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978-1-107-02007-8 - Contracts in the Real World: Stories of Popular Contracts and Why They Matter

Lawrence A. Cunningham

Excerpt

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INTRODUCTION

The wedding celebration of Leo and Elizabeth Facto took place on a humid August night in a New York City suburb. The ceremony was complete and their reception in full swing. They had rented a beautiful banquet hall, where champagne flowed, a band played, and a photographer preserved the memories. As the 150 guests kicked up their heels, one hour into the gala, an electric power failure gripped the region. The air conditioning shut down, the music died, and picture taking stopped.

Their night ruined, the Factos sued the banquet hall for a refund of the \$10,000 they paid months earlier when they signed their rental agreement. The Factos, like many people, thought a full refund was in order. After all, the Factos deserve sympathy, as they will never have their big celebration. The banquet hall countered that it was blameless for the regional power outage. It argued that the Factos had signed a contract to pay the \$10,000 and they should be bound to that.

The judge decided the case based on well-established principles of contract law that govern with an even hand.¹ The court noted that the banquet hall could not control the power grid, yet the outage made it impossible for the hall to perform its side of the deal. That meant the hall was excused from its duty to do so. But contract law also provides that when one side is excused from performing because of an uncontrollable event, the other side is excused too. So the Factos were likewise freed from their duty. However, to be fair, the court also ruled that the couple had to pay for the services they received. The hall was entitled to payment for decorations, candles, tables, and the food and

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beverages it served before the power outage; the Factos got a refund of the balance.

Contract law has wrestled with dilemmas like this for a long time and has forged well-worn paths through them. Solutions to contemporary problems, such as those the Factos encountered, can be found in cases that are scores or even hundreds of years old. Many people, among experts and the general public alike, wrongly think that such classic contract law cases makes the subject dusty and dull. They say the old cases are fossils of interest mostly because they reveal law's pathological streak and that contemporary legal education that teaches these specimens is outdated and out of touch.² This book's stories show that the classic cases are alive, well and bear directly on modern disputes that arise everyday, among ordinary folks such as the Factos as well as among the famous – from Coretta Scott King to Paris Hilton and Donald Trump; from poet Maya Angelou to novelist Clive Cussler; musicians Eminem, Lady Gaga, 50 Cent, and Rod Stewart; movie stars Sandra Bullock and Kevin Costner; and television personalities Conan O'Brien and Dan Rather.

Inherently interesting for their personalities and distinctive business or social settings – such stories stoke earnest discussions among neighbors and coworkers, in real time and online – these tales reveal contract law's remarkable capacity to use ancient principles to resolve today's puzzles. As the old saying goes, the more things change, the more they stay the same: Contract law principles timelessly thrive in the face of novel problems. Our credit card agreements differ from eighteenth-century promissory notes, but raise similar issues, like whether the rate is usurious and if late fees are part of the bargain. Attitudes shift about family life, transformations follow technological innovation, and standard form contracts proliferate. While people of goodwill debate the implications, most answers and general principles of contract law are readily adaptable to meet the needs in this ever-changing world.

Despite long-settled principles, moreover, a huge gap separates people's beliefs about contracts from the reality of contracts, a gap too often exploited by parties spinning the media, politicians grandstanding, and Internet and water cooler know-it-alls polluting what could be meaningful conversation. Many people think that promises must be kept, come hell or high water.³ They say promises are

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sacred and suppose that judges force people to perform them – as if Portia might have ordered Antonio’s pound of flesh paid to Shylock in Shakespeare’s “The Merchant of Venice.” Many believe judges punish those who breach promises. Some think that a valid contract must be signed, sealed, and delivered – as in the title of Stevie Wonder’s popular song. Hourly workers think companies can only fire them for “just cause.”⁴

This book’s tour of American contracts stories in the news will reveal how all these beliefs are mistaken. The gap between common belief and contract reality not only gives the devious or the ignorant tools to mislead others; it entices visionaries to recommend changes to contract law, often to conform to their political tastes. Moralists see in promise making a higher order of behavior that is sacrosanct and prescribe that promises must be kept.⁵ Economists think promise making can be measured solely in utilitarian terms. So they dictate choosing among alternative actions, such as performing a promise or breaching it, by comparing costs and benefits.⁶ Some on the political left suspect that contract law privileges the rich over the poor and the powerful over the weak. They urge a more egalitarian revision. Their foes on the political right declare that contract law is too paternalistic and yearn to oust normative law from the market altogether.

These positions can have considerable allure, for different reasons. Approaching the world with a measuring device like a utility function, and hunting for the efficient solution, offers the satisfaction of a definite course of action. Taking a contextual approach to problems and appreciating the plight of others brings the satisfaction of empathy. Despite allure, by showing how the settled doctrines of contract law have long served our widely accepted social and business goals, this book’s stories illuminate the flaws in these revisions. The book displays this body of ideas as holding a sensible center against extreme political positions and misguided populist intuitions.

To appreciate today’s clarity in contract law and its place in history, it is useful to recognize legendary figures dating back more than a century. In the 1870s, C. C. Langdell, as Dean of Harvard Law School, designed a simple way to organize the vast field of law, still used to this day. He thought that underlying law’s complexity were a handful of basic ideas. Examining leading cases organized around these

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ideas would reveal law's elements and rhythms.⁷ Common law actions, meaning those courts resolve one by one, were of greatest interest to Langdell and are the focus of this book. In the United States, following English traditions, common law is developed by state courts as disputes arise. Originally referring to law "common" to all citizens, today this system yields some variation among states, but general principles tend to prevail.⁸ Although the common law evolves as society and the economy change, judges draw on precedents when evaluating new cases, under the principle of *stare decisis*.⁹

Langdell organized the welter of cases on numerous topics according to basic questions: how, what, and why. The question of *how* isolates the procedures private parties follow when resolving disputes using civil litigation – like the Facto's wedding fiasco. This is the practice of the lawsuit, arranged into the subfield of study called civil procedure. The question of *what* addresses the stakes in a lawsuit, pivoting around entitlement to property. This involves drawing the lines of ownership, such as between what belongs to the Factos and what belongs to the banquet hall. Most pertinent, the question of *why* investigates justifications courts give when requiring property to change hands.

The answer to "why" is because of a judgment that one party instead of another is entitled to a sum of money or other property. Dean Langdell identified two sources of these obligations. One arises from behavior required of all people living in a civil society, called the law of torts, epitomized by the idea of negligence. The other comes from self-imposed undertakings, usually by a promise or an agreement, called the law of contracts. These two fields, torts and contracts, define the scope of civil obligation that courts may enforce. Civil obligation contrasts with criminal law. The substance of criminal law consists of invasions by a person of the rights of another or of the public (like treason) so serious as to require public force (the police and district attorney), not just private remedy, to redress. Such public interests also appear in constitutional law, which sets basic rights of individuals, as against government, plus the powers of the states in relation to each other, and to the federal government.

Contract law asks the vital question: Of all the promises made in the world, which should be recognized as enforceable in court? Equally important, it asks, among enforceable obligations, what remedy should

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be awarded upon breach? There are many promises contract law views as unenforceable. For example, contract law does not recognize social promises such as dinner dates as warranting enforcement,¹⁰ nor does it enforce most promises to make gifts. Instead, contract law concentrates on bargained-for transactions – such as promises to borrow and lend money or rent a car or banquet hall. There are also bargains that are enforceable even though a promise is not made. A customer who drops off suits at a dry cleaner owes the price for the service when performed, whether any promise was made or not.¹¹ A doctor who treats an unconscious person prone in the street is entitled to recover the reasonable value of services rendered, even though the patient obviously promised nothing.¹²

The substance of contract law expresses a political philosophy. In a capitalist society, contracts and contract law are essential. Where people are free to own and exchange property, contracts and contract law establish ownership and facilitate commerce. “Freedom of contract” describes an approach of deference to private autonomy and individualism. It means courts have a limited, albeit crucial, role: to decide whether contractual liability exists and order appropriate remedies for breach. Freedom of contract can be a wonderful way to unleash creative energies and expand productive capacity and well-being. Yet contractual freedom is neither unchecked nor unbridled. Government regulation provides social control over individuals by curtailing licentious pursuits of self-interest. Governmental regulation aims to protect people from the unscrupulous who would take advantage of contract law’s freedom. “Freedom *from* contract” provides a way to limit such exploitation. This gives courts a broader role. They decide not only questions of liability and remedy, but police against objectionable bargains.

Conflicts can arise between private autonomy and state regulation but, in contract law, there is remarkable harmony between the two: You can bargain for anything you want – almost. But that does not stop people from advocating that contract law should move toward the extremes. Devotees of pure capitalism, on the political right, campaign for uncompromising devotion to freedom of contract and resist state regulation that limits individual autonomy or contractual possibilities in any way. Opponents of rampant capitalism, on the political left,

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vigorously object to such rugged individualism, pushing for substantial social control and stressing freedom *from* contract. They exhort judges to review bargains for fairness or impress standards of behavior on people even if they did not agree to accept them.

Contract law in the United States reflects neither extreme. U.S. citizens may be conservative or liberal, Republican or Democrat, even libertarian or socialist. But the country, as a whole, is none of those things and neither is its contract law. The country's practices are capitalist and democratic, capacious notions stressing both entrepreneurship and responsibility.¹³ The nation's contract law gives enormous but not unlimited space for freedom of contract. Of course, contract law is dynamic, adapting as society and the economy change. And the philosophies of particular judges in individual cases affect their analysis and sometimes the resolution of a dispute. But contract law's evolution and its application by particular judges has vacillated within stable, practical boundaries.¹⁴ These boundaries are well defined by two other titans in the law of contracts: Samuel Williston and Arthur Corbin.

In 1920, Williston, a Harvard colleague of Langdell's, published a monumental treatise on the entire law of contracts and kept it updated until his death in 1963. In 1950, Arthur Corbin, a professor at Yale, promulgated an equally magisterial and comprehensive treatise based on earlier writings throughout his career. These works – still kept up to date by successor editors – have influenced generations of lawyers and judges addressing contract disputes.¹⁵ Williston's philosophy dovetailed with that of the eminent jurist, Oliver Wendell Holmes, Jr., and Corbin's resonated with that of the esteemed judge, Benjamin N. Cardozo.

Williston epitomized a formalist approach to law and reflected what some call the "classical" school of contract. It looks to whether parties in a transaction were giving and getting something, emphasizing a concept called "consideration" as the signal of an enforceable contract. This school of thought held unenforceable not only promises to make gifts or attend dinner, but promises merely inducing another party to take some action. In this view, the remedy for breach of a bargain is to pay the injured party money to put them in the same economic position they would have enjoyed had the other performed. This classical

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conception of contract law dominated well into the twentieth century and remains a force today.

Corbin took a realist approach to law and offered a more pragmatic conception of contract. Although agreeing with Williston on many points, Corbin recognized, as courts increasingly did in the twentieth century, a wider range of circumstances that create contractual obligations. Williston's bargain model of consideration remained, but loosened so that even some promises to make gifts could be enforced, so long as there was an identifiable return, like naming a college endowment.¹⁶ It recognized reliance on a promise as a basis of contractual liability, in a novel doctrine commonly called "promissory estoppel."¹⁷ Compensation for disappointed expectations remains the primary measure of remedy. But recognizing promissory estoppel gave equal dignity to measuring remedies by out-of-pocket costs incurred relying on a promise.¹⁸

These twentieth-century developments that Corbin captured and helped shape reflected broader social developments as well, moving law's orientation from a formalist to a realist conception. For example, classical contract's relative strictness, limiting the scope of contractual obligation, was accompanied by an equivalent strictness of enforcement: If a contract was hard to get into, it was also hard to get out of. People could be bound to contracts that were made based on mutually mistaken assumptions, or even where performance became impossible. But as the ambit of contractual obligation expanded, so did grounds for excusing it, like mutual mistake about the terms of a trade, or impossibility of performance, such as a power outage in a rented banquet hall. Similarly, classical contract law venerated written records, limiting the scope of obligation to what was plainly meant within a document's four corners. Corbin and his realist descendants were more willing to consider evidence supplementing these written expressions.

An example of this shift appears in a classic case from the 1920s.¹⁹ In the fall of 1923, the Laths proposed selling their Schenectady (New York) farm to the Mitchills.²⁰ The parties discussed how the Laths would remove an unsightly ice house they owned on the property of a neighbor. Their written contract took an elaborate form, containing a wealth of recitals about price, insurance, water supply, a land survey,

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a deed, and broker's commissions. It said nothing about removing the ice house. After the deal closed, the Mitchills renovated the place for use as a summer home and sued the Laths for failing to remove the ice house. The Laths stressed that the two couples had written up an elaborate contract that said nothing about any ice house. The Mitchills tried to persuade the court to look beyond the writing to the discussions they said the couples had about the ice house.

The court sided with the Laths. Judge William Andrews, an acolyte of Williston, explained that the written agreement, with its wealth of recitals, looked complete. Had the parties made a deal about removing an ice house, he would naturally have expected to see it in the writing. Therefore, the Mitchills were not even allowed to present at a trial any testimony about their negotiations with the Laths. In dissent, Judge Irving Lehman, more in tune with Corbin, was skeptical. When deciding whether the contract was complete, he took the negotiations into account and, with them in mind, said he would *not* naturally expect a side deal about the ice house to be included in the writing.

Judge Andrews reflected the era's dominant view: classical, formal, "four-corners." Lehman was ahead of his time, reflecting the ascendant view: contemporary, realistic, contextual. But even these oppositions are neither extreme nor ironclad, as Cardozo, a realist, joined the majority opinion in the case, siding with Andrews, not Lehman. The positions of these judges in this typical case show that most of the disagreements within contract law are differences with a practical rather than an ideological edge. The case was not about the rich or poor, the powerful or the oppressed, or a fight between freedom and control. Like most issues contract law addresses, it was about a pragmatic question: What weight to give a written contract compared to oral negotiations? Healthy debate continues about this and many other questions that divided titans like Williston and Corbin, although the range of credible debate is substantially bounded by positions those two staked out.

Unbounded is the range of subjects contracts involve, which is as large as life. Contract law addresses all exchange transactions and the universe of promises. Given such a sprawling enterprise, expect to find occasional tensions or contradictions between cases or within doctrines, or variation among states. Despite such findings, however, which tend

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to be clearest at microscopic levels of inspection, contract law shows a surprising degree of coherence across settings and geography.

Many have tried to provide a grand theory of contract law, but it is unsurprising that contract law's vastness defies tidy explanation using any single account. True, much of contract law is based on promises, but not all promises are recognized as legally binding;²¹ much of contract law probes whether people have consented to some exchange, but it is likewise true that not every consented deal is valid, and liability can attach even though consent is not obvious.²² It is particularly difficult to explain everything about contract law in terms of protecting people when they rely on others²³ or determining which arrangements are the most economically efficient,²⁴ although both reliance and efficiency are often relevant. If pressed, the best way to account for the vast run of contract law doctrine is pragmatism – a search for what is useful to facilitate exchange transactions people should be free to pursue.²⁵

Famous books have been published that consciously demonstrate not contract law's coherence, but its tensions, contradictions, and the dissolution of Langdell's revered categories, including the venerable distinction between torts and contracts.²⁶ Other approaches include the "law in action" movement, which insists that in contracting, business reality is more important than the law.²⁷ Proponents joined critics of Langdell's "case method" to debunk the practice of learning contracts from common law opinions, saying that was akin to learning zoology by focusing on unicorns and dodos.²⁸ Although influential, these tidings did not transform the field, which is still readily learned by the reading of opinions in individual cases and stitching them together into a tapestry of knowledge. The stories in this book take a similar approach, each one explaining its setting and then stating and resolving the conflict. They explore recurring issues people face in contracting and, in line with the concept of *stare decisis*, show how previous cases and their rationales apply to evaluate arguments.

Remarkably, this book recounts only forty-five main stories, along with as many supplemental tales, yet its insights are relevant to billions of people and contracts. The great majority of deals are made and completed without giving contracts or contract law the slightest thought. Only a tiny fraction trigger disputes of the kind these stories tell. Much as we breathe without thinking about the indispensability of

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oxygen, however, those invisible qualities of contract law enable doing deals without conscious thought on the subject. Keeping it that way means that people should appreciate how principles germinated generations ago remain vital to resolve ongoing challenges, know enough to discuss stories of contracts in the news intelligently and check those advocating extreme changes. This book, by telling entertaining stories capturing the essentials of this subject, aims to promote those goals.