only modest limitations on freedom of decision in the marketplace. Scholars, who championed expansion in the scope of social duty, had failed to convince the courts that a new vision of the relationship between parties who do business would prevent abuses in bargain transactions without hampering market efficiency.

It is not surprising that during the 1960s and 1970s, most courts resisted the temptation to make radical departures from their traditional role. In the late 1960s, the consumer movement gained momentum, fueled by complaints about fraud in credit transactions, shoddy merchandise, and unfinished services.[163] Existing common law and statutory principles failed to provide adequate relief to victims of these abuses.[164] A climate that favored more intensive government regulation of contracts and contract terms had emerged,[165] prompting Congress and state legislatures to enact scores of consumer protection laws.[166] These laws provided ample evidence that legislatures had continued to follow the path of greater government regulation to protect those who suffered from lack of bargaining power and imperfect information about the products and services they purchased.[167]

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[162] *See e.g.*, DeLong, *supra* note 159, at 945 (stating that efforts "by lawyers and Judges to limit commercial promissory liability to formal contract commitments is returning the commercial world to its pre-Section 90 tranquility."); Robert A. Hillman, *Questioning the "New Consensus" on Promissory Estoppel: An Empirical and Theoretical Study*, 98 COLUM. L. REV. 580, 588-96 (1998) (providing data that suggests a very low win rate on promissory estoppel claims); Hillman, *supra* note 158 (discussing the reluctance of courts to use promissory estoppel in the employment setting); Phuong N. Pham, *The Waning of Promissory Estoppel*, 79 CORNELL L. REV. 1263, 1271 (1994) (stating that "[r]ecent cases, however, suggest that promissory estoppel may not be the darling of contract law, as courts and scholars have widely assumed."). Other scholars have challenged the conclusion that promissory estoppel had been relegated to the margins of the law. *See, e.g.*, Holmes, *supra* note 20, at 267 ("Rather than waning, the law of promissory estoppel is...subject to the evolutionary process by which our law develops. Far from death, promissory estoppel steadfastly has evolved in the common law tradition for over five centuries."); Kostritsky, *supra* note 156, at 531 (stating that "based on a comprehensive five-year study of cases . . . it is too soon to announce the death of promissory estoppel . . . promissory estoppel is still a vital theory in contract.").

[163] *See generally* Homer Kripke, *Gesture and Reality in Consumer Credit Reform*, 44 N.Y.L. REV. 1 (1969) (describing the complaints that consumers voiced to members of Congress and discussing the role that the media played in drawing attention to the need for protection measures).

[164] *See* Larry Lawrence, *Toward a More Efficient and Just Economy: An Argument for Limited Enforcement of Consumer Promises*, 48 OHIO ST. L.J. 815, 851-52 (1987) (suggesting changes that should be made in legal principles and government institutions to enable consumer to make rational choices).

[165] *See* Edward L. Rubin, *Legislative Methodology: Some Lessons from the Truth-In-Lending Act*, 80 GEO. L. J. 233, 266 (1991) (stating that opposition to the enactment of consumer protection laws "counted for virtually nothing").

[166] *See* FARNSWORTH, *supra* note 51, at 609-13 (outlining some of the protection measures enacted by Congress and state legislatures).

[167] Businesses also claimed that they were in need of protection. For a discussion of legislative efforts to address their demands, *see, e.g.*, G. Richard Shell, *Substituting Ethical Standards for*

But the voices of those who supported legislative experimentation were quickly muffled by the claims of critics who viewed the flurry of activity with skepticism. Consumer protection measures triggered intense criticism. Some scholars concluded that Congress and state legislatures had simply tinkered with the existing system of laws. Aggrieved parties were entitled to relief in only limited circumstances and for only specific abuses. In most transactions, parties who did not have bargaining power or who could not assume the costs of private litigation were left at the mercy of those who were motivated by financial greed and selfishness.[168] Other critics relied upon the familiar claim that government intervention that limits freedom of contract is unwarranted and foolhardy. They insisted that most consumers are sophisticated purchasers[169] who do not need the "arm of the state, interfering with their independence of judgment and action"[170] and that the costs of regulation are inevitably passed on to the marketplace in the form of higher prices. Consumers must either pay these higher prices or do without the products or services.[171] It was against this background that courts were also called upon to decide the wisdom of robust use of community standards in contract transactions. As opposition to consumer protection measures soared and questions about the effects of state action multiplied, courts appeared determined to stay the course.

D. The Doctrine of Good Faith

In the late 1970s, the focus of attention shifted[172] from the doctrines of promissory estoppel and unconscionability to the doctrine of good faith.[173] The

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Common Law Rules in Commercial Cases: An Emerging Statutory Trend, 82 NW. U. L. REV. 1198 (1988).

[168] *See, e.g.*, Task Force of the A.B.A. Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title, Comm. on the Uniform Commercial Code, *An Appraisal of the March 1, 1990 Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981, 1003 (1991) ("There is not available a viable package of non-U.C.C. law to resolve consumer sales law problems.").

[169] *See, e.g.*, Fred H. Miller, The Revision of Article 2 of the Uniform Commercial Code: *Consumer Issues and the Revision of U.C.C. Article 2*, 35 WM. & MARY L. REV. 1565, 1565 n.1 (1994) (stating that consumers are "more sophisticated and better educated" than advocates of protective legislation suggest.).

[170] Lochner v. New York, 198 U.S. 45, 57 (1905).

[171] FARBER, *supra* note 140, at 57-58. *See also* Bates, *supra* note 16, at 27 (stating that "any solution to the form contract problem that relies on litigation . . . threatens transactional security and thus arguably undermines the utility of form contracts.").

[172] Scholars have suggested that lender liability cases caused the focus of attention to shift to the doctrine of good faith. *See, e.g.*, William. H. Lawrence, *Lender Control Liability: An Analytical Model Illustrated With Applications to the Relational Theory of Secured Financing*, 62 S. CAL. L. REV. 1387, 1387 (1989) ("Recent claims of lender liability have captured the attention of the practicing bar and potentially affected clients as few other topics ever have. Either as a response to difficult economic times or as a reaction to the immense success enjoyed by several plaintiffs, lender liability has attracted extensive national attention.").

[173] Section 1-304 is supplemented by a number of Code sections as well as official comments which tailor the obligation of good faith to particular circumstances. *See, e.g.*, U.C.C. §§ 2-306(1)

courts were flooded with cases in which parties, often "sophisticated business persons,"[174] claimed to be the victims of contract performance that violated the implied covenant.[175] The doctrine of good faith performance had its roots in judicial decisions issued in the early 1900s.[176] But neither these cases nor the Code's official comments provided guidance on when and how the covenant should be used and, not unsurprisingly, scholars offered radically different visions of the doctrine's scope, meaning, and effects.[177] Most courts did not appear especially concerned by the absence of guidelines or by the debate among commentators. Indeed, they incorporated the doctrine of good faith into the common law,[178] declaring that the covenant is implied in contracts of all subject matters.[179] However, this declaration did not discourage courts from imposing

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(providing that a term which measures quantity by output or requirements means "output or requirements as may occur in good faith"); 2-305(2) (requiring that a price fixed by a buyer or a seller be fixed in good faith); 3-302(a)(2) (providing that a holder of a negotiable instrument must take in good faith to qualify as a holder in due course); 4-109(a) (granting a collecting bank an extension of time limits if it makes a good faith effort to secure payment of an item drawn on a payor other than a bank); 2-209, cmt. 2 (requiring that that a modification of a contract for the sale of goods be made in good faith to be enforceable). For a discussion of other sources of the good faith obligation in transactions governed by Code articles, *see* Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 216-20 (1968). Professor Burton has stated:

> Good faith performance cases typically involve arm's-length transactions, often between sophisticated business persons. The relative strength of the party exercising discretion typically arises from an agreement of the parties to confer control of a contract term upon that party. The dependent party then is left to the good faith of the party in control.

Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 383-84 (1980).

[175] *See* Summers, *supra* note 173 (providing a survey of cases that provided the initial roadmap for use of the implied covenant of good faith in Code transactions).

[176] *See* Dubroff, *supra* note 15, at 564-71 (discussing the use of the covenant by the courts in the late 1800s and early 1900s).

[177] Most scholars agree that the following articles shaped the discussion about the doctrine's scope, definition, and effects. Burton, *supra* note 174; Steven J. Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1 (1981); Steven J. Burton, *More on Good Faith Performance of a Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497 (1984) [hereinafter Burton, *More on Good Faith Performance*]; E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963); Summers, *supra* note 173; Summers, *supra* note 124. Scholars continue to discuss the different theories about the content of the obligation. *See e.g.*, Russi, *supra* note 15, at 578–88.

[178] *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

[179] *See, e.g.*, McGrath v. Poppleton, 550 F. Supp. 2d 564, 575 (D.N.J. 2008); City of St. Joseph v. Lake Contrary Sewer Dist. 251 S.W.2d 362, 369 (Mo. Ct. App. 2008). Some states, however, have limited the application of the common law doctrine of good faith and fair dealing to certain subject matter contracts. *See, e.g.*, Allison v. Union Hosp., Inc. 883 N.E.2d 113,123 (Ind. Ct. App. 2008) (noting that Indiana courts have generally recognized the obligation only in employment and insurance contracts); WFND, LLC v. Fargo Marc, LLC 730 N.W.2d 841, 851 (N.D. 2007) (stating

limitations on the doctrine's use.[180] Scores of courts concluded that the covenant is not violated when a party's actions are unmistakably permitted by the terms of the contract.[181] The case of *Corenswet, Inc. v. Amana Refrigeration, Inc.*,[182] for example, involved an exclusive distributorship agreement which provided that either party could terminate the contract "at any time and for any reason"[183] on ten days notice. Amana terminated the agreement, prompting Corenswet to claim that the termination was "arbitrary and capricious."[184] The court concluded that the implied covenant of good faith was not relevant to the resolution of the

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that in North Dakota the covenant of good faith and fair dealing has been applied only to insurance contracts).

Professor Summers outlined the reasons why the Restatement's recognition of the doctrine of good faith and fair dealing marked a significant development in the state of the law.

> Section 205 represents a major advance for several reasons. First, the sheer volume of case law and statutory development it reflects is vast. Second, the section symbolizes a commitment to the most fundamental objectives a legal system can have – justice, and justice according to law. Thus, it is of a piece with explicit requirements of "contractual morality" such as the unconscionability doctrine and various general equitable principles. The increasing recognition of such requirements is one of the hallmarks of our times. Third . . . its relevance in contractual matters is peculiarly wide-ranging, and it rules out many varieties of bad faith in a diverse array of contexts. Fourth, section 205 embodies a general requirement that has a distinctively significant role to play in the law. It is a kind of "safety valve" to which judges may turn to fill gaps and qualify or limit rights and duties otherwise arising under rules of law and specific contract language. Finally...it has all the advantages of a direct and overt tool rather than an indirect and covert one.

Summers, *supra* note 124, at 811-12. Not every scholar has been as charitable. *See* Dubroff, *supra* note 15, at 616, 616-18 (stating that the covenant of good faith "has not, by and large, been helpful" and that "modern interpretation and gap-filling techniques . . . provide a more rational and principled basis for resolving interpretive issues that inevitably arise in express agreements.").

[180] It is interesting to note that in the early 1980s, scholars concluded that courts had exercised caution in invoking the covenant. *See* Gillette, *supra* note 133, at 620 (stating that "courts justifiably have restricted the scope of the obligation. This conclusion is predicated on arguments that an expansive obligation extends the responsibilities of commercial actors beyond bargained-for-risk allocations, subjects bargains to inconsistent and uncertain enforcement, and does not produce offsetting benefits in commercial conduct."); Summers, *supra* note 124, at 834 ("The risk of overextension is inherent in any doctrine. Experience to date indicates that the risk is not great with regard to section 205.").

[181] *See, e.g.*, Centerre Bank v. Distrib's, Inc., 705 S.W.2d 42, 48 (Mo. Ct. App. 1985). In rejecting the debtor's claim that good faith applies to the call for payment of a demand note, the court stated:

> The imposition of a good faith defense to the call for payment of a demand note transcends the performance or enforcement of a contract and in fact adds a term to the agreement which the parties had not included . . . . This court is not willing to rewrite the agreement which Distributors made that the demand note which it executed could be called for payment at any time by adding a provision that payment could only be demanded in good faith.

Id.

[182] 594 F.2d 129 (5th Cir. 1979).

[183] *Id.* at 135.

[184] *Id.* at 131.

dispute between the parties because the agreement's express terms, on their face, granted absolute and unfettered power to terminate:

> [N]o reasonable construction can reconcile the contract's express terms with the interpretation Corenswet seeks to glean from the conduct of the parties. The conflict could not be more complete: Amana's past conduct . . . may have created reasonable expectations that Amana would not terminate a distributor arbitrarily, yet the contract expressly gives Amana the right to do so.[185]

"When a contract contains a provision expressly sanctioning termination without cause there is no room for implying a term that bars such a termination. In the face of such a term there can be, at best, an expectation that a party will decline to exercise his rights."[186]

The court's decision rested squarely on the plain meaning rule that had guided the interpretation and enforcement of contracts for more than a century.[187] The rule provides that the ordinary meaning of the words used in the parties' agreement is conclusive evidence of their intent.[188] One court explained the rule as follows:

> It makes not the least difference whether a promisor actually intends that meaning which the law will impose upon his words. The whole House of Bishops might satisfy us that he had intended something else, and it would make not a particle of difference in his obligation. . . . Hence it follows that no declaration of the promisor as to his meaning when he used the words is of the slightest relevancy, however formally competent it may be as an admission. Indeed, if both parties severally declared that their meaning had been other than the natural meaning, and each declaration was similar, it would be irrelevant . . . . When the court came to assign the meaning to their words, it would disregard such declarations, because they related only to their state of mind when the contract was made, and that has nothing to do with their obligations.[189]

One of the principal purposes of the rule, judges insist, is to discourage judicial tampering with bargained-for rights and obligations,[190] a practice believed to cause injury to those it is intended to benefit.

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[185] *Id.* at 136.

[186] *Id.* at 138.

[187] Burr v. Stenton, 43 N.Y. 462, 464 (N.Y. 1871) ("The rule, that where the instrument contains an express covenant "regard to any subject, no covenants are to be implied in respect to the same subject, is to [sic] familiar to require more than its statement.").

[188] *See, e.g.*, Tang v. C.A.R.S. Prot. Plus, Inc., 734 N.W.2d 169, 180 (Wis. Ct. App. 2007) ("When the terms of a contract are plain and unambiguous, we will construe the contract as it stands."); Quality Prod. & Concepts Co. v. Nagel Precision, Inc., 666 N.W.2d 251 (Mich. 2003) (stating that "an unambiguous contractual provision is reflective of the parties' intent as a matter of law.").

[189] Eustis Mining Co. v. Beer, Sondheimer & Co., 239 F. 976, 984-85 (S.D.N.Y. 1917).

[190] In First Fed. Sav. Bank v. Key Markets, Inc., 559 N.E.2d 600 (Ind. 1990) the court observed:

> The idea that favoring one side or the other in a class of contract disputes can redistribute wealth is one of the most persistent illusions of judicial power. It comes from failing to consider the full consequences of legal decisions. Courts deciding contract cases cannot durably shift the balance of advantages to the weaker side of the market; they can only make contracts more costly to that side in the future, because [the other side] will demand compensation for bearing onerous terms.[191]

E. A New Role for the Covenant of Good Faith

The plain meaning rule leads to the conclusion that "as to acts and conduct authorized by the express provisions of the contract, no covenant of good faith and fair dealing can be implied which forbids such acts or conduct."[192] In other words, a party does not violate the covenant by engaging in conduct that is expressly and unambiguously permitted by the terms of the contract.[193] But literal enforcement of unfettered contract terms renders the doctrine of good faith irrelevant to the resolution of disputes about performance of these terms and limits use of the covenant as a tool to discourage unfair and irresponsible market behavior.[194] Indeed, it is the unfettered exercise of contract privileges that may

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> [C]ourts are bound to recognize and enforce contracts where the terms and the intentions of the parties can be readily determined from the language in the instrument. It is not the province of courts to require a party acting pursuant to such a contract to be "reasonable," "fair," or show "good faith" cooperation. Such as assessment would go beyond the bounds of judicial duty and responsibility. It would be impossible for parties to rely on the written expressions of their duties and responsibilities. Further, it would place the court at the negotiation table with the parties.

Id. at 604.

[191] Original Great Am. Chocolate Chip Cookie Co., Inc. v. River Valley Cookies Ltd. 970 F.2d 273, 282 (7th Cir. 1992).

[192] VTR, Inc. v. Goodyear Tire & Rubber Co., 303 F. Supp. 773, 778 (S.D.N.Y. 1969).

[193] *See, e.g.*, LoPresti v. Rutland Reg'l Health Serv's, Inc., 865 A.2d 1102, 1116 (Vt. 2004) ("Although we endorse the applicability of the good faith and fair dealing principle to employment contracts, its essence is the fulfillment of the reasonable expectations of the parties. Where employment is clearly terminable at will, a party cannot ordinarily be deemed to lack good faith in exercising this contractual right.").

[194] *See, e.g.*, Gen. Motors Corp. v. New A.C. Chevrolet, Inc., 263 F.3d 296, 302-03 (3d Cir. 2001). The automobile dealer argued, in part, that GM had breached the covenant of good faith and fair dealing when it approved the relocation of a competing franchisee to a more desirable location, thus taking business away from the dealer. GM claimed that a contract provision granted it sole discretion in its business judgment to make relocation decisions and that the covenant was irrelevant to the dispute. The court observed:

> Most provisions conferring blanket discretion on a decision maker . . . will give that decision maker the power to make the choice for its own reasons; such is the nature of the exercise of unfettered discretion. Were we to construe . . . language – which on its face confers unfettered and unbounded discretion . . . as an unmistakable and exhaustive expression of the parties' obligations, we would leave few if any situations in which the implied covenant of good faith would ever arise.

Id. at 335.

cause one party, who is at the mercy of the other party, to suffer significant financial losses.[195] By the mid-1980s, a series of cases suggested that courts could no longer resist the demands of aggrieved parties for relief from selfish and unreasonable contract performance.[196] Allegiance to the plain meaning rule appeared to be on the decline. The case of *Tymshare v. Covell*,[197] for example, involved an employment contract that granted Covell, a sales representative for Tymshare, commissions in excess of designated quotas. The contract also permitted the management of Tymshare to make retroactive adjustments to individual quota plans "at any time during the quote year within their sole discretion."[198] Tymshare increased Covell's quota retroactively and terminated his employment, thereby reducing the commissions due him. Covell argued that Tymshare had violated the covenant of good faith by acting for the sole purpose of depriving him of reasonably expected compensation.[199] Tymshare claimed

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[195] *See, e.g.*, K.M.C. Co. Inc. v. Irving Trust Co., 757 F 2d 752, 759 (6th Cir. 1985) (stating that "the literal interpretation of the financing agreement . . . would leave K.M.C.'s continued existence entirely at the whim or mercy of Irving, absent an obligation of good faith performance."). *Contra* BJC Health Syst. v. Columbia Gas Co., 478 F.3d 908, 915 (8th Cir. 2007) (stating that the covenant of good faith "does not extend so far as to undermine a party's general right to act on its own interests in a way that may incidentally lessen the other party's anticipated fruits from the contract."). Scholars have noted that debtors often suffer significant financial losses when lenders unexpectedly terminate financing. *See, e.g.*, Patterson, *A Fable*, *supra* note 29, at 504.

[196] The classic case is K.M.C. Co. Inc. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985). The Sixth Circuit abandoned the plain meaning rule and held that the duty of good faith required the lender to provide prior notice to a debtor before refusing to advance funds under a letter of credit agreement which stated that financing could be terminated at any time. The decision prompted extensive scholarly comment. For a criticism of the Sixth Circuit's decision, *see* Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L. J. 131, 142-44 (predicting that adverse consequences would flow to both borrowers and lenders from an expansive interpretation of the doctrine of good faith). Other scholars were more charitable. *See, e.g.*, Patterson, *Good Faith*, *supra* note 29, at 181-85 (discussing the ways in which the lender violated the reasonable expectations of the borrower). Other courts were also willing to depart from the formalism of the past. *See, e.g.*, Fortune v. Nat'l Cash Register Co., 373 Mass. 96, 364 N.E.2d 1251(Mass. 1977) (holding that the covenant of good faith was violated by an employer when it terminated an at-will employee for the purpose of depriving him of compensation already earned). *Fortune* continues to prompt scholarly comment and criticism. *See* Dubroff, *supra* note 15, at 584-87; Scott A. Moss, *Where There's At-Will, There Are Many Ways: Redressing the Increasing Incoherence of Employment at Will*, 67 U. PITT. L. REV. 295, 321-22 (2005) (noting that most courts have refused to grant relief to at will employees who are terminated before compensation is due). For a list of additional cases, *see* James J. White, *Good Faith and the Cooperative Antagonist*, 54 SMU L. REV. 679, 690 n.50 (2001).

[197] Tymshare Inc. v. Covell, 727 F.2d 1145 (D.C. Cir.1984). For an analysis of this case, *see* Apps, *supra* note 53, at 917–20.

[198] *Tymshare Inc.*, 727 F.2d at 1148 (management reserves). *See* Burton, *More on Good Faith Performance*, *supra* note 177, at 501 ("The concept of 'discretion in performance' refers to one party's power after contract formation to set or control the terms of performance."); Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reining in Good Faith*, 35 U.C. DAVIS L. REV. 319, 321 (2002) (discussing the reasons why parties may choose to grant one or both parties discretion in performance.

[199] *Tymshare Inc.*, 727 F.2d at 1151.

that it had acted in accordance with the express terms of the contract, which granted management unlimited discretion in making changes to the quota plan, and that its conduct did not violate the covenant of good faith.[200] The question to be decided, the court declared, "is whether it was reasonably understood by the parties to this contract that there were at least certain purposes for which the expressly conferred power to adjust quotas could not be employed[?]"[201]

The court conceded that parties may choose to execute a contract with the intention that certain contract terms confer absolute and unfettered power in performance.[202] Under these circumstances, literal enforcement of such terms is necessary to honor the parties' reasonable expectations.[203]

> But the trick is to tell when a contract has been so drawn – and surely the mere recitation of an express power is not always the test. Sometimes it may suffice, depending upon the nature of the expressed power. We cannot imagine, for example, entertaining a claim that a demand for payment of a demand not has been made "in bad faith." In the understood nature of human arrangements, a loan of money in exchange for a promise to repay on demand does not import an obligation to make the demand only if the money is really needed, or only without the purpose and effect of inconveniencing the obligor. But to say that every expressly conferred contractual power is of this nature is virtually to read the doctrine of good faith . . . out of existence. Many cases, for example, place "good faith" limitations upon the reasons for which an express power to terminate a contract "at will" can be exercised.[204]

The express contract term, which granted Tymshare discretion in performance, did not necessarily mean, the court stated, that the parties reasonably expected that discretion could be exercised "for any reason whatsoever, no matter how arbitrary or unreasonable."[205]

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[200] *Id.*

[201] *Id.* at 1153. RESTATEMENT OF CONTRACTS (SECOND) § 205, cmt. a (1981) provides: "Good faith performance or enforcement emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."

[202] *Tymshare Inc.*, 727 F.2d at 1153. *See* Big Horn Coal Co. v. Commonwealth Edison Co., 852 F.2d 1259, 1267-68 (10th Cir. 1988) (explaining why performance of certain contract terms does not trigger the covenant of good faith.).

[203] *Tymshare Inc.*, 727 F.2d at 1154. *See, e.g.*, Phoenix Capital Invs. L.L.C. v. Ellington Mgmt. Group, L.L.C., 51 A.D.3d 549, 550 (N.Y. App. Div. 2008) (noting that the parties expectations were made explicit in the language of the contract); Wolf v. Walt Disney Pictures & Television, 76 Cal Rptr.3d, 585, 597 (Ca. Ct. App. 2008) (stating that "if the express purpose of the contract is to grant unfettered discretion, and the contract is otherwise supported by adequate consideration, then the conduct is, by definition, within the reasonable expectations of the parties" and [does not] violate the covenant of good faith.").

[204] *Tymshare Inc.*, 727 F.2d at 1154–55. *See* Goldberg, *supra* note 198, at 321 (concluding that "courts have used good faith as a blunt instrument for providing protection [for] one party's reliance without asking whether that party would [be] willing to pay for such protection.").

[205] *Tymshare Inc.*, 727 F.2d at 1154 (internal citations omitted).

> Where what is at issue is the retroactive reduction or elimination of a central compensation element of the contract – a large part of the *quid pro quo* that induced one party's assent – it is simply not likely that the parties had in mind a power quite as absolute as [Tymshare] suggests. In the present case, agreeing to such a provision would require a degree of folly on the part of these sales representatives we are not inclined to posit where another plausible interpretation of the language is available.[206]

The outline for expansive use of the doctrine of good faith had emerged. According to this vision, "the mere recitation of an express power"[207] is not always conclusive evidence that the parties intend performance or enforcement of the power to be absolute and unfettered.[208] If the parties reasonably understand and expect that a term does not provide an exhaustive expression of their rights and obligations, then performance and enforcement of that term is molded by the aggrieved party's reasonable expectations. Accordingly, the other party violates the covenant of good faith if it acts selfishly and without regard for these expectations.[209] Would social duty, at least as reflected in the doctrine of good faith, finally play an important rule in shaping the limits of permissible contract conduct and expanding the obligation of courts to examine and respond to claims of bad faith performance?

The notion that the doctrine of good faith may be used as a tool to give effect to reasonable expectations about performance of express contract terms, which on their face grant absolute power, marked a significant, even radical, departure from the classical teaching that unambiguous terms are to be interpreted and enforced according to their ordinary meaning. The question of whether such a departure benefits or burdens parties who do business in the marketplace could not be answered with certainty. Thus, an open invitation existed for skeptics to charge that courts, which use the norms of honesty and fair dealing to require that parties act unselfishly in the performance of contract privileges, are actually engaged in unnecessary and unwarranted regulation of private bargaining.

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[206] *Id.*

[207] *Id.*

[208] *See, e.g.*, Rawson v. Conover, 20 P.3d 876, 885 (Utah 2001) ("In analyzing for compliance with the covenant [of good faith], both the contract language and the course of dealings between the parties should be considered to determine the parties' purpose, intentions, and expectations."). For a discussion of the debate that erupted between Professor Robert Summers and Professor Steven Burton over the timing of relevant expectations, *see* Apps, *supra* note 53, at 925–27.

[209] The notion that good faith should be used as a tool to give effect to the reasonable expectations of the parties received extensive scholarly analysis. For a list of articles, *see* Patterson, *A Fable*, *supra* note 29, at 522 n.119.

F. The Controversy Emerges

Opposition erupted, led by Judge Frank Easterbrook of the Seventh Circuit Court of Appeals. In *Kham & Nate's Shoes No. 2 v. First Bank of Whiting*,[210] the lender had extended credit to Kham over a period of several years. When Kahm began to experience cash flow problems, the Bank agreed to make additional loans if the loans could be made secure by a guarantee from the Small Business Administration ("SBA") or by a bankruptcy petition that was followed by an order, which granted Bank a post petition super priority.[211] Kham filed a petition in bankruptcy while waiting for the SBA to make a decision on its application.[212] After the court issued an order granting First Bank super priority, Kham and the Bank signed a loan agreement, which gave Kham a line of credit.[213] The agreement, which was accompanied by a demand note, stated that "nothing provided herein shall constitute a waiver of the right of the Bank to terminate financing at any time"[214] on five days notice. Shortly thereafter, First Bank notified Kham that it would make no further advances. The question to be decided was whether the Bank had acted in bad faith, thereby losing its super priority status.

Judge Easterbrook seized the opportunity to warn that courts, which favored robust use of the covenant of good faith, were putting the institution of contract at risk.[215] He noted that the Bank and Kham had signed an agreement that unmistakably allowed the Bank to cease making additional advances.[216] The contract, he declared, must be enforced in accordance with plain meaning of the express terms used by the parties in their agreement.[217] "The Bank exercised its

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[210] Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990). The decision prompted intense scholarly criticism. *See* Steven J. Burton, *Good Faith in Article 1 and 2 of the U.C.C.; The Practice View*, 35 WM. & MARY L. REV. 1533, 1550-51 (1994) (stating that the court construed the "contract without attempting as the standard rules of contract interpretation and implication require to protect the justifiable expectations of the parties arising from their agreement, understood in its commercial context"); Patterson, *A Fable*, *supra* note 29, at 504 ("For the borrower, the Seventh's Circuit's decision is surely disastrous, for it perhaps signals the end of the borrower's economic existence . . . . Regrettably, Judge Easterbrook's opinion forsakes careful appraisal of the issues presented and spins a tale straight out of Hobbes' *Leviathan*.").

[211] *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d at 1353.

[212] *Id.*

[213] *Id.*

[214] *Id.*

[215] *Id.* at 1357.

[216] *Id.*

[217] *Id. See, e.g.*, Pepsi-Cola Bottling Co. of Pittsburg v. Pepsi Co., Inc., 431 F.3d 1241, 1261 (10th Cir. 2005) (stating that "mere exercise of one's contractual rights . . . , without more, [is not a] breach of the implied covenant of good faith and fair dealing."); Uebelacker v. Allen Holdings, Inc., 464 F. Supp. 2d 791, 803 (W.D. Wis. 2006) (holding that "if a contract expressly provides a party with certain rights, exercising [these] rights cannot amount to a breach of the implied duty of good faith."). Scholars continue to debate the merits of the plain meaning rule. *See, e.g.*, Goldberg, *supra* note 198, at 321 ("A contract grants one party discretion for a reason. The reason may not always be obvious, and it may not be a very good reason. However, as in most other areas

contractual privilege . . . . It had a right to do this for any reason satisfactory to itself."[218] In other words, the covenant of good faith is not violated when a party's actions are clearly and unambiguously permitted by the terms of the contract. Courts must resist the temptation, he declared, to impose an obligation on each party to act as his brother's keeper. "Yet knowledge that literal enforcement means some mismatch between the parties' expectations and the outcome does not imply a general duty of 'kindness' in performance, or of judicial oversight into whether a party had 'good cause' to act as it did."[219] The covenant of good faith, he explained, serves as a gap filler;[220] it does not require that a party act unselfishly in the performance of unfettered contract powers or treat the other party's interests "with the same generosity as it treats its own interests."[221]

> Firms that have negotiated contracts are entitled to enforce them to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of "good faith." Although courts often refer to the obligation of good faith that exists in every contractual relation . . . this is not an invitation to the

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of contract law, the courts should defer to the judgment of the parties."). Patterson, *A Fable*, *supra* note 29, at 524 (stating that Judge Easterbrook "rejected the notion that the agreement of the parties is to be found anywhere other than in the express written terms of the parties' agreement . . . . This is inconsistent with even a straightforward reading of the Code.").

[218] *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d at 1357. The court offered the following criticism about the Sixth Circuit's decision in K.M.C. Co. v. Irving Trust Co., 757 F.2d 752, 759-63 (6th Cir. 1985):

> Although Bank's decision left Debtor scratching for other sources of credit, Bank did not create Debtor's need for funds, and it was not contractually obligated to satisfy its customer's desires. The Bank was entitled to advance its own interests, and it did not need to protect the interests of Debtor and Debtor's other creditors first. To the extent K.M.C., Inc. v Irving Trust Co. holds that a bank must loan more money or give more advance notice of termination than its contract requires, we respectfully disagree.

Kham & Nate's Shoes No. 2, Inc., 908 F.2d at 1358. Numbers of courts have expressed concern that efforts to ensure fundamental fairness lead to judicial rewriting of contracts and to the protection of parties who were failed to protect themselves. *See, e.g.*, Geldermann & Co. v. Lane Processing, Inc., 527 F.2d 571, 576 (8th Cir. 1975) ("It is not the province of the courts to scrutinize all contracts with a paternalistic attitude and summarily conclude that they are partially or totally unenforceable merely because an aggrieved party believes that the contract has subsequently proved to be unfair or less beneficial than anticipated.").

[219] *Kham & Nate's Shoes, Inc.*, 908 F.2d at. 1357.

[220] *Id.* A number of courts have concluded that the doctrine serves as a gap-filler. *See, e.g.*, U.S. v. Basin Elec. Power Co-op, 248 F.3d 781 (8th Cir. 2001).

> Courts must be careful when considering good faith, however, as it does not imply "an everflowing cornucopia of wished-for legal duties." Nor should good faith be construed to "give rise to new obligations not otherwise contained in the contract's express terms." The good faith covenant does not impose a general requirement that a party act reasonably. Rather, the covenant acts merely as a gap filler to deal with circumstances not contemplated by the parties at the time of contracting.

Id. at 786.

[221] White, *supra* note 196, at 691.

> court[s] to decide whether one party ought to have exercised privileges expressly reserved in the document. "Good faith" is a compact reference to an implied undertaking, not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties. When the contract is silent, principles of good faith . . . and the reasonable expectations of the trade . . . fill the gap. They do not block use of terms that actually appear in the contract.[222]

But Judge Easterbrook was not content to rely only on the proposition that parties are entitled to enforce contract terms "to the letter"[223] in his effort to dismantle the vision of good faith that molds the performance of contract powers in accordance with parties' reasonable expectations and understandings. He resurrected two age-old reasons to support his conclusion that courts must exercise restraint in displacing common law principles that are designed to protect the exercise of freedom of contract. First, he suggested that expansive use of the covenant constitutes unnecessary interference with the power of parties to structure their own affairs. Courts' business, he reasoned, is not to protect those who have suffered financial losses simply because they failed to protect themselves.[224] Second, he warned that robust application of the covenant would

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[222] *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d at 1357. In a subsequent decision, the Seventh Circuit offered the following explanation of how the doctrine functions to curb dishonesty in performance.

> Contract law does not require parties to behave altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper. That philosophy may animate the law of fiduciary obligations, but parties to a contract are not each other's fiduciaries . . . . Contract law imposes a duty, not to "be reasonable," but to avoid taking advantage of gaps in a contract in order to exploit the vulnerabilities that arise when contractual performance is sequential rather than simultaneous . . . . Suppose A hires B to paint his portrait to his satisfaction, and B paints it and A in fact is satisfied but says he is not in the hope of chivvying down the agreed-upon price because the portrait may be unsaleable to anyone else . . . . This . . . would be [considered] bad faith . . . because a provision had been invoked dishonestly to achieve a purpose contrary to that for which the contract had been made.

Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies Ltd., 970 F.2d 273, 280 (7th Cir. 1992). *But see* Rhode Island Charities Trust v. Engelhard Corp., 109 F. Supp. 2d 66 (D.R.I. 2000).

> Although [the doctrine] has been shrouded in mystery at times, the implied covenant of good faith and fair dealing is simply a residual gap-filling, default rule of contract law. In effect, it imposes limits upon one contracting party's ability to adversely impact the contract's value to the other party. Therefore, it determines when a party to a contract [can] no longer pursue his or her own self-interest but rather must engage in cooperative behavior by deferring to the other party's contractual interests.

Id. at 73.

[223] *Kham and Nate's Shoes No. 2, Inc.*, 908 F.2d at 1357.

[224] *Id. See also Original Great American Chocolate Chip Cookie Co.*, 970 F.2d at 280 (rejecting the notion that "judges have carte blanche to declare contractual provisions negotiated by competent adults unreasonable and to refuse to enforce them".).

produce undesirable consequences for the economic order. "[T]he institution of contract, with all the advantages [that] private negotiation and agreement bring"[225] is at risk, he declared, if courts interpret the covenant of good faith to require that each party act as his brother's keeper. In other words, use of the doctrine of good faith to give effect to reasonable expectations about the performance of unfettered contract terms allows government to make better contracts for the parties than they made for themselves, thereby reducing the benefits that flow to the community from "freedom of individual action and exercise of judgment."[226] Moreover, certainty and predictability in contract affairs are clearly in jeopardy, he claimed, if parties are encouraged to challenge the fairness of contract performance and courts must decide justice in individual cases. "Any attempt to add an overlay of 'just cause' . . . to the exercise of contractual privileges would reduce commercial certainty and breed costly litigation."[227]

The debate over the wisdom of efforts to ensure fundamental fairness for individual parties had finally reached into the courthouse, complicated by the deeply entrenched belief that predictability in the marketplace flows directly from the refusal of courts to decide justice in individual cases. Judicial consensus that social obligations are violated only in limited and specific circumstances had given way to an unexpected disagreement over what efforts can be made to ensure honesty and fair dealing in contract conduct without sacrificing individual liberty and market efficiency. At the heart of the disagreement was the plain meaning rule which courts had used for decades to draw the line between regulation and freedom of contract. The cases of *Tymshare* and *Kham* muddied the waters, creating uncertainty over where the line is to be drawn. Scholars were also hopelessly divided. Some writers applauded the willingness of courts to reject the formalism of nineteenth century contract principles. The plain meaning rule, they declared, hampers judicial efforts to respond to abuses that occur in contemporary contract practice and frustrates the development of a market climate where trust and good will exist between parties who do business. They claimed that vigorous use of the covenant of good faith simply requires that parties abide by the form of their agreement as well as its substance.[228] This use, they reasoned, is consistent with "the broadest understanding of contract doctrine" [229] and with the notion that

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[225] *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d at 1357.

[226] RESTATEMENT (SECOND) OF CONTRACTS § 72 cmt. b (1981).

[227] *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d at 1357. For a similar view, *see* Northview Motors, Inc. v. Chrysler Motors Corp., 227 F.3d 78, 91 (3d Cir. 2000) (stating that unless limitations are imposed on use of the doctrine, "every plaintiff would have an incentive to include bad faith allegations in every contract action. If construed too broadly, the doctrine could become an all-embracing statement of the parties' obligations under contract law, imposing unintended obligations upon parties and destroying the mutual benefits created by legally binding agreements.").

[228] *See, e.g.*, Patterson, *Good Faith*, *supra* note 29, at 201; Patterson, *A Fable*, *supra* note 29, at 523-24. For a list of additional articles that suggest that the covenant is to be vigorously applied, *see* White, *supra* note 196, at 690 n.51 (2001).

[229] Patterson, *A Fable*, *supra* note 29, at 522.

parties are better suited than government to determine the wisdom and fairness of their bargains.

But skeptics[230] viewed these declarations with disbelief, charging that courts had incorporated the "golden rule – do unto others as you would have them do unto you" into the laws that govern the bargain contract.[231] They claimed that a party cannot reasonably expect that terms, which on their face grant absolute power, are limited in performance. Accordingly, courts must exercise restraint and enforce unambiguous terms in accordance with their ordinary meaning to protect freedom of contract and the right that a party "has purchased by the price he has paid."[232] As one court explained:

> This kind of provision occurs, for example, when either party is given an unconditional power to terminate the contract or reduce the supply by merely giving written notice within a specified time . . . . In such a case the reason for invoking the provision is irrelevant. The reason may be purely a whim or caprice; all that matters is that proper notice be given . . . . The rationale behind these cases is that the parties expressly contracted for the unconditional right and thus they cannot reasonably expect any special implied protection from termination of the contract other than the proper written notice.[233]

The sharp division of opinion reflected the simple fact that neither courts nor scholars had reached agreement on when social duty, as envisioned by the doctrine of good faith, becomes regulation that restricts the exercise of freedom of contract. Storm clouds gathered as courts debated whether norms of honesty

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[230] One writer offered the following criticism of an expansive interpretation of the doctrine:

> Good faith performance, particularly in the context of lender liability, is a dangerous and unnecessary doctrine that unjustifiably restricts freedom of contract and creates a needless presumption that allows judges and juries to substitute their conceptions of reasonableness and fairness for those of parties more knowledgeable about the realities of the market. The inconsistent application of the good faith doctrine to lending practices adds uncertainty and other costs to business transactions in abrogation of the fundamental purposes of commercial law.

Snyderman, *supra* note 140, at 1338. Professor White has suggested a second criticism:

> If I am correct and if each party does and should expect that discretion granted to the other will be exercised in a comparatively selfish and biased way, then courts that demand unselfishness and require observation of the golden rule are wrong. They misconstrue the contract and exaggerate opportunities foregone. Worse, courts that unduly limit the cooperative antagonist's discretion deny that antagonist a right that he has purchased by the [] price he has paid.

White, *supra* note 196, at 695.

[231] White, *supra* note 196, at 690.

[232] White, *supra* note 196, at 695.

[233] Big Horn Coal Co. v. Commonwealth Edison Co., 852 F.2d 1259, 1267-68 (10th Cir. 1988). *See, e.g.*, Hubbard Chevrolet Co. v. Gen. Motors, Corp., 873 F.2d 873, 878 (5th Cir. 1989) (refusing to invoke the implied covenant of good faith to limit a no-relocation-without approval provision on the grounds that the dealer could not point to any "portion of this contract creating 'reasonable expectations' that GM would grant" requests for relocation).

and fair dealing produce unwanted costs, even for those the law intends to protect. By the mid-1990s, the state of the law had spiraled downward to conflicting visions of the institution of contract.

G. Judicial Loyalty to Traditional Propositions

It was against this background of controversy that courts were called upon to address the claims of bad faith performance in a vast array of transactions that included employment at will,[234] franchise,[235] and loan agreements.[236] It was clear that the doctrine of good faith offered judges an unprecedented opportunity to sweep away the barriers that discouraged judicial scrutiny of contract equities and to provide relief to parties who established that they were victims of selfish performance of contract privileges. But it was also clear that robust use of the

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[234] The Tennessee Supreme Court described the employment-at-will doctrine as follows: "All may dismiss their employees at will, be they many or few, for good cause, for no cause or even a cause morally wrong, without being thereby guilty of legal wrong." Payne v. W. & Atl. R.R., 81 Tenn. 507, 519-20 (Tenn. 1884). One of the few cases to recognize that the reasons for which an at-will employee may be terminated are shaped by the covenant of good faith is Fortune v. National Cash Register Co., 364 N.E.2d 1251 (1977) (covenant of good faith violated when at-will employee terminated for the purpose of depriving him of compensation for work already performed). *See also* Bohne v. Computer Associates Intern. Inc., 445 F. Supp. 2d 177, 183 (D. Mass. 2006) ("A logical interpretation of *Fortune* thus allows for the overriding of contract provisions governing the manner of termination when those provisions operate in a way that is contrary to the covenant of good faith and fair dealing."). For a detailed analysis of the reasons why courts continue to support the at will rule and the controversy that surrounds exceptions based on good faith, public policy, and employer fraud, *see* Moss, *supra* note 196. Many scholars have criticized the at will employment doctrine. *See, e.g.*, Stephen F. Befort, *Labor and Employment Law at the Millennium: A Historical Review and Critical Assessment*, 43 B.C. L. REV. 351, 407 (2002) ("The almost universal adoption of statutes in other countries limiting an employer's right to terminate employment provides an additional push toward a similar American statute. These statutes . . . establish a global norm of fundamental fairness with respect to the legal status of the employment relationship . . . . Some commentators go so far as to see in the American at-will rule a violation of international human rights principles."); Samuel J. Samaro, *The Case for Fiduciary Duty as a Restraint on Employer Opportunism Under Sales Commissions Agreements*, 8 U. PA. J. LAB. & EMP. L. 441, 455 (2006) (observing that "in almost every way that matters, the at-will rule benefits employers and burdens employees.").

[235] The question of whether the covenant of good faith may be used to mold contract performance by franchisors continues to trigger litigation. *See, e.g.*, Cottman Transmision Systems, L.L.C., v. Kershner, 536 F. Supp. 2d 543, 555-56 (E.D. Pa. 2008) (stating that the Pennsylvania Supreme Court has not decided whether the duty of good faith applies to all aspects of a franchise relationship, including termination and no-relocation without consent clauses).

[236] Lender liability cases reached their highwater mark during the 1980s and 1990s. *Compare* Duffield v. First Interstate Bank, 13 F.3d 1403, 1405 (10th Cir. 1993) (observing that the covenant of good faith applies "in all situations – including when a contract's express terms do not limit either party's right to act unreasonably") *with* Needham v. The Provident Bank, 675 N.E.2d 514, 523 (stating that a bank does not act in bad faith when it chooses to exercise its contract rights) (Ohio Ct. App. 1996). *See* Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131, 131 (1989) (noting "the emergence of the booming area of lender liability.").

covenant triggered dire predictions about the fate of the institution of contract. Over the course of the last decade, scores of cases, which have demanded that courts determine when the implied covenant is relevant to the resolution of parties' disputes, have filtered through the judicial system. It has become evident that most courts have concluded that vigorous efforts to protect those who are deemed competent to protect themselves are unnecessary and undesirable and that freedom of contract is preserved only if agreements are enforced as written.[237] Thus, the question of whether the covenant of good faith is satisfied or violated by the actions or conduct of one party is triggered only in limited and specific circumstances.[238] In other words, these courts have chosen to remain loyal to classical principles[239] and to follow the lead of the Seventh Circuit[240] that

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[237] *See, e.g.*, Rory v. Continental Ins. Co., 703 N.W.2d 23, 31 (Mich. 2005).

[238] Most courts concede that the covenant serves either as a gap filler or as a tool to interpret a contract that is ambiguous and subject to different constructions. *See, e.g.*, LaSalle Bank Nat'l Ass'n v. Moran Foods, Inc., 477 F. Supp. 2d 932, 937 (N.D. Ill. 2007) (stating that the covenant of good faith and fair dealing "is invoked [only] . . . where the contract is ambiguous and subject to more than one construction); Rhode Island Charities Trust v. Engelhard Corp., 109 F. Supp. 2d 66, 75 (D.R.I. 2000), *aff'd*, 267 F.3d 3 (1st Cir. 2001) (stating that the covenant functions as a gap filler to effectuate the intentions of the parties). *See* Dubroff, *supra* note 15, at 616, 618 (stating that the covenant of good faith "has not, by and large, been helpful" and that "modern interpretation and gap-filling techniques . . . provide a more rational and principled basis for resolving interpretive issues that inevitably arise in express agreements.").

[239] The plain meaning rule continues to guide judicial decision making. *See, e.g.*, DiCarlo v. St. Mary Hosp., 530 F.3d 255, 267 (3d Cir. 2008) (stating that the covenant of good faith and fair dealing does not bar a party from exercising its express contract rights); Hammonds v. Hartford Fire Ins. Co., 501 F.3d 991, 997 n.9 (8th Cir. 2007) ("Where the express language of the contract addresses the matter at issue, there is no need to turn to the implied covenant [good faith]."); F.W.F., Inc. v. Detroit Diesel Corp., 494 F. Supp. 2d 1342, 1357 (S.D. Fla. 2007) (stating that the covenant is not breached "where the contract expressly permits the actions being challenged, and the defendant acts in accordance with the express terms of the contract."); *In re* IAC/Interactive Corp., 948 A.2d 471, 506-07 (Del. Ch. 2008) (concluding that the covenant of good faith is not triggered if the issue is expressly addressed by the contract or the contract is intentionally silent on the issue); Nygaard v. Sioux Valley Hosps. & Health Sys., 731 N.W.2d 184, 194 (S.D. 2007) (noting that the express language of the contract addressed the issue and that the claim for breach of the covenant failed). *But see* City of St. Joseph v. Lake Country Sewer Dist., 251 S.W.3d 362, 370-72 (Mo. 2008) (stating that the covenant of good faith may be violated when actions taken are not permitted by the contract or evade the spirit of the bargain.). However, courts do acknowledge the difficulty in deciding whether language provides a complete and exhaustive expression of the parties' rights. *See* Planning Techs., Inc. v. Korman, 660 S.E.2d 39, 42-44 (Ga. Ct. App. 2008) (examining a number of judicial decisions, which interpreted contract terms granting discretion in performance, and deciding that language, which referred to one party's decision as "binding, final, and conclusive," subjected the party to the implied covenant of good faith.).

[240] A number of courts have concluded that the covenant of good faith is not applicable where the contract expressly states that it may be terminated without cause. *See, e.g.*, Cromeens, Holloman, Sibert Inc. v. AB Volvo, 349 F.3d 376, 395-96 (7th Cir. 2003); Gen. Aviation, Inc. v. Cessna Aircraft Co., 915 F.2d 1038, 1041-42 (6th Cir. 1990); Grand Light & Supply Co. v. Honeywell, Inc., 771 F.2d 672, 675, 679 (2d Cir. 1985); Triangle Mining Co. v. Stauffer Chem. Co., 753 F.2d 734, 739–40 (9th Cir. 1985), Hunt Ent's, Inc. v. John Deere Indus. Equip., Co., 18 F. Supp. 2d 697,

contract law does not require that parties be "fair, or kind, or reasonable or . . . share gains and losses equitably."[241] As one court explained:

> This approach, where judges divine the parties' reasonable expectations and rewrite the contract accordingly, is contrary to the bedrock principle of American contract law that parties are free to contract as they see fit, and the courts are to enforce the agreement as written absent some highly unusual circumstance such as a contract in violation of law or public policy. . . . The notion, that free men and women may reach agreements regarding their affairs without government interference and that courts will enforce those agreements, is ancient and irrefutable. It draws strength from common-law roots and can be seen in our fundamental charter, the United States Constitution, where government is forbidden from impairing the contracts of citizens. . . . It is, in short, an unmistakable and ineradicable part of the legal fabric of our society.[242]

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700 (W.D. Ky. 1997). *Contra* Cottman Transmission Sys., L.L.C. v. Kershner, 536 F. Supp. 2d 543, 555 (E.D. Pa. 2008) (stating that where a contract does not specifically provide that it is terminable without cause, the contract must be terminated in accordance with the parties' "reasonable expectations, principles of good faith, and commercial reasonableness."). Courts have also been reluctant to limit the purposes for which an employee-at-will may be terminated. *See, e.g.*, Nguyen v. CAN Corp., 44 F.3d 234, 237 (4th Cir. 1995) ("An employee is ordinarily at liberty to leave his employment for any reason or for no reason, upon giving of reasonable notice, without incurring liability to his employer. Notions of fundamental fairness underlie the concept of mutuality which extends a corresponding freedom to the employer."); Wagenseller v. Scottsdale Mem'l Hosp., 710 P.2d 1025, 1040 (Ariz. 1985) (refusing to invoke good faith to limit termination of an at will employee on the grounds that "[w]ere we to adopt such a rule, we fear we would tread perilously close to abolishing completely the at-will doctrine and establishing by judicial fiat the benefits which employees can and should get only through collective bargaining or tenure provisions."). Right-to-withhold approval clauses have also triggered litigation. *See, e.g.*, James v. Whirlpool Corp., 806 F. Supp. 835, 839 (E.D. Mo. 1992) (concluding that the manufacturer was given an absolute right to withhold its consent to an assignment by the distributor because "the parties set out the limits of what the contract required."). *Contra* Hunting Aircraft, Inc. v. Peachtree City Airport Auth., 636 S.E.2d 139, 141-42 (Ga. Ct. App. 2006) (holding that a no-assignment-without consent clause was subject to an implied obligation of good faith because the contract language did not expressly provide otherwise). *See also* Taylor Equip., Inc. v. John Deere Co., 98 F.3d 1028, 1034 (8th Cir. 1996) (noting the disagreement among the courts over the question of whether the covenant bars "dishonest exercise of an otherwise absolute right to disapprove."). Courts have also been reluctant to use the covenant of good faith to add terms to the parties bargain. *See, e.g.*, Parker v. Columbia Bank, 604 A.2d 521 (Md. Ct. Spec. App. 1992) ("Thus, the duty of good faith merely obligates a lender to exercise good faith in performing its contractual obligations; it does not obligate a lender to take actions that the lender is clearly not required to take under its loan documents."); Alpine Bank v. Hubbell, 506 F. Supp. 2d 388, 402 (D. Colo. 2007) (stating that where the contract expressly provided that lender could take certain actions "solely for the protection of Lender's interests," the words must be given their plain and ordinary meaning and, therefore, the lender was under no obligation to take these actions to protect the interests of the borrower.).

[241] Indus. Representatives v. CP Clare Corp., 74 F.3d 128, 132 (7th Cir. 1996).

[242] Wilke v. Auto-Owners Ins. Co., 664 N.W.2d 776, 782 (Mich. 2003).

The conclusion is inescapable that while social duty has become a more complex concept since the Code was enacted into law by state legislatures, its use in establishing the outer boundaries of unfettered freedom of contract remains surprisingly limited. Indeed, except where legislative enactments provide otherwise, the modern vision of the common law contract relationship bears a striking resemblance to the vision that courts created more than a century ago.[243]

But the lessons to be learned are not limited to an examination of the doctrines that compose the concept of social obligation or to an analysis of the judicial decisions that fueled controversy over the definition of the modern contract relationship. Equally, if not more important, is the fact that controversy lingers. While the fevered pitch of the debate over the scope of social controls and the role that courts should play in matters of private bargaining has been quieted in recent years, not everyone has been persuaded that courts must resist the temptation to deviate from the formalism of the past in order to avoid injury to individual and community welfare.[244] Indeed, the failure to reach agreement simply serves to remind us that we have not determined with certainty the need for and desirability of efforts to channel market conduct toward trust and good will. The debate over the wisdom of using social controls to guide the exercise of market liberty is as important today as it was in the early 1900s. But the fact remains that claims about the benefits and burdens of different visions of the institution of contract are still unproven.[245] Only minimal efforts have been made

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[243] One writer has offered the following explanation for the reluctance of judges to sweep away barriers to judicial scrutiny of contract equities.

> As the onset of the Reagan era brought "morning in America," a lot of clocks were being reset—or, at least, a lot of pendulums began to swing back. The momentum of "modern" contract law visibly slowed as accepted notions of "modern" contract jurisprudence were beset from left and right by new schools of theory . . . . And Reagan-era judges—often politically conservative, sometimes [the] devotees of Chicago-School Economic Analysis—began to nudge contract [law] back toward a kind of formalism that had seemed obsolescent only a decade or so ago.

Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191, 1202 (1998).

[244] *See, e.g.*, Bohne v. Computer Assocs. Int'l. Inc., 445 F. Supp. 2d 177, 183 (D. Mass. 2006) (stating that Massachusetts' courts have invoked the covenant of good faith to override not only contract provisions "which operate to violate the covenant in certain circumstances, but also those provisions which, on their face, directly conflict with the covenant of good faith and fair dealing."). A number of scholars have been critical of courts for their refusal to use the doctrine of good faith in the employment context. *See, e.g.*, Apps, *supra* note 53 (suggesting that the covenant of good faith has been underutilized by the courts in the employment setting); Befort, *supra* note 234, at 360-61; Samaro, *supra* note 234, at 465 ("Because of the at-will rule, courts accept opportunism as the employer's birthright, even when the agreement concerns matters other than job security."); Clyde W. Summers, *Employment at Will in the United States: The Divine Right of Employers*, 3 U. PA. J. LAB. & EMP. L. 65 (2000); Waldman, *supra* note 15; James Robert Ward, III, *The Endowment Effect and the Empirical Case For Changing the Default Employment Contract from Termination "At-Will" to "For-Cause" Discharge*, 28 LAW & PSYCHOL. REV. 205, 206 (2004).

[245] *See* Burton, *supra* note 174, at 392-93 (claiming that recognition of the covenant of good faith enhances efficiency in the marketplace because it reduces costs of contracting); DiMatteo, *supra*

over the years to collect data that might establish whether and under what circumstances social duty is accommodating or detrimental to individual parties and to the community.[246] Unfortunately, the results of these efforts have often been either inconclusive or contradictory.[247] Moreover, market research is unlikely given the cost required to gather and evaluate market data as well as the complexity and variety of transactions that would need to be studied.[248] Thus, the debate over what efforts can be made to ensure decency and fair dealing without sacrificing the benefits of freedom of contract will continue. But there is reason to be optimistic that, in the end, the body of our case law will benefit.

Where there is uncertainty in the law, a case can create an opportunity to weigh the merits of different views and contribute to debate through the judicious assessment of the strengths and weaknesses of competing visions of the law. To the extent that an opinion provides didactic or judicial lessons, the enterprise is all the better. [249]

V. CONCLUSION

Controversy over the wisdom of efforts to ensure fundamental fairness for individual contracting parties emerged in the late 1800s. It was fueled by the gap between classical contract theory's vision of the institution of contract and the realities of the marketplace where strong parties took advantage of those who were vulnerable to unfair overreaching. Over the course of time, market injustices multiplied and demands for reforms in the law reached a fevered pitch. The debate among scholars intensified, but neither proponents of greater state

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note 3, at 912 ("It is this just or equitable contract notion that allows long-term contractual relationships to flourish. Once an equitable relationship is established, parties will continue to interact in an efficient and just manner . . . . The act of contracting is most efficient when based upon virtues of honesty, fairness, and justice."). *Contra* Summers, *supra* note 124, at 827 ("We really do not know whether general recognition of this duty is economically efficient . . . . It might turn out only that the doctrine is not economically inefficient – or not obviously so – and this would be a slender reed, indeed, on which to rest section 205.").

[246] Many scholars have remarked on the lack of reliable data to establish the benefits and burdens of reform measures, especially measures designed to protect consumers. *See, e.g.*, Fred H. Miller, *Consumers and the Code: The Search For the Proper Formula*, 75 WASH. U.L.Q. 187, 197 n.57 (1997).

[247] Professor Bird, who has analyzed a number of studies that focus on the impact of applying the covenant of good faith and fair dealing in the employment context, has observed:

> There is some empirical evidence that a good faith covenant may impose costs, but these costs are limited and not uniformly found. This implies that the covenant may not impose large costs on employers if applied. On the other hand, the limited effects may be because good faith in employment is interpreted so narrowly where it exists at all. The impact of a robust good faith obligation . . . remains unexplored.

Bird, *supra* note 15, at 427.

[248] *See* Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 603 (1982) ("That it is imaginable that someone could one day actually produce the factual data makes it[ ] irrelevant that no one is practically engaged in that task, or ever will be.").

[249] Patterson, *A Fable*, *supra* note 29, at 532.

action nor skeptics could prove the truth or falsity of their respective claims. Thus, the task of deciding what combination of freedom of contract and social control should govern contract conduct fell to the courts. Consensus that social duty must play only a minor role in establishing the limits of permissible contract behavior gave way to a bitter feud over the appropriate use of the implied covenant of good faith. The feud triggered an unexpected and comprehensive examination by the courts of the need for change in the fundamental propositions classical theory. After more than a decade of debate most courts have been persuaded that radical change is too uncertain in its benefits to warrant displacement of traditional contract principles and doctrines. With only rare exceptions, the debate among the courts over the scope of social duty has faded into the background.

While judicial consensus fosters certainty and predictability in the rules that govern conduct in the marketplace, it does not provide an answer to the question of whether social controls benefit individual parties without imposing expense or injury upon others. Indeed, this question is as important today as it was more than a century ago. In the end, we must acknowledge that uncertainty is inevitable and that experimentation to end market evils is a matter over which there can be reasonable debate.