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# LOOKING FOR DEFAULT RULE LEGITIMACY IN ALL THE WRONG PLACES: A CRITIQUE OF THE AUTHORITY OF CONTRACT MODEL AND THE COORDINATION PRINCIPLE PROPOSED BY PROFESSOR BURTON

JULIET P. KOSTRITSKY\*

## INTRODUCTION

Default rule theories dominate contract scholarship.<sup>1</sup> Law-supplied default rules apply when parties fail to expressly resolve certain matters by contract.<sup>2</sup> Cases of omission raise the fundamental question of whether the law should supply a contractual term when the parties themselves fail to do so.<sup>3</sup> To identify and justify appropriate default rules, scholars have formulated a variety of approaches including efficiency,<sup>4</sup> communitarianism,<sup>5</sup> and relationalism.<sup>6</sup> According to

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1. Steven J. Burton, *Default Principles, Legitimacy, and the Authority of a Contract*, 3 S. CAL. INTERDISC. L.J. 115, 116 (1993).

2. "These rules establish contract rights, obligations, and powers needed to resolve disputes when the parties' agreement is indeterminate with respect to the result." *Id.* Two sources (at least) contribute to this contractual incompleteness: the transaction costs of achieving contractual completeness and strategic behavior. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92-95 (1989) (discussing these differing sources of contractual incompleteness).

3. These terms are usually non-mandatory. Burton, *supra* note 1, at 116.

4. In resolving what term, if any, the law should supply, the law must resolve whether it should intervene at all, requiring "projection . . . [of] how the ultimate results sought . . . will be

Professor Burton, all of the current default rules scholarship suffers from a critical deficiency: it fails to provide a legitimacy justification for imposing default rules on parties who have not expressly adopted them by contract.<sup>7</sup> To remedy this deficiency and to provide legitimacy, Burton proposes that current approaches to setting default rules be replaced with a coordination principle—one that “derives legitimacy from a certain view of fairness.”<sup>8</sup>

The need to legitimate contract default rules unquestionably demands attention.<sup>9</sup> The Burton philosophical model for judging the legitimacy of default rules, however, may be misconceived. First, because Professor Burton’s model is based on a fully contingent, determinate contract, it may be inappropriate for judging the more typical incomplete, indeterminate contract.<sup>10</sup> Professor Burton’s use of such a model stems from his failure to recognize that the very nature of contractual agreement extends beyond terms expressly

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furthered or frustrated by the use of interventions.” Ronald J. Coffey, *Perspectives on Legal Methods* 4 (July 6, 1990) (unpublished manuscript, on file with the author). This problem of justification is a major one because the “parties are being held in contract to terms to which they did not explicitly agree.” Jules L. Coleman et al., *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J.L. & PUB. POL’Y 639, 641 (1989). Efficiency proponents addressing default rules include Ayres & Gertner, *supra* note 2; David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991); Ronald J. Coffey, *Firm Opportunities: Property Right Assignments, Firm Detriment, and the Agent’s Performance Obligation*, 13 CAN.-U.S. L.J. 155 (1988); Jason S. Johnston, *Opting In and Opting Out: Bargaining for Fiduciary Duties in Cooperative Ventures*, 70 WASH. U. L.Q. 291 (1992); David I. Levine, *Just-Cause Employment Policies in the Presence of Worker Adverse Selection*, 9 J. LAB. ECON. 294 (1991); Stewart Schwab, *Shirking, Opportunistic Firings, and Contract-Law Limitations on At-Will Employment* (Dec. 1991) (unpublished manuscript, on file with the author); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597 (1990).

5. See Burton, *supra* note 1, at 117 n.5; see also Jay M. Feinman, *Critical Approaches to Contract Law*, 30 UCLA L. REV. 829, 858-60 (1983) (discussing utopian aspects of *Local 1330, United Steel Workers v. United States Steel Corp.*, 631 F.2d 1264 (6th Cir. 1980)).

6. For Ian Macneil’s contribution to contracts scholarship and relationalism, and a discussion thereof, see Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978); William C. Whitford, *Ian Macneil’s Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545.

7. Burton, *supra* note 1, at 117 (“Contract law, like all law, should have legitimacy; it should enforce only the genuine political obligations of the people subjected to official coercion.”).

8. *Id.* at 118.

9. I disagree, however, with Professor Burton’s contention that contract theorists have heretofore neglected the legitimacy topic. See *id.* at 120. Law-and-economics theorists have attempted to legitimize default rules in hypothetical consent terms. See, e.g., Coleman et al., *supra* note 4, at 644. Burton, however, rejects those efforts as flawed. Burton, *supra* note 1, at 120; see also *infra* part IV.

10. See Coleman et al., *supra* note 4, at 640 (stating that contracts often remain incomplete because of the cost of fully specifying all contingencies).

agreed to and includes law-supplied default rules that exist as "an inherent part of the contract calculus."<sup>11</sup> Because Professor Burton narrowly confines contract legitimacy to those terms expressly adopted by the parties, he proposes a legitimacy model for default rules that will necessarily regard such rules as externally imposed and therefore illegitimate unless they can be justified as ordinary civil laws are legitimated—by reference to a "ground of political obligation."<sup>12</sup> Second, Professor Burton's attempt to construct a morality from a description of the characteristics of promise-making activity fails to provide a normative guide for making principled choices among competing default rules when the parties have failed to explicitly resolve an issue by agreement.<sup>13</sup>

Finally, this comment suggests that in endorsing the coordination principle,<sup>14</sup> Professor Burton has left unanswered the fundamental question of why the law should supply a default term requiring coordination. Although the principle may seem intuitively fair,<sup>15</sup> and although Professor Burton finds coordination to be part of the parties' implicit agreement,<sup>16</sup> Burton never completely justifies why coordination inheres in their implicit agreement.

Justifying a law-supplied term of coordination requires a decision maker to advert to an economic model.<sup>17</sup> Such a model could identify what obstacles, including transaction costs, the parties face in negotiating (1) an express contract to detail coordination problems, and (2) a more generalized commitment of coordination. The scholar of default rules must explore not only the question of why the parties could not negotiate for an express clause covering coordination problems for unknown contingencies, but also why the parties could not or might not negotiate for a general clause requiring coordination.<sup>18</sup> Assuming that the decision maker finds obstacles to expressly

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11. See Clayton P. Gillette, *Cooperation and Convention in Contractual Defaults*, 3 S. CAL. INTERDISC. L.J. 167, 172 (1993).

12. Burton, *supra* note 1, at 120 ("A law has legitimate authority if it enforces a genuine political obligation of its subjects.").

13. See Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 504-505 (1989) (questioning ability of philosophical literature on the nature of promising to select appropriate default rules).

14. See Burton, *supra* note 1, part III.

15. *Id.* at 156-57.

16. *Id.* at 161 ("Like the implied covenant of good faith, the general obligation to coordinate is made whether or not the parties have it in mind.").

17. See *infra* part IV.

18. A general clause might obligate the parties to work out coordination problems by agreeing to cooperate whenever a dispute arose in the future. Professor Williamson suggests

negotiating for a coordination clause, the decision maker should then ask whether the parties would have bargained to include the term were these barriers not present. To answer that question, the decision maker should consider whether cheaper private alternatives for achieving the same goal of coordination existed at the time. If the decision maker concludes that a liability rule imposing a coordination principle is (1) one that the parties would have agreed to include were it not for certain obstacles, and (2) a less costly alternative to overcoming the barriers to its express inclusion, then the law should set a default rule of coordination.

Without answering questions about how parties subject to the liability rule of coordination would react to it, and whether imposing the rule will achieve or hinder the parties' private goals and at what cost,<sup>19</sup> the decision maker cannot resolve whether the rule would be preferred by the parties. Absent a structure of economic analysis, a model of average goals of the parties, and projected responses to and costs of various rules,<sup>20</sup> the decision maker must fall back on the argument that the coordination principle should be adopted because it is fair. However, if one regards contract as in the realm of private decision making, then it is important that any law-supplied default rule be grounded in consent. With an economic model of rational decision making, the scholar can provide a consent-based rationale for a law-supplied rule. It is, therefore, not necessary to "think of some default rules [as] outside the parties' agreement . . . ." <sup>21</sup>

### I. BURTON'S AUTHORITY OF CONTRACT: A MODEL GEARED TO THE FULLY CONTINGENT CONTRACT

Burton argues that default rules based on principles such as efficiency "lack a legitimating basis or fail to respect the authority of the contract."<sup>22</sup> However, the criteria he selects for judging the legitimate authority of contract seem too closely allied with the paradigm of the fully determinate express contract. These criteria are inappropriate arbiters of default rules for the non-fully contingent contract. They erroneously lead Professor Burton to (1) place too great an emphasis

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that opportunism will interfere with such general clauses in contracts requiring cooperation. OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 50-51 (1985).

19. Coffey, *supra* note 4, at 4.

20. *Id.*

21. Burton, *supra* note 1, at 155.

22. *Id.* at 117.

on the express terms' legitimacy, (2) give undue weight to a practical guidance function of rules without providing a methodology for guidance when the contract is incomplete, and (3) improperly exclude default rules as illegitimate if they require any cost/benefit analysis *ex post*.

#### A. THE PRIMACY OF EXPRESS TERMS

Burton's model gives exclusive legitimacy to the express private agreement of the parties. It regards the rules supplied by non-party decision makers as necessarily lacking such legitimacy. Express terms "need not be justified as anything more than the parties' desires."<sup>23</sup> Because default rules fall outside the parties' express agreement, they must be legitimated since the "supplied term is a deal the parties never made."<sup>24</sup> No contract, even with express language, can be self-interpreting.<sup>25</sup> Therefore, the vision of a bifurcated world in which some terms—express ones—are presumptively legitimate because they are grounded in private agreement, and other terms—law-supplied ones—are somehow in need of a legitimating authority, is false. If one accepts the reality of necessarily incomplete contracts (because of the transaction costs of complete specificity), even express contracts require interpretation which will entail default-rule choices outside the express terms of the contract.<sup>26</sup>

An inevitable blurring between express and implied terms occurs, requiring a legitimacy model to cover all of these terms. Because it may be costly to specify all terms expressly, parties may deliberately choose to leave certain matters open.<sup>27</sup> It may therefore be inappropriate to regard the implied terms as automatically nonconsensual.<sup>28</sup> Instead, such terms implied by default rules can be understood to be essential parts of the contract agreement, "rather than . . . defaults . . . imposed when the contract runs out . . ."<sup>29</sup> Under a broader view of the nature of contracting,<sup>30</sup> under which parties inevitably fail to resolve all matters by explicit agreement, one can construct a consent-

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23. *Id.* at 120 n.17.

24. *Id.* at 135.

25. Charny, *supra* note 4, at 1819.

26. *Id.*

27. Gillette, *supra* note 11, at 172.

28. *Id.*

29. *Id.* at 169.

30. *Id.* (Burton's project is contingent on acceptance of his narrow view of the reach of contractual agreement, while Gillette's work is based on a broader view of the nature of contracting).

based rationale for default rules. On the assumption that the default rule is a less costly means of achieving the parties' private goals than other private devices, one can conclude the parties would therefore prefer the rule as a means of minimizing transaction costs.<sup>31</sup>

The primacy given to express obligation, and the faith in parties' ability to allocate all risks *ex ante* by contract, explains Burton's critique of *J.J. Brooksbank Co. v. Budget Rent-A-Car Corp.*<sup>32</sup> In *Brooksbank*, a licensing agreement between Budget and Brooksbank governed their relationship.<sup>33</sup> As an early licensee, Brooksbank received a favorable deal: "The [1962] agreement required Budget to maintain reservation offices in New York, Los Angeles, and Chicago and to forward to Brooksbank all reservations made at all its offices at no charge to Brooksbank."<sup>34</sup> One-third of Brooksbank's out-of-town reservations came from these three offices.<sup>35</sup> When Budget adopted a central reservation system using a single toll-free 800 number, "Brooksbank sought a declaration that the 1962 agreement entitled it to free reservations from Budget's central reservations office."<sup>36</sup>

The Minnesota Supreme Court rejected Brooksbank's claim that it was entitled to free reservations under its contract with Budget, and granted Brooksbank reservations at two-thirds of their cost.<sup>37</sup> The court justified this allocation and the departure from the literal reading of the agreement entitling the claimant to free reservations by finding that "the 1962 agreement was based on the parties' interests in the effective flow of reservations while rewarding Brooksbank's willingness to sign with Budget early in the history of the car rental business."<sup>38</sup> Moreover, because Brooksbank had received one-third of its business at no charge, a declaratory judgment granting Brooksbank reservations at two-thirds of their cost would preserve the "essential bargain" the parties had made.<sup>39</sup>

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31. See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 262 (1985). *But see id.* at 264 (suggesting that default rules may generate costs and negative incentive to innovate).

32. 337 N.W.2d 372 (Minn. 1983).

33. *Id.* at 373.

34. Burton, *supra* note 1, at 132.

35. *Brooksbank*, 337 N.W.2d at 374.

36. Burton, *supra* note 1, at 132.

37. *Brooksbank*, 337 N.W.2d at 377.

38. Burton, *supra* note 1, at 132.

39. *Brooksbank*, 337 N.W.2d at 377.

Burton criticizes the result in *Brooksbank* because of the court's failure "to respect the contract's authority."<sup>40</sup> Burton argues that the court should have resolved the matter "on the basis of the express contract language, interpreted literally," and enforced Budget's obligation to furnish reservations free of charge to Brooksbank.<sup>41</sup> Denigrating the court's balancing of the parties' competing interests in order to arrive at the compromise, Burton asserts that "[i]t defeats the purpose of the directive to . . . revisit the balance of ex ante interests when determining what to do ex post."<sup>42</sup> According to Burton, such balancing is improper because the "agreement's directives should supplant those considerations . . ."<sup>43</sup> Regardless of whether the court reached the correct result, Burton's critique of the result suggests an unrealistic faith in the literal meaning of words and too great an emphasis on promises as the exclusive source of obligation.

Burton's critique of *Brooksbank* suggests that legitimate obligation must be grounded in an express agreement. This approach ignores the inevitable ambiguity in agreements.<sup>44</sup> Further, this approach assumes that all risks can be allocated ex ante by agreement, making any later balancing by the court improper. Professor Burton apparently never considered the possibility that while the contract language was clear and authoritative ("free of charge"), this language was not intended by the parties to refer to the completely different context of an 800 toll-free reservation system, or that the parties never contemplated this change. When an agreement is indeterminate,<sup>45</sup> the court needs a methodology for achieving the parties' interests and goals, and balancing the costs of intervention against the costs of nonintervention.

## B. PRACTICAL GUIDANCE

Other elements in the Burton authority model also reflect a bias toward the complete contingent contract. Under Burton's model the authority of contract derives in part from its practical authority: "Laws

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40. Burton, *supra* note 1, at 133.

41. *Id.* at 164.

42. *Id.* at 133.

43. *Id.* The "directives" presumably refer to the contract provisions.

44. See Charny, *supra* note 4, at 1819.

45. Of course, Professor Burton assumes away any indeterminacy in the language. Cf. *Brooksbank*, 337 N.W.2d at 375 (discussing contract incompleteness on issue of technological changes in the reservation system).



and contracts are supposed to guide conduct as a practical matter."<sup>46</sup> The complete contingent contract seems better able to meet this criterion of practical authority and guidance than an incomplete contract which cannot act as a practical guide, at least as to those matters not covered in the agreement. Even if practical guidance is important and can be achieved through default rules, if the express agreement fails to provide practical guidance, then one is left with the question of how to choose a default rule that will provide practical guidance to the parties. Since many different default rules potentially could provide practical guidance, the fundamental question is how to choose among various default rules and how to justify the choice of a particular default rule. The question remains: what principle should inform the choice of a particular rule? To resolve that question, the decision maker needs a model of parties' average goals and needs to resolve the question of whether a particular default rule is appropriate: he/she must ask how the parties will respond to various alternative rules and whether the law-supplied rule will achieve the goals of average parties and at what cost. Resolving these questions requires the decision maker to advert to an economic model.<sup>47</sup>

### C. REBALANCING

The third element of the Burton authority model requires an authoritative law that precludes a rebalancing of the costs and benefits of the law.<sup>48</sup> To the extent that this element must function as a more general basis for the legitimacy of default rules in the context of a necessarily incomplete contract, it suffers from the same shortcomings as the other elements: practical guidance and the primacy of express obligation.

The Burton model focuses on a paradigm law—stopping at a red light—that settles all issues and precludes a balancing of costs and benefits of the law. The ideal legitimate Burton law precludes a "revisiting" of the "reasons on which it is based."<sup>49</sup> For a law to be legitimate in Burton's model, it should tell the motorist how to behave.

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46. Burton, *supra* note 1, at 124.

47. *Id.* (rejecting the relevance of economic analysis because it merely "offer[s] theoretical observations, not practical guidance").

48. *Id.* at 126.

49. *Id.*

Further, the law would not be authoritative, and would thus be illegitimate, if one could not "identify the directive's content without revisiting all the reasons on which it is based."<sup>50</sup> "Thus, a legitimate traffic law will help a motorist to better fulfill her obligation to coordinate then if she simply considered the balance of safety and efficiency on each encounter with a red light."<sup>51</sup>

The implication seems to be that for a law to be authoritative and legitimate, it must be accepted unquestioningly and must obviate the need for rebalancing interests. In the context of a "stop at red lights" law, it may make sense to respect the command of the law and to preclude a weighing of costs and benefits *ex post*. The legislature is empowered to weigh costs and benefits, to adopt legislation that reflects the majority's view of the proper balance, and to document and defend that balance in legislative hearings. Allowing individuals to opt out and deviate from the law would undermine the power of the legislature to adopt and enforce its laws.

Compare, however, the different paradigm of the incomplete contract, where the filling of gaps necessarily involves the court in weighing the costs and benefits of alternative approaches. In the context of an incomplete contract, or a contract which appears complete but does not address changing circumstances, confining legitimacy to laws which respect the "directive's content" seems unsuitable. If the parties have not provided for a term, it is difficult for the legal decision maker to identify and respect the "directive's content." A legal decision maker cannot construct an appropriate default rule for such cases without weighing the costs and benefits of alternative approaches. Where legislation does not exist and parties are contracting, one or both parties may decide to leave certain issues open. The legal decision maker must then choose among alternative possible legal rules. The process used by the court should be similar to the one used by a legislative decision maker in choosing among possible laws. If the matter falls outside the legislative domain, or outside express resolution by contract, the legal decision maker must then do what any legislative decision maker would do by asking, "[W]hat goals or objectives will be served or jeopardized—promoted or threatened . . . —by a response awarding (or withholding) a property right or imposing (or not imposing) liability, in light of the response's likely effect on

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50. *Id.*

51. *Id.* at 125-26.

those who will be affected by litigation (immediate or future) or on those who will avoid litigation by adjusting their behavior?"<sup>52</sup>

Thus, the process of formulating a legal rule starts from a very different basis than the authoritative model. The legal decision maker starts with a model of human behavior and decides "what goals . . . individuals of the type involved in the controversy pursue in making their private choices[.]"<sup>53</sup> Having established those goals, the decision maker should determine whether certain "goals selected as worthy" will be "furthered or frustrated" by a legal default rule, given formulations about how average actors will react to the various rules.<sup>54</sup> Thus, in judging the legitimacy of default rules, it may be appropriate to start not with whether these rules command unquestioning respect, but rather—given assumptions about how people are likely to respond to alternative rules—with the question of how well the rules achieve certain goals.

Burton's focus on criteria developed in relation to an ideal of an express contract—practical guidance, the primacy afforded express obligations, and the ideal of a law which resolves all issues *ex ante*—obscures important issues.<sup>55</sup> The issue should not be whether an incomplete agreement provides practical guidance for the parties, or whether such guidance arises from the explicit bargain. The incomplete agreement will always be deficient in satisfying those criteria. The decision maker should instead focus on how the incomplete agreement should be filled in, what methodology is appropriate, and how it can be justified? Once a methodology is chosen, the court can fill in the gaps and the law-supplied terms will presumably supply the practical guidance that is inevitably lacking in an incomplete agreement.

## II. PROMISE-MAKING CHARACTERISTICS: IMPORTATION TO NORMS

The second failing of the authority model used for judging the legitimacy of default rules is that it builds on philosophical literature

52. Coffey, *supra* note 4, at 2. Presumably even for legislation, a balancing of costs and benefits may be required if the scope or interpretation of the statute is unclear.

53. *Id.* at 4.

54. *Id.*

55. A too-narrow primacy given to obligations established by the express contract, and a too-great emphasis on directive content leads Burton to summarily reject relational norms as a basis for default rules. See Burton, *supra* note 1, at 141-44. Relational norms could be important in identifying a behavioral reality necessary in determining the likely effect of rules on parties.

detailing what all promises have in common, and focuses on factors that do not provide a larger framework for deciding which legal default rule is appropriate.<sup>56</sup> The problem with finding authority for a contractual obligation based on whether it has certain promissory characteristics—including the characteristic of excluding certain reasons of party interest—is that “its focus is implicitly limited to cases where there is no question that a promise has been made, and no difficulty in determining the exact content of the promised action . . . .”<sup>57</sup>

The promissory characteristic of excluding certain “reasons of personal interest upon which the deal is based in the first place”<sup>58</sup> can be illustrated as follows: if *W* promises to repay a loan on Tuesday, a contract will prevent *W* from simply deciding that it is inconvenient to repay the loan on Tuesday.<sup>59</sup> The borrower may not seek excuse on inconvenience grounds because “[t]he agreed and determinate payment term supplants these considerations with a reason for timely payment stemming from the payment term.”<sup>60</sup>

The shortcomings of an analysis based on the promissory characteristic of excluding reasons of interest as a foundation for judging default rules can be illustrated by extending it to the indeterminate contract. If an output or requirements contract’s terms are indeterminate and give one party discretion, traditional doctrine requires that the party with discretion exclude certain reasons for non-performance—she may not act to recapture opportunities foregone at the time of contracting.<sup>61</sup> Burton justifies this exclusion of a reason in performance by explaining that “[t]he agreement excluded price from the buyer’s reasons for action in contract performance because price considerations were assessed *ex ante*, and the deal was concluded.”<sup>62</sup> Burton’s approach to the indeterminate contract seeks to establish as authoritative a default rule requiring good faith on the assumption that such a rule shares one of the qualities of promising—namely that it excludes certain reasons for acting once a contract is established.

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56. Craswell, *supra* note 13, at 503-05.

57. *Id.* at 505.

58. Burton, *supra* note 1, at 126.

59. *Id.* at 126-27.

60. *Id.* at 127.

61. *Id.*; see also Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980).

62. Burton, *supra* note 1, at 127.

Because the promise excludes certain reasons for acting—such as acting to recapture foregone opportunities—it respects the authority of contract.

Default rules can be analyzed to determine whether they have the quality of excluding a certain reason of party interest once the default-rule calculation has been made. However, Burton's analysis does not provide a methodology for determining which default rule should be adopted in the first place: Should the default rule be a good-faith requirement or some other default rule? What principles should apply? Nor does the analysis provide a rationale for interpreting the default rule of good faith to exclude acting for the reason of price speculation in contract performance when the agreement does not expressly prohibit such speculation. Burton is convinced that the exclusion of the price speculation reason in output and requirements contracts can be traced to the agreement itself "because price considerations were assessed *ex ante*."<sup>63</sup> Predicating the authority of contract on the quality of excluding reasons of interest that were settled by the initial agreement places too much faith in the ability of the initial agreement to provide a ready source of exclusions of reasons for acting. By postulating that the initial agreement will easily resolve which reasons of self-interest should be excluded, the analysis fails to grapple with justifying the default rule or the interpretive tests that it spawns (such as not acting to recapture foregone opportunities). The methodology for that calculus must lie outside the nature of promissory attributes.

### III. THE COORDINATION PRINCIPLE: JUSTIFYING THE ADOPTION OF A CONVENTION

Burton's suggested principle for legitimating default rules is based upon the coordination principle embraced by Hart and Rawls.<sup>64</sup> The justifications for adopting the principle of coordination leave unanswered the question of why the law should adopt a convention even if it is prevalent. To justify why the law should ever supply a term when the parties have negotiated a contract and failed to expressly include the term requires a model of how people bargain, what obstacles or impediments they faced in expressly negotiating a coordination term, how parties would react to alternative principles, and what the costs of alternative private approaches to solving the

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63. *Id.*

64. *Id.* at 156.

coordination problems might be. Only by addressing those questions can one answer the question of why the law should supply a term on consent grounds. Burton does not seem to address those questions; rather, he seeks to justify the adoption in other ways.

The first justification for the adoption of the Hart/Rawls coordination principle is that "a contract is a mutually advantageous cooperative venture according to norms . . . by which each [party] voluntarily restricts his or her liberty to yield advantages for both. . . . Therefore, each party, having agreed to cooperate, has a right to a similar cooperation by the other party."<sup>65</sup>

The difficulty with arguing that there is a right to expect "similar cooperation" is that when one is outside the realm of rights created by express obligations in the agreement, then one is left with the question of why there should be a right to expect similar acquiescence to limits on freedom that are not in the agreement.

Burton justifies the right to the coordination principle by arguing that it is part of the parties' implicit agreement.<sup>66</sup> "Like the implied covenant of good faith, the general obligation to coordinate is made whether or not the parties have it in mind. It is what their contract means even when it is not what they meant."<sup>67</sup> In essence, Burton finds a convention of coordination that is inherent in the nature of contracting itself. However, the argument that the law should adopt a coordination convention because it prevails begs the question of whether a coordination term should be part of the agreement, and if so, on what grounds.<sup>68</sup>

The fundamental question unanswered by Burton is this: if the obligation to coordinate is part of the implicit agreement of the parties, why did they not explicitly include it? To answer this question of why the law should supply a term the parties neglected to include, the decision maker must address and detail the obstacles the parties faced in negotiating expressly for a term. Even if there are obstacles, including transaction costs, the decision maker should also develop a model of what the parties' private goals were and whether these private goals would be hindered or advanced by the implication of a rule

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65. *Id.* at 162.

66. *Id.* at 161.

67. *Id.*

68. Gillette also raises this objection to adopting conventions, arguing that they are "less robust for purposes of generating the kinds of political obligations that Burton seeks." Gillette, *supra* note 11, at 174.

of coordination. The decision maker should consider whether the parties had available to them private devices for achieving the goals of coordination and how costly they were. If the decision maker is convinced that (1) the law-supplied term would accord with the objectives sought by most parties, and (2) the private devices for achieving those goals were more costly, only then should the court intervene by supplying a term.<sup>69</sup>

Under an economic model of parties' private goals, it may be possible to reconceptualize the coordination principle as a term that would be supplied by courts for efficiency reasons, on the theory that most parties would bargain for it were the obstacles not too great. "Contracting parties agree (explicitly or implicitly) to cooperate in the future, not because of altruism, but because it lowers the ex ante contract price by more than the cost of cooperation."<sup>70</sup> Without a grounding in efficiency terms, the lawmaker would have no basis for deriving a normative argument in favor of a coordination convention—one could only point to its prevalence.<sup>71</sup>

#### IV. AN APPROPRIATE GROUNDING: A LAW-AND-ECONOMICS EFFICIENCY APPROACH

If one takes seriously the transaction-cost models of contracting and recognizes that many barriers necessarily prevent the achievement of fully contingent contracts,<sup>72</sup> and if one accepts a model of assumptions about what goals average economic actors have, then one may begin to appreciate why parties leave certain terms incomplete, as for example, a coordination principle. Once the model is made more realistic and the legal decision maker appreciates why parties may not achieve fully contingent contracts, then the question becomes, What should the law do about it? Should it take a hands-off approach or should it intervene, and what would be the justifying rationale for legal intervention? The legal decision maker may decide that if the costs of private alternatives to overcoming the barriers are too high, and the term accords with the objectives sought on average

69. Thus, armed with a consent- and efficiency-based justification for default rules, the decision maker could presumably reject default rules that were not efficient and thus not optimal. An inquiry into the basis for a convention could better grapple with the normative question of whether a convention should be supplied by law and provide an "external metric" for judging conventions. See *id.* at 176.

70. Scott, *supra* note 4, at 605.

71. See Gillette, *supra* note 11, at 176.

72. *Id.* at 170; see also Scott, *supra* note 4, at 607.

by the parties, then the law should intervene with a term.<sup>73</sup> However, the law should intervene only if the alternative private devices are more costly than the benefits that they could achieve, and there are high costs of not supplying the term based on projections about how people will respond to alternative rules.<sup>74</sup> On balance, supplying the term may promote efficiency by saving the parties those costs, and at the same time promote the objectives sought by the parties on average, thus providing a grounding in the consent of the parties. Developing appropriate and legitimate default rules that will allow a decision maker to make principled choices among competing default rules requires a different model, one grounded in "real world conditions,"<sup>75</sup> one that fully recognizes the "practical impossibility"<sup>76</sup> of achieving fully contingent contracts.

This comment suggests that by looking to the reasons for the indeterminate contract, developing a model of the structural impediments<sup>77</sup> to fully contingent contracts, and drawing on an economic model of behavior under which actors seek on average a goal of minimizing transaction costs, the law can select an appropriate default rule—one that the parties would prefer because it will achieve the typical goals of average parties<sup>78</sup> at a lower cost than alternative private devices the parties might have used to overcome the barriers to completely contingent contracts. Further, by identifying the terms that rational parties would have agreed to, providing an explanation of the barriers that parties face in supplying those terms expressly, and identifying the costs of private devices to overcome those barriers, it is possible to infer a consent to a suggested default rule. Thus the legitimacy issue is a real one, but the legitimacy of contract default rules

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73. Coffey, *supra* note 4, at 4.

74. *Id.*

75. *Id.*

76. Coleman et al., *supra* note 4, at 640.

77. See WILLIAMSON, *supra* note 18, at 50-51 (detailing transaction-cost impediments to fully contingent contracts).

78. See Coffey, *supra* note 4, at 4.

The formulation of a rule justification with respect to the model facts of a controversy also requires the decisionmaker, either on the basis of evidence that has been collected and processed or, where empirical evidence is lacking, on the basis of a priori hypothesis, to make assumptions about how things (including people) behave in reality. What goals do individuals of the type involved in the controversy pursue in making their private choices? . . . What is common and what is not common in human nature?



can be grounded in the moral legitimacy of consent.<sup>79</sup> The court supplies terms under a default rule when it is convinced that the parties would have struck those terms were it not for certain obstacles—including the transaction costs of writing the terms expressly—and when it is convinced that the law-supplied term under the default rule is a less costly means of achieving the parties' goals than alternative private devices available to the parties and therefore is the one that the parties would prefer over other means of overcoming the obstacles to fully contingent contracts.<sup>80</sup> Thus, by accepting an economic model of decision making, it may be possible to construct plausible hypothetical bargains, and thus to provide a consensual basis for intervention through law-supplied rules.<sup>81</sup>

A model based on realistic assumptions and the difficulties of achieving fully contingent contracts moves away from an authority model of contract, and toward a model which can provide an efficiency justification for choosing among alternative default rules.

## V. CRITIQUING THE BURTON DEBUNKING OF EFFICIENCY

Despite the efficiency arguments that can be made for a law-supplied rule, Professor Burton attacks the efficiency principle because of its failure "to ground a default principle with legitimate authority."<sup>82</sup> He posits that according to efficiency there is no theoretical distinction between filling gaps "when the agreement has run out of guidance"<sup>83</sup> and the more unjustifiable result of mandating efficient deals.<sup>84</sup>

Burton attempts to undermine the legitimacy of the efficiency principle by use of the following example: "Assume that Costello has \$50,000 in a passbook savings account paying 2.25% interest at Abbott's savings bank. He plans to use the money next year for the

79. The consent is a projected one. Based on certain assumptions about parties' goals and values, and the projected costs of alternative approaches, one can infer that the parties would prefer the law-supplied rule and therefore it should be supplied by the legal decision maker.

80. See generally Juliet P. Kostritsky, *Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 HASTINGS L.J. 621 (1993) (suggesting a law-supplied liability rule in preliminary bargaining contexts involving sunk costs). I would also like to thank Professor Ronald J. Coffey for his helpful insights on this point.

81. See Gillette, *supra* note 11, at 170.

82. Burton, *supra* note 1, at 134.

83. *Id.* at 120.

84. See *id.* at 134-35.

down payment on a house. Abbott also sells certificates of deposit paying 3.85% interest with a mandatory six-month commitment."<sup>85</sup> Burton argues that under principles of market-mimicking, the law should treat the parties as if they had a deal for a transaction under which Costello moves his money into the certificate of deposit because, if you assume that both parties are rational maximizers, the certificate of deposit deal would make both parties better off and the deal should be compelled.<sup>86</sup> Thus, to the extent that one objects to the results of the market-compelled deal, one necessarily must reject efficiency principles as a basis for filling gaps: "the defects of compelling market-mimicking deals *ex ante* reveals the defects in market-mimicking default principles *ex post*."<sup>87</sup>

Although it may be possible to attack efficiency principles because they elevate the importance of self-interest and thus "obfuscate[ ] the role of norms as guides to conduct independent of the actor's self-interest,"<sup>88</sup> the Abbott and Costello example does not undermine the importance of efficiency analysis generally. The logic of Burton's argument is that because efficiency analysis mandates compelling deals the parties did not reach, it is a problematic form of analysis and, therefore, should not be used to fill gaps in incomplete contracts.

Several difficulties with using the mandated-deal hypothetical undermine the attack on efficiency analysis. Burton suggests that under efficiency analysis the parties should be required to "do the efficient thing."<sup>89</sup> Not only would most people intuitively think that the deal should not be enforced and that there should be no obligation to do the efficient thing when it means compelling the deal, but economists embracing the efficiency principle would probably also reject the law mandating a deal as well. Thus, to the extent Burton's attack on efficiency rests on the poor results of mandated deals, it does not succeed.

An efficiency analysis would not compel a deal for several reasons. First, efficiency analysis affords maximum domain to autonomy, so it would reject the forced decision making of mandated deals. Second, compelling a deal for efficiency reasons fails to take account of a

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85. *Id.* at 134.

86. *Id.* at 134-35.

87. *Id.* at 135.

88. *Id.* at 147.

89. *Id.* at 138.

major premise of efficiency arguments for law-supplied terms, namely that intervention in the form of a law-supplied term is justified when the parties face large hurdles to specifying complete terms or reaching an explicit bargain. To the extent that the legal decision maker identifies significant structural problems of specifying complete terms, the decision maker may be willing to intervene by supplying a term if she is convinced that this is the term for which the parties would have bargained were it not for high transaction costs.<sup>90</sup> Since the Abbott and Costello example seems to display no basic structural impediments to bargaining toward a complete contingent contract, there would be no particularly compelling reason for the court to intervene by supplying the term of mandating the efficient deal. In fact, if there are no barriers to bargaining, the economist would presumably conclude that the decision to remain in the passbook account is the efficient transaction. The economist would posit that even though the certificate of deposit pays a higher rate, in fact it may represent the less efficient deal. Because of individual differences in risk aversion, endowment and preferences, Abbott, the depositor, may prefer the passbook—it represents a higher value in use than the value in exchange resulting from a change to the certificate of deposit.<sup>91</sup>

Moreover, economists who accept the proposition that efficiency is good might well suggest that on the facts of Abbott and Costello, judicial intervention requiring the efficient deal would not be called for. Even if the certificate of deposit looks more efficient at first blush, in fact the legal decision maker can't tell whether the passbook or certificate of deposit deal is more efficient. In those circumstances where we don't know which deal is more efficient, the law should not intervene.<sup>92</sup>

90. See generally Kostriksy, *supra* note 80.

91. See RICHARD H. THALER, *The Psychology of Choice and the Assumptions of Economics*, in *QUASI RATIONAL ECONOMICS* 139-43 (1991) (stating that differences in loss aversion, for example, may cause individuals to regard identical asset positions differently). Differences in risk aversion and preferences may suggest that Costello values six months of liquidity more than the 1.5% difference in market rate between a CD and a passbook account. Thus, differences in the preference accorded liquidity may make the seemingly more efficient deal in fact less efficient.

92. Implicit in all law-and-economics scholarship is a disinclination to intervene, if intervention will not enhance efficiency. If a law-supplied rule will not improve efficiency, then there would simply be no conceptual basis in law and economics to intervene. The economist choosing a default rule would do so on the basis of "adopt[ing] the default rule which is most efficient (efficient in the sense of maximizing the sum of the parties' expected utility)." Richard Craswell, *The Relational Move: Some Questions from Law and Economics*, 3 *S. CAL. INTERDISC. L.J.* 91, 93 (1993). If there were no basis for believing that a particular rule would enhance efficiency, then the court should probably leave the parties where they are. Juliet P. Kostriksy, *Illegal*

Finally the economist might suggest that intervention is inappropriate on the facts of Abbott and Costello because intervention would prevent parties from making mistakes that might be helpful mistakes to make. It is only by making mistakes that people learn, and if the law mandated the efficient deal and parties were thus not permitted to make mistakes, they might not have the incentive to collect information to decide in the future whether or not a deal is efficient.<sup>93</sup>

Professor Burton has used the Abbott and Costello example to undermine the value of efficiency analysis generally. He takes a case where intuitive reactions suggest no liability and asserts that an efficiency analysis would lead to incorrect results. However, even efficiency advocates might well suggest that a mandated deal is inappropriate. Thus, if we are going to attack efficiency, it must be because it elevates as a goal the furtherance of the pursuit of self-interest. However, if one accepts that this goal is a legitimate one that the law ought to promote, then law-supplied terms may be appropriate to achieve efficient results.

### CONCLUSION

This comment agrees with Professor Burton that providing a legitimate grounding for default principles is crucial. However, Burton's authority of contract model may be misconceived because it is grounded in the ideal of a fully contingent contract. This comment argues that in searching for a legitimacy model, the decision maker must begin with a model that takes full account of the reality of the incomplete contract. Once that model of behavior is established and a projection of how parties will respond to various rules is made, it is possible to legitimate the default rules in consent. I disagree with the contention that "[a] consent-independent justification . . . is needed"<sup>94</sup> for default principles since "consent would not establish which of all possible default rules are justified."<sup>95</sup> In contrast, I argue that once a model of behavioral reality is formulated under which a legal decision maker can identify average goals of parties and their projected reactions to legal intervention, one can hypothesize the parties' consent to a particular default rule. Without that model, one is left wondering

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*Contracts and Efficient Deterrence: A Study in Modern Contract Theory*, 74 IOWA L. REV. 115, 153 (1988).

93. THALER, *supra* note 91, at 157.

94. Burton, *supra* note 1, at 155.

95. *Id.*

why the coordination principle is the appropriate default rule. Burton's attempts to justify coordination by reference to a party's right to cooperation and by reference to an implicit agreement leave unanswered the questions of why the coordination principle is part of the implicit agreement and why there is a right to cooperation if that right is not in the express agreement. Justifying the coordination principle requires a model of human behavior that will allow a court to construct an economic model under which parties might implicitly bargain for a cooperation principle. The decision maker must still resolve whether it is appropriate for the law to supply the principle based on a model of the obstacles the parties faced in explicitly adopting the principle, and the costs of alternative private devices to achieve the goals of cooperation. Thus, this comment suggests that fundamental questions of justification remain unresolved without reference to an economic model of behavior.