

Resolving the Paradox of the Consideration Doctrine: The Implications of Inefficient Signaling and of Anti-Commodification Norms

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Abstract:

This paper addresses one of the central problems of contract law, a puzzle that has troubled generations of contracts scholars: Why do we only enforce promises backed by consideration? Or, how can we justify insisting on the bargain context, but not requiring that the bargains be adequate? The lack of a theoretical solution to this puzzle has plagued the application of the consideration doctrine in courts of law.

We resolve this paradox through two innovations. First, using a game theory model based on asymmetric information, we dispute the common 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. Crucially, the mere fact that parties take advantage of a legally binding option does not imply that they desire the existence of that option. When courts create an option for the legal enforcement of promises, parties can essentially be forced into exercising that option.

How then can the law determine which promises to enforce? Our second innovation shows how social norms against commodification limit the availability of the consideration form. Where previous scholarship has assumed that anyone so wishing can invoke nominal consideration, we argue that anti-commodification norms make even nominal consideration unavailable within certain social contexts. Moreover, the contexts in which norms block the use of consideration are precisely the circumstances where creating a legally binding option would be most likely to harm both promisors and promisees.

Ultimately, what matters is not whether the parties actually *do* offer consideration, but rather whether they *can* voice consideration. Only when norms allow the use of consideration should we conclude that parties truly desire the option to have their promises legally enforced.

Outline

I. THE INADEQUACIES OF EXISTING THEORY AND PRACTICE

A) *The Inadequacies of Existing Formal Arguments*

1. The "Evidentiary" Rationale
2. The "Cautionary" Rationale

B) *The Inadequacies of Existing Substantive Arguments*

1. The "Sterile" Rationale
2. The "Trivial" Rationale
3. The "Unnecessary" Rationale

C) *The Morass of Current Doctrine*

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- II. RETHINKING THE QUESTION – THE PROBLEM OF INEFFICIENT SIGNALING
 - A) *An Overview of the Argument*
 - 1. Assumptions
 - 2. The Signaling Spiral
 - B) *The Aghion-Hermalin Model*
 - 1. Six Conditions for When the Model Applies
 - 2. Explaining the Model's Implication
 - C) *Extending the Model*
 - D) *Applying the Models to Gratuitous Promises*
- III. RESOLVING THE PARADOX – THE ROLE OF ANTI-COMMODIFICATION NORMS
 - A) *Consideration and Anti-Commodification Norms*
 - 1. Commodification in Sociology and Anthropology
 - 2. Commodification in Philosophy and Political Theory
 - 3. Commodification in Economics and Game Theory
 - 4. Drawing Conclusions from the Literature
 - B) *Relaxing the Assumption that Promises Have Only Two Terms*
 - 1. The Effects of Multiple Terms
 - 2. The Availability of Multiple Terms
 - C) *Circumstances in which Consideration is Unavailable*
 - 1. Tie-Breaking Factors
- IV. Conclusion

INTRODUCTION

One of the most fundamental questions of contract law is: *What constitutes a contract?* In other words, how do we distinguish between a non-binding promise and a contract that can be enforced in courts of law? In American contract law, the primary answer to this question comes from the consideration doctrine. According to the doctrine, promises that are exchanged for something of value are enforceable, while promises made out of unilateral generosity are not. The broad contours of this doctrine are easily understood. Even without legal training, most Americans recognize that a promise to pay a taxi driver is legally binding, but that a promise to drive a friend to the airport without compensation cannot usually be secured through the legal system.

Nevertheless, there is a deep puzzle at the heart of the consideration doctrine.¹ On the one hand, the doctrine refuses to enforce promises made outside of the bargain context. No matter how clearly and unequivocally one expresses a desire to be bound, a promise will not generally be enforced unless it is given as part of an exchange. Yet, on the other hand, courts typically refuse to look into the adequacy of consideration. Courts occasionally strike down promises secured by a mere pittance—or peppercorn—received in return.² But most courts agree that consideration need not be of equivalent value to the promise for which it is exchanged.

Herein lies the puzzle: How can we justify insisting on the bargain context but not requiring that the bargains be adequate? What purpose can bargains serve if the promises exchanged are not of comparable value?

¹ This description of the paradox follows Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417 (2004), who in turn bases his account on CHARLES FRIED, *CONTRACT AS PROMISE* (1981).

² There is mixed precedent for whether contracts backed by nominal consideration are enforceable. *See infra* Part I.C.

Scholars have attempted to resolve this puzzle using both formal and substantive arguments. On the formal level, many commentators have defended the doctrine as a method for determining whether or not the parties intended a promise to be enforced. There are a number of ways in which the use of formalisms can facilitate the administration of the legal system.³ Yet as Eric Posner explains, the choice of the consideration doctrine as the preferred formalism is suspect. “[T]here 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.”⁴ Although the need to create some legal formality is easily understood, this need does not validate the use of consideration specifically. Formal accounts of the consideration doctrine cannot justify using consideration in place of alternative forms.

On the substantive level, some commentators have argued that gratuitous promises are inherently less deserving of legal support. However, these arguments do not hold up to sustained reflection. Moreover, gratuitous promisors can often satisfy the consideration doctrine by having their promisees offer some small amount – a peppercorn – in return. If we truly wished to deny enforcement to gratuitous promises, we would only secure promises backed by adequate consideration.⁵ As Daniel Markovits writes, “it remains difficult to construct a plausible substantive account of the insistence on the fact of a bargain coupled with unconcern for the bargain’s character.”⁶ Neither formal nor substantive accounts of the consideration doctrine have been able to justify the doctrine’s prominent role in American contract law.

Meanwhile, courts have floundered over the doctrine’s flawed theoretical foundations. In order to prevent parties from constructing the appearance of a bargain where none actually exists, courts sometimes strike down contracts secured by only “nominal consideration.”⁷ But the precedents for what constitutes sufficient consideration are murky and often contradictory. The *Restatement (Second) of Contracts* rejects the use of nominal consideration where the *Restatement (First)* accepted it, but neither version has proved authoritative for how courts actually decide these disputes. The unresolved paradox at the heart of the doctrine has created real problems for anyone trying to predict which contracts will be enforced.

This paper argues that the problematic state of the consideration doctrine originates from a mistaken assumption shared by nearly all commentators. Whether they examine consideration from the perspective of economics, philosophy, or doctrine, scholars typically agree that the law should honor the intentions of contracting parties. In the words of Charles Fried, contract law rests on “the liberal principle that the free arrangements of rational persons should be respected.”⁸ Scholars arrive at this proposition from different starting points—some based on

³ See Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941).

⁴ Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 850 (2003).

⁵ We might wish to err on the side of enforcing promises when courts are uncertain about whether the consideration is truly of equivalent value to the promise for which it is exchanged. Yet this principle would not lead us to the consideration doctrine. Courts generally enforce promises where the consideration is more than nominal but still clearly far from adequate.

⁶ Markovits, *supra* note 1, at 1479.

⁷ 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).

⁸ FRIED, *supra* note 1, at 35.

promoting individual autonomy, others on maximizing economic welfare, and still others on avoiding the harm caused by frustrated expectations. Yet as a general rule, most commentators agree that the law should enforce promises that were intended to be legally binding at the time of contract formation. This common assumption forms the theoretical edifice upon which contract law is built.

Because scholars focus on enforcing parties' intentions, they seek a mechanism for rendering those intentions apparent to the outside world. When the parties want their promise to be legally enforceable, they will invoke this mechanism; when they don't, they won't. On this view, the consideration doctrine's success or failure depends on how closely it matches parties' intentions. Because it prevents the enforcement of many promises that were clearly intended to be binding, the consideration doctrine is often deemed to be flawed.

In contrast to the conventional approach, we dispute the underlying assumption that contract law should look to parties' expressed intentions at the time of contract formation. 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. In other words, there is a difference between one's choice when confronted by a legal rule and one's preference for what the legal rule should be.

Promisors make promises legally binding in order to signal their sincerity to promisees. But the more promisors who secure their promises through the law, the more suspicious promisees will be of the promisors who are left behind—the promisors who do not make their promises legally enforceable. So as not to be perceived as unreliable, promisors may be forced to render their promises legally binding, even if they would have preferred to have kept the promises unenforceable in the absence of a legally binding option.

Thus, the mere fact that parties choose to employ a legally binding form does not necessarily indicate that they benefit from the existence of that form.⁹ We show that welfare can be enhanced by *limiting* the ability of promisors to secure their promises through law. Although many promisors would choose to be legally bound if given the option, they might nevertheless prefer not to have that option made available. Therefore, rather than asking "*Did the parties intend to be bound?*" we should ask "*Would the parties want the option to be bound?*" Instead of looking for a formalism that can determine parties' intentions with respect to specific promises, we should seek a mechanism for identifying the circumstances in which parties would want a legally binding option to be made available.

We then show how the consideration doctrine can fill this role. We argue for enforcing all promises backed by at least nominal consideration, but not enforcing promises where no consideration is present. Traditionally, scholars have assumed that any promisor who wishes to create nominal consideration can do so by requesting that her promisee offer some token in exchange for the promise. Yet we show how social norms prevent parties from voicing even nominal consideration for certain categories of promises.

By its very nature, the use of consideration commodifies a transaction. In order to articulate consideration, the parties must explicitly agree that a promise is being exchanged for something desired in return. Many promises operate in a social space where commodification of

⁹ 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 II.C *infra*.

this sort would defeat the very purpose of the promise. For certain types of promises, strong social taboos prevent the parties from employing the consideration form.

There is an ongoing debate about the nature and scope of anti-commodification norms. Nevertheless, there is widespread agreement that norms block the use of bargain-type language and behavior for at least some transactions. 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 precisely determine 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, where the actual transfer of the promised goods or services plays only a secondary role.

Crucially, when anti-commodification norms make consideration unavailable, these same norms typically prevent parties from fully bargaining over their promises. Our game theoretic model of inefficient signaling incorporates the assumption that promises contain only two terms. This assumption generally holds in contexts where norms block the use of consideration, making inefficient signaling a significant cause for concern. But when parties are able to voice consideration, they should also be able to bargain over other terms of their promises, thereby alleviating the potential harms from inefficient signaling.

Consequently, we justify the consideration doctrine as a mechanism for determining whether parties are able to fully bargain over their promises. When norms block the use of bargain-type language and behavior, providing a legally binding option may harm both promisors and promisees as the parties are effectively forced into exercising the option. But in contexts where parties can back their promises by at least nominal consideration, the harms from inefficient signaling are minimal and parties should only secure their promises through law when they benefit from doing so. In other words, the consideration doctrine's function is not, as commentators have supposed, to reveal whether the parties intended a promise to be legally enforceable, but rather to reveal whether the promise is of a type for which an option for legal enforcement should be made available.

The paper proceeds in three parts. Part I further 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 versed in the puzzles at the heart of the consideration doctrine may wish to skip directly to Parts II and III where we develop our novel solution to these puzzles.¹⁰

In Part II, we reconsider the question that the consideration doctrine is designed to answer. Previous accounts have generally viewed the doctrine as a means for determining parties' intentions with respect to individual transactions. Since the parties choose to make their promises legally binding through the use of consideration, it is assumed that the parties desire the option to bind their promises through law. We show how this understanding of the question is based on a mistaken premise. Even parties who exercise an option to make their promises

¹⁰ 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 form a better overview than anything previously written. We also add several new critiques and observations that have not yet appeared in the literature. Nevertheless, the true value of our paper lies in Parts II and III. We doubt that many scholars of the consideration doctrine will be surprised with the results of our analysis in Part I.

legally enforceable may wish that the option not be offered. Consequently, instead of trying to design a form to determine parties' intentions with respect to individual transactions, we should seek a mechanism for determining the circumstances under which parties would desire the option to be legally bound.

Part III shows how the consideration doctrine can provide this mechanism. Social norms limit the availability of consideration to circumstances in which promisors should desire the option to bind themselves. In some situations, social taboos against commodification prevent both the use of consideration and bargaining over terms. When parties can invoke consideration, by contrast, they should also be able to bargain over other terms of their promises, thereby alleviating the harm from inefficient signaling. Therefore, only when parties are unable to articulate consideration should we deny them the option to have their promises enforced by law.

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 a peppercorn of consideration should be enforced, but promises should generally not be legally binding without at least a token amount of consideration. This rule obviates the need for many of the exceptions plaguing the current application of the consideration doctrine.

I. THE INADEQUACIES OF EXISTING THEORY AND PRACTICE

Despite vigorous debates about the underlying rationale for contract law, most commentators accept the need to honor promisors' intentions at the time of promising. 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.¹¹ A second school of thought focuses on the promisee's reasonable expectations, which will be disappointed if the promisor breaches.¹² 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.¹³ Here, legal enforcement of promises is required to ensure that promisees can rely without fear of breach. Thus, though each begins with a different premise, all three of the major schools of contract theory conclude that the law should follow promisor's 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 respecting parties' 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 unequivocally the promisor states his intention to perform—though he may “shout consideration to the housetops”¹⁴—the promise is a legal nullity if consideration is lacking.

¹¹ See, e.g., FRIED, *supra* note 1; Randy Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 289 (1986).

¹² See, e.g., Thomas Scanlon, *Promises and Practices*, 19 PHIL. & PUB. AFF. 199 (1990).

¹³ See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

¹⁴ *In re Greene*, 45 F.2d 428, 430 (S.D.N.Y. 1930).

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. The Inadequacies of Existing 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 unenforceable promises from 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.¹⁵ 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 of some sort—which is a little harder to make up out of whole cloth."¹⁶ Because donative promises are often oral, consideration is defended as a form of objective proof to corroborate a

¹⁵ Arguably, such a requirement would more closely track the expectations of the non-lawyer public.

¹⁶ RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 109 (5th ed. 1998).

promisee's claim.¹⁷ Such proof allegedly serves to reduce the likelihood that a false claim will prevail and lowers the cost of adjudicating all claims.¹⁸

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.¹⁹ 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.”²⁰ While the need to preserve evidence may justify some sort of ritual to solemnize a transfer, the consideration doctrine is a lousy candidate.²¹

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.²² 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.”²³ In any event, there is little reason to believe that rash donative promises are any more common than rash purchases.²⁴ 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.”²⁵ However, even

¹⁷ See Melvin Aron Eisenberg, *Donative Promises*, 47 U. CHI. L. REV. 1, 4-5 (1979-1980).

¹⁸ 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.* Fuller, *supra* note 3, at 821 (arguing that promises supported by moral obligation should be enforced *despite* the “evidentiary insecurity” they generate).

¹⁹ See James D. Gordon III, *A Dialogue About the Doctrine of Consideration*, 75 CORNELL L. REV. 987, 991 (1990).

²⁰ See Andrew Kull, *Reconsidering Gratuitous Promises*, 21 J. LEG. STUD. 39, 53 (1992).

²¹ 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 19, at 990-91.

²² This section discusses what Fuller called the “channeling” function of consideration in addition to what he labels as the “cautionary” function.

²³ Kull, *supra* note 20, at 46.

²⁴ 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.

²⁵ Kull, *supra* note 20, at 54.

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.²⁶ 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.”²⁷ 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. *The Inadequacies of Existing 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 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 Bofnoir 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

²⁶ See Gordon, *supra* note 19, at 991.

²⁷ Posner, *supra* note 4, at 850.

wealth and the division of labor, a gift is, in Bufnoir's words, a "sterile transmission."²⁸ And this description persists in the literature today.²⁹

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."³⁰

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."³¹ As Richard Posner has observed, "a promise would not be made unless it conferred utility on the promisor."³² 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, such as when businessmen exchange small tokens at the start of a business deal.³³ Even if the

²⁸ Fuller, *supra* note 3, at 815 (quoting CLAUDE BUFNOIR, *PROPRIÉTÉ ET CONTRAT* 487 (2d ed. 1924)).

²⁹ See Kull, *supra* note 20, 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 3, at 815 n.23 ("This remark of Bufnoir's cannot be taken too literally . . ."); see also Kull, *supra* note 20, 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.").

³⁰ Eisenberg, *supra* note 17, at 4.

³¹ 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).

³² Posner, *supra* note 18, 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).

³³ See Wessman, *supra* note 31, 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

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.”³⁴ 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.³⁵

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.³⁶ Allowing legal enforcement of donative promises might involve the court system in “a lot of trivial promises arising in social and family settings.”³⁷ 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.”³⁸ The consideration doctrine supposedly prevents the legal system from having to assume the administratively costly job of policing interpersonal squabbles.³⁹

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.”⁴⁰ And even where small donative promises are concerned, as Goetz and Scott point out, “it is no less expensive to litigate most small contracts.”⁴¹ As a means of screening out trivial disputes, the consideration doctrine is both under-inclusive (since many contracts are small) and over-inclusive (since many donative promises are large). Additionally, promisees are unlikely to sue promisors for breach of trivial promises. As Andrew

that “if someone does not give, the exchange may never get off the ground”); Gordon, *supra* note 19, 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.”).

³⁴ Posner, *supra* note 4, at 850; *see also* Goetz & Scott, *supra* note 31, at 1267-71 (1980); *id.* at 1269 (“[T]he production of beneficial reliance is perhaps the principal social rationale of promising . . .”).

³⁵ *See* Posner, *supra* note 18, at 411-14.

³⁶ *See id.* at 416-17.

³⁷ POSNER, *supra* note 16.

³⁸ *See* Posner, *supra* note 18, at 420.

³⁹ *See* Eisenberg, *supra* note 17, at 3; Posner, *supra* note 18, at 417.

⁴⁰ *See* Wessman, *supra* note 31, at 826; *see id.* (“The claim that gratuitous or donative promises are financially trivial is . . . empirically suspect.”).

⁴¹ Goetz & Scott, *supra* note 31, at 1301.

Kull observes, litigation over a promise to take someone out to dinner “would be a freak occurrence.”⁴² Finally, the legal system already denies enforcement to promises—whether unilateral or bilateral—for which any injury is truly minimal.⁴³ 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.⁴⁴ 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.⁴⁵ One study found that businessmen “seldom use legal sanctions . . . to settle disputes”⁴⁶ 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.⁴⁷ 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.”⁴⁸

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 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

⁴² See Kull, *supra* note 20, at 56.

⁴³ See Gordon, *supra* note 19, 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 20, at 57.

⁴⁴ Goetz & Scott, *supra* note 31, at 1304.

⁴⁵ See Gordon, *supra* note 19, at 994.

⁴⁶ Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 58 AM. SOC. REV. 55, 55 (1963).

⁴⁷ *Id.* at 63.

⁴⁸ Kull, *supra* note 20, 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.”).

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 the promise's 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."⁴⁹

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.⁵⁰ 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"⁵¹ 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.⁵² 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."⁵³

Cases that follow the First Restatement prioritize the consideration doctrine's formal justifications over its substantivist ones.⁵⁴ In *Scholes v. Lehman*,⁵⁵ for instance, the court cited

⁴⁹ 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 31, at 809-812.

⁵⁰ 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).

⁵¹ 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.").

⁵² RESTATEMENT OF CONTRACTS § 84, ill. 1.

⁵³ *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.").

⁵⁴ 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) ("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

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."⁵⁶ 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.⁵⁷

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.⁵⁸ 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.⁵⁹ In other words, courts should look through parties' attempts to dress up a donative promise as an exchange.⁶⁰

Courts that follow the Second Restatement's approach refuse to enforce promises they suspect of being gifts.⁶¹ In *O'Neil v. De Laney*,⁶² 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."⁶³ The use of nominal consideration is a "mere formality"⁶⁴—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

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)).

⁵⁵ 56 F.3d 750 (7th Cir. 1995).

⁵⁶ *Id.* at 756.

⁵⁷ *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.").

⁵⁸ RESTATEMENT (2D) CONTRACTS § 71(1)-(2).

⁵⁹ *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.").

⁶⁰ *See also* 2-5 Corbin on Contracts § 5.17 (agreeing with the Second Restatement); 1-3 Murray on Contracts § 61[A] (same).

⁶¹ *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").

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

⁶³ *Id.* at 1265 (quoting 1 Corbin on Contracts § 127, at 546 (1963)).

⁶⁴ *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 53 and accompanying text.

just that, often by suggesting that a gross disparity in the value of promises exchanged indicates fraud or unconscionability.⁶⁵

Typical is *Goodwin State Bank v. Mullins*.⁶⁶ 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.”⁶⁷ 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.”⁶⁸ 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.⁶⁹ This social usefulness contrasts with the claimed sterility of ordinary donative promises.⁷⁰ Since option contracts and guarantee contracts are socially valuable in substance, any imperfections in form can be ignored.⁷¹ 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.⁷² The minority position would enforce such contracts even with sham consideration.⁷³ The Second Restatement endorses the minority approach, opining that option and guarantee contracts may be binding even

⁶⁵ 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.”).

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

⁶⁷ *Id.* at 1079.

⁶⁸ *Id.*

⁶⁹ 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).

⁷⁰ 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”).

⁷¹ 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).

⁷² See, e.g., *Lewis v. Fletcher*, 617 P.2d 834 (Idaho 1980); *Berryman v. Knoch*, 559 P.2d 790 (Kan. 1977).

⁷³ 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.⁷⁴ 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.”⁷⁵

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.⁷⁶

And this list is not exclusive.⁷⁷

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,⁷⁸ while in others they are not.⁷⁹ Courts have carved out exceptions to exceptions, as doctrinal consistency and coherence are abandoned in favor of preferred policy objectives.⁸⁰ And further compounding this uncertainty is the fact that courts sometimes misapply the doctrine.⁸¹

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

⁷⁴ 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”).

⁷⁵ 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).

⁷⁶ Gordon, *supra* note 19, at 1001-02.

⁷⁷ 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).

⁷⁸ 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.”)

⁷⁹ 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.”).

⁸⁰ See *Wessman*, *supra* note 31, at 810-12.

⁸¹ 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. RETHINKING THE QUESTION – THE COSTS OF INEFFICIENT SIGNALING

When starting from the principle of respecting parties' intentions at the time of contract formation, the consideration doctrine requires affirmative justification. The doctrine serves to deny legal enforcement even where the parties clearly wish their promises to be binding. No matter what steps parties take to communicate a desire to be bound, the doctrine calls for ignoring the parties' declared wishes unless consideration is present.

As discussed previously, existing attempts to justify this departure from the principle of respecting parties' intentions have proven inadequate. Recognizing these inadequacies, many scholars have called for relaxing the doctrine to enforce all promises where the parties declared in writing an intention to have their promises enforced.⁸²

This Part argues that these accounts begin with the wrong question. In the absence of an affirmative justification for departing from parties' expressed intentions, many theorists have focused on the courts' need to determine whether a promise was intended to be legally enforceable. Following this logic, the consideration doctrine is thought to fall short because it denies legal enforcement to many promises that were sincerely intended to be binding. The ideal formalism, then, is one that perfectly identifies which promises are intended to be secured through law. The parties will invoke the formalism when they wish to be bound and will abstain when they do not.

We challenge this conventional wisdom by demonstrating that even an "ideal" formalism may make parties worse off. We argue that theorists who inquire *How can we tell whether the parties intended for a promise to be binding?* are focusing on the wrong problem. Rather than seek a formalism that can tell us whether parties intended to be bound, we should ask whether the parties would want such a formalism to exist in the first place.

The consideration doctrine only requires affirmative justification if we believe that the parties who employ the doctrine desire its existence. If the consideration doctrine could be shown to deny legal enforcement only to promises where the parties would prefer not to have the option to be bound, the doctrine could be justified as a direct application of the principle of honoring parties' intentions.

This idea can be illustrated by a simple example: A professor who grades based on student effort decides to hold an optional class session at 7 o'clock on a Friday morning. When many bleary-eyed students show up, the professor 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. Even though the professor sacrificed her own sleep in order to hold the extra session, she was glad to do so in order to assist the students who she believes needed the extra help, since otherwise they would not have attended the class.

⁸² See, e.g., Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 850 (2003).

Yet the professor's error is obvious: If she schedules an optional class, her students may choose to attend it, but this does not mean they are glad for the opportunity. 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. Both the professor and the students may have been better off without the optional class. The 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, choosing not to exercise that option can send a negative signal to promisees about their intention to perform. Yet when the option for legal enforcement is not available, the absence of such enforcement does not signal anything negative about a promisor's intentions. As such, 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 so as to demonstrate their sincerity to promisees, they may actually end up worse off than if no such option existed.

This Part proceeds in four sections. Section A offers an overview of the logic behind these results. The section is intended to be accessible to all readers, even those uncomfortable with mathematics and economic analysis. Consequently, the discussion is kept at a general level.

Section B begins our formal proof. The section adapts a game-theoretic model developed by Phillippe Aghion and Benjamin Hermalin.⁸³ Their work is part of a well-known branch of scholarship building on an earlier piece by Rothschild and Stiglitz.⁸⁴ 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. The section forgoes equations and the direct use of mathematics. Instead, the logic behind the model is explained through a series of graphs.

Section C 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. Our model remedies this deficiency. Although based on Aghion and Hermalin's work, our model is simplified so that it can be understood by readers lacking sophisticated training in mathematics. Nevertheless, our model cannot be demonstrated without the use of a few basic equations.

Finally, section D shows how the results of the two models apply to gratuitous promises. Both the Aghion-Hermalin model and our adaptation of that model require that we view promisors as making promises in order to receive some benefit, the magnitude of which correlates with both the value that the promise confers on the promisee and the promisor's perceived reliability. We show how these conditions hold for gratuitous promises as well as for market exchanges.

⁸³ Phillippe Aghion & Benjamin Hermalin, *Legal Restrictions on Private Contracts Can Enhance Efficiency*, 6 J.L. ECON. & ORG. 381 (1990).

⁸⁴ 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).

The sections are organized to make the Part accessible to a variety of readers. Readers who wish to avoid any technical discussion of game theory can obtain an overview of our results by reading only Section A and then skipping to Part III. Readers who feel comfortable with game theory, but who wish to avoid looking at equations, can skim over Section C. Readers who desire a formal proof of our results should read the entire Part.⁸⁵

A. An Overview of the Argument

1. Assumptions

Before proceeding with our argument, we need to specify four assumptions underlying our approach. 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.⁸⁶

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, as we discuss later, the benefit can come from altruistic motives or from the desire to develop trust or status.⁸⁷ 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. 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. 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.

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

⁸⁵ Readers wishing a formal proof of our results may also wish to examine Aghion and Hermalin's article, *supra* note 83.

⁸⁶ 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.

⁸⁷ See *infra* Part II.D.

judges of their future actions, this assumption seems reasonable.⁸⁸ 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 holds even for gratuitous promises, as we will discuss later.⁸⁹ 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 III, 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 in this Part, we assume that these terms completely define the content of all promises and contracts.

2. The Signaling Spiral

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.⁹⁰ 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

⁸⁸ 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.

⁸⁹ See *infra* Part II.C.

⁹⁰ 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.

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 account claims 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 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.

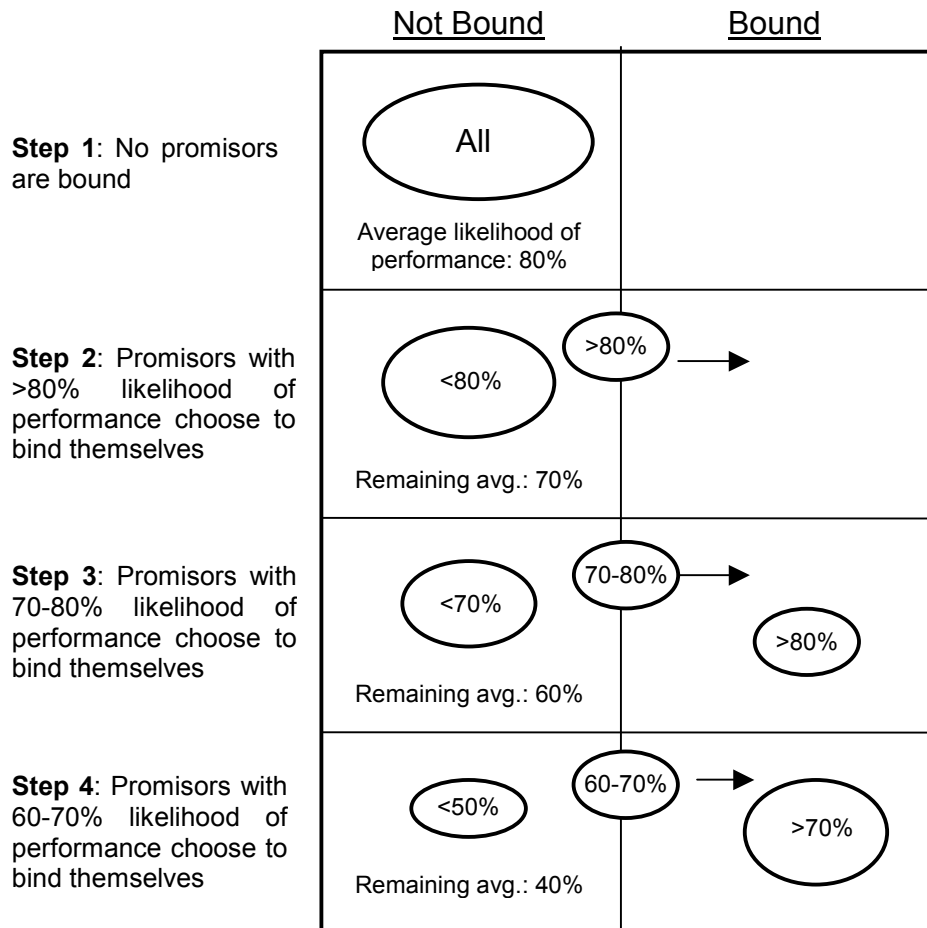
This process can create a harmful spiral.⁹¹ If promisors with a 90% chance of performance sign contracts in order to differentiate themselves from a group with an average performance rate of 80%, the remaining members of the group might be seen as having only a 70% chance of performance (the average 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.

This section has attempted to provide an informal description of the signaling spiral accessible to readers uncomfortable with economic modeling. The remainder of this Part proves these results more formally. Readers who do not require a formal proof for the signaling spiral may wish to skip ahead to Part III. Readers interested in the economics behind the signaling spiral should proceed to the next section where we adapt a model developed by two economists – Philippe Aghion and Benjamin Hermalin.

⁹¹ We model this spiral more formally in Parts II.B and C.

Figure 1. The Signaling Spiral



B. The Aghion-Hermalin Model

The Aghion-Hermalin model shows how limitations on contractual terms can be welfare enhancing.⁹² The model is part of a newer form of game theory based on asymmetric information.⁹³ This branch of scholarship first developed as part of insurance economics, but the

⁹² The authors' paradigmatic case involves an entrepreneur raising capital for a project. Aghion & Hermalin, *supra* note 83, 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 heavily upon Ayres's work in seeking to present a simplified description of the Aghion-Hermalin model.

⁹³ Aghion & Hermalin, *supra* note 83, 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.

approach has since been applied to numerous problems in law and economics.⁹⁴ Nevertheless, this article is the first time a model of this sort has been used to analyze the consideration doctrine.⁹⁵ This section first discusses the conditions under which the Aghion-Hermalin model holds and then explains the model's implications through a series of graphs.

1. Six Conditions for When the Model Applies

Space constraints prevent us from formally elaborating the Aghion-Hermalin model.⁹⁶ Fortunately, the authors prove that their results hold whenever six conditions apply.⁹⁷ The conditions are as follows: First, there must be “opposite preferences over the contract terms.”⁹⁸ Second, both promisors and promisees must have “convex preferences over the terms of the contract.”⁹⁹ Third, the different types of promisors must systematically differ with regard to the “marginal rate of substitution between the terms of the contract.”¹⁰⁰ Fourth, promisors must have “private information” that “cannot be contracted on.”¹⁰¹ Fifth, promisors must have “bargaining power.”¹⁰² And sixth, the terms of the contract must lie on a continuous spectrum.¹⁰³

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. Promisors prefer lower amounts for the size of a promise and for the

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.

⁹⁴ 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).

⁹⁵ 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.

⁹⁶ 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.

⁹⁷ Aghion & Hermalin, *supra* note 83, at 384 and 398.

⁹⁸ *Id.* at 398.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *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.*

level of sanctions, while promisees prefer that these terms be higher.¹⁰⁴ 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.¹⁰⁵ 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.¹⁰⁶ Like most economic actors, promisors and promisees should generally be risk averse.

The fourth 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 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.¹⁰⁷

Finally, we assume that the sixth condition holds for the purposes of this section. 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 section.¹⁰⁸ For balance, we adopt the opposite assumption when creating our own model in Section C.

¹⁰⁴ 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.

¹⁰⁵ See *infra* Part II.C for a justification of this premise.

¹⁰⁶ 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.

¹⁰⁷ 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.

¹⁰⁸ 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

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.¹⁰⁹

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.

2. Explaining the Model's Implication

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.¹¹⁰

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

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 note 126, *supra*, for further discussion.

¹⁰⁹ 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.

¹¹⁰ Aghion & Hermalin, *supra* note 83.

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 .¹¹¹ Whether a promisor needs to offer the terms described by V_R or V_U depends on the promisor's perceived reliability, not her actual reliability.¹¹² 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.¹¹³

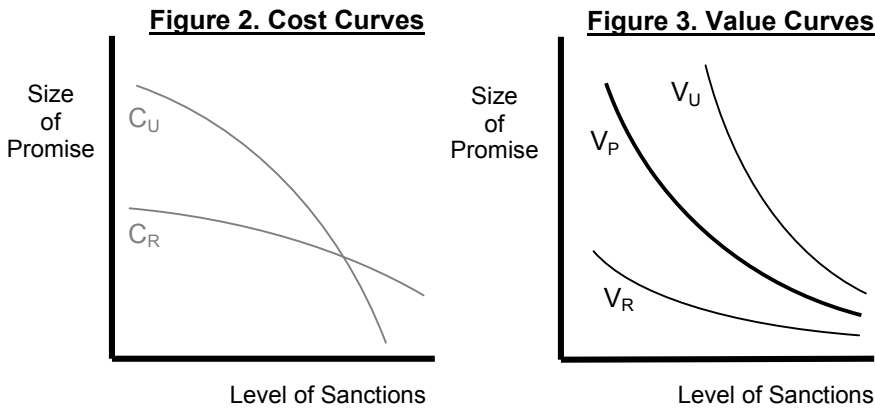


Figure 4 combines the cost and value curves to show a possible equilibrium for the terms chosen by the two promisors. Point A represents the spot along the pooled value curve where the reliable-type promisor can derive the specified level of value with the minimal cost. Without any ability to distinguish 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.

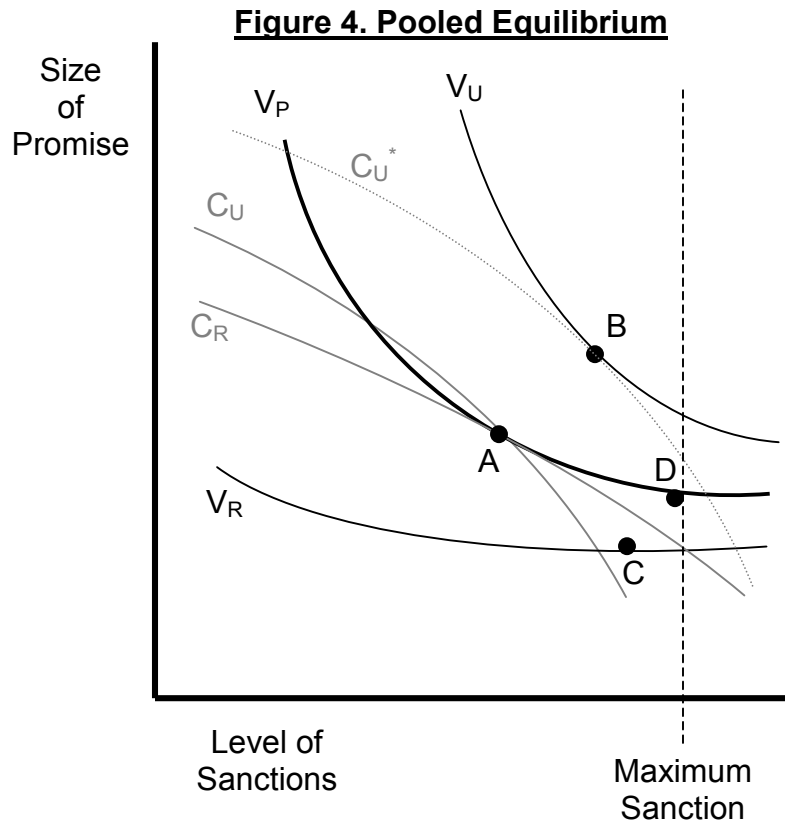
Yet, once the reliable promisors offer point C, unreliable promisors will no longer have the option of promising point A. Choosing anything other than point C would reveal that a promisor is unreliable. Instead, unreliable promisors must either follow the reliable promisors in

¹¹¹ 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.

¹¹² Again, the amount promisees offer in exchange for a promise depends on the promisor's perceived reliability, not actual reliability.

¹¹³ 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.

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 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.

As Ian Ayres describes the 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.”¹¹⁴ 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.¹¹⁵

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.¹¹⁶

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

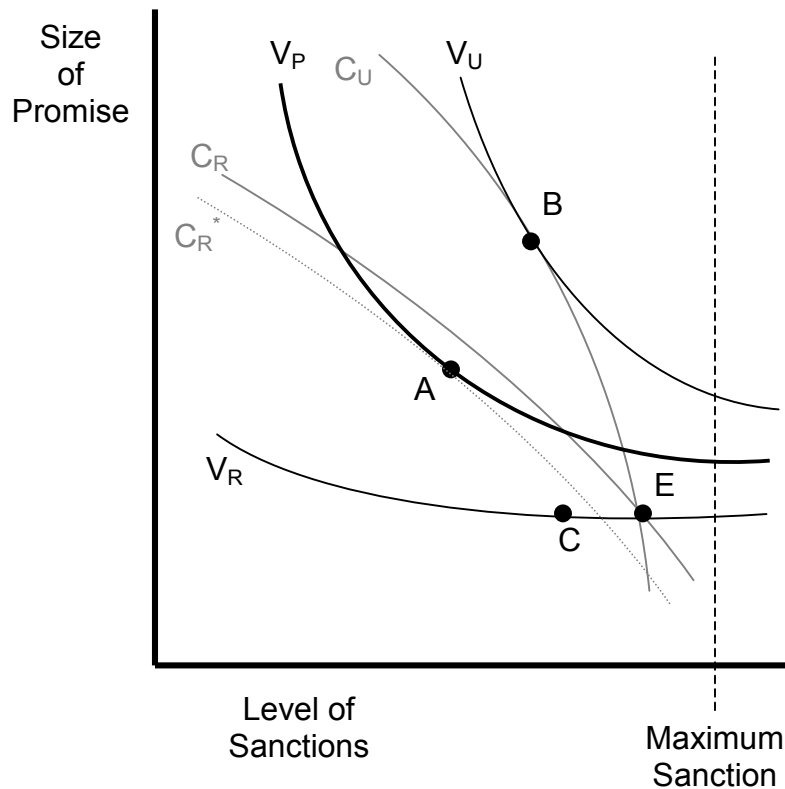
¹¹⁴ Ian Ayres, *The Possibility of Inefficient Corporate Contracts*, 60 U. CIN. L. REV. 387, 400 (1991). Ayres is discussing corporate charters rather than the consideration doctrine, but his description of the Aghion-Hermalin model remains valid.

¹¹⁵ *Id.* (describing a parable from DR. SEUSS, *THE SNEETCHES AND OTHER STORIES* 1-25 (1961)).

¹¹⁶ 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.

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

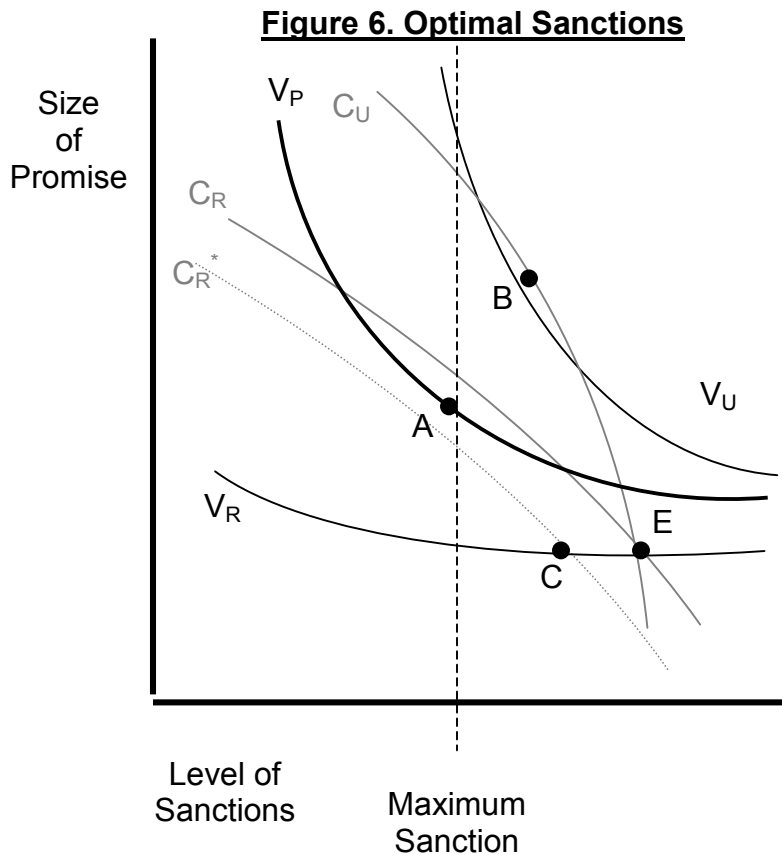


These inefficient outcomes can be prevented by setting the maximum sanctions at the appropriate level.¹¹⁷ Figure 6 shows how the promisors from Figure 5 could benefit by a

¹¹⁷ 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 83, at 397.

reduction in the maximum level of legal sanctions.¹¹⁸ 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.

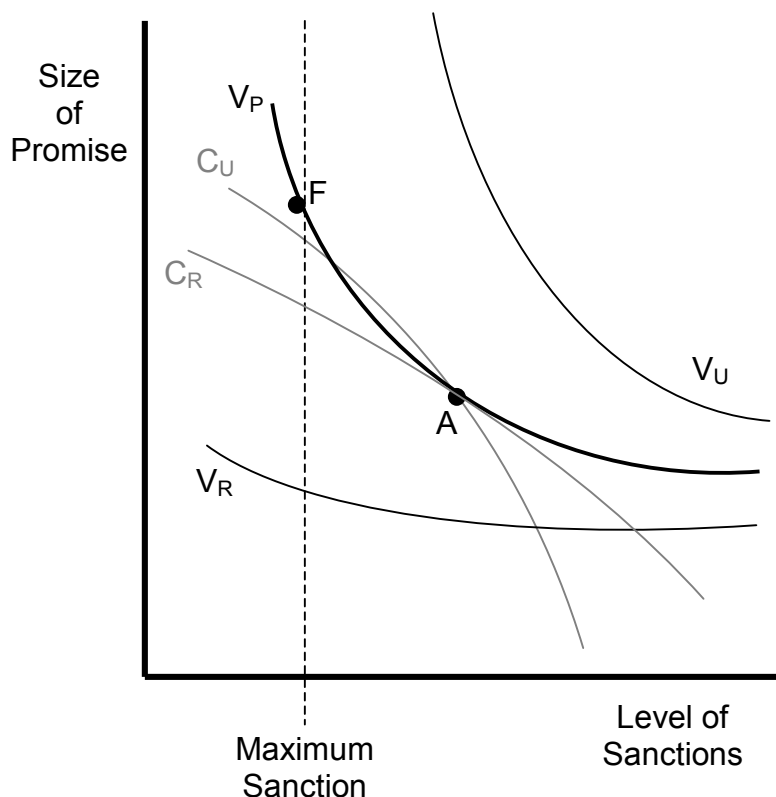


The Aghion-Hermalin model shows how a limit on the maximum level of legal sanctions can enhance welfare. By limiting the sanctions that a promisor can offer in the event of breach, the law can prevent inefficient signaling. As Aghion and Hermalin summarize their findings:

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.¹¹⁹

¹¹⁸ 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.

¹¹⁹ Aghion & Hermalin, *supra* note 83, at 403.

Figure 7. Inefficiently Low Sanctions

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 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 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? The Aghion-Hermalin model cannot answer this question. But it 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.

C. Extending the Model

The Aghion-Hermalin Model 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.¹²⁰

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. Readers who wish to avoid the mathematical analysis, and who are satisfied with the proof for the signaling spiral offered in the previous sections, may wish to skip ahead to section D where we discuss how the models apply to gratuitous promises.

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.¹²¹

Using the constant R as a placeholder coefficient, we express the benefit promisors receive from making a promise as: $(1-P_{avg})RX$. We discuss the nature of promisor benefit more fully in the next section. For now, it is enough to reiterate that promisor benefit increases with the size of the promise (X), but is discounted by the promisor's perceived reliability $(1-P_{avg})$.

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,

¹²⁰ 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.

¹²¹ 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.

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:¹²²

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

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.¹²³ As such, the welfare promisors derive from making binding promises can be expressed as:¹²⁴

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

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.¹²⁵ 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.¹²⁶

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

¹²² The first term corresponds with the promisor's value curves—Figure 1 in the previous section. The second and third terms combine to form the promisor's cost curves—Figure 2 in the previous section.

¹²³ 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.

¹²⁴ Although we label the equations as referring to actual welfare for simplicity and brevity, all four equations actually refer to expected welfare.

¹²⁵ 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.

¹²⁶ 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.¹²⁷ 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.¹²⁸ R is derived and then used as a constant.¹²⁹

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.

¹²⁷ 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.

¹²⁸ 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.

¹²⁹ 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.

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

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.¹³⁰ 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.¹³¹ Overall welfare is maximized by not allowing promisors the option of securing their promises through law.

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 Figure 9 suffer relatively smaller losses from the need to pay legal sanctions in the case of breach

¹³⁰ 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.

¹³¹ Promisee two also gains, even though promisor two does not.

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 by legal damages or when they are limited to the damages corresponding with social stigma. The model cannot answer this question. 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.¹³² As with Aghion and Hermalin's work, 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.

D. Applying the Models to Gratuitous Promises

Up to now, we have specified that promisors make promises in order to receive benefit without discussing the nature of this benefit. It is easy to see how this works in the case of exchange-oriented promises such as standard market transactions. An exchange-oriented promise is offered in return for something of value received directly from the promisee. How much the promisee offers in return depends on both the size of the promise and the promisor's perceived reliability.

These observations also hold for gratuitous promises. As with exchange-oriented promises, promisors make gratuitous promises in order to receive something of benefit in return. And as with exchange-oriented promises, the amount of this benefit depends on both the size of the promise and the promisor's perceived reliability.

In order to demonstrate these conclusions, we divide promises into four general categories based on promisor motivations.¹³³ In addition to being exchange-oriented, promises can be trust-building, status-enhancing, or altruistic.¹³⁴ As stated previously, promisors make exchange-oriented promises in order to receive a defined benefit from promisees in recognition

¹³² 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.

¹³³ These categories can overlap. In fact, most gratuitous promises are likely made based on multiple of the listed motives.

¹³⁴ 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.

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.¹³⁵ Similarly, 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.¹³⁶ 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.

Hence, regardless of the promisor's motives, we can view promises as being made in order to obtain something of benefit. And the magnitude of this benefit depends on the size of the promise. 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 promisors receive from making a promise also depends on the promisor's perceived reliability. In exchange-oriented promises, promisees will generally be willing to offer more in return for promises they view as likely to be fulfilled. Promisors thus immediately benefit from being viewed as reliable by receiving more in exchange for their promises. Similarly, for both trust-building and status-enhancing 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. Little status would be gained by a pauper's promise of a million-dollar donation. 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.¹³⁷

One might think that these immediate gains from perceived reliability would be negated by the possibility of greater losses in the future if the promisor ends up defaulting. It is easiest to see the flaws of this counter-argument as applied to exchange-oriented promises. Promisors garner any benefit received in trade immediately. In the event of later breach, they only suffer to the extent that their promise is enforced by legal or social sanctions. But the level of the

¹³⁵ See *supra* note 33 and accompanying text.

¹³⁶ 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.

¹³⁷ Since beneficial reliance is the primary purpose for making an altruistic promise to deliver a future benefit, rather than merely conveying that benefit at the future date, altruistic promisors should generally care about their perceived reliability.

sanctions cannot be conditioned on the promisor's actual reliability, as underlying reliability remains unobservable. Unreliable promisors face a greater likelihood that they will end up being subject to these sanctions. Still, their expected gains from promising remain higher when they are perceived as reliable. Being viewed as reliable increases the amount gained at the time of promising without raising the costs if breach occurs.

The same logic applies to trust-building and status-enhancing promises. Being perceived as reliable allows these promisors to immediately gain more trust or status as a result of promising. If the promisor later ends up defaulting, it will often be hard to tell whether the promisor was inherently unreliable or was a generally reliable promisor who just happened to have bad luck. No promisor is one hundred percent reliable. There are circumstances under which even the most reliable promisor will need to renege. So while promisors may lose status or trust in the future if they end up renegeing on the promise, they do not lose more when perceived as reliable than when perceived as unreliable. The expected value of the trust or status gained increases with the perception of the promisor's probability of performance.

Moreover, promisors should generally value immediate gains over potential future losses. The principle of discounting future gains is familiar for monetary values. Since exchange-oriented promises frequently involve goods or services capable of being priced, promisors should discount the value they attach to these goods or services. Whether trust and status are subject to discounting is a little less clear. But the fact that promisors can make trust-building or status-enhancing promises implies that trust and status can be gained by expending marketable resources. Hence, there is reason to think that future trust and status are also discounted, leading promisors to value immediate gains over potential future losses.

Since promisors benefit from being perceived as unlikely to default, unreliable promisors face incentives to mimic any statements made by reliable promisors. Consequently, promisors cannot directly communicate information about their probability of performance because their statements will not be believable.

Only in the case of pure altruistic promises might promisors lack any incentives to exaggerate their reliability. Unreliable altruistic promisors would not benefit promisees by exaggerating their reliability, since they would not want the promisees to place unwarranted confidence in them. However, reliable altruistic promisors can still benefit promisees by conveying the fact that they are reliable. Since being able to engage in beneficial reliance enhances promisee welfare and since altruistic promisors care about promisee welfare, altruistic promisors receive less benefit when their perceived reliability is lower than their actual reliability. Assuming that altruistic promisors cannot easily distinguish themselves from trust-building or status-enhancing promisors with a lower probability of performance, even altruistic promisors face incentives to signal their greater reliability by entering a legally binding form.¹³⁸

Both the Aghion-Hermalin model and our extension of that model apply as long as promisors promise in order to receive some benefit and as long as this benefit is correlated with both the size of the promise and the promisor's perceived reliability. These conditions generally hold for exchange-oriented promises and for all three types of gratuitous promises. Therefore, all four promisor types are potentially subject to the welfare-diminishing signaling described in the models. Regardless of a promisor's motives, the mere fact that parties employ a legally binding form does not indicate that they benefit from the existence of that form. Instead of trying to justify the consideration doctrine as a departure from the principle of honoring parties'

¹³⁸ See Steven Shavell, *supra* note 96.

intentions, we should ask whether the doctrine can serve as a mechanism for determining the circumstances under which parties would desire the option to enforce their promises through law.¹³⁹

III. RESOLVING THE PARADOX – THE ROLE OF ANTI-COMMODIFICATION NORMS

Contract law rests on the principle of enforcing parties' wishes as expressed at the time of contract formation. Yet as the previous Part demonstrated, the mere fact that parties exercise a legally binding option does not indicate that they desire the existence of that option. Under the assumptions of the models, creating a legally binding option can harm both promisors and promisees.

This Part examines the circumstances under which the assumptions of the models do and do not apply. Specifically, we consider the assumption that promises and contracts contain only two terms. In some social contexts, promises and contracts may be characterized by more than two terms. In addition to the previously discussed terms of the size of the promise and the level of sanctions, the parties can also specify a promise's scope and its level of return payments. We define the scope and return payment terms later in this Part.¹⁴⁰ In brief, the scope of a promise refers to the circumstances under which a promisor's performance will be excused. Return payments are what a promisee gives in exchange for a promise – in other words, consideration.

The circumstances under which promises and contracts can contain more than two terms are controlled by anti-commodification norms. In some social situations, explicit bargaining over the content of a promise is taboo. When anti-commodification norms hold sway, parties have limited ability to discuss promises using cost-benefit terminology or bargain-form language. Parties may thus find it socially awkward to negotiate a promise's scope or its level of return payments. Moreover, when anti-commodification norms limit parties to only two terms, the norms will frequently also block the use of consideration.

In order to activate the consideration doctrine, parties must articulate that a promise is being exchanged for something of value given in return. Describing a promise in this fashion may commodify the transaction by suggesting that the promisor is operating based on a cost-

¹³⁹ It is 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 83, 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 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 III.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.

¹⁴⁰ III.B.

benefit mindset rather than out of true concern for the promisee. Clearly, commodification presents no problem for some promises, such as those involved in market exchanges. But when promises occur within ritualized social contexts where the message sent by the promise is more important than the actual transaction, parties may find it socially impossible to invoke the consideration doctrine.

We argue that there is a substantial overlap between the circumstances where consideration is unavailable and the circumstances where parties are unable to adjust a promise's scope and its level of return payments. As such, we justify the consideration doctrine as a means for determining whether parties are able to fully bargain over their promises – by negotiating over more than two terms. When parties can voice consideration, they should generally be able to adjust the promise's scope and level of return payments. And when social norms block parties from articulating consideration, the norms will typically also limit the use of more than two contracting terms.

The inefficient signaling spirals described in Part II only occur when anti-commodification norms limit parties to two terms. The harm from inefficient signaling resulted from parties' reducing the size of their promises when signaling caused them to raise their level of sanctions by making their promises legally binding. Reductions in the size of a promise are costly because they prevent potential gains from trade. For most exchange-oriented and altruistic promises, we generally assume that transferring the promised goods or services from the promisor to the promisee increases social welfare. As compared to the promisors, the promisees typically either place greater value on the promised goods or services or else have greater need for these goods or services. When signaling spirals lead to reduced promise sizes, they thereby limit the promises' value-creating potential.

This result does not hold when promisors can adjust a promise's scope or its level of return payments instead of reducing the promise's size. Unlike reductions to the size of a promise, adjustments to a promise's scope or its level of return payments do not block gains from trade. Moreover, negotiating over the level of return payments can create additional gains from trade, and specifying a promise's scope can convey valuable information to the promisee. When social norms allow the use of multiple terms, inefficient signaling presents little cause for concern.

As such, the consideration doctrine is only available in circumstances where the harms from inefficient signaling are likely to be minimal. By only enforcing promises where the parties can articulate consideration – even if the consideration is a mere token – we can avoid the potential harm from inefficient signaling spirals.

To complete our analysis, we consider circumstances where parties cannot voice even nominal consideration. The models from Part II apply in these contexts, making it uncertain whether the parties would desire a legally binding option. With the welfare effects of allowing promises to be enforced ambiguous, we support a default rule of non-enforceability. We argue for this default rule based on a number of tie-breaking factors, such as the administrative costs of enforcement. We do not claim that any of these factors should supercede the parties' true desires. But in circumstances where the parties' expressed intentions may not reflect their underlying wishes, the tie-breaking factors justify a default rule against enforcing promises.

Where substantive theorists praise the consideration doctrine as a means for denying enforcement to gratuitous promises, and formalist theorists support the doctrine as a mechanism for determining parties' wishes, our justification relies on a different logic. Instead of distinguishing between gratuitous promises and exchanges, we value the consideration doctrine

for its potential to identify the circumstances where bargain-form language is socially permissible. Only when the parties can bargain without violating anti-commodification norms do we accept the formalist position that the law should enforce parties' intentions as expressed at the time of contract formation.

A. *Consideration and Anti-Commodification Norms*

Our justification for the consideration doctrine calls for a loose interpretation of the doctrine. In accordance with the First Restatement, but unlike the Second Restatement, we would enforce promises backed by nominal consideration. As such, parties could make their promises enforceable merely by voicing that the promise is being exchanged for some iota given in return. Even a penny would suffice.

We are not the first scholars to argue for enforcing promises backed only by nominal consideration. Many formalist commentators have reached the same conclusion. Yet these theorists view nominal consideration as a mechanism for determining whether a promise was intended to be legally binding. According to these accounts, any gratuitous promisor who wishes to make a promise binding can simply ask her promisee to offer some small amount in exchange for the promise. Consequently, parties could articulate nominal consideration whenever they want their promises to be enforced, making the doctrine a reasonably effective formalism for determining parties' wishes.¹⁴¹

What these accounts have failed to realize is that social norms sometimes prevent parties from voicing even nominal consideration. In order to invoke the consideration doctrine, the contractual parties must point to some form of recompense explicitly offered in return for the 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 is given as part of an exchange. As such, the language required to call forth the consideration doctrine may commodify the promise. Commodification of this sort can violate strong social taboos. These taboos serve to make the consideration doctrine effectively unavailable in certain social circumstances.

Scholars who write about commodification do not fully understand the phenomenon.¹⁴² We lack a consensus understanding for what categories of transactions are subject to commodification and for 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.

We discuss how norms against commodification can prevent parties from invoking the consideration doctrine by looking 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

¹⁴¹ Although, as we discussed earlier, other formalisms—such as a writing requirement—are probably superior for formalist purposes.

¹⁴² For a good sample of the recent controversies surrounding commodification, see Carol M. Rose, *Whither Commodification?* (Need cite for actual book. Partial manuscript on file with authors).

transactions are more important than the desire to transfer goods or services. When parties transact with the primary purpose of exchanging goods or services, anti-commodification norms seldom apply.

1. 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.¹⁴³ 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.¹⁴⁴

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.¹⁴⁵ “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.”¹⁴⁶ 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.¹⁴⁷

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.”¹⁴⁸ Any outward sign that a gift has been

¹⁴³ 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).

¹⁴⁴ 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 (“marketizing 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.”).

¹⁴⁵ 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))).

¹⁴⁶ GRAEBER, *supra* note 143, at 32.

¹⁴⁷ See Melvin Aron Eisenberg, *The World of Contract and the World of Gift*, 85 CALIF. L. REV. 821, 844-45 (1997).

¹⁴⁸ *Id.* at 843.

assigned a monetary value, by either the donor or the donee, is strictly forbidden.¹⁴⁹ 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, by implication, the relationship.¹⁵⁰ Similarly, a donor “cannot demand or require reciprocity without disqualifying her transfer as a gift”¹⁵¹ 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.¹⁵² 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.”¹⁵³ 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.”¹⁵⁴ Although the norms governing

¹⁴⁹ See, e.g., PIERRE BOURDIEU, *OUTLINE OF A THEORY OF PRACTICE* 172-73 (1988 trans. Richard Nice).

¹⁵⁰ See, e.g., Eisenberg, *supra* note 147, at 845 (noting that a gift of cash to an intimate “would be regarded as bizarre, deeply insulting, or both”).

¹⁵¹ *Id.* at 843.

¹⁵² 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”).

¹⁵³ MAUSS, *supra* note 144, 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.”).

¹⁵⁴ GRAEBER, *supra* note 143, at 28-29 (describing a prevailing anthropological school of thought); see also BOURDIEU, *supra* note 149, 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.”).

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.¹⁵⁵

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”¹⁵⁶ 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.’¹⁵⁷

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.”¹⁵⁸ 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.¹⁵⁹ 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

¹⁵⁵ This description corresponds with our category of trust-building promises. See Part II.D.

¹⁵⁶ MAUSS, *supra* note 144, at 1.

¹⁵⁷ MICHAEL WALZER, SPHERES OF JUSTICE 123-24 (1983).

¹⁵⁸ Carol M. Rose, *supra* note 148, at 16.

¹⁵⁹ 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).

transactions.¹⁶⁰ Though they undeniably engage in market behavior, it is impossible to accurately describe these actors as mere market participants.¹⁶¹

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.”¹⁶² To claim that all human interactions can be categorized as either “economic” or “social” is to ignore the complexity that attends real-world relationships.¹⁶³ Instead, it is necessary to recognize that different types of monetary transfers take place within different types of relationships.¹⁶⁴

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 is no more acceptable than asking one’s fiancée to pay for the cost of her engagement ring.

2. 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.¹⁶⁵ The use

¹⁶⁰ Deborah Stone, *Care and Trembling*, AMERICAN PROSPECT, Mar.-Apr. 1999, at 61.

¹⁶¹ 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.”).

¹⁶² Zelizer, *supra* note 159, at 7.

¹⁶³ 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”).

¹⁶⁴ See *id.* at 9. See generally VIVIAN A. ZELIZER, *THE SOCIAL MEANING OF MONEY* (1994).

¹⁶⁵ 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.¹⁶⁶ 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.”¹⁶⁷ 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.”¹⁶⁸

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 where baby-selling is taboo, adoption is fully acceptable.¹⁶⁹ Where the sale of organs is controversial, organ donation is laudable.¹⁷⁰ 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.¹⁷¹

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.”¹⁷² 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.”¹⁷³ 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.

¹⁶⁶ 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).

¹⁶⁷ Cohen, NOTE, “*The Price of Everything, the Value of Nothing: Reframing the Commodification Debate*,” HARV. L. REV. (summarizing the literature on commodification) (Need full cite, manuscript of file with authors)

¹⁶⁸ Sunstein, *supra* note 171.

¹⁶⁹ Radin & Sunder, *The Subject and Object of Commodification* 6

¹⁷⁰ *id.*

¹⁷¹ See *In re Baby M*, 537 A.2d 1227 (N.J. 1988).

¹⁷² Carol Rose, *supra* note 148, at 32 (summarizing an argument from Margaret Jane Radin, *Market Incommensurability*, 100 HARV. L. REV. 1849 (1987)).

¹⁷³ *Id.* at 33.

the non-market sphere can undermine the social norms and relationships needed for the non-market sphere to function.¹⁷⁴ 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.”¹⁷⁵ 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.¹⁷⁶ 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.¹⁷⁷

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.’”¹⁷⁸ 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.”¹⁷⁹

Dignity-based arguments draw support from Kant’s categorical imperative against treating humans only as a means.¹⁸⁰ 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.¹⁸¹ 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

¹⁷⁴ 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 165.

¹⁷⁵ ANDREW KIMBRELL, *THE HUMAN BODY SHOP* 35 (1993).

¹⁷⁶ Michael Walzer, *supra* note 163.

¹⁷⁷ 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.

¹⁷⁸ ELIZABETH ANDERSON, *VALUE IN ETHICS AND ECONOMICS* 144 (1993).

¹⁷⁹ *id.*

¹⁸⁰ IMMANUEL KANT, *GROUNDING FOR A METAPHYSICS OF MORALS* 429 (James W. Ellington trans., 1981) 1785).

¹⁸¹ 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.”¹⁸² 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.”¹⁸³ 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.”¹⁸⁴ 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.

3. 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.

Earlier, we divided promisor motivations into four categories: exchange-oriented, altruistic, trust-building, and status-enhancing.¹⁸⁵ The first motive explains market transactions, the other three correspond with donative promises and gift-giving. Promisors usually operate out of a combination of two or more of the listed motives, but different motives dominate for different transactions. To the extent we can explain the norms against vocalizing cost-benefit rationales in gift-giving contexts as rational behavior, the reason comes from the trust-building and status-enhancing motivations.

Looking first to status-enhancing gifts, donors 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 donors seeking to gain the appearance of being altruistic, whether the altruism is general or oriented toward a specific group or purpose. But there is a difference between being viewed as someone who wants to be seen as charitable

¹⁸² Carol M. Rose, *supra* note 178, at 24.

¹⁸³ *Id.* at 31

¹⁸⁴ *Id.* at 31-32.

¹⁸⁵ Part II.D.

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.¹⁸⁶ 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 gift 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. Remember, altruistic promisors are the only type who do not face incentives to exaggerate their probability of performance.¹⁸⁷ 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 desire to gain the item of value than by charitable inclinations. But if the parties claim that a promise is being exchanged for something of negligible value, 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.¹⁸⁸ 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

¹⁸⁶ B. Douglas Bernheim, *A Theory of Conformity*, 102 J. POL. ECON. 841 (1994).

¹⁸⁷ See Part II.D, *supra*.

¹⁸⁸ Amihai Glazer & Kai A. Konrad, *A Signaling Explanation for Charity*, 86 AM. ECON. REV. 1019, 1021 (1996).

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.¹⁸⁹ 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.¹⁹⁰ 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 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.¹⁹¹

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

¹⁸⁹ 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.

¹⁹⁰ Colin Camerer, *Gifts as Economic Signals and Social Symbols*, 94 AM. J. SOC. S180 (1988).

¹⁹¹ See Posner, *supra* note 138, at 10.

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.

4. 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 predict the circumstances under which social norms will block the commodification of transactions. Without taking sides in this debate, we cannot determine whether the set of non-commodifiable transactions is large or small. Even where 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. Our discussion of the commodification phenomena is necessarily incomplete. Even a partial survey of the topic would require several books. Within the limitations of a single article, we can only make vague generalizations about the contexts in which anti-commodification norms are likely to hold sway.

Nevertheless, we can draw a few conclusions from the literature. We can be fairly confident that anti-commodification norms deter at least some parties from articulating consideration. There is widespread agreement that social spaces exist wherein explicit bargaining would be taboo. Moreover, the three branches of knowledge make similar predictions about the 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. Even without knowing the precise nature or scope of the norms against commodification, these conclusions suffice to justify the consideration doctrine. The remaining two sections will demonstrate how.

B. 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 section completes the analysis by arguing against enforcing promises where parties cannot voice even nominal consideration.

When modeling inefficient signaling spirals in Part II, 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 the consideration doctrine only allows legal enforcement of promises when the costs of inefficient signaling are minimal is based on two claims. First, the potential for offering return payments and scope adjustments alleviates the harm from inefficient 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 frequently block parties from making return payments or scope adjustments. As such, inefficient signaling spirals will typically only be a problem where 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 promises' 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.¹⁹²

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.¹⁹³ 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.

¹⁹² See section I.B.1. for more on this point.

¹⁹³ III.A.3.

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.

Signaling through scope adjustments also avoids the harms from reducing a promise's size. The models in Part II 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.¹⁹⁴

¹⁹⁴ 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

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 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

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.

which are inappropriate to the emotional and moral realm of gifts.”¹⁹⁵ 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.¹⁹⁶ 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 their ability, and promisees are expected to understand if circumstances arise that make the promisor unable to perform.¹⁹⁷ 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.¹⁹⁸ 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.¹⁹⁹ 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.

¹⁹⁵ Jane B. Baron, *Gifts, Bargains, and Form*, 64 *IND. L.J.* 155, 196 (1989).

¹⁹⁶ III.A.3.

¹⁹⁷ See Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 58 *AM. SOC. REV.* 55 (1963).

¹⁹⁸ III.A.2.

¹⁹⁹ III.A.1.

When social norms block parties from voicing consideration, these norms will typically prevent return payments and scope adjustments as well.

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

C. 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 harms from inefficient signaling. 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 from Part II 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.”²⁰⁰ 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

²⁰⁰ Aghion & Hermalin, *supra* note 83, at 404.

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.²⁰¹

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.²⁰² 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.

1. 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,

²⁰¹ 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 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.

²⁰² 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.

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. When we are truly uncertain about whether the law could effectively monitor a social dispute, administrative costs form a tie-breaker justifying legal restraint.²⁰³

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.²⁰⁴ 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.²⁰⁵ 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.²⁰⁶

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

²⁰³ 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).

²⁰⁴ 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 and Swedberg eds., 1994).

²⁰⁵ Posner, *supra* note 82.

²⁰⁶ 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.

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 potential costs from signaling spirals are factored in, we might presume that enforcing these promises would generally reduce welfare.²⁰⁷

On a related note, our fourth tie-breaking factor looks back to our discussion of Philosophy and Political Theory. 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.²⁰⁸ 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

²⁰⁷ 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.

²⁰⁸ 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.

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

IV. CONCLUSION

Previous accounts of the consideration doctrine have been unable to justify requiring the bargain form but not inquiring into the adequacy of the consideration. In light of this paradox, some commentators of the substantivist persuasion have argued against enforcing promises backed only by nominal consideration. Instead, they favor requiring substantial—or greater—consideration. Other scholars have viewed the consideration doctrine as a flawed formality, and have argued for enforcing all promises that were clearly intended to be binding at the time of contract formation, even when consideration is absent.

Our inquiry began with the following questions: *How can we justify insisting on the bargain context but not requiring that the bargains be adequate? What purpose can bargains serve if the promises exchanged are not of comparable value?* Our answer looks to inefficient signaling and to anti-commodification norms. 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.

We thus provide a functional account of the consideration requirement that holds up even when the consideration is merely nominal.²⁰⁹ The consideration form serves to identify contexts in which parties can fully bargain over the content of their promises. What matters is not that the parties *do* offer consideration, but rather that the parties *can* articulate consideration. The key question is whether social norms permit bargaining over the terms of a promise. The use of consideration language informs courts that providing a legally binding option would likely enhance welfare. By voicing consideration, the parties demonstrate that their expressed intentions correspond with their underlying desires – that the 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 law have arisen from courts' attempts to determine which promises are socially valuable. These inquiries are misguided. When the consideration doctrine is interpreted to allow nominal consideration, the parties can make this determination instead of the courts. Whenever the parties care sufficiently about making their promises binding – valuing the substance of the transaction over any messages it might send – the parties can invoke consideration. The consideration requirement only denies enforcement

²⁰⁹ Of course, we only claim to resolve the paradox of the consideration doctrine in that we explain a functional account for the doctrine which can be used to guide case law. We do not argue that our account explains how the doctrine actually developed. Our solution to the paradox is normative, not descriptive.

when promises are made within a ritualized social context in which norms block parties from articulating even nominal consideration – a context in which inefficient signaling combines with tie-breaking factors so that enforcing these promises would likely diminish welfare.

Ultimately, our justification for the consideration doctrine provides stronger support for enforcing promises backed by nominal consideration than for failing to enforce all promises in which such consideration is lacking. Future empirical studies may show that the harm from inefficient signaling spirals is particularly low for certain types of non-commodifiable promises, or that the costs of preventing promisors from assuring promisees of their reliability are particularly high. For instance, future analysis might justify carving out an exception for donations promised to charitable organizations, enforcing these promises even when consideration is absent.

Yet our account of the consideration doctrine provides a new framework for analyzing whether exceptions of this sort are valid. It is not enough to claim that the exempted promises are socially valuable. 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 donations to charities above any potential harm to promisors, this would not necessarily justify excepting charitable 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.

Our discussion raises as many questions as it answers. In particular, we have only scratched the surface of exploring the potential implications of anti-commodification norms. We cite as a tie-breaking argument 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.²¹⁰ How courts should react to anti-commodification norms is an under-theorized question that merits further inquiry. What is certain is that anti-commodification norms play an important role in contract law, a role that has been largely overlooked by previous scholarship. Even if our overall conclusions turn out to be mistaken, we hope to have performed a valuable service by alerting contracts scholars to the need to study the anti-commodification phenomenon.

²¹⁰ 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.