Introduction

Understanding Implied Obligations: Reasoning and Methodology

REASONING ABOUT OBLIGATIONS

Formidable barriers stand in the way of developing a unifying theory of contracts. When disputes arise, contract terms may fail to provide an unambiguous basis for determining obligations; indeterminate terms, unexpressed but implied obligations, and unaddressed ex post circumstances all require a basis from which we can use the raw material of the exchange, its text and context, to determine each party's obligations. The variety of subject matter, promissory utterances, and relationships based on promising and contracting add layers of complexity to any effort to find a single method for deciphering obligations. We might wonder whether we should ever hope to develop a unified mental map for evaluating promissory relationships as different, for example, as intimate social relationships and detailed provisions for maximizing cooperation over time. The variety is capacious enough to house many kinds of theories, but the realm is diverse enough to suggest the impossibility of a general, coherent theory of contracting and promissory obligations.

Moreover, although it is widely understood that contracting requires the parties to identify and allocate the risks that threaten their relationship's success, and that the allocation of risks determines a party's obligations, it is not always clear how the parties have in fact allocated risks. Risks, and thus obligations, are the subject of the exchange and therefore cannot be assumed to fall one way or the other until we fully understand the exchange's bargaining dynamics. If a party rents an apartment from which to see a coronation parade, one would think that that party would bear the risk of the coronation being cancelled. Yet, if the party informs the owner of the reason for the rental, the risk can easily shift to the owner.[1]

Any approach to promising and contracting must also account for both the person who would take advantage of the other party (the Holmesian bad person) and the person who would do the right thing once they knew what was right in the

[1] *See* Chapter 13 ("Excused Performance and Risk Allocation").

circumstances (the Hartian good person).[2] Indeed, depending on the context, the good and the bad person may inhabit the *same* person. That puts in play the concept of a contract. Are we to think of promising and contracting as a struggle between two parties with proclivities to take advantage of each other, or as mechanisms for achieving collaborative outcomes? And if the answer is that we need to do both, how do we maximize cooperative solutions while inhibiting opportunism or shading? How do we simultaneously encourage and control the power that promises and contracts entail? Should contracting be conceived as an adversarial process by which one party can seek to control the darker angels of the other party, or should contracting be perceived as a process of building trust and shared goals?

Contract law has mechanisms for addressing these questions, of course: gaps fillers, interpretive techniques, and rules concerning consideration, promissory estoppel, excuse, and remedies. And contract theory has plenty of ideas about what contract law does, how it functions, what obligations it entails, and how contract law facilitates cooperation and wealth production. But how are we to choose among those ideas, and on what basis should we make a choice between ideas that seem to offer conflicting visions? Philosophers reason on the basis of moral principles or social practices to determine the obligations that promising and contracting entail. They seek to determine fair or moral obligations from the raw material of promising and contracting. Economists, on the other hand, emphasize that promising and contracting increase wealth. They seek, from the same raw material, to determine efficient incentives. Is the search for justified end points doomed by our choice of starting points?

Before we give in to balkanization (with different theories for various kinds of promises and contracts) or to pluralist surrender,[3] we might turn to a mental model that explores a method of nondoctrinal reasoning about obligations as a possible unifying lens. That is what this book proposes. Starting with the intuition that beneath the diverse views about promising and contracting lies a realm of reasoning that supports, justifies, and explains what we know, this book explores a realm of reason that seems to be common to, and undergird, a wide variety of views about contracting.

Consider the possibility of focusing on how people ought to reason about their obligations, given the text and context of their relationships. We might find

[2] The role of these two prototype persons in legal theory is discussed in Chapter 8 ("Relationality Redux: Law on the Ground and Law on the Books").

[3] Two trends threaten the unity of thought about promises and contracts. One is the trend toward bespoke rules for different kinds of contracts, suggesting that we need different rules for contracts between sophisticated business people and, say, between sellers and consumers. The other threat to the unity of promising and contracting is the trend toward pluralistic theories – theories that highlight various values but fail to provide a way of understanding the relationship between them. *See* Kreitner (2011–2012); Bix (2012). Resort to a pluralistic theory is unnecessary and unwise. Pluralistic theories are essentially anti-theories, denying the idea that we can understand how those values relate to, or ought to be understood in relation to, one another.

a method of reasoning that, because of its properties, displays the hallmarks of moral reasoning about relationships: neutrality, universality, and allegiance to relational expectations. We might also find that the same method of reasoning is used by people who want to minimize costs and maximize the gains from exchange. That is what this book seeks to do. By asking the parties to understand their individual interests in terms of the social values that their personal interests would advance, and then asking the parties to reason about how contested values ought to be balanced behind the veil of ignorance, we can identify which decisions were made with the proper moral and maximizing reasoning. Under this approach, the parties are obligated to subject their private interests to the interests of the relationship by reasoning about the relative weight of contesting values as if they did not know how the resulting rules would affect their private interests.

Consider the situation of parties facing a dispute. Rather than resorting to doctrine as a dispute settlement mechanism, this book offers a method of reasoning as the way of filling the gap of indeterminacy in doctrine and theory. Nondoctrinal reasoning allows the parties to address whether the contractual language is imprecise or incomplete, how the contractual language ought to be interpreted, and what to do when unanticipated events arise. Reasoning helps implement legal doctrine when legal requirements are vague, amorphous, or incomplete.[4] And because not all promises are legally enforceable, reasoning helps appreciate why and when some obligations are relegated to relational settlement.

Consider also the role of nondoctrinal reasoning in resolving disputes. The law provides the basis on which disputes are to be resolved; that basis has to be generalizable to assist in resolving similar disputes. The law's quest is to find the basis for determining obligations when the parties, unable to resolve their disputes, resort to third party dispute resolution. Dispute resolution ought to be faithful to the choices the parties made while providing authoritative guidance for future disputes. Courts face bounded knowledge[5] and conflicting information about the trade-offs the parties made, and the cost of acquiring and processing relevant information is itself a cost of contracting, a cost that is magnified if contracting parties lack confidence in a court's ability to interpret the conflict to reflect their exchange. Courts are in the position of attempting simultaneously to minimize dispute resolution's information and the error costs, which covary.[6] But a sound method of

[4] *See, e.g.*, Cohen (2011) at 128 ("[i]t seems fair to say, however, that many if not most contracts are incomplete, or at least the question of their completeness is itself a legitimate question for judicial interpretation.").

[5] *See* Williamson (1985) at 44 ("[Bounded rationality] acknowledges limits on cognitive competence" and it is "the cognitive assumption on which transaction cost economics relies."). This assumption assumes that economic actors are "*intendedly* rational, but only *limitedly* so." (quoting Simon (1996) at 45) (emphasis in original). *See also* Crawford (2013) at 512; Harstad & Selten (2013) at 496; and Rabin (2013) at 528.

[6] Minimizing error costs requires investment. Schwartz & Scott (2003) at 577 (emphasizing that because contracts are incomplete "firms will attempt to write contracts with sufficient clarity to permit courts to

nondoctrinal reasoning about obligations reduces information costs (by identifying what information is necessary) and error costs (by allowing precise justifications), thus reducing the costs of contracting.

Importantly, the authoritative guidance we expect from judicial dispute resolution is most successful if judges make transparent the method of reasoning that the promising, contracting parties ought to use when addressing a dispute over their obligations. Such transparency helps to align how judges think about obligations with the method the parties ought to use to think about obligations. If parties to a contract use identical methods of reasoning about obligations, they can settle disputes on their own. If the parties cannot settle the dispute, one of them is reasoning in the wrong way, and the court ought to correct that method of reasoning.[7]

This book explores a supplemental method of legal reasoning in three parts. Part I justifies the search for reasoning that undergirds authority and theory. Chapter 1 sets out three characteristics of promising and contracting that seem to characterize promissory obligations: relationality, self-directedness, and contextuality. Relationality emphasizes the interdependence of promissory obligations: a promise is to someone to do something, and the other person reacts to the promise. Promises of the kind that contract law addresses are other-directed. Yet, promises are also self-directed; they seek to advance the private projects of the promisor. This duality identifies the tension of promising: promises are self-directed, but create a form of interdependence that requires other-directed decisionmaking. Promises are also highly contextual: a promise to have lunch with a friend is different from a promise to have lunch with a potential business partner. Reasoning about obligations must be able to take context into account, which begs the question of which contextual details matter, and why they matter.

The remainder of Part I examines various approaches to promising and contracting and finds their implementation to require supplemental reasoning. Chapter 2 presents a legal realist critique of reasoning from authority; it argues that reasoning from authority (legal reasoning) does not fully reveal the reasoning process that is necessary to implement the authority in individual contexts. The chapter does not deny the authority of authority; it locates that authority in nondoctrinal reasoning rather than in command. In addition to pointing out the difficulty of implementing

find correct answers, though with error."); *see also* Posner (2005) (discussing the relationship between negotiating, drafting, interpretive, and enforcement costs).

7 Implicitly, this approach views the common law to be a dispute settlement process rather than a rule-making process. To be sure, the resolution of individual disputes can form the grounds for determining rules to govern behavior, but those rules are rarely stated with sufficient justificatory specificity to govern the contingencies of the next dispute. For that reason, the settlement of relational disputes does not turn on a rule but instead on a way of reasoning about the circumstances that allow the parties and legal decisionmakers to determine how parties in a relationship ought to treat each other. That is what courts do when they settle a dispute, whether they do so by referring to the terms of a promise, legal rules, or the circumstances that determined the outcome of prior disputes. Courts implement rules through reasoning, and that reasoning displays the method of reasoning courts want the parties to use.

legal doctrine and concepts without a supplemental method of reasoning, the chapter makes an important point about contract theory. Because promising and contracting have the quality of relationality, no single value can capture the essence of promising and contracting. Promising and contracting involve the autonomy, reliance, empowerment, consent, wealth, and well-being of at least two people, and those valuable attributes clash. What we value for one party is at odds with what we value for the other party; we care about the autonomy of both parties, and sometimes their autonomy pulls in opposite directions. There must be some basis for deciding whose autonomy, reliance, empowerment, consent, wealth, and well-being matter.

The final two chapters of Part I examine philosophical and economic theories. Although these theories are themselves diverse, they seem to suffer from indeterminacy and therefore from insufficient justificatory and implementary reasoning. Moral principle theories provide a moral justification, but to be implemented, they call for a moral implementary reasoning. Social practice theories, because of their contextuality, can be implemented through the context that reveals the social practices, but they call for a form of reasoning that justifies the morality of practices. Moral principle and practice approaches can both be profitably supplemented with a method of reasoning that contextually examines the source and scope of obligations.

Economic theories are theories of maximization; they capture the relationality and contextuality of promising and contracting. Yet, even if we view economic theories through a broader maximand (say well-being rather than wealth), maximization theories seem to be indeterminate without a supplementary mode of reasoning. Given transaction costs, the ability of bargaining parties to choose from among a range of trade-offs, and inevitable contractual gaps (including gaps from ambiguous language), it is difficult to determine from the existence of a contract the performance obligations the parties agreed to. Only an interpretation that reflects the exchange the parties made will support the institution of contracting and enhance socially valuable transacting.[8] Yet when disputes arise it is because the terms of the contract have run out; then obligations must be determined by identifying how the parties implicitly assigned various risks, their shared but unarticulated assumptions, and the obligations that flow naturally from the choices the parties made. Those issues also call for a method of reasoning about the source and scope of obligations.

Having sought to establish that legal authority and theory would profit from a supplemental method of reasoning, Part II of the book presents the outline of an appropriate method of relational reasoning. The central characteristic of this

[8] Schwartz and Scott note that the "goal of contract interpretation is to have the enforcing court find the 'correct answer.'" Schwartz & Scott (2003). One of the justifications for finding the correct answer is "consistent with an efficiency-based view of contract law" in which "parties contract to maximize the surplus that their deal can create." *Id.* That "goal is unattainable if courts fail to enforce the parties' solution but rather impose some other solution." *Id.*

method of reasoning is that it is nondoctrinal; it does not start with authority, doctrine, or theory. Instead, it displays a method of reasoning about the contest of values implicated in a dispute, suggests a method of choosing among the relevant values, and ends up with a decision that respects both sets of values but reconciles them in a fair and efficient way. I call it values-balancing reasoning.

Values-balancing reasoning posits that a contractual dispute represents a contest between conflicting values, say reliance and freedom to change one's mind. It identifies those values and provides a method for determining how to reconcile them in particular contexts. Because this mental model focuses on how conflicting values ought to be reconciled, the mental model focuses on a process (a methodology) of reasoning rather than on the rules generated by the process of reasoning.[9] Because the mental model takes into account the values presented by two autonomous persons, it serves to supplement and implement approaches that are based on a single value – such as fairness or efficiency.[10] And because the mental model is trans-contextual, I offer it as a possible unifying methodology for understanding contract law.[11]

This mental model claims to be moral reasoning because it recognizes that reasoning is built on values that are universal, neutral, and attentive to relational expectations. The model is maximizing because it recognizes that values must be traded off against each other and that what matters are the consequences of that trade-off for the well-being of two persons. The theory of reasoning purports to identify obligations that are both fair and efficient precisely because they come from a method of reasoning that is both deontic and consequential.

Two key ideas animate this method of reasoning. The first is that it is rational to take into account the well-being of others when making decisions, and thus to make other-regarding decisions. Economic rationality is not limited to self-interest; it is

[9] The ideas presented here have many ancestors. I build on the path suggested by James Gordley, namely that contract law involves the Aristotelian concern with "what people should choose to do" once they are in a relationship. Gordley (2001) at 268. Under this conception, contract law "is concerned with how, through voluntary agreements, people are able to get things that help them lead a better life while being fair to others. Consequently it is concerned with the value of what is chosen, with the value of choosing rightly." *Id.* Similarly, I seek to amplify, and provide implementing details for, the philosophical theory of Daniel Markovits (Markovits 2003–2004) that the morality of contracts is determined by the independent value of relationships among people, the collaborative community. He has, for example, captured the spirit of the other-regarding person; the obligation of good faith is neither the duty to act in your contract partner's best interests, nor is it license to act in whatever way would best serve your own. It is, instead, a commitment to the relationship "structured around a shared understanding of a voluntary obligation." *Id.* at 292. Under the view presented here, the obligations of contracting are reciprocal obligations of each party to employ a method of reasoning that is tethered to the terms and context of the relationship.

[10] By supplementing theories of fairness and efficiency, I add to efforts to find common ground between these two concepts. *See, e.g.*, Kraus (2000) and Kraus (2007).

[11] This discussion was also foreshadowed by Bratman (2006) (developing a theory of shared reasoning to accomplish cooperative activities) and by Shapiro (2011) (developing a theory of law as planning that allows us to see the law of a contract as a process of reasoned planning).

often efficient to rely on others and to internalize their well-being into one's decisions. Humans do not choose between self-interested or altruistic motivations; their self-interest also leads humans to be other-regarding. Indeed, contracting would be difficult if bargaining partners were oblivious to the interests of the counterparty. "Getting to yes" (as it were) is not just an exercise of self-interest; it is an exercise of choices that are other-directed to advance self-directed interests.

The second central idea of Part II is that obligations do not arise by operation of law out of thin air; obligations flow from, and are reflected in, the choices that people make. The obligations that flow from personal choices are then recognized by law. A person is under one set of obligations if a person decides to make fireworks; the person is under a different set of obligations if a person decides to join a monastery. Obligations are self-imposed in the sense that they follow the choices people make. The idea of self-imposed obligations and other-regarding choices are related. The choices one makes often imply the obligation to be other-regarding, the choices are not just self-directed but, because they affect others, are other-directed. That other-directedness is the source of obligations to others. Part II ends by showing how values-balancing reasoning illuminates and explains the relationship between law on the ground and law on the books, the nature of cooperation, the development of trust in relationships, and the dynamic of order without law.

Part III of the book then applies the idea of values-balancing reasoning to enduring doctrinal controversies: formation, performance, the problem of standard terms, doctrines that excuse performance, and remedies. Because values-balancing reasoning is non-doctrinal reasoning, it yields interesting insights about the source and implementation of contract doctrine.

The application chapters in Part III amplify and illustrate the book's Part I claims that reasoning from authority is, without more, an inadequate basis for reasoning about promissory and contractual relationships. They also show the way in which values-balancing, other-regarding reasoning implements legal doctrine. The chapters do something more: they suggest that reasoning about obligations precedes doctrine and that, in fact, doctrine is the concluding point, rather than the starting point. for appropriate reasoning. This allows values-balancing reasoning to focus directly on the issue for which doctrine is giving an answer, and thus, in a sense, to replace doctrine. Under this view, consideration doctrine becomes the answer to this question: At what point can a promisor no longer revoke or modify a promise? Implied obligations, (including good faith) become the answer to this question: When a promisor makes a choice, what kind of obligations are naturally implied by that choice? The doctrine surrounding standard term contracts becomes the answer to the question: Would the counterparty reasonably have expected to encounter these terms? The doctrine of excuse becomes the answer to the question: Given the circumstances of the exchange, which party bore the risk of unaddressed future events? And questions surrounding contractual remedies are driven by this question:

Given the context of the exchange, what implied remedial promises did the parties make?

The application chapters also reinforce the contextuality of promising and contracting. In the approach offered here, we do not seek a hypothetical set of obligations, nor determine what most people, or most reasonable people, would have thought their obligations to be. Those are counterfactual questions that by their nature may differ from the obligations the parties agreed to.[12] We will search, instead, for the obligations that a person reasoning in a values-balancing, other-regarding way would have understood about how the parties divided the risks, the proper interpretation of a disputed term, the implied terms that are binding on the counterparty, and other attributes of contractual obligations.[13]

Several general features of values-balancing reasoning may aid the reader. In the view I present, obligations are not external to the relationship. They do not represent attempts to address distributional values or social ills. Obligations are self-imposed and self-controlled, subject only to the constraint, imposed from a party's choice to invoke the practice of promising, that the parties reason in an appropriate way about their obligations. This may mean, of course, that the parties must take into account the circumstances of the counterparty, but only when other-regarding reasoning suggests that those circumstances are relevant. This book provides no refuge for scholars who would use the law to impose external standards of socially appropriate behavior on contracting parties.

The values-balancing approach also addresses the concern that generalist courts will not successfully interpret obligations. Values-balancing reasoning does not require a special knowledge of the economics of exchange or the art of the deal. The information needed to determine which party is reasoning in a value-balancing way when disputes arise about obligations does not require a court to be steeped in the intricacies of moral hazard or adverse selection, which, after all, are simply labels for intuitive concepts. It requires only the ability to reason about the reasoning that the parties should have used, given the terms of the contract.

Finally, the approach does not subsume contract law within tort law; it conciliates the two doctrinal domains by identifying their substructure of reasoning. The book endorses "the promise principle, which is the principle by which persons may impose obligations [on themselves] where none existed before."[14] And it endorses the principle that in a promissory or contractual relationship the parties get to design the obligations they are willing to assent to; as is often said, the parties legislate their

[12] Listwa (2019).

[13] As an illustration, if I agree to have lunch with a friend next week, the agreement is not likely to specify the obligations or excuses that accompany that agreement. Yet, the obligations can be inferred from the nature of the relationship and how the other-regarding person would think about the obligations, given the relationship. Under most circumstances, a right-thinking person would understand that if something important comes up the obligation to have lunch is probably excused, but that the agreement comes with an implicit obligation to call the friend so that she can make other plans.

[14] Fried (1981) at 1.

own obligations. But in the view presented here, neither the promise principle nor the self-legislation metaphor determine the existence or scope of the obligations that flow from a promise or contract once disputes arise. The scope of any obligation necessarily invokes the proposition that under certain circumstances one ought to consider the well-being of others in a values-balancing way, which I believe to be the unifying principle of private law.[15] Each person in an exchange, in pursuit of its private projects, absorbs burdens that benefit a counterparty. Reasonable people use values-balancing reasoning, and it is that method of reasoning that I believe breathes life into our understanding of how a reasonable person makes reasonable, contextual decisions.[16]

METHODOLOGICAL COMMITMENTS

Because the ideas developed in this book reflect methodological commitments that may not be widely shared, the reader may find a summary of those commitments to be helpful.

There is, I posit, a substructure to the law, a substructure of reason. Given the subject matter of this book, that substructure lies in the method by which persons in a promissory, contractual relationship and lawmakers who evaluate private behavior ought to reason about what people owe each other. The method of reasoning I have in mind is not the method usually associated with legal reasoning. It is a method of reasoning about the factors and values that give rise to obligations, determinants that are nonlegal in the sense that their content does not depend on legal authority (even though the method of reasoning is reflected in legal authority). Consider the distinction between the law's structure from its substructure. The law's structure lies in legal authority, including doctrine, rules, standards, presumptions and, in contract law, a contract's text and context; conventional legal reasoning focuses on reasoning from that authority. The substructure, on the other hand, consists of the method of reasoning that led to the authorities and to structural relationships, a method that the structure may not reveal. Contracts develop from the joint

[15] This is the third (and final) book in my trilogy about the other-regarding person and social morality (what we owe each other). The other two cover tort law (Gerhart (2010)) and property (Gerhart (2014)).

[16] Torts, contracts, and property are differentiated by the source of the obligations to others, not by the scope of the obligations or the method of reasoning that determines the scope. In tort law, the obligation to others comes from creating a risk or standing in relation to someone that makes an actor responsible for the risks the other faces. In property, the source of obligations is the concept of ownership (which creates obligations for both owner and non-owner). In contract law, the source of the obligation is a promise. Yet in all three areas of private law, the existence and scope of any obligation is determined, I maintain, by the obligation to reason in the kind of values-balancing way that I present in this book, which requires each person in a relationship to account in a values-balancing way for the well-being of the person who would otherwise bear an avoidable loss. This principle applies to issues of formation (the existence of a duty), performance (the scope of a duty), and remedy (the losses that could have been, and should have been, avoided).

reasoning of two parties; that reasoning is how the parties structured their relationship. If we understand the shared reasoning from which the contract arose, the contractual substructure, we can more accurately determine the obligations embedded in the contract. Similarly, legal authority comes from some method of reasoning that reflects the reasoning that has guided the evolution of the law's structure.[17] If we can understand the method of reasoning that formed legal authority, the law's substructure, we can more accurately understand how the doctrinal structure ought to be implemented. The authority of contracts and of law is determined by nonlegal factors and those determinants underlie, and help implement, the authority.

Under this view, authority's commands lie not directly in the words of the authority but in the method of reasoning that led to the author's use of the command's words. "Because I said so" is not a sufficient basis for following authority. To implement authority when new disputes arise, we need to extract and replicate the method of reasoning that led to the authority, and then apply the method and content of that reasoning to the dispute that must be decided. This approach turns conventional legal reasoning on its head; rather than start with authority, we start with the factors and values that led to the authority, making the implementation of authority the output of the reasoning (and a new basis for reasoning about how to implement authority).

Implementing this methodology requires a method of identifying the factors and values that determined authority. We do well to put aside what judges say and to concentrate on what judges do. Justice Stevens famously said: "this Court reviews judgments, not opinions."[18] By that Justice Stevens signaled that the law is found in a dispute's outcome (that is, a court's judgment in favor of one party or the other), and not in judicial opinions that seek a doctrine to justify the outcome in terms of doctrine. A dispute's outcome is binding on the parties and on any person similarly situated, but its binding effect depends on reasoning about which persons are in the category of "similarly situated" persons.[19] The judge's opinion can be influential in that subsequent determination, but to have a binding effect on others the law depends on a subsequent finding of similarity, and that depends on how one reasons about similarity, not on prior doctrinal statements.[20]

[17] In a state of nature, before law existed, the first legal decision, the one that purported to create authority, must have been grounded on a method of reasoning that did not itself depend on authority. That method of reasoning, if it was worthy of being followed as authority, must have been about the factors and values that the decisionmaker found to be attractive. A role of the dice would not serve as legal authority. Those factors and values must have influenced the implementation of that authority in other cases.

[18] *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984).

[19] Kraus (2008) uses this distinction to understand debates on contract law. Kraus (2007) explores the jurisprudential implications of the distinction between outcomes and judicial explanations. *See also* Steinman (2013).

[20] This approach does not deny the power of stare decisis. It simply locates the power of stare decisis in the outcome of cases, not in the rationale that judges provide for the outcome. The power of