

Commodification and Contract Formation: Placing the Consideration Doctrine on Stronger Foundations

David Gamage[†] and Allon Kadem^{††}

Abstract:

Under the traditional consideration doctrine, a promise is only legally enforceable if it is made in exchange for something of value. This doctrine lies at the heart of contract law, yet it lacks a sound theoretical justification – a fact that has confounded generations of scholars and created a mess of case law.

This paper argues that the failure of traditional justifications for the doctrine comes from two mistaken assumptions. First, previous scholars have assumed that anyone can back a promise with nominal consideration if they wish to do so. We show how social norms against commodification limit the availability of the consideration form. Some promises are made in social contexts in which invoking consideration—that is, exchanging a promise in return for something of value—violates social taboos. Specifically, we show that anti-commodification taboos operate where the social message sent by a transaction is more important than the desire to transfer goods or services. Whereas previous scholarship has assumed one can always invoke consideration, we argue that anti-commodification norms make even nominal consideration unavailable within these contexts.

Second, scholars have assumed that when parties utilize a formalism—such as nominal consideration—to make their promises legally binding, they necessarily desire to be bound. Using a game-theoretic model based on asymmetric information, we dispute the conventional wisdom that the law should honor parties’ intentions as articulated at the time of contract formation. We show how parties’ expressed intentions may not conform to their underlying desires. A promisor may render her promise legally enforceable—even though she does not want to—in order to signal her sincerity to the promisee. As a result, in a cycle of inefficient signaling, other promisors may feel forced to do the same. Thus, the mere fact that parties take advantage of a legally binding form does not imply that they desire the existence of that option. Having the option to legally enforce a promise may harm both promisors and promisees.

Having exposed these two flawed assumptions, we provide a new framework for determining which promises the law should enforce. Ultimately, what matters is not whether the parties actually *do* invoke consideration, but rather whether they *can* invoke consideration. Norms prevent parties from invoking consideration where the social message sent by a promise is more important than the substance of the transaction—and these are precisely the types of promises in which inefficient signaling is likely to occur. In other words, norms block the use of consideration precisely where the option for legal enforcement of promises is most likely to harm both promisors and promisees. Therefore, only when social norms allow the use of consideration should we conclude that parties truly desire the option to have their promises legally enforced.

[†] Visiting Assistant Professor, University of Texas (Austin) School of Law.

^{††} Judicial Clerk to the Hon. Mark R. Kravitz. The authors would like to thank Daniel Markovits, Ian Ayres, Bernie Black, Larry Garvin, Mark Gergen, Christine Hurt, Ethan Lieb, Ronald Mann, and the participants in the Conglomerate Junior Scholars Workshop for their invaluable input. Research for this Article was supported in part by a grant from the Paul & Daisy Soros Foundation. All views and errors are, of course, our own.

Outline

- I. THE INADEQUACIES OF EXISTING THEORY AND PRACTICE
 - A. *Formal Arguments*
 - 1. The “Evidentiary” Rationale
 - 2. The “Cautionary” Rationale
 - B. *Substantive Arguments*
 - 1. The “Sterile” Rationale
 - 2. The “Trivial” Rationale
 - 3. The “Unnecessary” Rationale
 - C. *The Morass of Current Doctrine*
 - II. THE ROLE OF ANTI-COMMODIFICATION NORMS
 - A. *Commodification in Sociology and Anthropology*
 - B. *Commodification in Philosophy and Political Theory*
 - C. *Commodification in Economics and Game Theory*
 - D. *Drawing Conclusions from the Literature*
 - III. THE PROBLEM OF INEFFICIENT SIGNALING
 - A. *The Assumptions Behind Inefficient Signaling Spirals*
 - B. *A Conceptual Explanation of Inefficient Signaling Spirals*
 - IV. TOWARD A NEW UNDERSTANDING OF THE CONSIDERATION DOCTRINE
 - A. *Relaxing the Assumption that Promises Have Only Two Terms*
 - 1. The Effects of Multiple Terms
 - 2. The Availability of Multiple Terms
 - B. *Circumstances in which Consideration Is Unavailable*
 - C. *Tie-Breaking Factors*
 - V. CONCLUSION
- APPENDIX A. THE AGHION-HERMALIN MODEL OF INEFFICIENT SIGNALING
- APPENDIX B. AN EXTENSION OF THE AGHION-HERMALIN MODEL

INTRODUCTION

People make promises all the time. In the course of a day, we might promise a spouse to complete household chores, a coworker to finish a project by its deadline, and a service provider to pay for a service upon completion. Yet only the last of these promises will generally impose a legal obligation. Whereas the first two statements are mere unilateral promises, the fact that the third promise is exchanged for something of value—the service—makes it a contract that can be enforced in courts of law.

This rule is known as the consideration doctrine: The law will not enforce unilateral promises, but promises exchanged for something of value become legally binding contracts. There are many exceptions to this doctrine. Other rules besides consideration can make a promise legally binding, and not all promises backed by consideration are legally enforceable. Nevertheless, the consideration doctrine remains the most important rule for distinguishing between unenforceable promises and contracts backed by law.

Unfortunately, we lack a sound theoretical justification for the consideration doctrine.¹ Underlying most of contract law is the general principle that parties' intentions should be honored.² So why, then, do we refuse enforcement to even those unilateral promises which were clearly intended to be binding?

Existing attempts to justify the consideration doctrine fall into two general camps. First, formalist scholars defend the doctrine as a mechanism for determining parties' intentions. By creating a hoop the parties must jump through in order to make their promises binding, the law creates a mechanism for parties to convey which promises they intend to impose legal obligations. In order to make their promises legally enforceable, the parties need only claim that their promise is being exchanged for something of value. In other words, they need only recite consideration. Yet as Eric Posner explains, "there is no reason to require parties to recite a consideration as opposed to reciting that they want their [promise] to be enforced. . . . Efforts to rationalize this practice as a way of ensuring that courts can distinguish enforceable and unenforceable promises fail because they do not explain the 'form' of the formality."³ No one doubts that formal mechanisms have their place within the legal system. But formal accounts of the consideration doctrine have failed to justify the use of consideration specifically. If the ultimate goal is to determine which promises the parties intended to be binding, why not simply require parties who desire enforcement to declare so in writing?⁴

In contrast to formalist scholars, who view the consideration doctrine as a tool for determining when parties want their promises to be enforced, substantive theorists see the doctrine as a means for separating unilateral promises from exchanges. Substantive accounts argue that unilateral—or "gratuitous"—promises are less socially valuable than promises made as part of a bilateral exchange. The substantive approach cares not for the parties' intentions or what steps they take to communicate a desire to be bound; only "true" exchange promises are deemed worthy of legal enforcement.

¹ See Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1477-81 (2004).

² In the words of Charles Fried, contract law rests on "the liberal principle that the free arrangements of rational persons should be respected." CONTRACT AS PROMISE 35 (1981).

³ Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 850 (2003).

⁴ See *infra* Part I.A for more on this point.

At first glance, substantive arguments might seem to offer a valid justification for the consideration doctrine. Yet, as we shall see, these arguments fail to withstand sustained reflection.⁵ Like most other scholars who have reviewed the literature, we conclude that gratuitous promises are not inherently less deserving of legal support.

While academics have debated about these flawed accounts of the consideration doctrine, courts have floundered over the doctrine's weak theoretical foundations. Some courts have followed the formalist approach, enforcing promises backed by even trivial amounts of consideration, while other courts have invoked substantive principles in striking down promises where the consideration is insignificant in value.⁶ The *Restatement (Second) of Contracts* rejects the use of nominal consideration – consideration of minimal worth – where the *Restatement (First)* had accepted it, but neither version has proved authoritative for how courts actually decide these disputes. As current doctrine stands, there is no predictable answer to the question of how much consideration is needed before a promise will be enforced.

This paper argues that the problematic state of the consideration doctrine flows from two assumptions shared by nearly all commentators. First, scholars have assumed that any parties who desire to do so can back a promise with nominal consideration. And second, scholars have assumed that only parties who truly want their promises to be legally enforced will utilize a formalism—like nominal consideration—to make their promises binding. As we will demonstrate, both of these assumptions are flawed.

The first assumption claims that all parties who wish to do so can back their promises with nominal consideration. After all, what could possibly prevent parties from exchanging a promise for a penny in order to make it binding? Our answer is anti-commodification norms.

By its very nature, the use of consideration commodifies a promise by insisting that the promise be exchanged for something of value. Many promises are made within relationships in which the parties are supposed to be guided by more than just self-interest and economic rationality. Within these relationships, a promisor who asks for something in return for her promise risks signaling that she views the relationship in instrumental terms. The consideration doctrine can only be activated when parties agree that a promise is made as part of a bargained-for exchange. But discussing promises using bargain-oriented language and behavior may be inappropriate within certain social contexts. To even suggest the use of nominal consideration might undermine the trust upon which these relationships are built.

We examine the literature on commodification within three branches of knowledge: (1) sociology and anthropology, (2) philosophy and political theory, and (3) economics and game theory. Although the literature does not enable us to determine precisely the circumstances under which consideration will be socially unavailable, we can still reach some broad conclusions about the nature of anti-commodification norms. These norms apply when the message sent by a promise is more important than the substance of the promise—that is, where the actual transfer of the promised goods or services plays only a secondary role.

For example, when promising to take a loved one out for her birthday, the substance of the promise may be less important than the message of affection it conveys. To commodify this sort of promise—say, by asking the loved one to pay a dollar to ensure that the promise is honored—would violate anti-commodification norms. Yet for other promises, the message sent

⁵ See *infra* Part I.B.

⁶ See, e.g., *Scott v. Scott*, No. CA03-692, 2004 Ark. App. LEXIS 341, at *10 (Ark. Ct. App. 2004); *Noel v. Noel* 512 P.2d 324 (Kan. 1973).

is not as important as the substance of the pledge. A businesswoman who promises to distribute goods on time will not violate norms by asking for payment in return for a guarantee of timely delivery.

Scholars have recognized the importance of anti-commodification norms for many aspects of the legal system—particularly within property law. Yet contracts scholars have not heretofore discussed the implications of these norms for the consideration doctrine. Although we have only a tentative understanding of how these norms work in practice, one conclusion is clear: There exist circumstances in which anti-commodification norms block the use of consideration. The assumption that all parties who so wish can readily make use of nominal consideration is simply wrong.

We thus have a partial answer to the formalist's dilemma. Due to anti-commodification norms, a formal rule based on nominal consideration differs from other formal alternatives—such as a seal or writing requirement. But does this difference favor the use of nominal consideration? After all, the principle of honoring parties' intentions would seem to justify using the least-restrictive legal rule. To answer this question, we turn to the second flawed assumption made by previous commentators: the assumption that parties' expressed wishes necessarily reflect their underlying desires.

To follow the principle that contract law should honor parties' intentions, courts need to determine the content of the parties' intentions. In the absence of contravening circumstances like duress, courts typically assume that parties who invoke a legal rule for making their promises binding actually want their promises to be legally enforced. As adherents of the traditional accounts might ask: Why would anyone take steps to bind themselves unless they actually wanted to be bound? Yet as we demonstrate, this logic relies on a shallow understanding of the nature of parties' desires.

Employing a game-theoretic model based on asymmetric information, we show how parties can essentially be forced into a legally binding form once that form is made available to them. Even parties who would prefer not being able to make their promises legally enforceable may find it necessary to utilize a doctrine like nominal consideration once it is put into place. Crucially, there is a difference between one's choice when confronted with a legal rule and one's preference for what the legal rule should be.

Consider the practice of promising. When a promisor makes her promise legally binding, she exposes herself to legal sanction if she doesn't follow through. Through this willingness to face sanctions, promisors can signal commitment, assuring promisees of their sincerity. But when only some promisors secure their promises through the law, promisees may become suspicious of the promisors who fail to do so—suspicious, that is, of promisors who choose not to make their promises legally enforceable. So as not to be seen as unreliable, promisors may be forced to render their promises legally binding, even if they would have preferred to avoid the potential legal entanglement.

Thus, promisors' expressed intentions do not necessarily match their underlying desires. Under a regime in which promisors can render their promises legally enforceable, they may choose to do so. However, the promisors might well wish they lived in a regime without this

option. In other words, the mere fact that parties choose to employ a legally binding form does not necessarily indicate that they desire the option to use that form.⁷

Having discarded the two flawed assumptions underlying traditional accounts of the consideration doctrine, we can outline our novel justification for the doctrine. Rejecting the first assumption tells us that a rule based on nominal consideration differs from other formal alternatives. Due to anti-commodification norms, not all parties can utilize nominal consideration. Rejecting the second assumption tells us that parties who take advantage of a legal rule might not desire its existence. Utilizing a permissive approach—such as enforcing all promises where the parties express a desire for enforcement in writing—could end up harming both promisors and promisees.

To synthesize these two observations into our novel account of the consideration doctrine we need one final insight: Anti-commodification norms deny the option of legal enforcement to precisely those parties who should prefer not to have the option made available. Social norms prevent the parties from invoking consideration where the social message sent by a promise is more important than the substance of the transaction—and these are precisely the types of promises in which inefficient signaling is likely to occur. Conversely, where the substance of the transaction is more important than the message sent, inefficient signaling is unlikely to take place. Thus, where anti-commodification norms allow parties to invoke consideration, the parties should generally benefit from having the option to make their promises legally binding. And where anti-commodification norms prevent parties from using consideration, we can expect that the parties prefer not having an option for legal enforcement.

Our novel account of the consideration doctrine is formalist in nature. Yet where previous formalist arguments have been unable to justify the use of consideration over alternative forms, we show that the consideration doctrine better tracks parties' underlying desires. If we allowed parties to bind themselves through an alternative form like a writing requirement, some promisors might feel forced to make their promises legally enforceable even when they would prefer not to be able to do so. The consideration doctrine avoids this result by providing an option of legal enforceability that can only be exercised within social relationships where parties are likely to desire the option.

The paper proceeds in four parts. Part I describes the inadequacies of existing theoretical accounts of the consideration doctrine and of the manner in which the courts have applied the doctrine. The Part is primarily intended to provide background information; readers who are already familiar with the problematic state of the consideration doctrine may wish to skip directly to Parts II, III, and IV, where we develop our novel solution to the doctrine's problems.⁸

In Part II, we survey the literature on anti-commodification to show how social taboos prevent some parties from backing their promises with even nominal consideration. Part II depicts the first flawed assumption made by traditional accounts of the consideration doctrine.

⁷ The availability of a legally binding form can harm promisees as well as promisors. There are costs to securing a promise through the legal system. Forcing promisors to bear these costs may lead them to reduce the magnitude of their promises, thereby reducing the value received by promisees. See Part III.C *infra*.

⁸ This is not to suggest that Part I adds nothing to the literature. We believe our description of the inadequacies of existing theory and doctrine forms a better overview than other accounts. We also add several new critiques and observations that have not yet appeared in the literature. Nevertheless, the primary value of our paper lies in Parts II, III, and IV. We doubt that many scholars of the consideration doctrine will be surprised with the results of our analysis in Part I.

Even when courts enforce promises backed only by nominal consideration, some parties remain unable to utilize the consideration form.

Part III explains the second flawed assumption of existing theories. The principle of honoring parties' intentions does not mean that we should always look to parties' expressed wishes with regard to an individual transaction. There is a difference between one's actions when confronted by a legal rule and one's preference for what the legal rule should be. Granting parties an option to bind themselves can ultimately harm both promisors and promisees.

Part IV synthesizes the results from the previous two parts to provide a novel justification for the consideration doctrine. Expanding on our game-theoretic analysis, we argue that anti-commodification norms only prevent the use of consideration in circumstances wherein parties should generally prefer not to have a legally binding option made available. Where the option for legal enforcement is beneficial, anti-commodification norms should not prevent parties from invoking consideration. Hence, we would use the consideration doctrine as a means for distinguishing, not between promises, but between the social contexts in which promises are made.

To conclude, we demonstrate how our new justification for the consideration doctrine can help resolve the morass of existing case law. Our account calls for strict application of the principle of nominal consideration. All promises backed by even trivial amounts of consideration should be enforced, but promises should generally not be legally obligating without at least a token amount of consideration. This rule obviates the need for the many exceptions and qualifications plaguing current applications of the doctrine.

I. THE INADEQUACIES OF EXISTING THEORY AND PRACTICE

Despite vigorous debates about the underlying rationale for contract law, most commentators accept the goal of honoring parties' intentions as expressed at the time of contract formation. One school of thought maintains that promisors should be free to commit themselves to a future course of action, and that enforcing a promise both increases the promisor's liberty and demonstrates respect for her autonomy.⁹ A second school of thought focuses on the promisee's reasonable expectations, which will be disappointed if the promisor breaches.¹⁰ Under this approach, the enforcement of promises primarily serves to avoid the harms of dashed expectations. A third school of thought emphasizes the social utility of promises, which allow promisees to reorder their affairs in anticipation of performance.¹¹ Here, legal enforcement of promises is required to ensure that promisees can rely without fear of breach. Thus, though each of the major schools of contract theory begins with a different premise, all three conclude that the law should follow a promisor's stated intentions at the time of promising.

Against this backdrop of respecting parties' wishes, the consideration doctrine requires affirmative justification. By rendering promises unenforceable when not accompanied by appropriate recompense, the consideration doctrine departs from the principle of honoring parties' expressed intentions. The doctrine allows even the most sincere of promisors to later renege with impunity when the promise was not made as part of an exchange. No matter how

⁹ See, e.g., FRIED, *supra* note 2; Randy Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 289 (1986).

¹⁰ See, e.g., Thomas Scanlon, *Promises and Practices*, 19 PHIL. & PUB. AFF. 199 (1990).

¹¹ See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

unequivocally the promisor states his intention to perform—though he may “shout consideration to the housetops”¹²—the promise is a legal nullity if consideration is lacking.

As discussed previously, attempts to justify the non-enforceability of promises that lack consideration divide into two general categories—formal arguments and substantive arguments. Yet existing arguments of both types have failed to provide a convincing rationale for the consideration doctrine. Based on these flawed theoretical principles, courts have created a mess of their attempts to apply the doctrine to actual cases.

A. Formal Arguments

Formal arguments emphasize not the significance of a promise, but the form that it takes. The legal system must have some mechanism for distinguishing between unenforceable promises and binding contracts. Formal arguments discuss rationales related to the needs of the legal system. Without a clear set of rules for limiting the promises enforceable in law, we would risk having our everyday utterances transformed into binding contracts even when we have no intention of invoking a legal form. On the other hand, it is hard to imagine our capitalist system functioning without some method for securing at least those contracts used to facilitate market transactions. No one supports enforcing all promises or none at all. Formal arguments seek to help courts with the difficulties involved in drawing a line between these two extremes.

Formal arguments thus stress the importance of a promise’s outward appearance. Promises that take a particular form are more worthy of legal enforcement, not because they are substantively superior, but because the form says something about the process by which the promise came about. Because formal arguments focus on superficial indicia, rather than on content, they often point in opposite directions from substantive arguments. For instance, formalist theories usually support enforcing promises backed by only nominal consideration, whereas substantive accounts frequently do not.

At first glance, a formal approach to justifying the consideration doctrine might appear to serve contract law’s aim of respecting parties’ intentions. By outlining the conditions under which promises will be enforced, the consideration doctrine provides parties with a blueprint for giving legal force to their intentions. Yet the consideration doctrine is a poor means of effectuating parties’ wishes, because it denies enforcement to many promises where there is no question that the promisor intended to be bound. An alternative more consistent with the underlying goal of respecting parties’ desires would be to require only that the parties clearly declare their intentions in writing.¹³ As the following discussion demonstrates, a writing requirement would be preferable to the consideration doctrine in terms of the formal arguments typically offered to support it.

1. The “Evidentiary” Rationale

Many formal theorists maintain that the consideration requirement is necessary to preserve evidence of a transaction for later judicial inquiry. In the words of Richard Posner, the consideration doctrine “reduces the number of phony contract suits, by requiring the plaintiff to prove more than just that someone promised him something; he must show that there was a deal

¹² *In re Greene*, 45 F.2d 428, 430 (S.D.N.Y. 1930).

¹³ Arguably, such a requirement would more closely track the expectations of the non-lawyer public.

of some sort—which is a little harder to make up out of whole cloth.”¹⁴ Because donative promises are often oral, consideration is defended as a form of objective proof to corroborate a promisee’s claim.¹⁵ Such proof allegedly serves to reduce the likelihood that a false claim will prevail and lowers the cost of adjudicating all claims.¹⁶

However, to argue that legal enforcement of a promise should only occur where a promisee can produce evidence substantiating his claim is not necessarily to argue in favor of a consideration requirement. Many possible methods of maintaining evidence exist, most notably a writing requirement. In fact, the consideration doctrine is a relatively poor way to preserve proof, since a promisee’s delivery of a nominal sum to the promisor can be easily denied—leaving the parties in precisely the same position as if no consideration for the promise existed. And when the consideration for one promise is another promise, as is often the case, *no* evidence of the transaction is preserved.¹⁷ As Andrew Kull notes, “it is difficult to think of any respect in which [problems of proof] are necessarily exacerbated if the promise is gratuitous rather than compensated.”¹⁸ While the need to preserve evidence may justify some sort of ritual to solemnize a transfer, the consideration doctrine is a lousy candidate.¹⁹

2. The “Cautionary” Rationale

Another formal argument claims that the consideration doctrine ensures that a promisor intends to be legally bound and that she does so only after sufficient deliberation.²⁰ By requiring an extra step—the transfer of consideration—before rendering a promise enforceable, the doctrine prevents promisors from hastily committing themselves to obligations they might later regret. The ritual of consideration also ensures that the promisor intends to be bound legally. Even a promisor who fully intends to perform at the time the pledge is made may wish not to render his promise legally enforceable. By failing to receive consideration in return for the promise, the promisor can ensure that the legal system will not become involved in the event of breach.

As to the former justification, the prevention of hasty promises, one might wonder whether the consideration doctrine is overkill. As Kull notes, “[s]uch cases are easy to imagine but hard to find in the reports.”²¹ In any event, there is little reason to believe that rash donative

¹⁴ RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 109 (5th ed. 1998).

¹⁵ See Melvin Aron Eisenberg, *Donative Promises*, 47 U. CHI. L. REV. 1, 4-5 (1979-1980).

¹⁶ The consideration doctrine’s evidentiary function has been claimed to justify the minority rule that past moral obligation may serve as a substitute for consideration. See Richard A. Posner, *Gratuitous Promises in Economics and Law*, 6 J. LEGAL STUD. 411, 418-19 (1977). *But cf.* Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 821 (1941) (arguing that promises supported by moral obligation should be enforced *despite* the “evidentiary insecurity” they generate).

¹⁷ See James D. Gordon III, *A Dialogue About the Doctrine of Consideration*, 75 CORNELL L. REV. 987, 991 (1990).

¹⁸ See Andrew Kull, *Reconsidering Gratuitous Promises*, 21 J. LEG. STUD. 39, 53 (1992).

¹⁹ Moreover, the statute of frauds already requires that substantial problems be recorded in writing, so that problems of proof will only exist, if at all, for relatively minor donative promises. See Gordon, *supra* note 17, at 990-91.

²⁰ This section discusses what Fuller called the “channeling” function of consideration in addition to what he labels as the “cautionary” function.

²¹ Kull, *supra* note 18, at 46.

promises are any more common than rash purchases.²² Yet the law does not control for deliberation in bargain context, even though a poorly thought-out bargain might prove ruinous to one or both parties, “because the law does not really care about deliberation.”²³ However, even if the deterrence of hasty donative promises is important, the consideration doctrine is hardly an inevitable choice. Any formal enforceability requirement—that the promisor stand on his head and count backwards from twelve, for instance—would serve the same purpose.²⁴ And any formality would similarly ensure that the promisor intended to be bound.

Neither evidentiary nor cautionary arguments can justify the consideration doctrine. However worthwhile the desire to preserve evidence for future dispute resolutions or to guarantee that donative promises are made carefully and with the intention to be bound, a consideration requirement is no better than other formalities. Indeed, the transfer of a dollar is a far shoddier means of preserving proof than a requirement that donative promises be made in writing. Thus, formal arguments for the consideration doctrine cannot “explain the ‘form’ of the formality.”²⁵ Although we clearly need some mechanism for distinguishing binding contracts from empty statements, existing formal accounts do not show why the consideration doctrine best serves this role. To the extent we believe in the principle of honoring parties’ intentions, we should instead enforce all promises where the promisor clearly declares that she wishes to be bound.

B. Substantive Arguments

Where formal arguments look to the needs of the legal system, substantive arguments examine the content of promises. Some substantive theorists claim that the consideration doctrine serves to distinguish between socially valuable exchanges and socially worthless gifts, enforcing the former but not the latter. Others maintain that donative promises should not be enforced because the costs of enforcement outweigh the benefits. Substantive accounts do not deny that as a general rule we should enforce promises when the parties desire it. Instead, substantive accounts try to show how this wisdom does not apply to a subset of promises that do not merit enforcement. Substantive arguments thus run directly counter to the idea that contract law should respect parties’ intentions in all cases. No matter how strongly the parties wish to be bound, no matter what hoops they are willing to jump through to render their intentions enforceable, a substantive approach would deny enforcement to promises not made as part of an exchange. Yet existing substantive arguments for the consideration doctrine ultimately prove unpersuasive.

1. The “Sterile” Rationale

A common defense of the consideration doctrine argues that promises lacking in consideration are less socially useful than promises exchanged for something of value. Whereas

²² It is, perhaps, not coincidental that the term “buyer’s remorse” exists but that “donor’s remorse” does not—though one might argue, however implausibly, that the existence of the consideration doctrine is responsible for suppressing the supply of remorseful donors.

²³ Kull, *supra* note 18, at 54.

²⁴ See Gordon, *supra* note 17, at 991.

²⁵ Posner, *supra* note 3, at 850.

exchanges enhance overall social wealth, donative transfers merely redistribute it. Characterizations of donative promises as economically “sterile” have a long pedigree. Quoting the 1884 lectures of Claude Bufeoir in his famous article, *Consideration and Form*, Lon Fuller opined that “While an exchange of goods is a transaction which conduces to the production of wealth and the division of labor, a gift is, in Bufeoir’s words, a “sterile transmission.”²⁶ And this description persists in the literature today.²⁷

Yet despite the influence of the notion that donative promises are economically sterile, its validity is highly questionable. As a preliminary matter, donative transfers may themselves be welfare-enhancing: If the donee values a gift more than the donor, then the transfer enhances social utility. As Melvin Eisenberg explains, “gifts have a wealth-redistribution effect, and taken as a class probably redistribute wealth to persons who have more utility for money than the donors.”²⁸

Some economists have claimed that gift giving is inefficient, because—barring wealth effects—if a donee had valued the gift at more than its cost, then the donee would have already purchased it for himself. That the donee did not purchase the item for himself suggests that he values it at less than its price. But there are several reasons to doubt this claim. First, the value a donee places on an item may increase by virtue of the fact that the item is given as a gift. Many are those who would walk by a flower stand without buying anything but would be thrilled to receive a dozen roses from a loved one. The giving of a gift suggests thoughtfulness and affection on the part of the giver, and these sentimental effects may increase the gift’s value well beyond its purchase price. Second, in some situations the donor may have better information than the donee either about the donee’s preferences or, more likely, about the existence, availability, or value of the gift. The donor may also have better access to the gift. For instance, the donor may promise to return from a trip to the Andes with an Incan vase she knows her friend would love. Third, many gifts cannot be purchased. A particular piece of artwork, for instance, may only exist in the donor’s collection. If the donee values the piece more than the donor, the donor will increase social welfare by giving it as a gift. Donative promises to perform services often fall into this category. Fourth, the donor gets satisfaction from knowing that her gift will be appreciated by the donee—in economic terms, the donor and donee have “interdependent utility functions.”²⁹ As Richard Posner has observed, “a promise would not be made unless it conferred utility on the promisor.”³⁰ Even if the donee values the gift below its cost, the combination of the donor’s satisfaction and the gift’s value to the donee may exceed the gift’s cost. Finally, gifts may be given as a means of facilitating future economic transactions,

²⁶ Fuller, *supra* note 16, at 815 (quoting CLAUDE BUFNOIR, *PROPRIÉTÉ ET CONTRAT* 487 (2d ed. 1924)).

²⁷ See Kull, *supra* note 18, at 49 (“Bufnoir’s lectures . . . continue to be cited by American writers for this . . . assertion.”). However, even Fuller shied away from relying too heavily on this argument. See Fuller, *supra* note 16, at 815 n.23 (“This remark of Bufnoir’s cannot be taken too literally . . .”); see also Kull, *supra* note 18, at 49 n.33 (“None of these authors [citing the sterility of donative promises] argue that the gift promise is entirely ‘sterile.’ All, in fact, suggest some respects in which a gift promise might be at least modestly fruitful.”).

²⁸ Eisenberg, *supra* note 15, at 4.

²⁹ See Mark B. Wessman, *Retraining the Gatekeeper: Further Reflections on the Doctrine of Consideration*, 29 *LOY. L.A. L. REV.* 713, 819-20 (1996); *id.* at 820 (“Interdependent utility is a perfectly familiar phenomenon and is quite likely to be present in the context of true donative promises among family or friends . . .”); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 *YALE L.J.* 1261, 1272 (1980).

³⁰ Posner, *supra* note 16, at 412; see also Joseph Siprut, Comment, *The Peppercorn Reconsidered: Why a Promise To Sell Blackacre for Nominal Consideration Is Not Binding, But Should Be*, 97 *NW. U.L. REV.* 1809, 1831-33 (2003).

such as when businessmen exchange small tokens at the start of a business deal.³¹ Even if the initial gift exchange does not increase social welfare, the ensuing economic transaction that it facilitates very well might.

More fundamentally, however, even if donative *transfers* were socially sterile, donative *promises* would still be socially valuable because they allow for beneficial reliance in advance of performance. As Eric Posner explains, “A promise to give a gift enables the promisee to rely in anticipation of receiving the benefit and enables the promisor to defer performance until the funds or goods are acquired.”³² If a donee knows that a donor intends to give her a car at some future date, she can avoid the costs of purchasing a car on her own in the interim. Beneficial reliance of this sort is made possible by the enforcement of the promise, because the donee can rest assured that her reliance will not be in vain. Even if donative gifts were sterile, the legal enforcement of donative promises could still be welfare enhancing.³³

2. The “Trivial” Rationale

A second substantive argument against enforcing donative promises is that such promises are too trivial to merit legal recognition. Donative promises are sometimes casual and insignificant—of the “I promise to take you out to dinner” variety.³⁴ Allowing legal enforcement of donative promises might involve the court system in “a lot of trivial promises arising in social and family settings.”³⁵ The exception to the consideration doctrine for charitable pledges has been justified by contrasting the trivial nature of most donative promises with “the large size of many charitable donations.”³⁶ The consideration doctrine supposedly prevents the legal system from having to assume the administratively costly job of policing interpersonal squabbles.³⁷

However, even if it were true that many donative promises are too trivial to merit legal enforcement, the consideration doctrine is a curious way to deal with the problem. A much more direct approach would be to refuse to involve the legal system in disputes in which only a small sum was at issue. Moreover, there is little reason to assume donative promises tend to be relatively insignificant, or that the costs of litigating such promises would be particularly high. Many donative promises tend to be quite substantial—for instance, “[a] parent’s promise to finance a medical school education.”³⁸ And even where small donative promises are concerned,

³¹ See Wessman, *supra* note 29, at 820; Carol Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295, 310-11 (1992) (noting that the practice of “giv[ing] a little for the sake of the larger bargain . . . happens all the time among business dealers” and that “if someone does not give, the exchange may never get off the ground”); Gordon, *supra* note 17, at 995 (“Some promises are related to exchanges, are ancillary to bargains, but are not themselves given in exchange for some identifiable price. These promises have economic and social utility because they assist exchanges and promote economic activity.”).

³² Posner, *supra* note 3, at 850; *see also* Goetz & Scott, *supra* note 29, at 1267-71 (1980); *id.* at 1269 (“[T]he production of beneficial reliance is perhaps the principal social rationale of promising . . .”).

³³ See Posner, *supra* note 16, at 411-14.

³⁴ See *id.* at 416-17.

³⁵ POSNER, *supra* note 14.

³⁶ See Posner, *supra* note 16, at 420.

³⁷ See Eisenberg, *supra* note 15, at 3; Posner, *supra* note 16, at 417.

³⁸ See Wessman, *supra* note 29, at 826; *see id.* (“The claim that gratuitous or donative promises are financially trivial is . . . empirically suspect.”).

as Goetz and Scott point out, “it is no less expensive to litigate most small contracts.”³⁹ As a means of screening out trivial disputes, the consideration doctrine is both under-inclusive (since many donative promises are large) and over-inclusive (since many contracts are small). Additionally, promisees are unlikely to sue promisors for breach of trivial promises. As Andrew Kull observes, litigation over a promise to take someone out to dinner “would be a freak occurrence.”⁴⁰ Finally, the legal system already denies enforcement to promises—whether unilateral or bilateral—for which any injury is truly minimal.⁴¹ Thus, recourse to the consideration doctrine to screen out trivial promises is not needed.

3. The “Unnecessary” Rationale

A third substantive argument maintains that enforcement of donative promises is unnecessary because extra-legal sanctions will be sufficient to ensure performance. For altruistic promisors who care about the well-being of their promisees, “the promisor may regard costs suffered by the promisee as equivalent to costs suffered by himself,” thus obviating the need for a legal sanction.⁴² Moreover, social norms against welshing may shame into performance even those promisors unconcerned about their promisee’s interests. Therefore, some claim that legal enforcement of donative promises is superfluous.

Yet arguments based on extra-legal sanctions hold no more validity than arguments claiming that donative promises are trivial or sterile. First, even if extra-legal influences can ensure performance in most instances, this does not explain why legal remedies should be unavailable where such influences prove insufficient. Second, extra-legal sanctions may also be more important than the law for most bargain exchanges.⁴³ Sociological accounts have long recognized that businessmen “seldom use legal sanctions . . . to settle disputes”⁴⁴ because “there are many effective non-legal sanctions,” such as norms of honesty, close ties between those in the same industry, and anticipation of future interactions.⁴⁵ Third, extra-legal sanctions may prove ineffective to ensure performance when the promisor has passed away. The promisor’s heirs or estate may be much less concerned with the promisee’s welfare, less influenced by norms of promise-keeping (since it was not their promise in the first place), and less likely to face social opprobrium from the relevant peer group. Indeed, suits against promisors’ estates represent “[t]he overwhelming majority of suits to enforce [donative] promises.”⁴⁶

In sum, substantive arguments for the consideration doctrine fall short because the presence of consideration is a poor proxy for a promise’s value or society’s interest in enforcing

³⁹ Goetz & Scott, *supra* note 29, at 1301.

⁴⁰ See Kull, *supra* note 18, at 56.

⁴¹ See Gordon, *supra* note 17, at 995 (“[T]he law already screens out claims involving trivial injuries by awarding only certain kinds of damages. For example, suppose A and B mutually promise to meet each other for dinner. The mutual promises are valid consideration However, the law declines to compensate with damages the slight injury suffered, and so the case is not worth pursuing.”) (footnotes omitted); Kull, *supra* note 18, at 57.

⁴² Goetz & Scott, *supra* note 29, at 1304.

⁴³ See Gordon, *supra* note 17, at 994.

⁴⁴ Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 58 AM. SOC. REV. 55, 55 (1963).

⁴⁵ *Id.* at 63.

⁴⁶ Kull, *supra* note 18, at 45-46; see *id.* at 46 (“The reason may be that unequivocal gift promises are highly likely to be performed, provided the promisor lives long enough; or that the recipient of a gift promise, feeling toward his benefactor something of the same altruism that motivates the promise, is likely to forgive a performance that the promisor subsequently comes to regret.”).

it. Donative promises are not necessarily any less socially beneficial or significant than bilateral promises, nor is the legal enforcement of donative promises any less necessary.

Existing accounts, whether substantive or formal, fail to offer a convincing rationale for not enforcing donative promises where the parties clearly intended the promise to be legally binding. This lack of a coherent theoretical explanation for the consideration doctrine has plagued its application in courts of law.

C. *The Morass of Current Doctrine*

As the previous sections demonstrate, the consideration doctrine lacks a compelling justification under existing theories. Indeed, the two categories of justification for the doctrine often conflict. While formal arguments suggest that any promise taking the requisite form should be legally enforceable, substantive arguments invite courts to further inquire into promises' social usefulness. This ambivalence has manifested itself in the doctrine, with some authorities favoring the former and others the latter. The result is a confused state of affairs in which potential promisors face uncertainty about which donative promises will be enforced. As one commentator noted: "The courts are not consistent in their application of the rule, partly because they are unwilling to enforce it strictly in all cases, and partly because they are often hazy in their understanding and knowledge of the topic. All this leads to present uncertainty and doubt."⁴⁷

Consider first the notion that courts will strike down promises backed by only trivial amounts of consideration. Authorities fall into opposing camps on the subject. According to traditional doctrine, so long as both sides of a transaction receive something from the exchange, the fact that one side receives something of much greater value is of no moment.⁴⁸ Indeed, even if what one party gives up is of nearly no value at all but is only given for the sake of serving as consideration—so-called "nominal consideration"⁴⁹ or "peppercorn consideration"—the exchange remains legally enforceable. Thus, in 1932 the First Restatement of Contracts maintained that a promise by one party to transfer land valued at \$5000 to another party in exchange for \$1 is supported by "sufficient" consideration.⁵⁰ This notion of consideration is highly formal—in the words of Oliver Wendell Holmes, then of the Massachusetts Supreme Court, "as much a form as a seal."⁵¹

Cases that follow the First Restatement prioritize the consideration doctrine's formal justifications over its substantivist ones.⁵² In *Scholes v. Lehman*,⁵³ for instance, the court cited

⁴⁷ Clarence D. Ashley, *The Doctrine of Consideration*, 26 HARV. L. REV. 429, 429 (1913). Although written in 1913, these words remain the view of many scholars today. See, e.g., Wessman, *supra* note 29, at 809-812.

⁴⁸ See, e.g., *Thomas v. Thomas*, 114 Eng. Rep. 330 (Q.B. 1842) (finding that the exchange of a life estate in property for a promise to pay £1 per year and keep the premises in good repair); see generally *The Form of Bargain as Consideration in Contracts*, 24 COLUM. L. REV. 896, 900-901 (1924) (collecting cases).

⁴⁹ See 2-5 Corbin on Contracts § 5.17 ("By the word 'nominal' we mean 'in name only'—the purported consideration is given, but is not bargained for as part of an exchange. It is given as a mere pretense or formality.").

⁵⁰ RESTATEMENT OF CONTRACTS § 84, ill. 1.

⁵¹ *Krell v. Codman*, 28 N.E. 578, 578 (Mass. 1891); see also *id.* ("We presume that, in the absence of fraud, oppression, or unconscionableness, the courts would not inquire into the amount of such consideration.").

⁵² See, e.g., *Smith v. Riley*, No. E2001-00828-COA-R3-CV, 2002 Tenn. App. LEXIS 65, at *9 (Tenn. Ct. App. 2002) ("[A] stipulation in consideration of \$1 is just as effectual and valuable a consideration as a larger sum stipulated for or paid." (quoting *Danheiser v. Germania Sav. Bank & Trust Co.*, 194 S.W. 1094, 1096 (Tenn. 1917))); *Lacer v. Navajo County*, 687 P.2d 404, 410 (Ariz. 1983); *Hart v. Hart*, 160 N.W.2d 438, 444 (Iowa 1968)

Fuller's *Consideration and Form* for the proposition that the consideration doctrine serves formal purposes: "a cautionary function of bringing home to the promisor the fact that his promise is legally enforceable and an evidentiary function, important in a legal regime that enforces oral contracts, of making it more likely that an enforceable promise was intended."⁵⁴ Notably, the court omits any reference to Fuller's description of donative promises as economically sterile—or to any other substantivist concerns. Instead, the court opines that a court will not even consider consideration's adequacy unless fraud or mistake is alleged.⁵⁵

Rejecting this formal approach, the Second Restatement suggests that courts look past the form of the transaction to make sure that gratuitous promises cannot be transformed into binding contracts by adding minimal amounts of consideration. That the parties intend to be bound is not enough. Transfer of "nominal" consideration in order to make a donative promise legally binding will not be respected.⁵⁶ Because nominal consideration is not bargained for, but is instead merely a formality—that is, because the transaction is donative in *substance*, even though it is an exchange in *form*—it is not sufficient to render an agreement legally enforceable.⁵⁷ In other words, courts should look through parties' attempts to dress up a donative promise as an exchange.⁵⁸

Courts that follow the Second Restatement's approach refuse to enforce promises they suspect of being gifts.⁵⁹ In *O'Neil v. De Laney*,⁶⁰ the court observed that a gross disparity between the value of a promise and the consideration offered in return for it signal that the parties "did not actually agree upon an exchange."⁶¹ The use of nominal consideration is a "mere formality"⁶²—a fact that, for the court, counsels against enforcement. Many courts pay lip service to the notion that consideration's adequacy is not to be scrutinized but then proceed to do

("The general rule is that consideration is not insufficient merely because it is inadequate. The legal sufficiency of a consideration for a promise does not depend upon the comparative economic value of the consideration and of what is promised in return. Even a nominal consideration . . . will sustain a promise if it is the consideration in fact agreed upon." (quoting 17 AM. JUR. 2D *Contracts* § 102, at 445-46 (1964))).

⁵³ 56 F.3d 750 (7th Cir. 1995).

⁵⁴ *Id.* at 756.

⁵⁵ *Id.* ("One purpose the [consideration] requirement does not serve . . . is identifying fair exchanges. Unless fraud or mistake is alleged, ordinarily a court will not even permit inquiry into the adequacy of the consideration for a promise or a transfer.").

⁵⁶ RESTATEMENT (2D) CONTRACTS § 71(1)-(2).

⁵⁷ *See id.* § 71, ill. 5 ("A desires to make a binding promise to give \$ 1000 to his son B. Being advised that a gratuitous promise is not binding, A offers to buy from B for \$ 1000 a book worth less than \$ 1. B accepts the offer knowing that the purchase of the book is a mere pretense. There is no consideration for A's promise to pay \$ 1000.").

⁵⁸ *See also* 2-5 Corbin on Contracts § 5.17 (agreeing with the Second Restatement); 1-3 Murray on Contracts § 61[A] (same).

⁵⁹ *See, e.g.,* *Scott v. Scott*, No. CA03-692, 2004 Ark. App. LEXIS 341, at *10 (Ark. Ct. App. 2004) ("[T]wo deeds recited only nominal consideration, and it has been recognized that such a recitation does not destroy the transaction's character as a gift."); *Noel v. Noel* 512 P.2d 324 (Kan. 1973) (observing that the recital of "Love and affection and one dollar" as consideration will not render a promise enforceable, as it "is characteristic of a gift").

⁶⁰ 415 N.E.2d 1260 (Ill. App. Ct. 1980).

⁶¹ *Id.* at 1265 (quoting 1 Corbin on Contracts § 127, at 546 (1963)).

⁶² *Id.* (quoting 1 Corbin on Contracts § 127, at 546 (1963)). Interestingly, the quoted section of Corbin cites Holmes's opinion in *Krell v. Codman* for support. Yet Holmes never used the word "mere" to describe the effect of nominal consideration, and it is far from clear that Holmes disapproved of its use. *See supra* note 51 and accompanying text.

just that, often by suggesting that a gross disparity in the value of promises exchanged indicates fraud or unconscionability.⁶³

Typical is *Goodwin State Bank v. Mullins*.⁶⁴ The court starts with what seems like a categorical prohibition: “While the court will inquire to determine whether a contract is supported by consideration, it will not inquire into the adequacy of the consideration.”⁶⁵ In its next breath, however, the court notes that an inquiry may be appropriate where “the amount is so grossly inadequate as to shock the conscience of the court.”⁶⁶ Significantly, the court makes no mention of the parties’ intentions. That the promisor meant to be bound is immaterial; what matters is whether the transaction is such as to merit enforcement.

Authorities are thus split between the First Restatement’s formal approach and the Second Restatement’s substantive approach. Yet even authorities that generally insist that consideration be non-trivial often make exceptions for certain classes of promises. For instance, option contracts and guarantee contracts represent two notable exceptions to the rule that consideration must be bargained for. What explains this striking departure? According to the Second Restatement, the exceptions for option and guarantee contracts result from their social utility.⁶⁷ This social usefulness contrasts with the claimed sterility of ordinary donative promises.⁶⁸ Since option contracts and guarantee contracts are socially valuable in substance, any imperfections in form can be ignored.⁶⁹ Ironically, whereas these authorities normally prioritize substance over form, they are willing to accept form over substance for promises that they recognize as sufficiently valuable.

While many courts agree that some promises deserve special treatment and can be exempted from the full consideration requirement, there is little agreement about exactly how special this treatment should be. The majority position maintains that option and guarantee contracts are enforceable with only nominal consideration but refuses to enforce promises where consideration is promised but never delivered—so-called “sham” consideration.⁷⁰ The minority position would enforce such contracts even with sham consideration.⁷¹ The Second Restatement endorses the minority approach, opining that option and guarantee contracts may be binding even

⁶³ See, e.g., *Rose v. Lurvey*, 198 N.W.2d 839, 841-42 (Mich. App. 1972) (relying on its power of equity to invalidate the transfer of a parcel of land for \$1.05); *id.* at 841 (“It is a general principle of contract law that courts will not ordinarily look into the adequacy of the consideration in an agreed exchange. Equity will, however, grant relief where the inadequacy of consideration is particularly glaring.”).

⁶⁴ 625 N.E.2d 1056 (Ill. App. Ct. 1993).

⁶⁵ *Id.* at 1079.

⁶⁶ *Id.*

⁶⁷ RESTATEMENT (2D) CONTRACTS § 87, cmt. b; RESTATEMENT (2D) CONTRACTS § 88, cmt. a.; see also 1464 Eight, Ltd. v. Joppich, 154 S.W.3d 101, 110 (Tex. 2004) (adopting the Second Restatement’s reasoning).

⁶⁸ See 2-5 Corbin on Contracts § 5.17 (arguing that the doctrine of nominal consideration need not be applied to option and guarantee contracts because “[i]t is the area of the donative promise that justifies the invalidity of nominal consideration”).

⁶⁹ See also 1464 Eight, Ltd. v. Joppich, 154 S.W.3d 101, 110 (Tex. 2004) (agreeing with the Restatement that an exception to the traditional consideration doctrine is warranted in the case of option contracts because of their social utility).

⁷⁰ See, e.g., *Lewis v. Fletcher*, 617 P.2d 834 (Idaho 1980); *Berryman v. Knoch*, 559 P.2d 790 (Kan. 1977).

⁷¹ See, e.g., 1464 Eight, Ltd. v. Joppich, 154 S.W.3d 101 (Tex. 2004); *Real Estate Co. v. Rudolph*, 153 A. 438 (Pa. 1930); RESTATEMENT (2D) CONTRACTS §§ 87-88; see also 1 Murray on Contracts § 61 (4th ed. 2001) (“[M]ost courts hold that, upon proof that the recited amount has not been paid, the promise fails for want of consideration.”).

if the purported consideration never changes hands.⁷² A third position would require no consideration whatsoever; Corbin on Contracts argues that “[c]ommercial promises such as options and credit guaranties should be enforceable without consideration.”⁷³

Each position thus takes a different stance on how much of a formality should be required to render an option or guarantee contract enforceable—nominal consideration, sham consideration, or no consideration. At base, this conflict represents a disagreement about the persuasiveness of formal and substantive justifications for the consideration doctrine, and about how to make tradeoffs between the two. Equitable concerns invariably put pressures on courts to relax the strict substantive approach in appropriate cases. But because courts lack a single, compelling justification for the consideration requirement, they inevitably disagree about when (if ever) to make exceptions.

Consider other deviations from the bargained-for requirement. Some courts will enforce many unilateral promises without even a pretense of consideration. Apparently the courts regard these promises as even more substantively valuable than option and guarantee contracts. One author found the following examples:

promises to waive nonmaterial conditions; promises to pay a prior indebtedness which was unenforceable because of the statute of limitations, the promisor’s minority, or bankruptcy; certain promises made in recognition of a benefit previously received by the promisor; stipulations regarding pending judicial proceedings; and firm offers by merchants, written waivers of claims, and certain negotiable instruments under the UCC.⁷⁴

And this list is not exclusive.⁷⁵

Predictably, not all courts share the same view on the value of various promises. For instance, charitable donations are enforceable without consideration in many jurisdictions,⁷⁶ while in others they are not.⁷⁷ Courts have carved out exceptions to exceptions, as doctrinal consistency and coherence are abandoned in favor of preferred policy objectives.⁷⁸ And further compounding this uncertainty is the fact that courts sometimes misapply the doctrine.⁷⁹

The current state of the consideration doctrine is thus deeply confused: Nominal consideration will render a promise enforceable in some jurisdictions, but not in others. In

⁷² RESTATEMENT (2D) CONTRACTS § 87, cmt. c (“[T]he option agreement is not invalidated by proof that the recited consideration was not in fact given.”); RESTATEMENT (2D) CONTRACTS § 88, cmt. b (precluding inquiry into whether the purported consideration “was in fact given”).

⁷³ See, e.g., 2-5 Corbin on Contracts § 5.17; see Joppich, 154 S.W.3d at 110-11 (Jefferson, C.J., concurring) (agreeing with Corbin on Contracts that an option contract should be enforceable without any consideration).

⁷⁴ Gordon, *supra* note 17, at 1001-02.

⁷⁵ See, e.g., RESTATEMENT (2D) CONTRACTS § 90(2), cmt. f (observing that courts routinely enforce charitable subscriptions and marriage settlements that are unsupported by consideration).

⁷⁶ See, e.g., *Salsbury v. Northwestern Bell Tel. Co.*, 221 N.W.2d 609 (Iowa 1974); see also RESTATEMENT (2D) CONTRACTS § 90(2), cmt. f (“American courts have traditionally favored charitable subscriptions . . . , and have found consideration in many cases where the element of exchange was doubtful or nonexistent.”)

⁷⁷ See, e.g., *Congregation Kadimah Toras-Moshe v. DeLeo*, 540 N.E.2d 691 (Mass. 1989); *Maryland Nat’l Bank v. United Jewish Appeal Fed’n, Inc.*, 407 A.2d 1130 (Md. 1979). Compare *Schwedes v. Romain*, 587 P.2d 388 (Mont. 1978) (refusing to allow a voidable or unenforceable promise to serve as consideration for a return promise), with RESTATEMENT (2D) CONTRACTS § 78 (“The fact that a rule of law renders a promise voidable or unenforceable does not prevent it from being consideration.”).

⁷⁸ See *Wessman*, *supra* note 29, at 810-12.

⁷⁹ See *id.* at 810 n.395 and accompanying text.

jurisdictions disallowing nominal consideration, formalities are not sufficient, except for certain categories of promises where they are. And such jurisdictions disagree about which promises merit an exception and what sort of formalities will suffice. Unless a new persuasive explanation for it can be made, the consideration doctrine is destined to produce conflicting results in the hands of courts that disagree with one another about the reasons for its existence.

II. THE ROLE OF ANTI-COMMODIFICATION NORMS

In order to explain our novel account for the consideration doctrine, we must first dispel two flawed assumptions of the traditional approaches. The first flawed assumption is that any promisor who wishes to do so can back her promise with nominal consideration. We need to defeat this assumption in order to show how the consideration doctrine differs from other formal requirements for distinguishing between binding and non-binding promises—such as a seal or writing requirement. Their inability to appreciate how nominal consideration is a unique formalism has prevented scholars from valuing it over alternative formalisms.

Our insight is that a nominal consideration requirement differs from alternative formalisms because of anti-commodification norms. To invoke the consideration doctrine, contracting parties must point to some form of recompense explicitly offered in return for a promise. In other words, consideration requires the appearance of a bargain. Although it may be trivial in size, the consideration must still be present; the parties must be able to claim that the promise was given as part of an exchange.⁸⁰ As such, the language required to satisfy the consideration doctrine “commodifies” a promise—that is, turns the promise into a commodity that is exchanged for another commodity. Commodification of this sort can violate strong social taboos. These taboos serve to make the consideration doctrine effectively unavailable in certain social circumstances, preventing parties from employing even the pretense of consideration.

Scholars who write about commodification do not fully understand the phenomenon.⁸¹ We lack a consensus understanding for what categories of transactions are subject to commodification and how these categories change over time. Nevertheless, there is widespread agreement that social norms prohibit certain forms of transactions on account of their commodifying nature. In this Part, we look to three branches of knowledge: (1) sociology and anthropology, (2) philosophy and political theory, and (3) economics and game theory. Although the three scholarly fields rely on different methodologies, they reach similar conclusions about the commodification phenomenon. All three approaches support the existence of anti-commodification norms, and all three conclude that these norms govern transactions where the relationships between the transacting parties or the social messages sent by the transactions are more important than the desire to transfer goods or services. On the other hand, when parties transact with the primary purpose of exchanging goods or services, anti-commodification norms seldom apply.

⁸⁰ Even in the case of sham consideration, the parties must still claim that consideration is present.

⁸¹ For a good sample of the recent controversies surrounding commodification, see Carol M. Rose, *Whither Commodification?* (Forthcoming; Partial manuscript on file with authors).

A. *Commodification in Sociology and Anthropology*

Sociologists and anthropologists have long recognized that market exchanges and gift-giving represent drastically different social phenomena and that the norms governing the former are very different from those governing the latter.⁸² Whereas individuals engaged in a market context are expected to exhibit rational calculation based on personal self-interest, explicit considerations of monetary gain are taboo in relationships involving gifts. Indeed, such non-reciprocal interactions are said to involve a wholly different manner of thinking.⁸³

Although not all sociologists and anthropologists use the term commodification, there is widespread agreement that the language and behavior used for market exchanges are often inappropriate for gifts and for certain other forms of non-market transactions. Anyone who conducts a gift transaction using the behavior reserved for market exchanges risks commodifying the transaction and thereby violating social norms.

What accounts for the dichotomy between gift transactions and market exchanges? While market exchanges are utilitarian in nature, serving a discrete purpose and requiring no prolonged relationship between the involved parties, gift-giving is a means by which two individuals establish an ongoing social intimacy.⁸⁴ “The classic distinction between commodities and gifts is that while commodity exchange is concerned with establishing equivalencies between the value of objects, ‘gifts’ are primarily about relations between people.”⁸⁵ The gift comes to represent the value of the relationship, instilling the gift with a “totemic” quality that distinguishes it from a regular market commodity.⁸⁶

As a result, gift-giving “must be based, or purport to be based, on affective or moral motives, and it may not be expressly required by the terms of the original transfer or viewed by the parties as the price of the original transfer.”⁸⁷ Any outward sign that a gift has been assigned a monetary value, by either the donor or the donee, is strictly forbidden.⁸⁸ For a donee to offer to compensate a donor for a gift would be to suggest that the donee has put a price on the gift—and,

⁸² See, e.g., DAVID GRAEBER, *TOWARD AN ANTHROPOLOGICAL THEORY OF VALUE* 32 (2001); LEWIS HYDE, *THE GIFT: IMAGINATION AND THE EROTIC LIFE OF PROPERTY* 62-66 (1979); G. PALMER, *ALTRUISM: ITS NATURE AND VARIETIES* 60 (1920).

⁸³ See, e.g., Jane B. Baron, *Gifts, Bargains, and Form*, 64 *IND. L.J.* 155, 196 (1989) (“The personal, connected quality of giving may require the donor to employ modes of thinking quite different from those appropriate to the market. Some believe that economic transfers call for detached, analytic deliberation in quantitative, cost-benefit terms which are inappropriate to the emotional and moral realm of gifts.”); Carol M. Rose, *supra* note 148, at 32 (“[M]arketizing some human activities inappropriately makes us talk about them differently, and talking about them differently can make us *think* about them differently.”). But see MARCEL MAUSS, *THE GIFT: FORMS AND FUNCTIONS OF EXCHANGE IN ARCHAIC SOCIETIES* 1 [1927] (1954 Trans. Ian Cunnison) (“The form usually taken is that of the gift generously offered; but the accompanying behavior is formal pretence and social deception, while the transaction itself is based on obligation and economic self-interest.”).

⁸⁴ See, e.g., Gretchen M. Herrmann, *Women’s Exchange in the U.S. Garage Sale: Giving Gifts and Creating Community*, 10 *GENDER & SOCIETY* 703, 710-11 (1996) (“It is the cardinal difference between gift and commodity exchange that a gift establishes a feeling-bond between two people, while the sale of a commodity leaves no necessary connection.”) (quoting LEWIS HYDE, *THE GIFT: IMAGINATION AND THE EROTIC LIFE OF PROPERTY* 56 (1983)).

⁸⁵ GRAEBER, *supra* note 82, at 32.

⁸⁶ See Melvin Aron Eisenberg, *The World of Contract and the World of Gift*, 85 *CALIF. L. REV.* 821, 844-45 (1997).

⁸⁷ *Id.* at 843.

⁸⁸ See, e.g., PIERRE BOURDIEU, *OUTLINE OF A THEORY OF PRACTICE* 172-73 (1988 trans. Richard Nice).

by implication, the relationship.⁸⁹ Similarly, a donor “cannot demand or require reciprocity without disqualifying her transfer as a gift”⁹⁰ and thereby demoting the status of her relationship with the donee. Thus, bargaining, which requires an articulation and discussion of the object’s value by both donor and donee, cannot take place within the gift-giving relationship.

Consequently, the social context of gift-giving is incompatible with the consideration form. To claim that a gift promise is being exchanged for something in return—the essence of the consideration doctrine—is to violate the social rules surrounding the gift-giving relationship. Attempts to invoke the consideration form can commodify a transaction by suggesting that a price is being placed on the social interaction.

The distinction between gift-giving and market exchanges is not always clear-cut. Interactions that are ostensibly market-based may be constitutive of a relationship that requires its participants to adopt many of the outward indications of friendship. A supplier may have a very cordial ongoing relationship with his distributor, requiring that he refrain from exacting as great profits as possible when he knows the distributor is pressed for cash. Similarly, gift-giving may be employed as a means of facilitating future economic transactions.⁹¹ But the basic point remains that reciprocation and negotiation—the explicit articulation of and bargaining over value—are frequently precluded in some gift-exchange scenarios due to social norms.

A possible objection to the above might dispute whether gift exchanges are truly non-reciprocal. Certainly, the giving of any particular gift may be uncompensated in the sense that its transfer does not result in immediate monetary payment, but the gift may be given with the expectation of a return gift in the future, and such expectation of repayment is enforced through rigid social norms. If A gives B a birthday present, B may be obliged to respond in kind. As Marcel Mauss wrote in his classic treatise on gift-giving, “In theory such gifts are voluntary but in fact they are given and repaid under obligation.”⁹² Though accounting need not be one-for-one, anyone allowing himself to fall too far in another’s debt risks loss of face or even ostracism. And even if the price of a gift is not a return gift, the donor may expect a return on her “beneficence” in the form of social esteem or some other non-material compensation. In the words of one anthropologist, “When people act in ways that seem economically irrational, this is only because the values they are maximizing are not material.”⁹³ Although the norms governing gift-exchange do not permit the participants to *explicitly* acknowledge that their behavior is motivated by self-interest, this may nonetheless be the primary motive.⁹⁴

⁸⁹ See, e.g., Eisenberg, *supra* note 86, at 845 (noting that a gift of cash to an intimate “would be regarded as bizarre, deeply insulting, or both”).

⁹⁰ *Id.* at 843.

⁹¹ See Carol Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295, 310-11 (1992) (noting that the practice of “giv[ing] a little for the sake of the larger bargain . . . happens all the time among business dealers” and that “if someone does not give, the exchange may never get off the ground”).

⁹² MAUSS, *supra* note 83, at 1; see also *id.* (“The form usually taken is that of the gift generously offered; but the accompanying behavior is formal pretence and social deception, while the transaction itself is based on obligation and economic self-interest.”).

⁹³ GRAEBER, *supra* note 82, at 28-29 (describing a prevailing anthropological school of thought); see also BOURDIEU, *supra* note 88, at 177 (“Practice never ceases to conform to economic calculation even when it gives every appearance of disinterestedness by departing from the logic of interested calculation (in the narrowest sense) and playing for stakes that are non-material and not easily quantified.”).

⁹⁴ This description corresponds with our category of trust-building promises. See Part II.D.

But while the underlying motivation of gift-giving may be self-interest, what is relevant for our purposes is that gift-exchange participants are barred from any outward acknowledgment of this motivation. Social norms require a “formal pretense and social deception”⁹⁵ that forbids any discussion of compensation between gift-exchange participants. Even when the parties are transacting based on purely selfish motives, the gift-giving context prevents the articulation of these motives in the manner required to invoke consideration.

Consider Walzer’s discussion of the Kula exchange among the Trobriander islanders,

[The Kula] isn’t a ‘trade’ in our sense of the word: necklaces and bracelets ‘can never be exchanged from hand to hand, with the equivalence between the two objects discussed, bargained about and computed.’ The exchange has the form of a series of gifts. . . . [Contrast this with] what Malinowski calls ‘trade, pure and simple’ and what the islanders call gimwali. Here the trade is in commodities, not ritual objects; and it is entirely legitimate to bargain, to haggle, to seek private advantage. The gimwali is free; it can be carried on between any two strangers; and the striking of a bargain terminates the transaction. The islanders draw a sharp line between this sort of trade and the exchange of gifts. When criticizing bad conduct in the Kula, they will say ‘it was done like a gimwali.’⁹⁶

The Kula presents a prime example of the social restrictions on gift-giving transactions. Kula transactions are highly ritualized. Even though Kula are given as part of an exchange, where the gift of a Kula imposes obligations on the recipient, the participants are precluded from explicitly voicing cost-benefit motives or consideration-type language. The same phenomenon characterizes many gift-giving transactions in modern American society. As Carol Rose writes, there are “occasions on which gifts are appropriate but cash is not. Bringing a bottle of wine to the dinner party will be just fine, and may even be expected, but paying its price in cash would offend the host.”⁹⁷ Just as the Kula exchange cannot be “done like a gimwali,” many modern forms of gift-giving preclude the use of market-oriented language and behavior. Gifts may be exchanged in a ritualistic fashion, but the parties may not bargain over these transactions or explicitly acknowledge that the gifts are given in order to receive something in return.

Not all theorists agree that affective and economic interactions occur in wholly distinct social arenas. The sociologist Viviana Zelizer, for example, forcefully disputes this “Hostile Worlds” paradigm—her label for the dominant view of the gift-giving relationship among sociologists and anthropologists.⁹⁸ Eschewing the notion that monetary transactions are impossible among social intimates or that market participants are incapable of affective relationships, she argues that real-world interactions cannot be reduced to a simple either/or dichotomy. On the one hand, participants engaged in ostensibly “market behavior” often demonstrate a concern for one another that cannot be ascribed merely to economic self-interest. For example, a recent study of home care workers and their patients demonstrates that genuine bonds of friendship develop during what might be characterized as fee-for-service transactions.⁹⁹

⁹⁵ MAUSS, *supra* note 83, at 1.

⁹⁶ MICHAEL WALZER, SPHERES OF JUSTICE 123-24 (1983).

⁹⁷ Carol M. Rose, *supra* note 81, at 16.

⁹⁸ Viviana A. Zelizer, *Intimate Transactions*, in THE NEW ECONOMIC SOCIOLOGY: DEVELOPMENTS IN AN EMERGING FIELD (Randall Collins et al. ed. 2002), manuscript at 3 (on file with author).

⁹⁹ Deborah Stone, *Care and Trembling*, AMERICAN PROSPECT, Mar.-Apr. 1999, at 61.

Though they undeniably engage in market behavior, it is impossible to accurately describe these actors as mere market participants.¹⁰⁰

And on the other hand, social relationships—even deeply intimate ones—often involve monetary transactions: “[P]arents give their children allowances, subsidize their college educations, help them with their first mortgage, and offer them substantial bequests in their wills. Friends and relatives send gifts of money as wedding presents, and friends loan each other money. Immigrants dispatch remittances to kinfolk back home.”¹⁰¹ To claim that all human interactions can be categorized as either “economic” or “social” is to ignore the complexity that attends real-world relationships.¹⁰² Instead, it is necessary to recognize that different types of monetary transfers take place within different types of relationships.¹⁰³

While such an admonition against reductionism is well taken, it does not undermine the basic premise of our argument: that explicit market-oriented articulations are off-limits in certain social relationships. Though norms might permit—and even encourage—a parent to loan her child money to help with the down payment on a house, a parent who charges her child a premium “because you’re such a poor credit risk” would likely run afoul of taboos. Transactions involving money may not *per se* be impossible among social intimates, but the conditions under which transfers may be proposed, discussed, and completed are much more limited than those acceptable for market transactions—even if the market participants do not treat each other merely as tools of personal gain. That different forms of monetary transactions are permissible within different relationships does not defeat the basic argument, so long as contexts remain in which parties cannot specifically articulate consideration.

To summarize, even if we reject the dominant “hostile worlds” paradigm, we can still conclude that social norms prevent parties from voicing consideration for certain non-market transactions. The explicit quid-pro-quo language needed to invoke consideration risks expressing utilitarian motives and thus commodifying the relationship. Non-commodifiable gift transactions often operate within a highly ritualized social space where the message conveyed by a gift is more important than the gift itself. Muddying such gifts with consideration language can be viewed as rude and offensive, potentially undermining the feelings of trust and affection that form the basis of these non-market relationships.

B. Commodification in Philosophy and Political Theory

Commodification in philosophy and political theory arises from the concept of spheres. Sphere-oriented theorists usually place market exchanges into one sphere and non-market transactions, or at least certain forms of non-market transactions, into another sphere.¹⁰⁴ The use

¹⁰⁰ See Susan Himmelweit, *Caring Labor*, in *Emotional Labor in the Service Economy*, ANNALS OF AMER. ACADEMY OF POLITICAL & SOCIAL SCI., Jan. 1999, 27, 32 (Ronnie J. Steinberg and Deborah M. Figart, eds., special issue) (“It is not so much that we are adding an element of the unpaid to the paid but that paid relationships themselves can include strong feelings and personal attachments.”).

¹⁰¹ Zelizer, *supra* note 98, at 7.

¹⁰² See *id.* at 6-7 (arguing that the idea “that money and intimacy represent contradictory principles whose intersection generates conflict” represents a “failure to recognize how regularly intimate social transactions coexist with monetary transactions”).

¹⁰³ See *id.* at 9. See generally VIVIAN A. ZELIZER, *THE SOCIAL MEANING OF MONEY* (1994).

¹⁰⁴ Theorists disagree about the number and classification of spheres. For instance, Sandel argues for three spheres – for market goods, civic goods, and sacred goods. Michael Sandel, *What Money Can't Buy: The Moral Limits of Markets*, 21 THE TANNER LECTURES ON HUMAN VALUES 94, 112 (Grethe B. Peterson ed., 2000). In contrast,

of market-oriented behavior or language within the non-market sphere is deemed corrupting.¹⁰⁵ More specifically, these theorists “suggest that there are various ‘spheres’ (sometimes called ‘modes’) of valuation, and an exchange is corrupting when it ignores the differences between these spheres of valuation and forces us to value all goods in the same way.”¹⁰⁶ The value premises behind transactions in the non-market sphere are considered “incommensurable” with the value premises of the market sphere. Mixing these value premises does “violence to our considered judgments about how these goods are best characterized.”¹⁰⁷

Even though the sale of non-market-sphere goods is impermissible, these goods may still be given as gifts as long as the transactions take place without the use of market-oriented language. So whereas baby-selling is taboo, adoption is fully acceptable.¹⁰⁸ Where the sale of organs is controversial, organ donation is laudable.¹⁰⁹ And while prostitution is highly frowned upon, the free exchange of sexual favors is not equally condemned. As long as the participants in a gift transaction eschew the bargain form, they can usually complete non-market sphere exchanges without violating social norms. The key distinction is that parties cannot explicitly articulate consideration-type language or explicitly contemplate consideration-type motives. A suitor may give jewelry in the hopes of receiving sexual favors, and the recipient may reward the gift by providing such favors. Yet if the parties openly acknowledge that the jewelry is being exchanged for sex, or bargain over the transaction, the exchange is labeled prostitution and becomes taboo. Similarly, adopting parents are allowed to pay for certain of the birth mother’s expenses, but not for the actual child. Any suggestion that payments are made in order to induce the birth mother to give up her child would violate both social norms and the laws of most states.¹¹⁰

At the risk of vastly oversimplifying the literature, we divide sphere-oriented theories into two general categories based on their rationales for keeping the spheres distinct. First, consequentialist approaches worry about the corrupting force of market imperialism. In the words of one scholar, “the application of market rhetoric to non-commodifiable matters coarsens our understanding of these matters, leading us into mistakes, loosening our moral grasp, and undermining our ties to others.”¹¹¹ For instance, “[f]rom a conservative perspective, this is the problem with marriage. Contract obligations in this intimate setting, it is said, could make the married partners talk and think about their individual entitlements, undermining the moral foundation of sharing that should permeate their relationship.”¹¹² Ever since Titmuss’s classic work on blood donation, scholars have recognized that allowing market-form transactions into

Walzer identifies a multitude of spheres, and claims that the delineation between these spheres differs amongst various societies and times. MICHAEL WALZER, *SPHERES OF JUSTICE* (1983). Still, essentially all sphere-oriented theorists define separate spheres for market and non-market transactions.

¹⁰⁵ See Cass R. Sunstein, *Incommensurability and Kinds of Valuation: Some Applications in Law*, in *INCOMMENSURABILITY, INCOMPARABILITY, AND PRACTICAL REASON* 234-38 (Ruth Chang ed., 1997).

¹⁰⁶ Cohen, Note, “*The Price of Everything, the Value of Nothing: Reframing the Commodification Debate*,” *HARV. L. REV.* (summarizing the literature on commodification) (manuscript of file with authors).

¹⁰⁷ Sunstein, *supra* note 105.

¹⁰⁸ Radin & Sunder, *The Subject and Object of Commodification* 6

¹⁰⁹ *Id.*

¹¹⁰ See *In re Baby M*, 537 A.2d 1227 (N.J. 1988).

¹¹¹ Carol Rose, *supra* note 81, at 32 (summarizing an argument from Margaret Jane Radin, *Market Incommensurability*, 100 *HARV. L. REV.* 1849 (1987)).

¹¹² *Id.* at 33.

the non-market sphere can undermine the social norms and relationships needed for the non-market sphere to function.¹¹³ Once some people are paid for their blood, blood donation may lose its expressive character as a duty of good community-members. Or as Kimbrell writes, “If I buy a Nobel Prize, I corrupt the meaning of the Nobel Prize.”¹¹⁴ Similarly, conducting a friendship based on explicit cost-benefit analysis corrupts the meaning of the friendship relationship.

As an alternative form of consequentialist argument, Michael Walzer famously claimed that humans flourish within many different spheres of activity.¹¹⁵ Inevitably, human relations become unequal within individual spheres—as employers dominate employees, doctors dominate patients, and the wealthy dominate the poor. Yet Justice requires that we not allow unequal power within one sphere to be leveraged into unequal power in other spheres. No person should be able to dominate another within all spheres of human activity. The non-market spheres must, therefore, be shielded from market logic in order to prevent disparities in wealth and market power from creating complete inequality across multiple spheres. If the wealthy were allowed to explicitly purchase friendship, romance, or esteem; inequities in wealth would engender more widespread and insidious forms of inequality and injustice.¹¹⁶

Whereas consequentialist arguments focus on the social consequences of market imperialism, dignity-oriented theories claim that subjecting non-market relationships to bargain-form logic directly harms the object of this commodification. Non-market goods and relationships are thought to be infused with an inherent dignity. Subjecting these goods or relationships to market language and behavior represents a failure to accord them with the respect they reserve. Elizabeth Anderson labels “the mode of valuation appropriate to pure commodities ‘use.’”¹¹⁷ She claims that “Use is a lower, impersonal, and exclusive mode of valuation. It is contrasted with higher modes of valuation, such as respect. To merely use something is to subordinate it to one’s own ends, without regard for its intrinsic value.”¹¹⁸

Dignity-based arguments draw support from Kant’s categorical imperative against treating humans only as a means.¹¹⁹ Due respect for human dignity and autonomy requires that people be regarded as ends in themselves. Expanding on this logic, modern dignity-oriented theorists have argued that a wide variety of goods—such as environmental resources—similarly deserve to be treated as ends in themselves.¹²⁰ Viewing a good or relationship as an end prohibits bargaining in a manner that suggests the good or relationship is valued solely for its use potential.

Another form of dignity-based argument claims the use of market language denies the uniqueness of the object of the bargain. “Market rhetoric assumes that everything can be traded

¹¹³ RICHARD M. TITMUSS, *THE GIFT RELATIONSHIP: FROM HUMAN BLOOD TO SOCIAL POLICY* 225 (1971). However, other scholars challenge the claim that market imperialism undermines the values underlying the non-market sphere. See, e.g., Thomas Haskell, *Capitalism and the Origins of Human Sensibility (Part 2)*, 90 *AM. HIST. REV.* 547, 549-59 (1985); ALBERT O. HIRSCHMAN, *THE PASSIONS OF THE INTERESTS*, 54-63 (1977); Zelizer, *supra* note 98.

¹¹⁴ ANDREW KIMBRELL, *THE HUMAN BODY SHOP* 35 (1993).

¹¹⁵ WALZER, *supra* note 96.

¹¹⁶ Of course, barriers between the spheres can never be perfect. Even without explicit bargaining, the wealthy can leverage their monetary assets into power within other spheres. But social norms against consideration-type bargaining for non-market goods can, arguably, limit the corrosive effects of market imperialism.

¹¹⁷ ELIZABETH ANDERSON, *VALUE IN ETHICS AND ECONOMICS* 144 (1993).

¹¹⁸ *Id.*

¹¹⁹ IMMANUEL KANT, *GROUNDING FOR A METAPHYSICS OF MORALS* 429 (James W. Ellington trans., 1981) 1785).

¹²⁰ See, e.g., MARK SAGOFF, *THE ECONOMY OF THE EARTH* 90 (1988).

for everything else, and that through the medium of money, all is fungible.”¹²¹ For people or goods with inherent dignity, this assertion of fungibility offends the sense of uniqueness and self-worth. For example, your “children might be frightened and confused if they hear you talk about the market for babies.”¹²² No child should have to wonder about their market value; neither should a friend or intimate. Bargaining over goods with inherent dignity results in “simplifying and flattening of all nuance, idiosyncrasy, and sentiment, not only for the speaker of this rhetoric but for the hearers as well.”¹²³ Proper respect for non-market goods and relationships requires recognition of their non-fungibility. Explicitly suggesting that these goods or relationships can be exchanged for something of value undermines their claims to uniqueness and inherent dignity. A favor rendered by a friend is not the same as a service purchased in the market and should not be treated as though it were.

The commodification literature in philosophy and political theory is controversial. Some market adherents call for removing barriers to commodification and expanding the scope of the market, while proponents of anti-commodification norms often wish to strengthen these norms through acts of law. We lack general agreement about the proper scope of the non-market sphere or about the rationales for protecting the sphere from market rhetoric and logic. Nevertheless, there is widespread consensus that norms shield at least some forms of non-market transactions from bargain-form language. And few call for completely abolishing the non-market sphere; no one wants to reestablish slavery or to force intimates to explicitly negotiate every aspect of their relationships. The literature from Philosophy and Political Theory adds support for the existence of anti-commodification norms and explains potential rationales for the function of these norms.

C. *Commodification in Economics and Game Theory*

Economists seldom concern themselves with concepts like commodification. A basic tenet of neoclassical economic theory is that individuals act as rational agents. Almost by definition, rational agents would be unlikely to deny themselves the use of a legally binding form merely on account of social norms. However, there are several branches of game theory literature which develop a concept similar to commodification.

In order to explain how commodification works within the game theory literature, we categorize promises as being of four types based on the motives of the promisor.¹²⁴ Our schema labels promises as either exchange-oriented, trust-building, status-enhancing, or altruistic.¹²⁵ Promisors make exchange-oriented promises in order to receive a defined benefit from promisees in recognition of their promise. In contrast, promisors make trust-building promises in order to receive undefined benefits from a promisee. These promisors typically seek to develop goodwill in order to later benefit from their relationship with the promisee. Examples of trust-building promises include the lavish gifts law firms bestow on summer associates and the gifts businessmen make in the hopes of securing an eventual business relationship.¹²⁶ Similarly,

¹²¹ Rose, *supra* note 91, at 24.

¹²² *Id.* at 31

¹²³ *Id.* at 31-32.

¹²⁴ These categories can overlap. In fact, most gratuitous promises are likely made based on multiple of the listed motives.

¹²⁵ These categories build on distinctions made by Eric Posner, *Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises*, 1997 WIS. L. REV. 567.

¹²⁶ See *supra* note 31 and accompanying text.

status-enhancing promises are meant to build promisors' reputations with the outside society. For example, promisors may seek a reputation for being charitable or for being a good family member, friend, or community leader. Certain gifts to charities are among the most obvious forms of status-enhancing gifts, and the status-enhancing motive likely explains why so few large charitable gifts are made anonymously.¹²⁷ Finally, altruistic promisors care about promisees and benefit from improving their promisees' welfare. In the language of economics, these promisors have interdependent utility functions with the promisees they wish to help.

Promisors may operate out of a combination of two or more of these motives, but the general point remains that different motives will dominate for different transactions. To the extent game theory sheds light on anti-commodification norms, these norms will primarily operate for trust-building and status-enhancing promises.

Looking first to status-enhancing promises, promisors may wish to be viewed as charitable or to be seen as a good friends, family-members, or participants in other social relationships. In other words, the status-enhancing motivation often involves promisors seeking to gain the appearance of being altruistic, whether the altruism is in general or is oriented toward a specific group or purpose. But there is a difference between being viewed as someone who wants to be seen as charitable and being viewed as someone who actually is charitable. Cost-benefit type language can make it appear that a promise is being made for instrumental purposes. Phrasing a promise in bargain form can undermine the promise's status-enhancing potential.

Douglas Bernheim has developed a model which supports this result.¹²⁸ Since one's charitable nature is not directly observable, status-seekers try to signal their beneficence by making public gifts. Their goal is to mimic the actions of those who actually are charitable. As such, status-seekers must take care not to reveal their actual motivations by departing from the behavior of a truly altruistic donor. If the status-seekers give the appearance that they are trying to gain something in return for their gifts, they may inadvertently reveal their status-seeking motives. Hence, a specific agreement for a charitable recipient to publicize a gift or to grant the donor special privileges can diminish the amount of status the donor receives from the gift. This is not to suggest that recipient organizations do not publicize gifts or grant donors special privileges. However, a gift's status-enhancing potential is maximized when the recipients make it appear that they are publicizing a gift of their own accord, rather than at the request of the donor. The use of consideration language can render a promisor's motivations in making these gifts too overt.

This problem is not as severe when a status-enhancing promise is exchanged for a dollar rather than for special privileges granted by the promisee. Still, the public might wonder why the contracting parties deem it necessary to go to such lengths to secure a promise through law. If the promisee believed the promisor to be truly charitable, the promisee should not worry about the promisor later reneging. That a promisee seeks legal assurances that the promise will be fulfilled might be taken to indicate that the promisee suspects the promisor is status-seeking rather than altruistic. Consequently, if the parties claim that a promise is being exchanged for something of actual value, the public may believe that the promisor is motivated more by the

¹²⁷ Amihai Glazer & Kai A. Konrad, *A Signalling Explanation for Charity*, 86 AM. ECON. REV. 1019, 1021 (1996) (showing that anonymous gifts constituted less than 2% of the total donations made to several well-known institutions). Of course, not all charitable gifts will be made for status-seeking purposes; many will be of the altruistic type.

¹²⁸ B. Douglas Bernheim, *A Theory of Conformity*, 102 J. POL. ECON. 841 (1994).

desire to gain the item of value than by charitable inclinations. But if the parties claim that a promise is being exchanged for a mere trifle, the public may believe that the promisee does not trust the promisor's motives. In either case, voicing consideration can suggest that a promisor merely seeks the appearance of being charitable rather than actually being charitable.

The same conclusion holds when status-seeking promisors wish to be known for possessing qualities other than charity. For example, Amihai Glazer and Kai Konrad have constructed a model in which donors seek to gain status on account of being wealthy.¹²⁹ Since wealth is not directly observable, and since conspicuous consumption can only take one so far, these donors try to signal their wealth by making lavish donations. These donations provide the promisors with a means of signaling that is both public and too expensive for the less wealthy to mimic. The moderately wealthy may purchase a yacht if they truly enjoy yachting, but only the extremely wealthy are likely to donate massive sums without seeking personal benefit; only the extremely wealthy can donate on a whim. The moderately wealthy are far more likely to take precautions to insure that their donations create the intended result.

As such, when promisors appear to be seeking something in return for their donations—when the donations are made using the bargain form—the donations may lose some of their potential to signal extreme wealth. If the promise is exchanged for something of value, the promisor may be viewed as greatly desiring the item of value rather than as donating because the costs of doing so are low. And if the promise is exchanged for something of negligible value, the public may wonder why the parties felt the need to make their promise legally binding; perhaps the promisee was concerned the promisor would no longer be able to afford the promise if her economic situation worsened before performance?

Regardless of what form of status they pursue, status-seeking promisors cannot reveal the signaling motivations for their promises. Articulating consideration or using cost-benefit language threatens to undermine the message these promisors wish to send.

Similar conclusions follow for trust-building promises. Economists have increasingly come to realize that legal sanctions are insufficient for monitoring long-term interdependent relationships.¹³⁰ Courts simply lack the ability to verify that parties fulfill all aspects of an agreement in good faith. Colin Camerer uses a signaling model to explain how parties can make trust-building gifts in order to signal their reliability as a contractual partner.¹³¹ The gifts serve to distinguish relationship-builders from opportunists, where relationship-builders sincerely desire a long-term relationship and opportunists seek to benefit by taking advantage of the other party's trust. By giving gifts that are expensive for opportunists to mimic, relationship-builders can demonstrate their commitment to the donee.

However, if the donors try to negotiate over the terms of a gift or speak about a gift using cost-benefit language, they may be viewed as opportunists who are attempting to mimic the signals sent by relationship-builders. Even suggesting that the promisee offer a penny in return for a promise in order to make it legally binding may suggest that the promisor believes the promisee needs reassurance of the promisor's intentions. The promisee may wonder if the promisor has a reputation for being unreliable that is unknown to the promisee. When parties

¹²⁹ Amihai Glazer & Kai A. Konrad, *A Signaling Explanation for Charity*, 86 AM. ECON. REV. 1019, 1021 (1996).

¹³⁰ See, e.g., Oliver Williamson, *Transaction Cost Economics: The Comparative Contracting Perspective*, 142 J. OF INST. & THEOR. ECON. 178 (1987). More generally, the economics subfield of transaction-cost-economics is based on this observation.

¹³¹ Colin Camerer, *Gifts as Economic Signals and Social Symbols*, 94 AM. J. SOC. S180 (1988).

truly desire long-term cooperative relationships, they must learn to trust one another for promises that the law cannot enforce. Beginning a relationship with a suggestion that a promise is not trustworthy unless it can be made legally binding raises questions, at the very least.

Similarly, if promisees try to bargain over the conditions of a gift, they may be viewed as opportunists who want to take the gift without being interested in the long-term relationship. Any proposal that bargain-form language be used to invoke the consideration doctrine might be taken as evidence of insincere behavior. In the words of Eric Posner,

Attempting to bargain over a trust-enhancing gift is terribly improper, as it suggests that the donee is neither a cooperator who seeks a relationship nor a cooperator who does not seek this particular relationship, but rather an opportunist seeking to get a signaling gift at no cost to himself—something that would be in the interests of no one to admit.¹³²

The social norms against commodifying gift-giving transactions correspond with the signaling-based motives of status-enhancing and trust-building promises. For both types of promises, articulating consideration can undermine the signals that the promises are intended to convey. Game theory explains a process by which the norms against voicing consideration in gift-giving relationships may have arisen. As successive generations of parties internalized the appropriate behavior for gift-giving relationships, this behavior may have begun to seem natural; parties may have forgotten the original rationale for the limitations on what behavior feels suitable for gift-giving transactions. Even thinking about these transactions using cost-benefit rationales may have come to feel inappropriate.

Of course, these results are somewhat speculative. We do not claim that the consideration form is always unavailable for status-enhancing and trust-building promises. But the evidence from Sociology and Anthropology strongly suggests that there exist categories of gratuitous promisors who cannot articulate consideration due to social norms, and the literature from Philosophy and Political Theory provides additional support for this conclusion. The game theory models discussed in this section add both further support and another potential explanation for the proposition. At the very least, the signaling-based motivations of trust-building and status-enhancing promisors have probably played a role in the development of the norms against commodifying gift-giving relationships.

D. Drawing Conclusions from the Literature

Controversy rages over the nature and scope of commodification. Studies of the topic have yet to reach a point for us to accurately predict when norms will block specific transactions. As such, our discussion of anti-commodification norms has been necessarily vague. We offer few specific examples and the examples we do give tend to the extreme—such as transactions over sex or transactions regarding ritual objects in tribal cultures. We use these extreme examples because they best illustrate our argument.

Nevertheless, we believe that anti-commodification norms also operate for routine transactions that occur throughout the economy. We believe these norms frequently govern gift promises given to foster market exchanges as well as promises made within social relationships such as those between friends, family members, and neighbors. Although the literature is not sufficiently mature to prove this point, we suspect that there are also a multitude of transactions

¹³² See POSNER, *supra* note 14, at 10.

made within economic relationships—particularly among ongoing business partners—for which the explicit use of bargain-oriented language would be awkward, if not taboo.

Despite the underdeveloped state of the literature, we can still reach a few conclusions about anti-commodification norms. We can be fairly confident that these norms deter at least some parties from articulating consideration. There is widespread agreement that social spaces exist wherein explicit bargaining is prohibited. Moreover, the three branches of knowledge make similar predictions about the general types of transactions for which anti-commodification norms are likely to apply.

Sociologists and anthropologists tell us that non-commodifiable transactions are highly ritualized, serving primarily to establish social intimacy or to solidify relationships, as opposed to merely resulting in a transfer of goods. Similarly, philosophers theorize that anti-commodification norms guard the non-market sphere—the norms function to prevent market forces from corrupting intimate relationships, to shield goods and relationships infused with inherent dignity from assaults by market-oriented language and logic, or to block those with market resources from purchasing power within other spheres of human activity. Finally, Game Theory shows how voicing consideration in trust-building and status-enhancing transactions can undermine the signaling-based purposes of these transactions.

Although the three branches of knowledge employ different methodologies, they reach similar results. All three approaches conclude that anti-commodification norms govern transactions where the relationships between the transacting parties or the social messages sent by the transactions are more important than the actual exchange of goods or services. When a promisor seeks only to give something of value to a promisee, anti-commodification norms do not usually come into play. Instead, non-commodifiable transactions are ritual-oriented or signaling-based. They operate within a realm of social activity in which market logic is subordinated to other purposes, where parties seek non-market values like friendship or esteem. Although the dividing lines are blurry, there exists both a market sphere where commodifying language is fully acceptable and a more relationship-oriented sphere where such language is taboo. By enforcing only promises backed by at least nominal consideration, courts can limit legal enforcement to promises made within the market sphere while avoiding entanglement with the personal domain.

Of course, even when norms frown on the use of consideration, some parties will inevitably ignore these norms and take whatever steps are required to make their promises legally binding. Moreover, the content of anti-commodification norms is likely to change over time and amongst subcultures. And consideration may be available through ritualized “gentleman’s agreements” even in circumstances where other forms of bargain-type behavior would be prohibited. When looking beyond the extreme cases, we cannot know whether and to what extent anti-commodification norms actually apply.

But this ambiguity supports the central premise of our paper. We wish to dissuade courts from trying to determine the specific circumstances wherein promises backed by nominal consideration should be binding. Instead of creating one rule for option and guarantee promises, another for interfamilial promises, and further rules for still other type of promises, we call for a single rule to be applied to all cases. By making nominal consideration both a necessary and a sufficient condition for a promise to be enforced, we would rely on the parties to demonstrate when they are able to overcome any extant anti-commodification norms.

Without further analysis, we cannot evaluate the normative implications of the limits anti-commodification norms place on access to nominal consideration. Looking to the principle

of honoring parties' intentions, it might seem like we should abandon the use of consideration and provide parties with a method for enforcing their promises that is more readily available. Yet, as the next two Parts will demonstrate, anti-commodification norms only block access to consideration in circumstances wherein parties should generally prefer to not have a means for making their promises legally binding. In order to understand this counter-intuitive argument, we must first address the assumption that parties only choose to make their promises legally obligating when they actually desire the promises to be enforced. The next Part shows how parties' expressed intentions may not reflect their underlying desires.

III. THE PROBLEM OF INEFFICIENT SIGNALING

When starting from the principle of respecting parties' intentions at the time of contract formation, the consideration doctrine is a bit puzzling. The doctrine serves to deny legal enforcement even when the parties clearly wish their promises to be binding. No matter how unequivocally the parties communicate a desire to be bound, the doctrine calls for ignoring the parties' declared wishes unless consideration is present.

The previous Part demonstrated that anti-commodification norms block some parties from invoking nominal consideration. Hence, even when courts enforce promises backed by nominal consideration, not all parties can make use of the consideration form. To the extent that we rely on the consideration doctrine as a means for parties to bind themselves, the law will sometimes be unable to effectuate parties' expressed wishes. Under the traditional assumption that parties' expressed wishes correspond with their true desires, our discussion of anti-commodification norms would cast substantial doubt on the consideration doctrine. After all, anti-commodification norms prevent many parties from invoking consideration even when they want their promises to be binding. Instead of looking to consideration, perhaps we should seek a less-restrictive form, such as enforcing all promises where the parties declare in writing a desire for legal enforcement.

But the traditional assumption is flawed; parties stated intentions do not necessarily reflect their true desires. Just because a promisor states her intention to make her promise binding does not mean she desires the option to be bound. This idea can be illustrated by a simple example: A professor worries that a few of her students may be confused and thus decides to hold an optional class session at 7 o'clock on a Friday morning. When numerous bleary-eyed students show up, the professor assumes that more students were confused than she originally thought and pats herself on the back for being so generous—after all, the students would not have attended if the costs of doing so outweighed the benefits. Though the professor sacrificed her own sleep in order to hold the extra session, she was glad to do so to assist her students, who obviously needed the extra help, since otherwise they would not have attended the class.

The professor's error is obvious. If she schedules an optional class, her students may choose to attend it, but this does not necessarily mean they needed extra help. The attending students may not require any additional assistance, but may merely seek to prevent the professor from thinking they are putting in less effort on account of their not attending the extra session.¹³³ Both the professor and the students may have been better off without the optional class. The

¹³³ This result is particularly likely if the Professor grades even partially based on student effort. But the result is possible as long as students suspect that the Professor might take her perception of their effort into account.

mere fact that students choose to attend the class once offered does not indicate that they wanted the class to be offered in the first place. Contrary to the professor's beliefs, the principle of honoring students' desires does not support holding the optional class session.

An analogous dynamic applies to a promisor's choice of whether to secure her promises through law. When promisors have the option to legally bind themselves, promisors who choose not to exercise that option may send a negative signal to promisees about their intention to perform. Promisors who do not make their promises binding look insincere compared to those who do. As a result, in order to avoid looking insincere, promisors may render their promises binding even though they would prefer not to. When the option for legal enforcement is not available, on the other hand, there is no worry that the wrong signal will be sent. Nothing about a promisor's intentions can be deduced from the fact that her promise is not binding.

Like the students who attend the make-up session, promisors may exercise the option for legal enforcement even if they wish the option didn't exist. The mere fact that parties choose to employ a legally binding form does not mean that they benefit from the existence of that form. When promisors have the option to legally secure their promises in order to demonstrate their sincerity to promisees, they may actually end up worse off than if no such option existed. To respect parties' true desires might actually require taking away the option for the legal enforcement of promises.

This Part describes the intuitions behind the problem of inefficient signaling and outlines the assumptions we use to model the problem. When inefficient signaling takes place, promisors may bind themselves even when they would prefer not to have the option to be bound. The formal analysis proving this result can be found in Appendices A and B.

Appendix A contains the first part of our formal proof. The Appendix adapts a game-theoretic model developed by Phillippe Aghion and Benjamin Hermalin.¹³⁴ Their work is part of a well-known branch of scholarship building on an earlier piece by Rothschild and Stiglitz.¹³⁵ We do not present the Aghion-Hermalin model in full. Instead, we show how the question of enforcing promises fits the conditions needed for the model to apply. Appendix A forgoes equations and the direct use of mathematics. Instead, the logic behind the model is explained through a series of graphs.

Appendix B extends the Aghion-Hermalin analysis by presenting a model of our own design. The Aghion-Hermalin model proves most of the results needed for our justification of the consideration doctrine, but the model was not designed with the consideration doctrine in mind and thus leaves gaps in our story. Most importantly, the Aghion-Hermalin model is unable to show how the creation of a legally binding option can harm promisees as well as promisors. Appendix B remedies this deficiency. Although based on Aghion and Hermalin's work, our model in Appendix B is simplified in order to meet the space requirements of a law journal article. The model should be viewed as an extension of Aghion and Hermalin's work, not as a piece of analysis intended to stand on its own.

Although the results of this Part depend on the formal models in the appendices for support, the body of the Part provides a conceptual explanation of the inefficient signaling problem. We hope this explanation should suffice for most readers. In order to situate our

¹³⁴ Phillippe Aghion & Benjamin Hermalin, *Legal Restrictions on Private Contracts Can Enhance Efficiency*, 6 J.L. ECON. & ORG. 381 (1990).

¹³⁵ M. Rothschild and J. Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 QUART. J. OF ECON. 629 (1976).

conceptual overview of the problem, we also explain the major assumptions behind our formal models of inefficient signaling.

A. The Assumptions Behind Inefficient Signaling Spirals

Before proceeding with our analysis, we need to specify four assumptions underlying our approach. Although these assumptions are not strictly necessary for the conceptual argument contained in the body of this Part, we believe it important to explain the assumptions upon which we base the formal proof for our argument.

Our assumptions are as follows: First, we adopt a welfare-maximization framework. Second, we employ an offer-acceptance model. Third, we assume parties have asymmetric information. And fourth, we define promises and contracts as containing only two terms.

To begin with, we utilize a welfare-maximization framework, which seeks to maximize the overall benefit to all involved parties—that is, all promisors and promisees. We use this framework because we lack cause for prioritizing the desires of specific promisors or promisees. When looking to whether parties would desire to have a legally binding option for a category of promises, we need a method for determining group preferences in cases where individual members of the group might disagree. We assume that groups will—or at least should—choose the option that maximizes the overall welfare of the group. We do not concern ourselves with the distribution of gains and losses amongst the members of a group.¹³⁶

As our second assumption, we employ an offer-acceptance model of promising. We view promisors as rationally making offers in order to obtain some specific benefit. This benefit can be something of monetary value offered by the promisee in return for the promise. Alternatively, the benefit can come from altruistic motives or from the desire to develop trust or status.¹³⁷ Regardless, promisors fashion an offer and then look to see whether they can gain their desired level of benefit from making the promise. In the case of market exchanges, a promisor's offer would be followed by the promisee's acceptance or rejection. If the offer is rejected, the promisor can then fashion a new offer with different terms. In the case of gratuitous promises, we model promisors as first deciding the minimum benefit they would need to receive in order to make promising worthwhile, and then looking to see whether they would actually receive this benefit from making the promise. If the expected benefit falls below the minimum threshold, this counts as a rejection, and the promisors can then repeat the process by calculating a minimum threshold for a new promise/offer. Of course, the offer-acceptance approach is not the only method for modeling promising. The parties might instead bargain amongst themselves and jointly set the terms of the promise, or gratuitous promisors might start by calculating the expected benefit rather than the minimum threshold. Nevertheless, we employ the offer-acceptance model because it greatly simplifies our analysis and strikes us as a reasonable approximation of how many promises are made.¹³⁸

¹³⁶ We do not claim that distribution is unimportant as a general matter. When individuals differ with respect to morally relevant characteristics—such as their existing level of wealth—distributive concerns may trump the goal of welfare maximization. But we do not view one's status as a promisor or promisee or one's probability of being able to fulfill a promise as morally relevant characteristics.

¹³⁷ See *supra* Part II.C.

¹³⁸ As the modeling task would be prohibitively difficult, we have not tested whether our results are robust to relaxing the offer/acceptance assumption. But we see no reason for thinking that our results depend on this assumption.

For our third assumption, we specify that parties have asymmetric information. Specifically, we view promisors as having better information about the probability that they will be able to fulfill their promises than do promisees. Since individuals are generally the best judges of their future actions, this assumption seems reasonable.¹³⁹ Yet promisees only care about promises to the extent they view them as reliable. A promisee will not generally offer much in exchange for a promise she believes is unlikely to be fulfilled. Consequently, the benefit promisors receive from making a promise partially depends on their perceived reliability. This result applies to gratuitous promises as well as to exchange promises.¹⁴⁰ Unable to assess promisor reliability directly, a promisee evaluates a promisor's likelihood of performance based on the average reliability of all promisors with similar observable characteristics.

Since promisors benefit from being viewed as reliable, it is worth asking why promisors with a high probability of performance cannot simply communicate that information to promisees. The answer is that promisors with below-average probabilities of performance may mimic the communications made by more reliable promisors. A promisor might tell a promisee that she is very likely to perform, but the promisee cannot know whether the promisor is speaking truthfully or is falsely attempting to increase the perception of her reliability in order to gain more from making the promise. Only by taking concrete actions such as making a promise legally binding can promisors increase their perceived reliability.

Our last assumption is particularly important. We only make this final assumption in order to demonstrate the conclusions of this Part. Looking ahead to Part IV, we show how this assumption—that promises contain only two terms—holds only under certain conditions. We then show how this fact justifies the consideration doctrine.

With that preface, our fourth assumption defines promises and contracts as containing only two terms—(1) the size of the promise, and (2) the level of sanctions for breaching. The size of the promise refers to the amount a promisor pledges to the promisee. Equivalently, the term measures the value the promisee receives if the promise is fulfilled. The level of sanctions refers to the negative consequences to the promisor in the case of breach. Sanctions include both any damages imposed by law and any stigma that would result from social norms against breach. In order to build the models described in this Part, we assume that these terms completely define the content of all promises and contracts.

We make a few additional assumptions when constructing the formal models in our appendixes, but those additional assumptions are less important for understanding the intuitions behind our results.¹⁴¹

¹³⁹ There may be circumstances in which the promisee has better information about the promisor's likelihood of performance—such as when the promisee can aggregate information across numerous similarly situated promisors and the promisor does not have access to this information. Yet exceptions of this sort should be rare.

¹⁴⁰ For both trust-building and status-enhancing gratuitous promises, the promisee and the outside society are more likely to respect promises viewed as reliable over promises viewed as likely to result in default. Being perceived as reliable results in an immediate benefit, as the promisors can gain more trust or status for the same cost. The picture is more complicated for altruistic promisors, but even these promisors care about their perceived reliability to the extent they wish their promisees to engage in beneficial reliance – which is the primary purpose for making an altruistic promise to deliver a future benefit, rather than merely conveying that benefit at the future date.

¹⁴¹ It is also worth noting another assumption underlying our analysis – that promisors will not signal through other means when prevented from making their promises legally binding. As Aghion and Hermalin write, *supra* note 133, at 404, it remains uncertain “whether restricting only a subset of signals can improve efficiency.” If promisors responded to the lack of a legally binding option by hiring the mob to enforce their promises, this outcome would

B. A Conceptual Explanation of Inefficient Signaling Spirals

As a consequence of asymmetric information, promisors may be more or less reliable than they are perceived to be. Promisors whose actual reliability exceeds their perceived reliability may seek means for convincing promisees of their greater-than-average likelihood of performance. Given the option of having their promises legally enforced, these promisees might agree to bind themselves.¹⁴² There are costs to entering a legally binding form. The world is unpredictable and no promisor can be completely certain that she will still wish to fulfill her promise at the appropriate future date. Securing a promise as a binding contract forces the promisor to bear costs in the event that she is unable—or unwilling—to perform. Nevertheless, the contractual form may still be attractive when the benefit from increasing perceived reliability exceeds the cost of potentially paying legal damages.

Following this logic, the conventional accounts claim that parties should be allowed to legally bind themselves because promisors will only exercise this option if the benefits of doing so exceed the costs. Thus conceived, the existence of a legally binding form does not influence a promisor's wishes—it merely effectuates them. But what this account ignores is that creating a legally binding form can diminish the perceived reliability of promises that are not made pursuant to that form.

Imagine a group of promisors with an average probability of performance of 80%. Some promisors will have a higher likelihood of performance, and others will have a lower one, but promisees, unable to distinguish relatively reliable promisors from unreliable ones, will view any member of the group as having an expected likelihood of performance of 80%. Now imagine that some of these promisors secure their promises as legally binding contracts while others do not. All else being equal, the promisors who take advantage of the legally binding option should have a lower-than-average chance of default. This is because promisors with a relatively low probability of default can enter a legally binding form with far less cost, as there is less chance that they will end up being subject to legal sanctions. Once the most-reliable promisors choose to bind themselves, the remaining pool of (non-bound) promisors will be viewed as having an increased average likelihood of default. In other words, allowing relatively reliable promisors to

clearly be worse than the inefficient signaling spirals created by legal enforcement. Promisors might conceivably engage in a variety of costly behaviors designed to signal their reliability.

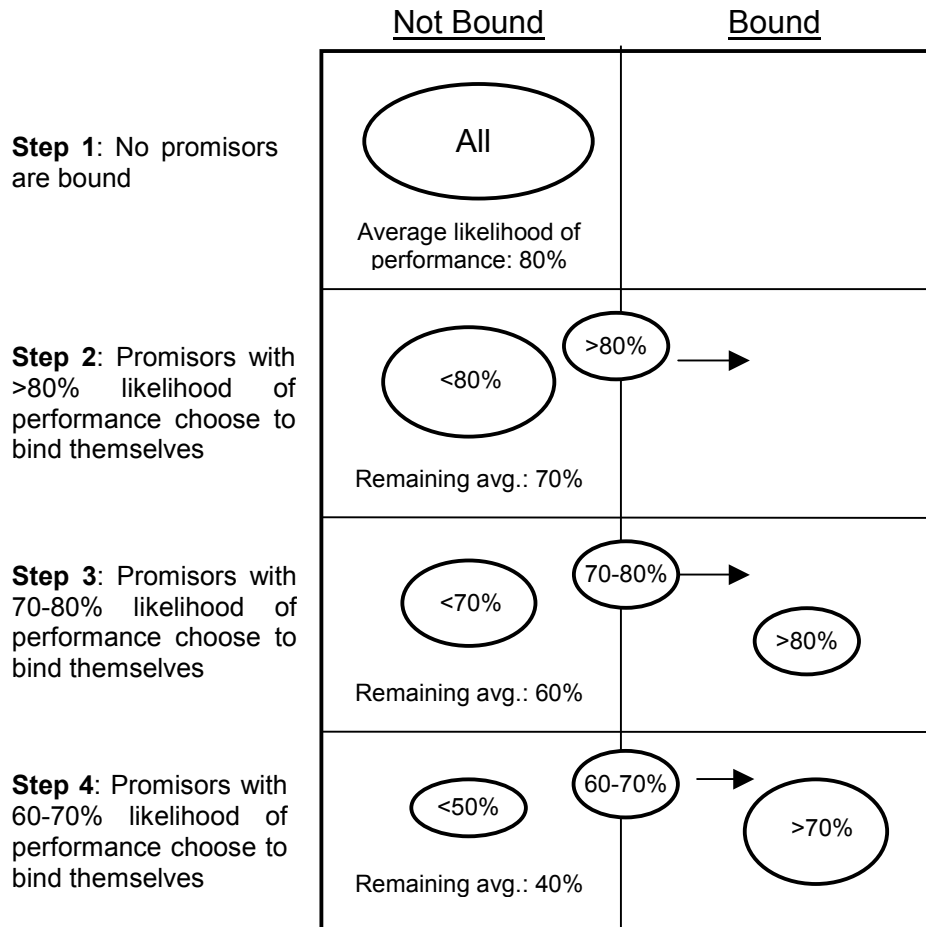
Yet making a promise legally binding is an exceptionally strong signal. To a large extent, the prospect of paying expectation damages effectively raises a promisor's reliability to 100%. Factoring in litigation costs lowers the promisees eventual recovery, but also provides an additional deterrent to promisors. Only alternatives like mob enforcement are likely to have anywhere near this strength, and we doubt that more than a tiny fraction of promisors will employ alternatives of this sort. As such, we feel reasonably comfortable modeling promisors as lacking alternative signals.

Moreover, looking ahead, promisors who are willing to use extreme alternative forms of signaling are unlikely to avoid articulating consideration merely on account of anti-commodification norms. As we discuss in Part IV.C.1, *infra*, the consideration doctrine makes a legally binding option available for promisors who care sufficiently about securing their promises to ignore any taboos against the use of bargain-form language. The set of promisors who will be deterred by anti-commodification norms despite being willing to employ costly alternatives to legal enforcement, is likely to be sufficiently small so as to not be worth noticing.

¹⁴² This result corresponds with Steven Shavell, *An Economic Analysis of Altruism and Deferred Gifts*, 20 J. LEG. STUD. 401 (1991). Yet Shavell's model only include two types of promisors—sincere promisors and masqueraders who have no intention of performing. As such, Shavell's conclusions are directly opposite to ours. We owe Shavell a debt of gratitude for inspiring our own analysis, but his model is ultimately flawed do to its failure to recognize that even sincere promisors can differ with respect to their probability of performance.

differentiate themselves from the general group will lead promisees to assign a reduced likelihood of performance to any promisors who refuse to employ the legally binding form.

Figure 1. The Signaling Spiral



This process can create a harmful spiral. If promisors with a 90% chance of performance sign contracts in order to differentiate themselves from a group with an average performance rate of 80%, the remaining members of the group might be seen as having only a 70% chance of performance (the average probability of the now-smaller group). This reduced assessment of reliability might then cause the promisors with an 80% chance of performance to sign contracts in order to differentiate themselves from the new group average of 70%, thereby further reducing the assessed reliability of the remaining members of the group. Continuing the pattern, promisors with a 70% chance of performance might sign contracts in order to differentiate themselves from the new 60% average, and so on. Figure 1 depicts this process pictorially.

In this fashion, promisors can essentially be forced into adopting a legally binding form. Even when many, or even most, of the promisors would prefer for there not to be a legally binding option, once that option exists the promisors may feel obliged to exercise it. Consequently, promisors may well prefer *not* to have the option to bind themselves.

As Ian Ayres describes the inefficient signaling phenomenon, the “inefficiency of signaling stems not only from the efforts of [reliable promisors] to signal but also from the efforts of [unreliable promisors] to falsely match those signals which cause the [reliable promisors] to run even further away from the efficient contracting point.”¹⁴³ Ayres continues by analogizing inefficient signaling to Dr. Seuss’s parable about the Sneetches:

High-status Sneetches had stars on their bellies and low-status Sneetches did not. As the tale unfolds, vast inefficiencies are generated as the low-status Sneetches try to match the high-status ones by affixing stars to their bellies and the high-status Sneetches try to further distinguish themselves by then removing their stars. The moral of the story is that finding credible signals may be extremely hard and that the mere attempt to distinguish yourself *whether or not it succeeds* can generate social inefficiencies.¹⁴⁴

In addition to harming promisors, the creation of a legally binding form can also harm promisees. Promisors should only make promises when their benefit from doing so exceeds their costs. Regardless of whether a promisor seeks something of material value in exchange for a promise, seeks increased trust or status, or seeks to altruistically enhance the welfare of a promisee, the promisor will only bind herself when doing so can be expected to result in her obtaining enough additional benefit from promising to compensate for the costs of potentially paying sanctions if she ultimately needs to default. In the absence of signaling motivations, promisors should size their promises so as to maximize their expected benefit from promising while minimizing their costs.

By reducing the perceived reliability of promisors who choose not to bind themselves, signaling spirals force promisors to either reduce their expected benefits or else increase their expected costs. If the promisors refuse to bind themselves, they will receive less benefit from promising on account of their lower perceived reliability. But if the promisors do choose to bind themselves, they will thereby increase their costs due to the possibility of needing to bear legal sanctions. In either case, signaling spirals can make promising less attractive to promisors.

Some promisors will decide that this less attractive value proposition no longer justifies promising. When the benefits of promising are reduced, the benefits may no longer exceed the costs, causing some promisors to leave the promising game altogether. Other promisors will reduce the size of their promises, so as to lower their potential costs if they end up needing to pay damages. Through a combination of these reactions, signaling spirals can reduce the overall value of what promisors offer to promisees. In this manner, signaling spirals can harm promisees as well as promisors.

This Part has attempted to provide a conceptual overview of the logic behind signaling spirals. Again, we prove these results through formal models in the appendices. But it is important to realize that not all signaling spirals are inefficient. The goal of this Part was to demonstrate that allowing promisors to bind themselves does not necessarily benefit either promisors or promisees. In some instances, even parties who choose to make their promises legally obligating would prefer not having the option to do so. But in other circumstances, the benefits of allowing promisors to back their promises through law should exceed the costs.

¹⁴³ Ian Ayres, *The Possibility of Inefficient Corporate Contracts*, 60 U. CIN. L. REV. 387, 400 (1991). Ayres is discussing corporate charters rather than contract formation, but his description of the Aghion-Hermalin model for inefficient signaling remains valid.

¹⁴⁴ *Id.* (describing a parable from DR. SEUSS, *THE SNEETCHES AND OTHER STORIES* 1-25 (1961)).

Without further analysis, we cannot distinguish the circumstances where parties would benefit from having a legally binding option from the circumstances where providing this option would be harmful. All we can know is that the mere fact that parties take advantage of a legally obligating form does not mean that they benefit from the existence of that form. The traditional assumption that parties' expressed intentions necessarily reflect their true desires is flawed. There is a difference between one's actions when confronted with a legal rule and one's preferences for what the legal rule should be.

IV. TOWARD A NEW UNDERSTANDING OF THE CONSIDERATION DOCTRINE

We have now demonstrated the flaws in two assumptions underlying traditional accounts of the consideration doctrine: First, not all parties who might wish to do so can back their promises with nominal consideration. Second, the mere fact that parties utilize an option for making their promises legally binding does not imply that they desire the existence of this option. Part III argued that parties' expressed intentions do not necessarily conform to their underlying desires. Yet if we cannot look to parties' expressed intentions for determining whether they want to be bound, to what can we look? Must we abandon any hope that contract law might honor parties' wishes?

Our new account of the consideration doctrine synthesizes the analysis from the previous two Parts. On a general level, we advocate using nominal consideration as a mechanism for determining when bargaining is limited by anti-commodification norms. Although the dividing lines are blurry, anti-commodification norms separate a market-oriented sphere of interactions in which parties can bargain over their promises from a relationship-oriented sphere in which parties face severe limitations on their ability to bargain. We argue that the law should only enforce promises made within the market-oriented sphere. When anti-commodification norms prevent parties from bargaining, the law should not allow these parties to bind themselves.

Our account is in some respects similar to the substantive theories discussed in Part I. Yet where substantive theorists have called on courts to strike down promises backed only by nominal consideration, we would enforce these promises. The reason substantive theorists wish to deny enforcement to promises backed only by nominal consideration is to prevent gratuitous promisors from binding themselves by dressing their promises in bargain-form language. But as we have shown, nominal consideration will generally be unavailable to promisors operating wholly within the non-market sphere. To the extent that substantive theorists seek only to block enforcement of promises made within the relationship-oriented sphere, they need not oppose the enforcement of promises backed by nominal consideration.

As we argued in Part I, substantive accounts are mistaken in their belief that consideration-backed promises are inherently more deserving of legal support. So why then do we favor denying enforcement to promises that lack even nominal consideration? Our answer is formalist in nature. We justify nominal consideration as the best mechanism for determining which promises parties actually desire to make binding.

Our game theory analysis described in Part III relied on the assumption that promises and contracts contained only two terms. Yet this assumption does not hold for promises made within the market-oriented sphere. When parties are able to bargain—where anti-commodification norms do not apply—they are also able to design contracts using more than two terms. In addition to the terms previously discussed—the size of the promise and the level of sanctions—these parties should also be able to specify their promises' scope and level of return payments.

We will define both of these terms later in this Part.¹⁴⁵ In brief, the “scope” of a promise refers to the circumstances under which a promisor’s performance will be excused. And “return payments” refers to what a promisee gives in exchange for a promise—in other words, the consideration.

Crucially, our analysis from Part III does not apply when parties can negotiate over a promise’s scope and return payments. When parties are able to overcome anti-commodification norms and dress their promises as bargains, we can generally conclude that the parties would benefit from having their promises legally enforced. For promises made within the market-oriented sphere, the fact that parties choose to use a legally binding form generally *does* indicate that they desire the existence of this form.

Our account thus seeks to distinguish between the market- and relationship-oriented spheres, not for substantive reasons, but for formalist purposes. Only within the market-oriented sphere can a form like nominal consideration provide parties with an effective mechanism for communicating when they truly wish to be bound.

To complete our argument, we turn last to promises made wholly within the relationship-oriented sphere—promises for which anti-commodification norms prevent the parties from using even a pretense of the bargain form. For these promises, legal formalisms cannot adequately determine the parties’ actual desires. Unlike market-oriented promisors, relationship-oriented promisors cannot negotiate over a promise’s scope or its level of return payments. With only two terms available for characterizing their promises, these parties are subject to the inefficient signaling spirals described in Part III. When parties are unable to bargain, any mechanism we might give them to legally bind themselves could end up enforcing promises that the parties would prefer to leave non-binding.

Moreover, a number of tie-breaking factors further support our position of not enforcing promises where anti-commodification norms block the use of nominal consideration: These promises are administratively costly to enforce. And, to the extent that we believe the philosophical arguments against commodification, enforcing these promises might advance the forces of market imperialism, damaging non-market values and relationships. Perhaps most importantly, relationship-oriented promises are made within a complicated web of personal interactions and interlocking obligations. Due to the same anti-commodification norms that make bargaining impossible, many of the parameters of these relationships are unstated. Enforcing these promises might cause injustice to the parties by making some commitments legally obligating while other, unstated, return commitments remained outside the legal domain. Combined with our inability to know whether parties actually desire non-market promises to be enforced, these tie-breaking factors call strongly against providing legal support for promises not backed by even nominal consideration.

To summarize, unlike the substantive accounts that seek to deny enforcement to gratuitous promises, we value the consideration doctrine for its potential to identify the circumstances in which bargain-form language is socially permissible. Only when parties can bargain without violating anti-commodification norms do we accept the formalist position that the law should honor parties’ intentions as expressed at the time of contract formation. For only within this market-oriented sphere can we conclude that parties who utilize a form like nominal consideration actually desire to make their promises binding.

¹⁴⁵ III.B.

A. Relaxing the Assumption that Promises Have Only Two Terms

The consideration doctrine creates an option for the legal enforcement of promises in contexts where parties can voice consideration and denies this option where norms block the use of consideration. The doctrine must thus be justified against two potential alternatives—denying enforcement to a larger set of promises and permitting a larger set of promises to be enforced. This section argues in favor of allowing parties to make certain gratuitous promises enforceable against the alternative of denying enforcement to all gratuitous promises. In other words, the section argues for enforcing promises backed only by nominal consideration as opposed to requiring substantial consideration or an even more-restrictive legal form. The next two sections complete the analysis by arguing against enforcing promises where parties cannot voice even nominal consideration.

When describing inefficient signaling spirals in Part III, we assumed that promises consisted of only two terms—the level of sanctions and the size of the promise. Inefficient signaling occurred when the promisors attempted to signal their reliability by making their promises legally binding (by increasing their level of sanctions). Since increasing the level of sanctions raises the costs to promisors of making a promise, these costs must be offset by adjustments made to the other contracting terms. Under our previous assumption of only two terms, promisors decreased the size of their promises whenever signaling caused them to make their promises legally binding. These reductions in the size of promises diminished welfare, as they caused promisors to depart from their optimal bundle of terms for signaling purposes.

If we relax the assumption of only two contracting terms, promisors can adjust more than just the size of a promise when compensating for raising the level of sanctions. In addition to the size of a promise and the level of sanctions, promises may consist of two other terms—the promise's scope and its level of return payments.

Scope relates to the conditions under which performance will occur. A promisor might qualify his promise by listing the circumstances that will lead to non-performance—for example, “I promise to take you to Disneyland, *unless* I lose my job, the Red Sox make the playoffs, or a relative dies.” By narrowing the scope of a promise, promisors reduce the costs to themselves of making the promise and the value the promise confers on the promisees. In the event that a scope-reducing event takes place, the promisor need neither fulfill the promise nor be subject to sanctions. In contrast, a reduction in the size of a promise might entail taking the promisee to a local amusement park instead of to Disneyland. Size adjustments affect the value of what is delivered under all circumstances, while scope adjustments affect the conditions under which the promise must be carried out.

“Return payments” is our term for anything offered by the promisee in order to induce the promise—in other words, the consideration. For promises made as part of a market exchange, the promisor's desire for return payments forms their primary motivation for entering into the promise. Without return payments, exchange-oriented promises would not take place. Although gratuitous promisors are primarily motivated by something other than the desire for return payments, they may still value return payments.

For the purposes of this section, we evaluate return payments as a promise term rather than as a mechanism for inducing promisors to make a promise. As a promise term, return payments can be adjusted in order to trade off with the other terms. If the parties wish to raise the level of sanctions without reducing the size of the promise, they can instead raise the level of return payments. Consequently, as we use the term, return payments must be different in nature

from what the promisor offers the promisee. If a promisor is offering to give the promisee a hundred dollars at a future date, a return payment cannot consist of the promisee giving ten dollars back at the same date. In this case, offering the return payment would be equivalent to reducing the size of the promise by ten dollars. In contrast, a promisee's offer to deliver ten dollars now as partial consideration for a future promise of a hundred dollars could constitute a return payment. The key difference between these scenarios is that the parties might have different preferences for how they value money now as opposed to money at the future date. Return payments must be different in nature from the promised goods or services; the parties must have different preferences for tradeoffs between the return payments and the size of the promise. If the parties have the same preferences for tradeoffs between the return payments and the promised goods or services, adjustments to return payments would be equivalent to adjusting the size of the promise. Only when return payments are different in nature from the promised goods or services can they function as a separate term.

Our argument that parties who can invoke nominal consideration are not subject to inefficient signaling spirals is based on two claims. First, the potential for offering return payments and scope adjustments alleviates the harm from this type of signaling. Second, there is a substantial overlap between the contexts in which parties can articulate consideration and the contexts in which parties can make return payments and scope adjustments. Where anti-commodification norms prevent the use of consideration, the same norms will usually block parties from making return payments or scope adjustments. As such, signaling spirals will typically only be costly when consideration is unavailable.

1. The Effects of Multiple Terms

In the absence of signaling considerations, promisors should size their promises so as to minimize their costs while maximizing the value conferred on their promisees. The promisors should likewise select a level of sanctions that minimizes their costs while maximizing value to their promisees. Promisors only depart from this optimal bundle of terms in order to signal their reliability. When signaling leads promisors to raise their level of sanctions above the optimal level (by making their promises legally binding), the promisors must compensate by adjusting the other terms of their promise so that their costs do not exceed the benefit they receive from promising.

Under our previous assumption of only two terms, signaling-based increases in the level of sanctions forced promisors to reduce the size of their promises. These departures from the promisees' optimal sizes create harms for both promisors and promisees.

In most promises, transferring the promised goods or services increases value for the promisee more than it decreases value for the promisor. This result is most clear for exchange-oriented promises. Exchange-oriented promisors should only offer their promised goods or services if they value them less than what the promisees offer in return. Similarly, the promisees should only accept a promise if they value what is promised above what they give up in exchange for the promise. That promisees and promisors have different value functions is what makes exchanges welfare-enhancing. This value-creating function of market exchanges lies at the heart of economic theory.

Altruistic promises present a more complicated picture. Nevertheless, promisors should only promise if they prefer the promisee to have the promised goods or services rather than maintaining possession themselves. When we combine the value promisors receive from

interdependent utility with the value promisees gain from receiving the promise, altruistic promises create value just as market exchanges do.¹⁴⁶

For both altruistic and exchange-oriented promises, transferring the promised goods or services creates value for society. Whether the same result holds true for trust-building and status-enhancing promises is unclear, as we will discuss further in the next section. However, as we explained previously, promisors making trust-building and status-enhancing promises will often be unable to articulate consideration.¹⁴⁷ This section argues for enforcing gratuitous promises where parties can voice consideration against the alternative of not enforcing any gratuitous promises. As such, for the purposes of this section, we can ignore trust-building and status-enhancing promises. The majority of promises for which consideration is socially available will be dominated by altruistic or exchange-oriented motives. For ritualized or signaling-based promises, the transfer of goods or services plays a secondary role to the messages the promises convey. In contrast, altruistic and exchange-oriented promises are primarily concerned with the actual transfer of the goods or services. For these promises, the transfer of goods or services from the promisor to the promisee creates value.

The opposite relationship holds for return payments. At a minimum, we have no reason to think that promisees value the goods or services offered as return payments more than promisors do. If money is used as a return payment, for example, we might assume that the parties value the money equally. Consider a promisor who offers to drive a promisee to the airport. If the promise were made legally enforceable, the promisor might need to reduce the size of the promise in order to compensate for the costs of entering the legally binding form. Perhaps the promisor would offer to drive the promisee only to the nearest bus station, forcing the promisee to take the bus the rest of the way to the airport. Since the promisor would have been willing to drive the promisee all the way to the airport in the absence of sanctions, we can assume it costs less for the promisor to drive the promisee to the airport than it does for the promisee to take the bus. Hence, if return payments were available, the promisee might offer ten dollars in exchange for the promisor's driving her all the way to the airport. If the parties can agree on a return payment that can induce the promisor to maintain the original size of her promise (a ride all the way to the airport) despite the costs of entering the legally binding form, this new outcome will be a Pareto improvement over the alternative—a reduction in the size of the promise (a ride only to the bus station). The promisee should value being driven all the way to the airport more than the money given as a return payment, and the promisor should value the return payment above the costs of the additional driving.

Moreover, this example actually understates our argument. When something other than money is used as a return payment, there is every reason to think promisees will offer something that the promisors value more than they do. Rational promisees should offer whatever return payment they have available that maximizes the benefit conferred on promisors at the minimum cost to the promisee. In the airport example, the promisee might offer to watch the promisor's kids, to give the promisor guitar lessons, or to provide some other good or service that the promisee can offer at below-market costs. Consequently, signaling through the use of return payments does not create the same harms as signaling through reductions in the size of a promise.

¹⁴⁶ See section I.B.1. for more on this point.

¹⁴⁷ Part II.C

Signaling through scope adjustments also avoids the harms from reducing a promise's size. The conclusions in Part III relied on the assumption of asymmetric information. Promisors only engage in inefficient signaling when they cannot directly communicate their probability of performance to promisees. Under conditions of symmetric information, there are no incentives for inefficient signaling, and promisors should offer welfare-maximizing combinations of terms. Promisors only depart from the welfare-maximizing bundle of terms in order to signal their reliability.

By making scope adjustments, promisors can directly communicate information about their probability of performance. This communication is not perfect, and excessive use of scope adjustments can lead to inefficiencies. But scope adjustments still avoid the harms associated with reducing a promise's size.

The reason promisors cannot directly communicate information about their reliability without scope adjustments is that unreliable promisors face incentives to mimic what is said by reliable promisors. Scope adjustments specify conditions under which a promise will not be performed. When reliable promisors make scope adjustments in order to compensate for increasing their level of sanctions, they explain circumstances that would cause them to renege on the promise. Facing incentives to mimic the statements of reliable promisors, unreliable promisors may make similar scope adjustments.

Still, unreliable promisors should not need to specify the same exact conditions for non-performance as reliable promisors. Multiple reliable promisors may differ in the exact circumstances under which they would be unable to perform. Reliability is an aggregate characteristic. Two promisors are equally reliable when the sum of their probabilities of non-performance due to various conditions is the same; the exact composition of the individual non-performance conditions need not be identical. Unreliable promisors should thus only need to mimic reliable promisors with regard to their aggregate probability of non-performance. They can specify non-performance conditions freely as long as they do not exceed the aggregate probability expressed by reliable promisors. Since unreliable promisors may mimic the aggregate reliability conveyed by reliable promisors, scope adjustments cannot create symmetric information. Promisors still cannot directly convey their probability of performance. Yet the key point remains that scope adjustments communicate some information about non-performance conditions.

Promisees benefit from knowing the composition of promisors' non-performance conditions even when they do not know whether the specified conditions are the only circumstances under which the promisor will not perform or the aggregate probability of performance. Knowing some of the conditions under which a promisor might renege can help the promisee to take precautions against default. The probability associated with each condition may not remain constant over time. If a promise is to be fulfilled two years after it was formed, the promisee may wish to reevaluate the probability of performance at the end of year one. To the extent the promisee knows some of the conditions under which non-performance is likely to occur, she can better estimate the new aggregate likelihood of breach. If a promisor specifies a non-performance condition that she will not drive the promisor to the airport if there is ice on the road, the promisee can check the weather forecast the day before and thereby determine whether she needs to order a cab. Reassessments of this sort made after the time of promising do not affect promisor welfare. But the promisees can benefit from being able to better decide the degree to which the promise should be relied on. Overall welfare increases to the extent

promisees can avoid relying too much or too little. Specification of scope conditions helps promisees rely optimally.

The overall effects of signaling-based scope adjustments depend on the reason the promisors failed to specify these scope conditions prior to signaling. One possibility is that, with sanctions low, the promisors preferred not to reveal information that might cause the promisees to lower their assessments of the promisors' reliability. All else being equal, a promisee might assign a lower probability of performance to promisors specifying scope conditions than to promisors who do not specify these conditions. After all, specifying a scope condition involves admitting at least one potential circumstance under which the promisor will not perform. But once signaling forces these promisors to make their promise legally binding, the prospect of facing legal sanctions in the event of breach may overwhelm their concern about worsening the perception of their reliability in the eyes of the promisees.

To the extent this forms the reason that promisors fail to specify scope conditions in the absence of signaling, signaling-based scope adjustments clearly increase welfare. Specifying the scope conditions does not decrease the magnitude of what the promisor actually intends to deliver, but only involves the promisor conveying information about the circumstances under which she is likely to breach. This conveyance of information to the promisees helps them rely optimally and thereby improves welfare.

However, promisors might face costs in analyzing their non-performance conditions. At some level, evaluating all of the circumstances under which the promisor would need to breach might not be cost effective. Or signaling might cause promisors to specify scope conditions for circumstances where they might have actually performed in the absence of signaling concerns. Hence, the potential for scope adjustments might not completely alleviate the potential harms from signaling spirals. But, at a minimum, scope adjustments should greatly minimize these harms. And if signaling causes promisors to make value-enhancing scope specifications that they would otherwise have been unwilling to reveal, these scope adjustments might even make the signaling spirals efficient. Whereas size adjustments reduce the potential gains from trade, scope adjustments provide information that can improve promisee welfare.

Together, the potential for return payments and scope adjustments should alleviate most of the harms from inefficient signaling, and may even cause this signaling to be efficient. Where size adjustments reduce overall welfare, return payments and scope adjustments may enhance welfare. At the very least, adjusting these terms should not create anywhere near as much harm as size reductions create.¹⁴⁸

Once we relax the assumption of only two terms, signaling spirals no longer present a significant cause for concern. When return payments and scope adjustments are available, we can return to the standard assumption that parties benefit when the law enforces their mutually agreed upon statements made at the time of contract formation. Promisors should only make promises when they benefit from doing so, and promisees should only accept the promises when they likewise benefit. Promises made with multiple terms enhance social welfare by transferring

¹⁴⁸ Moreover, it seems reasonable to assume that promisors face increasing marginal costs from making adjustments to any one term. Even if return payments and scope adjustments were just as harmful as size adjustments, the ability to adjust these terms might still mitigate some of the harm from inefficient signaling. To the extent adjusting terms produces increasing marginal costs, more welfare is lost from a second reduction to the size of a promise than from a first adjustment of equivalent magnitude, with even more welfare lost by a third adjustment. If the promisors can split their adjustments across multiple terms, instead of adjusting only the size of the promise, less welfare may be lost even when equivalently sized adjustments to any one of the terms would be equally costly.

the promised goods or services to the parties who value them the most or who have the greatest need for them, while permitting promisees to rely adequately on the promisor's ultimate performance.

2. The Availability of Multiple Terms

Having satisfied ourselves that the potential for multiple terms alleviates the harm from signaling spirals, we need to determine the circumstances under which promises can be characterized by multiple terms. Our answer is simple: Multiple terms will generally be available in the same contexts in which parties can invoke consideration. When anti-commodification norms prevent parties from articulating consideration, these norms will often obstruct return payments and scope adjustments as well.

The reasons for this are readily apparent in the case of return payments. Consideration is a form of return payment. When a promisee offers consideration in exchange for a promise, she is by definition offering a return payment. The consideration doctrine can only be activated when the parties claim that a promise is being given in exchange for a return payment/consideration. When social norms permit parties to explicitly discuss return payments, they should also allow the parties to use return payments as a term of the promise. The act of bargaining entails a discussion of the amount of consideration, which effectively makes the level of return payments a term of the promise.

Nevertheless, we might imagine circumstances in which return payments are available but consideration is not. In order to invoke the consideration doctrine, the parties must explicitly acknowledge the consideration/return payment. If the parties were permitted to make return payments, but not to explicitly acknowledge these return payments, the consideration doctrine would still be unavailable.

Yet using return payments as a term of a promise requires communication between the promisor and promisee. The promisee must offer the return payments in exchange for the promisor maintaining the size of the promise. It is hard to imagine communications of this sort taking place in contexts in which consideration is unavailable. Where parties can negotiate explicitly, they should be able to discuss tradeoffs between return payments and the size of the promise. Where the parties cannot negotiate explicitly—where consideration is unavailable—the parties will often find it impossible to negotiate over the level of return payments as a term of the promise.

A similar logic applies to scope adjustments. The reason consideration is often unavailable is that cost-benefit language can commodify a promise. As Jane Baron writes, “economic transfers call for detached, analytic deliberation in quantitative, cost-benefit terms which are inappropriate to the emotional and moral realm of gifts.”¹⁴⁹ Expressing a long list of conditions under which a promise will not be performed is the epitome of cost-benefit language.

Consider our previous discussion of the economic logic behind trust-building promises.¹⁵⁰ In some relationships, courts are unable to effectively monitor whether the parties cooperate in the manner required by the relationship. In place of legal sanctions, the parties rely on mutual trust. The use of consideration and cost-benefit language in trust-building promises violates the spirit of the relationship. Promisors are expected to fulfill promises to the best of

¹⁴⁹ Jane B. Baron, *Gifts, Bargains, and Form*, 64 *IND. L.J.* 155, 196 (1989).

¹⁵⁰ See *supra* Part II.C.

their ability, and promisees are expected to understand if circumstances arise that make the promisor unable to perform.¹⁵¹ Perhaps promisors can permissibly inform promisees if there are particularly noteworthy circumstances under which performance would be impossible. But attempts to negotiate tradeoffs between scope conditions and the size of the promise, or indications that the promisor is trading off between these terms, suggest a cost-benefit mentality inappropriate for trust-building purposes.

Looking back to our discussion of anti-commodification norms in philosophy and political theory, the explicit specification of duties within intimate relationships was thought to corrupt the meaning of those relationships.¹⁵² Evaluating in advance whether performance is cost effective under myriad circumstances implies that a relationship is valued as a means rather than as an end. Specifying scope conditions signals that the value of the relationship is finite and definable, that the costs of maintaining the relationship can be traded off against other potential uses for the resources invested in the relationship. In circumstances where anti-commodification norms block the use of consideration, the norms are likely to prevent the use of scope adjustments as well.

As anthropologists and sociologists have explained, even thinking about non-commodifiable relationships in cost-benefit terms can seem inappropriate.¹⁵³ Yet specifying scope conditions requires the promisor to evaluate the predicted costs of performance under various circumstances and to weigh these costs against the benefit to be obtained from making the promise—or from making the promise a certain size. When norms block the use of cost-benefit thinking and language, parties will often lack the capacity to engage in this sort of reasoning.

We do not mean to overstate our case. We do not claim that there is a perfect relationship between social contexts in which consideration is unavailable and contexts in which norms prevent return payments and scope adjustments. Social norms are intricately complex and circumstance dependent. Any attempt to describe the content of norms at a general level is likely to be oversimplified. Yet we have reason to expect a substantial overlap between the circumstances in which consideration is unavailable and the circumstances in which parties cannot make return payments or scope adjustments. Consideration is a form of return payment; scope adjustments can only be made using a cost-benefit mentality that anti-commodification norms are designed to block. When parties are able to articulate consideration, there is every reason to believe they will also be able to negotiate return payments and scope adjustments. When social norms block parties from voicing consideration, these norms will typically prevent return payments and scope adjustments as well.

As such, any harms caused by signaling spirals will tend to be minimal under circumstances where consideration is socially available. The consideration doctrine divides promisor-promisee relationships into a first category in which voicing consideration is possible and the parties are likely to be able to make return payments and scope adjustments, and a second category in which social norms prevent the articulation of consideration and likely obstruct the use of return payments and scope adjustments as well. A legally binding option is

¹⁵¹ See Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 58 AM. SOC. REV. 55 (1963).

¹⁵² See *supra* Part II.B.

¹⁵³ See *supra* Part II.A.

only granted for the first category, the category of circumstances in which inefficient signaling spirals are unlikely to occur.

B. Circumstances in which Consideration Is Unavailable

When contracting parties are able to voice consideration, they should typically be able to make scope adjustments and return payments, thus alleviating the potential harm from signaling spirals. But what about promises for which norms block the use of consideration—promises for which inefficient signaling can pose a significant cause for concern?

The models described in Part III show that allowing a legally binding option for these promises can harm both promisors and promisees. But the models do not show whether, on balance, allowing legal enforcement actually does harm the promisors and promisees. The models conclude only that the welfare effects of a legally binding option are uncertain, that we cannot simply assume that parties desire the existence of this option based on their exercising the option.

Whether an option for legal enforcement of promises enhances or diminishes welfare depends on a variety of factors, including: the promisors' probabilities of performance, the potential benefits from increasing promisee reliance, and the magnitude of the costs promisors bear when faced with legal sanctions. We might question whether enforcing promises would either be generally welfare enhancing or welfare diminishing within the likely specifications for these factors. But how can we know what specifications are reasonable?

Aghion and Hermalin conclude that “the question of whether a given set of restrictions improves or reduces efficiency is an empirical one: only by considering variations in these restrictions over time, across states, or across nations can one truly determine the effects of these restrictions on efficiency.”¹⁵⁴ Empirical analysis might shed some light on our question. Perhaps empirical studies could show that the effects of inefficient signaling are muted for certain types of promises, or conversely, that the likely harms from inefficient signaling are particularly severe for select groups of promises. But we doubt that empirical studies are capable of determining the effects of making a legally binding option available for the entire range of non-commodifiable promises.

Signaling spirals only occur among groups of promisors with similar observable characteristics. When a legally binding option is offered to a group of promisors, this should not affect promisors with different observable characteristics—promisors who are not part of the same reference group. For example, if Gina promises to give Fred a car at a future date, Fred will probably try to assess Gina's probability of performance by looking to whether promisors similar to Gina fulfilled promises of a similar nature in the past. If Gina is an elderly social worker, and Barbara is a young shopkeeper, Fred probably will not assess the likelihood of Gina actually delivering the car by examining whether Barbara previously fulfilled a promise to sell bubblegum for a dollar. Both the promisors and the promises are sufficiently dissimilar in these two scenarios that they are unlikely to be part of the same reference group.¹⁵⁵

¹⁵⁴ Aghion & Hermalin, *supra* note 134, at 404.

¹⁵⁵ As an aside, we do not actually believe that promisees assess promisors' reliability in such a formulaic fashion. Nevertheless, we do believe that people form expectations about the likely behavior of others through experience and through stories of others' experiences. Fred may not actually search his mind for whether promisors similar to Gina performed in the past when determining his expectations about whether Gina will perform. But Fred's

As such, a necessary first step to performing any empirical analysis requires determining which promises are in the same reference group. This assessment is by no means trivial. Individual promisors may fall within multiple reference groups for different types of promises, creating an interlocking web of reference groups. And promisees may differ about what observable characteristics they find most salient. For instance, a racist promisee might not consider promises made by the members of a minority group as comparable to promises made by the majority, while a non-racist promisee would lump promisors into reference groups without looking at the color of their skin. Any promisor can be viewed as having an infinite number of observable characteristics, yet promisees will only take some of these characteristics into account when making judgments about which promisors are comparable.¹⁵⁶ A meaningful empirical analysis would have to sort through this convoluted and constantly-shifting web of reference groups in order to evaluate the magnitude of signaling costs.

In the absence of convincing empirical studies, we need a default determination about whether to provide a legally binding option for non-commodifiable promises. We must look beyond the models in order to decide which default determination is more appropriate—either denying enforcement to promises unbacked by consideration or allowing all promises to be enforced.

C. Tie-Breaking Factors

The standard assumption that the law should enforce parties' expressed intentions relies on the notion that these expressed intentions represent the parties' underlying desires. But for non-commodifiable promises, signaling spirals can lead promisors to enter a legally binding form even when they would prefer that the form not exist. Lacking means for determining parties' true desires, we look to a number of tie-breaking factors that support a default rule of non-enforcement. None of these factors are particularly persuasive, at least to the extent we have developed them here; we do not claim any of the factors would justify ignoring parties' wishes if we could confidently ascertain those wishes. But in the absence of a better guide for policy, these factors support a default rule of denying enforcement to promises unbacked by consideration.

For our first tie-breaking factor, we cite the administrative costs of enforcement. Enforcing promises through the legal system creates numerous costs. Someone must pay for the judge's salary and the salaries of the other court employees. And lawyers typically take a significant portion of the eventual judgment or settlement. Even the time the parties invest in litigating a dispute can represent significant costs. These costs warn against legal overreaching.

expectation about Gina's likelihood of performance must arise from somewhere. If Fred has witnessed promisors similar to Gina reneging on their promises in the past, he is more likely to doubt Gina's probability of performance. Signaling spirals do not take place immediately. But over time, removing some of the members from a reference group is likely to alter promisees' expectations about the remaining members of the group.

¹⁵⁶ We continue to assume that promisors have limited control over their observable characteristics. Or, at a minimum, that any efforts by promisors to adjust their observable characteristics for signaling purposes when consideration is not available do not create significant welfare costs. To the extent promisors invest in being viewed as responsible, these efforts might be welfare enhancing. The set of behaviors likely to signal that one is a reliable promisor are generally viewed as socially desirable – avoiding lying, displaying generosity, and so on. See note 139 *supra* for a related discussion.

When we are truly uncertain about whether the law could effectively monitor a social dispute, administrative costs form a tie-breaker justifying legal restraint.¹⁵⁷

As a second tie-breaking factor, we note that non-commodifiable promises operate within a web of complex obligations. The fact that parties cannot voice consideration for these promises suggests that there may be other mutually understood obligations that are never explicitly stated in a form that courts can identify.¹⁵⁸ To enforce only the explicitly promised obligations would risk imposing an undue burden on the promisor, as her explicitly articulated obligations would become enforceable but any unarticulated return obligations of the promisee would remain unenforced.

Third, even ignoring the potential harm from inefficient signaling, the welfare consequences of non-commodifiable promises may be ambiguous. Eric Posner has discussed at length why status-enhancing and trust-building promises are not necessarily welfare enhancing.¹⁵⁹ The reason is that these promises are positional in nature. When one promisor gains status, others lose status. And when promisors use gifts to gain a promisee's trust, these gifts can raise the costs to everyone else of gaining trust. The use of promises to gain trust or status can result in a prisoners' dilemma problem. Promisors may find themselves giving gifts merely to retain their relative position, such that they would be better off if everyone abstained from making status-enhancing and trust-building promises.¹⁶⁰

Almost by definition, the message sent by non-commodifiable promises is more important than the actual transfer of goods or services. We assume that the transfer of goods or services from altruistic and exchange-oriented promises enhances welfare because otherwise these promises would not be made. Promisors make exchange-oriented promises in order to gain something of value from the promisees—something that they prefer more than the goods or services they give up. And promisors make altruistic promises because they want the promisees to have the promised goods or services. But we have no reason for assuming that the actual transfer of goods or services enhances welfare in non-commodifiable promises. Consequently, it is hard to generalize about whether these transfers enhance or diminish welfare. When the

¹⁵⁷ Moreover, administrative costs may be particularly high for non-commodifiable promises. These promises were originally made within thick social relationships where the promisors were more concerned with the message sent by the promise than by the actual transaction. Promisees will typically only sue over breaches of these promises when the relationship between the parties has soured beyond repair. Non-commodifiable relationships are thick and infused with meaning. When these relationships go bad and lead to litigation, the parties may pursue the litigation without regard to its costs or economic rationality. Winning the dispute may become more important to the parties than the actual recovery; the parties may be willing to invest more in the lawsuits than the amount of the recovery can justify. As such, the case for a default rule against legal enforcement based on administrative costs gains additional strength for non-commodifiable promises. See Marc S. Galanter, "Reading The Landscape Of Disputes: What We Know And Don't Know (And Think We Know) About Our Allegedly Contentious And Litigious Society," 31 *UCLA L. REV.* 4, 24-25 (1983).

¹⁵⁸ This observation has spawned the field of transaction cost economics. See, e.g., Oliver E. Williamson, *Transaction Cost Economics and Organizational Theory*, in *THE HANDBOOK OF ECONOMIC SOCIOLOGY* 77 (Smelser & Swedberg eds., 1994).

¹⁵⁹ Posner, *supra* note 125.

¹⁶⁰ Refusing to enforce these promises would not prevent parties from making trust-building or status-enhancing gifts. But without enforceable promises, parties would at least be prevented from making gifts larger than they can currently afford.

potential costs from signaling spirals are factored in, we might presume that enforcing these promises would generally reduce welfare.¹⁶¹

On a related note, our fourth tie-breaking factor looks back to our discussion of Philosophy and Political Theory.¹⁶² Many of the arguments supporting anti-commodification norms contain value judgments. The norms against commodification were thought to perform important functions such as preventing the wealthy from purchasing power within non-market spheres, protecting goods and relationships with inherent dignity from being corrupted by market language and logic, and insuring that these goods and relationships are treated with the respect they deserve. When it is normatively inappropriate for the parties to discuss a promise using cost-benefit language, do we really want a judge or jury to assign damages for breach? Calculating damages requires cost-benefit thinking; the promise must generally be assigned a dollar value.¹⁶³ This is the essence of commodification. Anti-commodification norms might warn against legal enforcement just as they prevent the parties from explicit bargaining.

Finally, we note that parties can always transgress anti-commodification norms and invoke the consideration doctrine if they place sufficient value on having their promises enforced. Even parties operating within thick relationships sometimes hire lawyers. We do not claim any certainty about the nature or scope of anti-commodification norms. In many contexts, promises may be characterized by mixed motives. The parties may care about both the substance of the transaction and the message sent by the transaction. By requiring only nominal consideration, our preferred version of the consideration doctrine would provide a legally binding option for all parties who sufficiently care about the substance of their transaction to ignore any norms against voicing consideration. When the parties already trust one another, for instance, they may find it easy to invoke consideration. But when the parties are engaged in a delicate courtship dance with high potential for misunderstandings, they may decide that the potential gains from making a promise binding do not justify the risk of violating anti-commodification norms.

In a sense, we force the parties to trade off between concerns over inappropriate signaling and the inability to secure their promises through law, rather than requiring courts to make these judgments. If the parties place sufficient value on making a promise enforceable, they can always declare that the promise is being exchanged for a penny, even if doing so is socially awkward or risks sending an undesired message. As such, when anti-commodification norms deter parties from invoking even nominal consideration, we can expect that the parties were not overly concerned about being unable to secure their promise through law.

Our tie-breaking factors are speculative and under-theorized. We cannot fully develop these arguments within the space constraints of this article. Nevertheless, we believe the factors combine to justify a default rule against enforcing non-commodifiable promises. When

¹⁶¹ We express deep discomfort about these speculations into promises' social worth. Again, we only resort to these substantivist arguments as a tie-breaker; we would instead look to the parties' desires if we could confidently ascertain their desires. However, it is worth noting that our substantivist tie-breaker argument draws a different line than the substantivist arguments we discussed in Part I.B. We continue to believe that gratuitous promises as a class are no less valuable than exchange promises. Altruistic promises should generally be welfare enhancing. We suggest only that non-commodifiable gratuitous promises – promises made for signaling purposes such as trust or status – might lack socially value.

¹⁶² Part II.B.

¹⁶³ We might avoid calculating damages by only providing the remedy of specific performance. But this would require a significant adjustment to our law of contract remedies.

signaling spirals make it impossible to determine the parties' true desires, the tie-breaking arguments provide cause for denying the option to have promises enforced.

V. CONCLUSION

Substantive theorists have sought to deny legal support for gratuitous promises; formalist scholars have been unable to justify the use of consideration in place of alternative forms. Our account takes a different approach, arguing that requiring nominal consideration leads to enforcing promises when parties actually wish to be bound. We base our account on the roles of anti-commodification norms and of inefficient signaling. What previous scholars have failed to realize is that even nominal consideration is unavailable within certain social contexts. When parties are unable to articulate consideration, they will generally also be unable to make return payments and scope adjustments, creating the potential for inefficient signaling spirals that can harm both promisors and promisees.

The consideration form can thus serve to identify contexts in which parties are fully able to bargain over the content of their promises. What ultimately matters is not whether the parties *do* offer consideration, but rather whether they *can* offer consideration. The key question is whether social norms permit bargaining over the terms of a promise. As such, the use of consideration language informs courts that providing a legally binding option will benefit the contracting parties. By voicing consideration, the parties demonstrate that their expressed intentions correspond with their underlying desires—that their promise is of a type for which parties should generally desire an option for legal enforcement.

Our account provides a framework for clearing up the morass of existing doctrine. Many of the conflicting precedents that currently plague the case law have arisen from courts' attempts to determine which promises are socially valuable.¹⁶⁴ These inquiries are misguided. When the consideration doctrine is interpreted to allow nominal consideration, parties can make this determination instead of the courts. Whenever the parties care sufficiently about having their promises supported by law—valuing the substance of their transaction over any messages it might send—the parties can invoke consideration. A nominal consideration requirement only denies enforcement when promises are made within ritualized social contexts in which norms block the use of even nominal consideration—contexts in which inefficient signaling combines with tie-breaking factors so that parties would generally prefer to leave their promises non-binding.

The consideration doctrine is not the only mechanism used for making promises legally binding. In addition to consideration, courts sometimes consider other doctrines like reliance. Our paper seeks only to justify the consideration doctrine, not to provide a complete account of all potential rules for contract formation. Indeed, our account provides strong support for enforcing promises backed by nominal consideration, but it does not necessarily mean that promises lacking consideration should *not* be enforced. The law might well benefit from using other doctrines like reliance to supplement the consideration doctrine, providing additional methods by which promises might be enforced.

Although our account does not completely address potential supplements to the consideration doctrine, our discussion provides a framework through which these supplementary approaches should be analyzed. For instance, some states enforce promises using a seal doctrine

¹⁶⁴ See *supra* Part I.C.

even when consideration is lacking. By signing written statements of their promises in the presence of a notary public, promisors in these states can make even unilateral promises legally binding. To determine the merits of this supplemental rule, future papers must look to both inefficient signaling and to anti-commodification norms. We have assumed for the purposes of our argument that alternatives to nominal consideration like a seal or writing requirement are less-sensitive to anti-commodification norms, but this might not be the case. Certainly, anti-commodification norms block more than just the use of bargaining. There might be circumstances in which bargaining is socially appropriate, but where going to a notary public would violate taboos.

We have argued that a nominal consideration requirement effectively divides the circumstances in which inefficient signaling presents a serious problem from circumstances in which this problem does not occur. We believe that nominal consideration performs this role far better than any alternative forms. Although nominal consideration is not the only formalism entangled with anti-commodification norms, no other formalism equally signifies whether parties are able to negotiate over more than two terms. After all, the existence of consideration (otherwise known as return payments) is one of the additional terms we analyze in Part IV. And the other term—scope adjustments—will be permissible within the same general set of social scenarios as nominal consideration. Although we are open to the use of alternative doctrines as a supplement to our nominal consideration rule, we remain confident that nominal consideration should be the primary mechanism through which promises are made legally binding.

We believe that anti-commodification norms have significant implications for contract formation. We hope to see further work analyzing the implications of these norms. As a tie-breaking argument, we note that it may be undesirable for courts to entangle themselves with non-commodifiable promises. Yet this argument might stand on its own, justifying the consideration doctrine even apart from our game theory and welfare analysis.¹⁶⁵ How courts should react to anti-commodification norms is an under-theorized question that merits further inquiry. And future empirical studies might demonstrate that certain sets of promises are not subject to inefficient signaling spirals and should thus be enforceable even without nominal consideration.¹⁶⁶

This paper has been dedicated to proving a single point: that courts should enforce promises backed only by nominal consideration. Despite the many questions our account leaves unanswered, on this point we are certain. Courts should not create special rules to deny legal support for inter-familial promises and the like. To the extent that the relationship-oriented

¹⁶⁵ To fully develop this argument would require a much deeper engagement with the commodification literature than we offer here. Where we avoid taking sides in the commodification debate and limit ourselves to drawing general conclusions from the literature, developing an argument of this sort would require evaluating conflicting theories about the nature of the anti-commodification phenomenon and its normative implications.

¹⁶⁶ Yet, even here, our account would provide a framework for analyzing whether exceptions of this sort are valid. It is not enough to claim that exempted promises are socially valuable, as these inquiries have been made in the past. This argument only had force against the assumption that other gratuitous promises were valueless, an assumption we have shown to be mistaken. Even if we prioritize encouraging certain promises – for example: donations to charities – above any potential harm to promisors, this would not necessarily justify excepting these promises from the consideration requirement. Inefficient signaling spirals can harm promisees—such as charitable recipients—in addition to harming promisors. Only if future empirical studies show that inefficient signaling is unlikely for certain categories of non-commodifiable promises should we exclude these promises from the consideration requirement. Until studies of this sort can be conducted, we favor a default rule of only enforcing promises backed by at least nominal consideration. And we continue to doubt whether it would even be possible to conduct studies of this sort.

nature of these promises presents a problem, anti-commodification norms will deny these parties the use of nominal consideration without the need for courts to intervene. In place of the various substantive inquiries made by existing case law, we call for making the existence of nominal consideration both a necessary and sufficient condition for the use of the consideration doctrine. Our account provides courts with simpler and more coherent guidelines for applying the consideration doctrine, and with a superior method for determining which promises parties actually desire to have enforced.

APPENDIX A. THE AGHION-HERMALIN MODEL OF INEFFICIENT SIGNALING

This Appendix begins our formal proof for the problem of inefficient signaling, as discussed in Part III of the paper. Our proof relies on a model developed by Phillippe Aghion and Benjamin Hermalin.¹⁶⁷ Their model shows how limitations on contractual terms can be welfare enhancing.¹⁶⁸ The Aghion-Hermalin model is part of a newer form of game theory based on asymmetric information.¹⁶⁹ This branch of scholarship first developed as part of insurance economics, but the approach has since been applied to numerous problems in law and economics.¹⁷⁰ Nevertheless, this article is the first time a model of this sort has been used to analyze the consideration doctrine.¹⁷¹ This Appendix proceeds in two sections: Section A shows how our question – whether limitations should be placed on promisors’ ability to legally bind themselves – fits the conditions under which the Aghion-Hermalin model applies. Section B explains the model’s implications through a series of graphs.

A. Six Conditions under Which the Model Applies

Space constraints prevent us from formally elaborating the Aghion-Hermalin model.¹⁷² Fortunately, the authors prove that their results hold whenever six conditions apply.¹⁷³ The conditions are as follows: First, there must be “opposite preferences over the contract terms.”¹⁷⁴

¹⁶⁷ Aghion & Hermalin, *supra* note 1344, at 381-98.

¹⁶⁸ The authors’ paradigmatic case involves an entrepreneur raising capital for a project. Aghion & Hermalin, *id.*, at 381-98. Their paper shows the possibility of efficiency gains from limitations on the amount the entrepreneur can be forced to pay in the case of default, essentially justifying bankruptcy laws. *Id.* at 400-01. The authors also discuss how their model can be applied to limitations on penalties for breach of contract and to mandated benefits in employment contracts. In a separate paper, Ian Ayres has used their model to discuss possible inefficiencies in corporate contracting. Ian Ayres, *The Possibility of Inefficient Corporate Contracts*, 60 U. CIN. L. REV. 387 (1991). We draw upon Ayres’s work in seeking to present a simplified description of the Aghion-Hermalin model.

¹⁶⁹ Aghion & Hermalin, *supra* note 134, at 387-92. Aghion and Hermalin base their work on an extensive body of scholarship. In addition to the Rothschild and Stiglitz piece previously mentioned, *supra* note 84, noteworthy works include George Akerlof, *The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism*, 84 QUART. J. OF ECON. 488 (1970) and A. Michael Spence, *Job Market Signaling*, 87 QUART. J. OF ECON. 629 (1973). In 2001, Akerlof, Spence, and Stiglitz jointly won the Nobel Prize for their work on asymmetric information and signaling. Although our analysis relies on papers by these authors and others, we do not discuss all of our debts. Suffice it to say that both Aghion and Hermalin’s model and our own extension of that model stand on a mountain of previous economics scholarship.

¹⁷⁰ Ian Ayres describes some of the ways in which this scholarship has been applied to legal problems in Ian Ayres, *Playing Games with the Law*, 42 STAN. L. REV. 1291 (1990).

¹⁷¹ It is mysterious as to why scholars have failed to realize the implications of this scholarship for the consideration doctrine as at least some scholars interested in applying economic reasoning to contract law are familiar with the form of analysis. For instance, Eric Posner discusses the Aghion-Hermalin model in his recent essay *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L. J. 829, 860 (2003). Nevertheless, in the very same article, Posner repeats the conventional wisdom that contract law should decide which contracts to enforce by looking at promisor’s intentions, *Id.* at 849. He concludes his discussion of the consideration doctrine by supporting our premise that existing scholarship has failed to justify the doctrine’s refusal to enforce promises where promisors clearly intended the contract to be enforced. *Id.* at 850-51. He never mentions the possibility of applying an Aghion-Hermalin type model to address this puzzle.

¹⁷² The model fills twenty-nine pages of an economics journal and relies on a level of mathematical complexity beyond the ability of most readers of law journals to comprehend.

¹⁷³ Aghion & Hermalin, *supra* note 134, at 384, 398.

¹⁷⁴ *Id.* at 398.

Second, both promisors and promisees must have “convex preferences over the terms of the contract.”¹⁷⁵ Third, the different types of promisors must systematically differ with regard to the “marginal rate of substitution between the terms of the contract.”¹⁷⁶ Fourth, promisors must have “private information” that “cannot be contracted on.”¹⁷⁷ Fifth, promisors must have “bargaining power.”¹⁷⁸ And sixth, the terms of the contract must lie on a continuous spectrum.¹⁷⁹

The first five conditions clearly apply to our question—whether limiting the availability of a legally binding form can enhance welfare. Only the sixth condition is questionable.

The first condition is easily met; promisors and promisees have opposite preferences for both contracting terms. Holding the benefit the promisor expects to obtain from promising constant, promisors prefer to obtain this benefit using the lowest possible values for both the size of the promise and the level of sanctions, while promisees prefer higher values for these terms.¹⁸⁰ As such, promisors have cost and value curves that work in opposite directions. The higher promisors set the terms the more the promisees benefit, and the more the promisors can receive in return for making the promise.¹⁸¹ Yet raising the terms increases the costs of making the promise. Promisors should thus choose the combination of terms that generates the maximum value at the minimum cost.

Moving to the second condition, the parties should have convex preferences over the terms of the contract. Convex preferences come from risk aversion. Risk aversion is a standard assumption in economic models and is thought to originate from the decreasing marginal utility of money.¹⁸² Like most economic actors, promisors and promisees should generally be risk averse.

The third condition requires that promisors differ in their willingness to trade off between the two terms. This condition holds because promisors have varying probabilities of performance. For any fixed level of benefit, reliable promisors should be more willing to

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 384. Aghion & Hermalin assume that their contract terms are continuous following standard economic practice. As such, they do not discuss this assumption when generalizing their results. Also following standard economic practice, they assume their terms can be represented by twice-differentiable von Neumann-Morgenstern utility functions. *Id.*

¹⁸⁰ Promisees prefer higher levels of sanctions first because sanctions make it costly for the promisor to renege and thus increase the probability of performance and second because—in the case of legal damages—some portion of the sanctions are paid by the promisor to the promisee.

¹⁸¹ To see why this is the case, we must return to the four types of promises described in Part II.C of the paper. For all four types of promises, the value the promisors receive from making the promise depends on the benefit conferred on promisees. In the case of exchange-oriented and trust-building promises, the more promisors offer, the more promisees should be willing to give in return—whether in the form of a defined exchange or undefined goodwill. Similarly, large status-enhancing promises generate more status than do small status-enhancing promises. And altruistic promisors benefit directly from the value conferred on promisees due to interdependent utility. Thus, regardless of a promisor’s motivation, the benefit a promisor receives from making a promise partially depends on the size of the promise – the benefit conferred on the promisee.

¹⁸² *But see* MATTHEW RABIN, *Diminishing Marginal Utility of Wealth Cannot Explain Risk Aversion*, in CHOICES, VALUES, AND FRAMES (Kahneman & Tversky eds., 2000) (arguing that diminishing marginal utility of wealth cannot explain the levels of risk aversion frequently observed). Instead, Rabin claims risk aversion is a result of cognitive biases related to the endowment effect.

increase their level of sanctions while reducing the size of their promise than are unreliable promisors.

The fourth and fifth conditions require that promisors have private information and can exercise market power. These conditions follow from our assumption of asymmetric information and our use of the offer-acceptance model, respectively.¹⁸³

Finally, we assume that the sixth condition holds for the purposes of this Appendix. The sixth condition demands that both contracting terms fall along a continuous spectrum. In other words, promisors must be able to gradually increase or decrease both the size of their promises and the level of sanctions rather than being forced to choose between discrete options.

The size of a promise probably does fall along a continuous spectrum in most cases. A promisor might increase the magnitude of a promise by pledging to transfer a larger quantity of goods or services. When the quantity cannot be altered, a promisor might still increase the size of the promise by delivering the goods or services at an earlier point in time or otherwise making the promise more desirable to the promisee.

In contrast, we have doubts about whether the level of sanctions falls along a continuous spectrum. In many cases, promisors may be stuck with the discrete choice between offering either a set level of sanctions corresponding with social stigma or else a set level of sanctions resulting from legal damages. Nevertheless, we assume that the level of sanctions falls on a continuous spectrum for the purposes of this Appendix.¹⁸⁴ For balance, we adopt the opposite assumption when creating our own model in Appendix B.

Although we assume that the level of sanctions falls on a continuous spectrum, there is still a limit to the maximum level of sanctions. This limit can either be set by the promisor's wealth—promisors cannot pay more in damages than they own—or else by law. Where the consideration doctrine prevents parties from making their promises binding, such as for many gratuitous promises, the maximum level of sanctions corresponds with the highest possible amount of social stigma. Where the consideration doctrine allows parties to secure their promises through law, such as for most exchanges and for when courts enforce gratuitous promises backed by only nominal consideration, the maximum level of sanctions corresponds with the highest possible amount of legal damages. The level of sanctions is still continuous, as a promisor can set the sanctions at any level up to the maximum limit. But there exists a maximum level of sanctions which can be altered by changing the law.¹⁸⁵

Consequently, all six assumptions can be said to hold for the question of whether allowing a legally binding option might reduce welfare. As such, the Aghion-Hermalin model can be used to analyze the consideration doctrine.

¹⁸³ There are circumstances under which a promisee can have market power rather than the promisor—such as if the promisor is a supplier to a monopsonist buyer. But as a general rule, promisors should have market power as long as they design their promises as in the offer-acceptance model.

¹⁸⁴ This assumption is not entirely implausible. The potential for stigma might be increased by pledging publicly or by invoking a religious or culturally significant symbol to secure the promise. For instance, swearing to God or on a Bible might have more serious social consequences than a promise unbacked by any religious symbolism. And where the law permits the use of liquidated damages clauses, parties can set the amount of legal sanctions at any level they like. Still, there are natural limits to the level of stigma related damages and liquidated damages clauses are often unavailable due to either legal or practical limitations. See *infra* note 195, for further discussion.

¹⁸⁵ Allowing an option for legal enforcement increases the maximum level of sanctions above stigma levels. For enforceable promises, allowing liquidated damages clauses can increase the maximum level of sanctions. Striking down unreasonably high liquidated damages clauses limits the maximum level of legal sanctions.

B. Explaining the Model's Implications

Since all six conditions can be said to apply, Aghion and Hermalin's conclusions hold for our question. Limiting the availability of a legally binding form can increase welfare; the mere fact that parties choose to employ a legally binding option does not indicate that they benefit from the existence of that option. The logic behind this conclusion is best demonstrated through a series of graphs. Readers desiring more formal substantiation of these results should refer to Aghion and Hermalin's article.¹⁸⁶

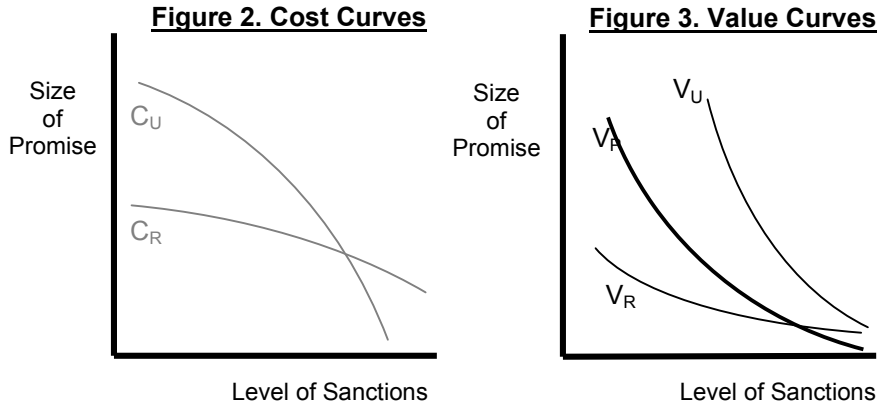


Figure 2 shows how promisors value the tradeoffs between the costs associated with the size of a promise and the level of sanctions. C_R depicts the cost tradeoff curve of a reliable promisor. C_U shows the cost tradeoff curve of a promisor with a lower probability of performance—an “unreliable” promisor. As the reliable promisor knows that she is less likely to default, she will be more willing to accept a high level of sanctions than will the unreliable promisor. Locations on the southwest portion of the graph correspond with lower costs for promisors than do locations to the northeast.

Figure 3 shows the combinations of the two terms capable of producing the same level of value for the promisors, in other words, the promisors' indifference curves or value curves. Since the value received by promisors is related to the benefit conferred on promisees, and since promisees prefer larger-sized promises and higher levels of sanctions, the level of value increases toward the northeast corner of the graph.

The value a promisor receives from making a promise also depends on her perceived reliability. Value curve V_R depicts the mix of terms a promisor can offer in exchange for a specified level of value if she is viewed as a reliable type. Value curve V_U shows the mix of terms required to produce the same level of value if the promisor is perceived as an unreliable type. Promisors perceived as unreliable need to offer a higher mixture of the two terms in order to derive the same value as promisors perceived as reliable types; hence, curve V_U lies to the northeast of curve V_R .¹⁸⁷ Whether a promisor needs to offer the terms described by V_R or V_U

¹⁸⁶ Aghion & Hermalin, *supra* note 134.

¹⁸⁷ Promisors perceived as unreliable also need to include a relatively higher level of sanctions in order to make their promises seem credible. As such, the value curve of the unreliable type promisor is more steeply sloped than the value curve of the reliable type promisor.

depends on the promisor's perceived reliability, not her actual reliability.¹⁸⁸ V_P shows the pooled value curve—the set of combinations of the two terms capable of producing the given level of value when it is impossible to tell whether the promisor is a reliable or unreliable type.¹⁸⁹

Figure 4 combines the cost and value curves to show a possible equilibrium for the terms chosen by the two promisors. Point A represents the spot along the pooled value curve where the reliable-type promisor can derive the specified level of value with the minimal cost. Without any ability to distinguish herself from unreliable promisors, a reliable promisor would select point A. Since unreliable promisors wish to be seen as reliable, they would also pick point A in order to avoid signaling their greater probability of default.

However, reliable promisors face incentives to signal their greater reliability through their choice of terms. For instance, reliable promisors might try to offer point C in order to differentiate their promises from those of the unreliable promisors. If a reliable promisor could successfully communicate her type, offering point C would allow her to achieve the same value previously gained by point A, but at a lower cost. In contrast, since the unreliable promisors have a steeper cost curve, offering point C would raise their costs as compared to point A. Thus, we might think that choosing point C would demonstrate that a promisor is of the reliable type.

Yet, once the reliable promisors offer point C, unreliable promisors will no longer have the option of promising point A. Choosing anything other than point C would reveal that a promisor is unreliable. Instead, unreliable promisors must either follow the reliable promisors in offering point C or else offer point B—the minimum cost for achieving the specified level of value along the unreliable promisor value curve. Point B corresponds to the cost curve C_U^* . Since point C lies to the southwest of C_U^* , the unreliable promisors will follow the reliable ones in offering point C.

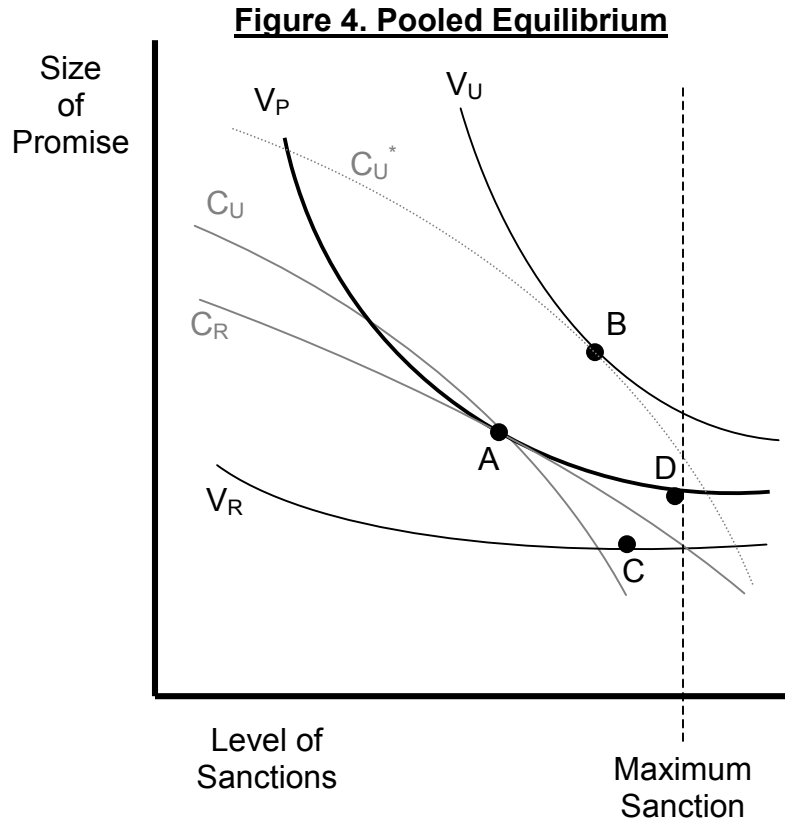
Once the unreliable promisors begin offering point C, the reliable promisors can no longer achieve the specified level of value by picking a point on the curve V_R . Instead, they must select a point along the pooled value curve V_P . Moreover, the reliable promisors no longer have point A available as an option. Any promisor who picks point A—regardless of their actual reliability—will be perceived as unreliable and will thus be unable to achieve the level of value associated with the pooled value line V_P . The only options available are locations to the right of point C along the pooled value line V_P , or else points along the unreliable promisor value line V_U . The reliable promisors thus face incentives to continue increasing their level of sanctions in order to signal their difference from the unreliable promisors. The unreliable promisors will continue following the reliable ones by also raising the level of sanctions they offer. This process continues until both types of promisors reach the maximum level of sanctions. Consequently, both types of promisors end up offering point D, where the maximum level of sanctions intersects the pooled value curve V_P .

The pooled equilibrium at point D is not an efficient outcome. Both reliable and unreliable promisors would face lower costs and achieve the same benefit by offering promises at point A. Assuming the value curves correspond with the benefit derived by promisees, the

¹⁸⁸ Again, the amount promisees offer in exchange for a promise depends on the promisor's perceived reliability, not actual reliability.

¹⁸⁹ The slope of the pooled indifference curve must lie somewhere between the slope of the indifference curves for the reliable and unreliable type promisors. The exact placement of the pooled curve depends on the relative numbers of reliable and unreliable type promisors in the overall population.

promisees should be indifferent between receiving promises at point A or point D. As such, moving to point A would represent a Pareto improvement over the pooled equilibrium at point D. Both types of promisors would be better off if the promises were made at point A, while the promisees would not be harmed.



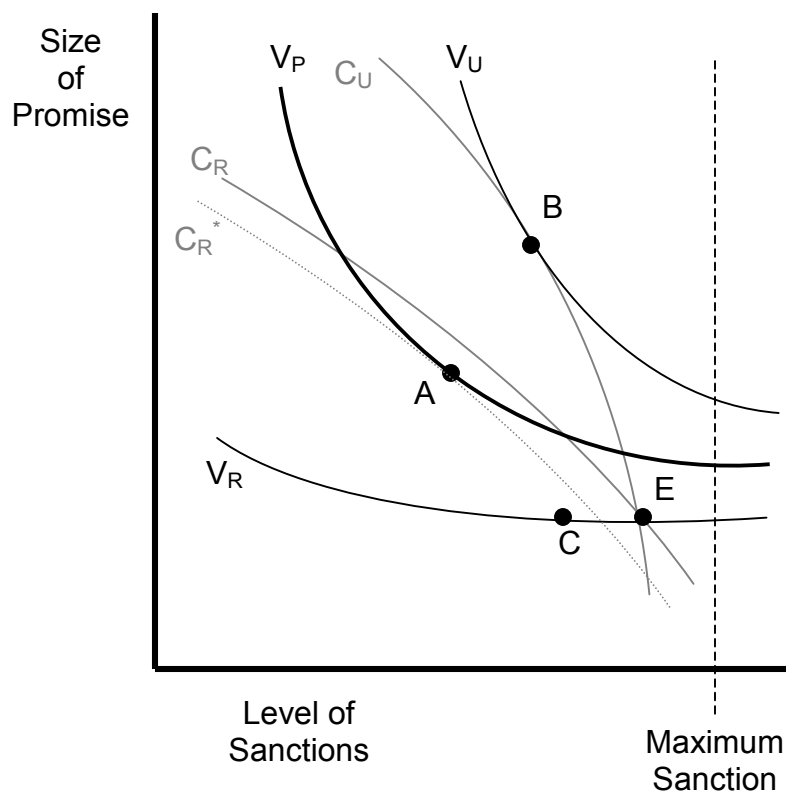
A pooled equilibrium is not the only possible outcome for the signaling game. Figure 5 shows how the game can generate a separating equilibrium. The slopes of the cost curves have been adjusted from those in Figure 3 in order to produce the new outcome. In Figure 5, the reliable promisors can offer point E and thus signal their greater probability of performance. Point E lies just to the right of the unreliable promisor cost curve C_U , so the unreliable promisors will prefer to offer point B along their own value curve rather than following the reliable promisors in offering point E. Having signaled their difference from the unreliable promisors, the reliable promisors are able to offer point E along the reliable promisor value line instead of being forced to use the pooled value line.

Like the pooled equilibrium in Figure 4, the separating equilibrium depicted in Figure 5 is not an efficient outcome. Both reliable and unreliable promisors would face lower costs by offering promises at point A as opposed to their respective outcomes at points E and B. Assuming the value curves correspond with the benefit derived by promisees, the promisees as a group should be indifferent between receiving promises at point A from both types of promisors or receiving promises from the reliable promisors at point E and from the unreliable ones at point

B. As such, a pooled equilibrium at point A would represent a near Pareto improvement over the separating equilibrium at points B and E.¹⁹⁰

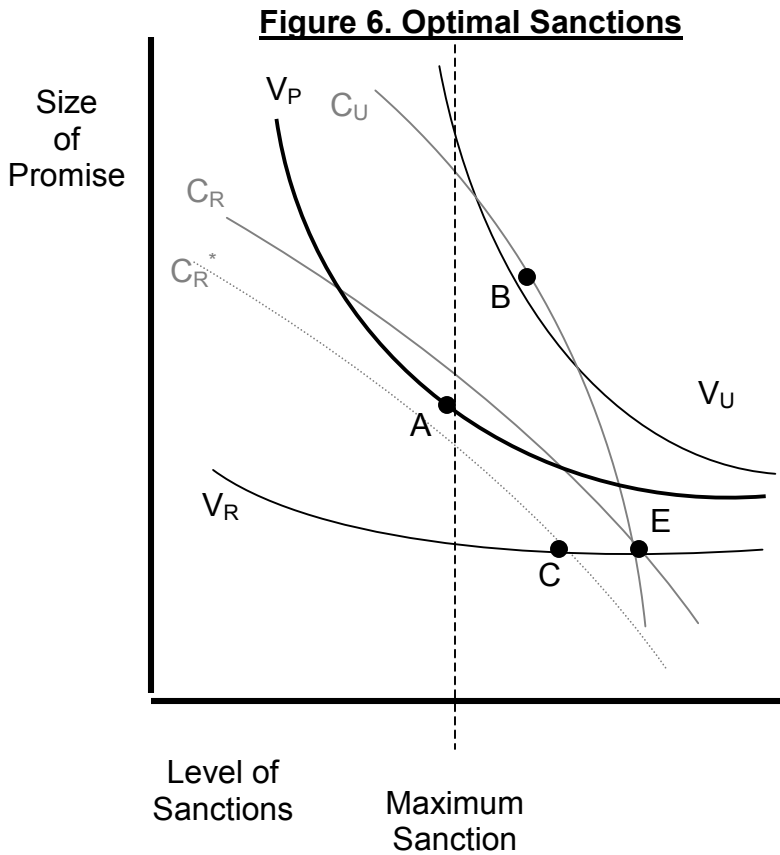
Why then don't the reliable promisors just stick with offering promises at point A rather than moving to point E? Because the reliable promisors do not actually have the choice between offering promises at point A or at point E. From a starting place of point A, reliable promisors face incentives to instead offer point C. Once the unreliable promisors follow the reliable types in offering point C, point A is no longer available. Any promise made at point A would be seen as coming from an unreliable promisor. Continuing their attempts to signal their greater reliability, reliable promisors will offer promises further to the right along the reliable promisor value curve V_R . Unreliable promisors will follow these signals until the reliable promisors end up offering point E, at which time it becomes preferable for the unreliable promisors to offer point B along their own value curve. Any reliable promisors who sought to depart from the new equilibrium outcome by offering a promise to the left of point E would be viewed as unreliable and would thus need to offer a promise along the unreliable promisor value curve. Once again, the signaling process ends up harming both types of promisors.

Figure 5. Separating Equilibrium



¹⁹⁰ The pooled outcome represents only a near Pareto improvement rather than an actual Pareto improvement because it has different distributional implications for individual promisees within the larger group.

These inefficient outcomes can be prevented by setting the maximum sanctions at the appropriate level.¹⁹¹ Figure 6 shows how the promisors from Figure 5 could benefit by a reduction in the maximum level of legal sanctions.¹⁹² With the maximum allowable sanctions set so as to intersect point A, reliable promisors will be unable to signal by increasing their choice of sanctions above the level of point A. Consequently, both reliable and unreliable promisors will promise at Point A, thus improving the welfare of both types of promisors.



¹⁹¹ Pooled equilibria like those depicted in Figure 3 can always be made more efficient by setting the maximum level of sanctions at an appropriate level. This result comes partially from the fact that pooled equilibrium can only result from a maximum level of sanctions. Were sanctions unlimited—either by the law or by promisors’ wealth—a separating equilibrium would always result.

However, it is possible to construct a separating equilibrium that cannot be made more efficient by imposing a maximum level of legal sanctions. See Aghion & Hermalin, *supra* note 134, at 397.

¹⁹² It is easy to see how the same result can be reached for the promisors in the pooled equilibrium from Figure 3. The separating equilibrium in Figure 4 can be transformed into a pooled equilibrium by shifting the level of maximum sanctions to the left of where curve C_U intersects curve V_R . This would cause both types of promisors to promise where the new maximum sanctions line intersected curve V_R . Since this result is less efficient than pooling at point A, further reducing the level of maximum sanctions would thus benefit both types of promisors.

The Aghion-Hermalin model shows how a limit on the maximum level of legal sanctions can enhance welfare. By limiting the sanctions that a promisor can offer in the event of breach, the law can prevent inefficient signaling. As Aghion and Hermalin summarize their findings:

Parties to a contract may enter into inefficient contracts because of asymmetric information. Under asymmetric information, a contract plays two roles. First, it sets the terms of trade, and, second, it can reveal private information. As it is the first role that determines the efficiency of a contract, the second role can lead to inefficiency. Restrictions on contracts can increase efficiency if they limit the signaling role without affecting the terms of trade role.¹⁹³

However, just because a limit on sanctions *can* improve welfare does not mean that it *does* improve welfare. Without knowing the slopes of promisor cost and value curves, we cannot know the appropriate setting for the maximum level of legal sanctions. The consideration doctrine might reduce sanctions to an inefficiently low level.

Figure 7. Inefficiently Low Sanctions

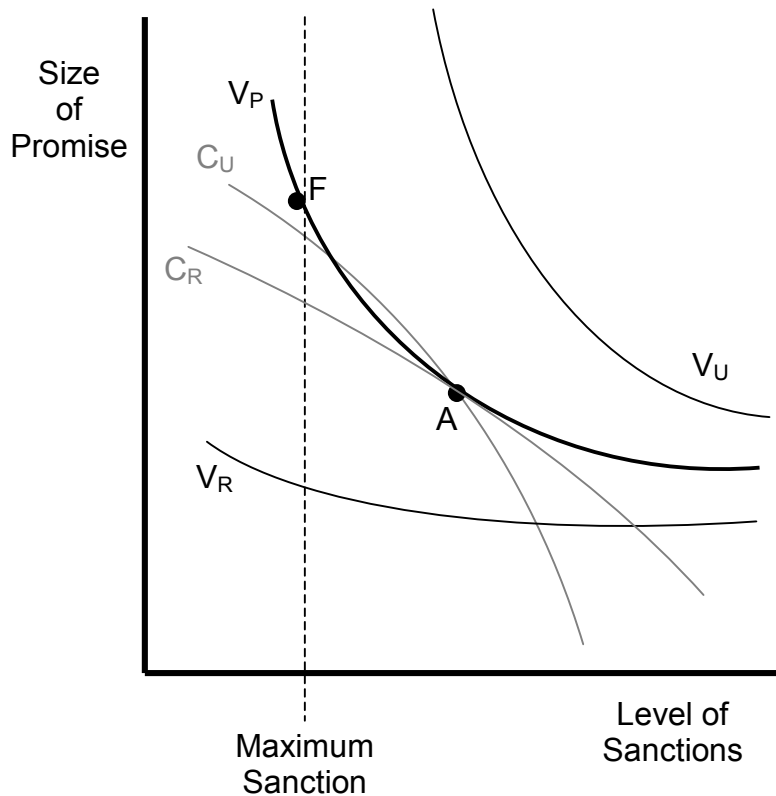


Figure 7 shows the consequences of setting the maximum level of legal sanctions too low. Instead of creating a pooled equilibrium at point A, promisors are limited to the level of sanctions associated with point F. Hence, point F represents the new pooled equilibrium outcome. Since point F lies to the northeast of the cost curves both promisors would have faced

¹⁹³ Aghion & Hermalin, *supra* note 134, at 403.

had they been able to offer point A, point F is an inefficient outcome. Allowing promisors to offer point A would create a Pareto improvement—enhancing the welfare of both types of promisors without harming promisees.

The maximum level of legal sanctions can be set too high or too low. Either result diminishes welfare. The question, then, is how to set sanctions at the appropriate level. Are parties made better off when they can back their promises by legal damages or would welfare be enhanced by limiting them to the damages corresponding with social stigma? As noted in Part III, our formal models cannot answer this question.¹⁹⁴ But the Aghion-Hermalin model can—and does—disprove the current paradigm of assuming that parties who utilize a legally binding option necessarily benefit from the existence of that option.

¹⁹⁴ See *supra* note 142, and accompanying text.

APPENDIX B. AN EXTENSION OF THE AGHION-HERMALIN MODEL

This Appendix concludes our formal proof for the problem of inefficient signaling, as discussed in Part III of the paper and in Appendix A. The Aghion-Hermalin Model described in Appendix A proves that the mere fact that parties employ a legally binding form should not be taken as evidence that the parties desire the continuation of that form. Parties may be made better off when denied the option to back their promises with legal damages. Nevertheless, the Aghion-Hermalin Model tells our story imperfectly. Since the model uses only two types of promisors, it cannot fully demonstrate how a legally binding form can create a negative spiral harming larger groups of promisors and promisees. Crucially, the model does not provide any means for showing how the imposition of a legally binding option affects promisees. Moreover, the model's assumption that damages fall on a continuous scale departs from our intuitions about promises and contracts. Parties may often have only two options for damages—either a fixed amount of stigma if the promise is not legally binding, or else a set level of legal damages if the promise is backed by law.¹⁹⁵

Consequently, we have extended Aghion and Hermalin's work to develop our own model. Our model uses four types of promisors and allows only two options for remedies—either stigma-related penalties or full expectation damages. We have kept our model significantly less formal than Aghion and Hermalin's in order to fit its analysis within the space constraints of this article. Nevertheless, our model does rest on a few simple equations.

To begin elaborating our model, we need to define a few terms. Let X measure the size of a promise. And let P_i measure a promisor's probability of breach (for promisors i equals one through four). We use P_{avg} to indicate the average probability of breach for all promisors who do not employ the legally binding form, assuming an equal percentage of each type of promisor within the overall population. Hence, P_{avg} also refers to the perceived likelihood of breach for promisors not using the legally enforceable option.¹⁹⁶

Using the constant R as a placeholder coefficient, we express the benefit promisors receive from making a promise as: $(1 - P_{avg})RX$. Looking back to our discussions of the benefit promisors receive from promising, recall that promisor benefit increases with the size of the promise (X),¹⁹⁷ but is discounted by the promisor's perceived reliability $(1 - P_{avg})$.¹⁹⁸

¹⁹⁵ In theory, promisors can use liquidated damages clauses to set legal sanctions at any level they like. Yet practical considerations often prevent the use of liquidated damages clauses. Current doctrine places limits on the use of these clauses, frequently ignoring the clauses in favor of expectation damages. Even when the courts do enforce these clauses, contracting parties may find it difficult to agree upon a specified amount of damages at contract formation. Consequently, parties often have only a single choice for the level of legal damages. Similarly, parties often have little control over the damages of social stigma. Parties may sometimes be able to alter stigma-related damages by making their promises more or less publicly, but it is hard to negotiate publicity. Regardless of what the parties agree on, promisees face incentives to later publicize the promise in order to deter breach. Hence, parties may often have only two options for damages – either a set level of legal damages or a set level of stigma damages. When legal enforcement is not available, parties may not have any choice regarding the level of sanctions, with the set level of stigma damages being their only option.

¹⁹⁶ The reason follows from our specification that perceived reliability comes from the average reliability of all promisors with similar observable characteristics. Any promisors with distinctive observable characteristics would be excluded from our pool.

¹⁹⁷ See note 179, *supra*, and accompanying text.

¹⁹⁸ See notes 139-141, *supra*, and accompanying text.

Of course, there are costs to fulfilling a promise. These costs are discounted by the promisor's actual probability of performance, rather than perceived probability of performance, since the costs are only incurred if the promise is fulfilled. The costs of completing a promise can thus be expressed as: $(1-P_i)X^E$. The E exponent is used so that costs increase faster than benefits. Without the use of an exponent, either all promises would be infinitely sized or else no promises would be made. The use of an exponent also captures the intuition that there are increasing marginal costs to making promises larger in size.

Finally, promisors also face stigma-related costs in the event of breach. Using the constant S as a coefficient for the impact of stigma, these costs can be expressed as: $(P_i)SX$.

Combining the terms, we can calculate the total welfare a promisor expects to receive from making a non-legally binding promise as:¹⁹⁹

$$(A) \text{ Promisor Welfare (not bound)} = (1-P_{avg})RX - (1-P_i)X^E - (P_i)SX$$

Through the use of a legally binding form, a promisor can essentially reduce both her perceived probability of breach (P_{avg}) and actual probability of breach (P_i) to zero, insofar as they affect the first two terms.²⁰⁰ As such, the welfare promisors derive from making binding promises can be expressed as:²⁰¹

$$(B) \text{ Promisor Welfare (bound)} = RX - X^E - (P_i)(S+D)X$$

The first two terms come directly from equation A above. The simplification results from setting both P_i and P_{avg} to zero. The final term comes from adding the costs of legal damages—D—to the costs associated with stigma in the case where the promisor is unable to perform. Despite being bound, circumstances may prevent the promisor from fulfilling the promise in the manner originally intended.²⁰² The constant D captures any additional costs—beyond stigma—that legal sanctions impose on the promisor over the costs that would have been incurred were she able to perform.²⁰³

In order to calculate the welfare received by promisees, we need to introduce the placeholder constants H, L, and V. V acts as a coefficient on the value promisees receive from a fulfilled promise. H relates to the harm promisees suffer from relying on a non-legally binding promise that is breached. For promises that are legally binding, L measures the legal costs

¹⁹⁹ The first term corresponds with the promisor's value curves—Figure 2 in Appendix A. The second and third terms combine to form the promisor's cost curves—Figure 3 in Appendix A.

²⁰⁰ The remedy of expectation damages means that even in the event of breach the promisor must still confer a benefit to the promisee equivalent to that originally promised. Hence, P_i and P_{avg} become zero for the first two terms. Any difference between the costs incurred in paying these damages and the actual costs of performance is measured by the constant D. P_i does not become zero in the third term, as promisors are only subject to stigma and legal damages in the case of breach.

²⁰¹ Although we label the equations as referring to actual welfare for simplicity and brevity, all four equations actually refer to expected welfare.

²⁰² While impossibility can sometimes be used as a defense excusing non-performance, it is easy to imagine circumstances that fall short of impossibility but that would still cause a sincere promisor to breach.

²⁰³ D can be negative if the cost of legal sanctions is less than the originally anticipated cost of performance or if stigma is less burdensome in the legally binding scenario than in the unbound scenario. D essentially acts as a composite term for any differences in the costs associated with breach when a promisor is legally bound than when the promisor is not bound.

associated with forcing the promisor to pay damages.²⁰⁴ As such, we can express the welfare promisees receive from non-binding and binding promises, respectively, as:

$$(C) \text{ Promisee Welfare (not bound)} = (1-P_i)VX - P_i(HX)$$

$$(D) \text{ Promisee Welfare (bound)} = VX - P_i(LX)$$

Using these equations, we can model the welfare consequences of introducing a legally binding form. Whether allowing the option for legal enforcement enhances or diminishes overall welfare depends on the settings for the constants and on the promisors' probabilities of breach. Just as the results of the Aghion-Hermalin model depend on the slopes for the promisors' cost and value curves, the results of our model depend on the settings for the terms used to calculate the parties' costs and values.

Figure 8 shows the model's results when $P_i=(5\%, 10\%, 15\%, 20\%)$, $E=2$, $V=15$, $H=2$, $L=5$, $C=2$, $S=20$, and $D=24$. X is set at 10 in the absence of a legally binding option, and is derived from the above equations when promises can be made legally binding.²⁰⁵ R is derived and then used as a constant.²⁰⁶

The first column in Figure 8 shows the welfare received by each promisor and promisee in the absence of a legally binding option. The numbers in the parentheses next to the values for promisor welfare depict the welfare each promisor would receive were she to employ a legally binding form. Hence, once such a form is introduced, promisor one should choose to bind herself because doing so increases her welfare from 95 to 107. None of the other promisors immediately bind themselves, as doing so would reduce their welfare.

Yet after promisor one chooses to bind herself, she is no longer included in the pool used to calculate P_{avg} . The second column shows the welfare promisors two through four—and their respective promisees—would receive from making non-legally binding promises subject to the higher value for P_{avg} . Even though promisor two received more welfare from making a non-binding promise while promisor one remained part of the pool (with a potential welfare of 90 for a non-binding promise and 85 for a binding promise), with promisor one removed from the pool, promisor two can gain more welfare from exercising the legally binding option (with a potential welfare of 84 for the non-binding promise and 85 for the binding promise). Hence, promisor two follows promisor one in utilizing the legally binding form, and P_{avg} increases yet again as we move to the final column.

²⁰⁴ L also includes any other differences between the value that the promisee receives from legal sanctions and the value the promisee would receive had the promisor performed faithfully. As with D , L is a composite term and can be negative.

²⁰⁵ Although the promisors initially make promises of the same size, they may alter the size of their promises when faced with the costs associated with making their promises legally binding. Unlike in the Aghion-Hermalin model, signaling is not an issue once promisors enter the legally binding form. The only signal that can be sent is to use the form.

The level for X is calculated by taking the derivative of the equation for promisor value with respect to X , setting the derivative equal to zero, and then solving for X . This method calculates the setting for X which produces the maximum benefit for promisors—the setting that would be chosen by an economically rational promisor.

²⁰⁶ R equals approximately 23 in the calculations behind both Figure 7 and Figure 8. The level of R is calculated so that X remains the same across all four promisors in the unbound scenario.

Promisors three and four still gain more welfare from abstaining from the legally binding form, making column three our final outcome. Both the overall group of promisors and the overall group of promisees lose welfare from the introduction of the legally binding option. Total promisor welfare drops from 350 to 335 and total promisee welfare drops from 515 to 510 as we move from column one to column three.²⁰⁷ Although promisor one and her associated promisee benefit from the legally binding option, their gains are overwhelmed by the losses suffered by the other promisors and promisees.²⁰⁸ Overall welfare is maximized by not allowing promisors the option of securing their promises through law.

Figure 8: D=24

Time 1: none bound	Time 2: P ₁ bound	Outcome: P _{1,2} bound
$P_{avg} = 12.5\%$	$P_{avg} = 15\%$	$P_{avg} = 17.5\%$
P ₁ : 5%	P ₁ : bound	P ₁ : bound
P ₂ : 10%	P ₂ : 10%	P ₂ : bound
P ₃ : 15%	P ₃ : 15%	P ₃ : 15%
P ₄ : 20%	P ₄ : 20%	P ₄ : 20%
<u>Promisor Welfare</u>	<u>Promisor Welfare</u>	<u>Promisor Welfare</u>
P₁: 95 (107)	P ₁ : 107	P ₁ : 107
P ₂ : 90 (85)	P₂: 84 (85)	P ₂ : 85
P ₃ : 85 (66)	P ₃ : 79 (66)	P₃: 74 (66)
P ₄ : 80 (49)	P ₄ : 74 (49)	P₄: 69 (49)
Total: 350	Total: 345	Total: 335
<u>Promisee Welfare</u>	<u>Promisee Welfare</u>	<u>Promisee Welfare</u>
P ₁ : 142	P ₁ : 152	P ₁ : 148
P ₂ : 133	P ₂ : 129	P ₂ : 134
P ₃ : 125	P ₃ : 120	P ₃ : 116
P ₄ : 116	P ₄ : 112	P ₄ : 108
Total: 515	Total: 513	Total: 510

promisor one binds
promisor two binds

Figure 9: D=10

Time 1: none bound	Time 2: P _{1,2} bound	Time 3: P _{1,2,3} bound	Outcome: all bound
$P_{avg} = 12.5\%$	$P_{avg} = 17.5\%$	$P_{avg} = 20\%$	$P_{avg} = N/A$
P ₁ : 5%	P ₁ : bound	P ₁ : bound	P ₁ : bound
P ₂ : 10%	P ₂ : bound	P ₂ : bound	P ₂ : bound
P ₃ : 15%	P ₃ : 15%	P ₃ : bound	P ₃ : bound
P ₄ : 20%	P ₄ : 20%	P ₄ : 20%	P ₄ : bound
<u>Promisor Welfare</u>	<u>Promisor Welfare</u>	<u>Promisor Welfare</u>	<u>Promisor Welfare</u>
P₁: 95 (114)	P ₁ : 114	P ₁ : 114	P ₁ : 114
P₂: 90 (99)	P ₂ : 99	P ₂ : 99	P ₂ : 99
P ₃ : 85 (84)	P₃: 74 (84)	P ₃ : 84	P ₃ : 84
P ₄ : 80 (71)	P ₄ : 69 (71)	P₄: 64 (71)	P ₄ : 71
Total: 350	Total: 356	Total: 361	Total: 368
<u>Promisee Welfare</u>	<u>Promisee Welfare</u>	<u>Promisee Welfare</u>	<u>Promisee Welfare</u>
P ₁ : 142	P ₁ : 158	P ₁ : 158	P ₁ : 158
P ₂ : 133	P ₂ : 144	P ₂ : 144	P ₂ : 144
P ₃ : 125	P ₃ : 116	P ₃ : 131	P ₃ : 131
P ₄ : 116	P ₄ : 108	P ₄ : 104	P ₄ : 118
Total: 515	Total: 525	Total: 536	Total: 550

promisors one and two bind
promisor three binds
promisor four binds

Figure 9 shows how a legally binding form can enhance welfare with the constants specified differently. The only difference between the calculations underlying Figures 8 and 9 is that D is set at twenty-four in Figure 8 and at ten in Figure 9. Consequently, the promisors in

²⁰⁷ Although promisees benefit from being paid legal damages, this benefit is overwhelmed by the losses they suffer as promisors decrease the size of their promises in response to the cost of possibly needing to pay the damages. If promisors refrained from promising all together, rather than just decreasing the size of their promises, these losses might be even more severe.

²⁰⁸ Promisee two also gains, even though promisor two does not.

Figure 9 suffer relatively smaller losses from the need to pay legal sanctions in the case of breach as compared to the promisors in Figure 8. This reduced value for D is sufficient to alter the results so that the introduction of a legally binding option enhances welfare.

All four promisors choose to bind themselves in Figure 9. First, promisors one and two bind themselves, moving us to column two. Even though promisor three faced incentives to refrain from using the legally binding form while promisors one and two remained part of the pool, the reduced value for P_{avg} in column two leads promisor three to bind herself as well. With all of the other promisors bound in column three, promisor four also binds herself to generate the outcome in the last column. Despite the fact that promisors three and four lose welfare from the introduction of the legally binding form, the overall group of promisors increases its welfare from 350 to 368 and the overall group of promisees increases its welfare from 515 to 550. In contrast to Figure 8, allowing a legally binding option enhances welfare.

Of course, these figures depict only two possible settings for the constants. By adjusting the constants, we can create numerous alternative scenarios. Some scenarios will show that the introduction of a legally binding form enhances welfare, while other scenarios will show welfare losses coming from allowing the form. The question remains whether parties are better off when they can back their promises with legal damages or when they are limited to the damages created by social stigma. As stated in Part III of the paper, our formal models cannot answer this question.²⁰⁹ We lack the information needed to determine reasonable values for the constants; and slight adjustments to the constants can switch the results over a wide range of possible settings.²¹⁰ As with Aghion and Hermalin's work in Appendix A, our model can only disprove the dominant wisdom that parties who take advantage of a legally binding option necessarily desire the existence of that option.

²⁰⁹ See *supra* note 142, and accompanying text.

²¹⁰ We encourage readers to play with the model's specifications in order to demonstrate this fact for themselves. We will happily send an excel spreadsheet which can be used to calculate the model's results for different settings of the constants to any reader who requests it.