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THE BARGAIN PRINCIPLE AND THE FAIRNESS PRINCIPLE IN CONTRACT DECISIONS: MICHIGAN, 1900-1950

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Abstract

Judges and scholars have traditionally argued that courts should not and do not rescind contracts solely on the basis of the fairness, or equivalence, of the exchange. This paper investigates the empirical basis of this argument. Five hundred Michigan contract cases decided between 1900 and 1950 were analyzed. The analysis concludes that in Michigan the pattern of decisions is more consistent with a judicial practice of deciding contract disputes by evaluating the substantive fairness of the contract than with a practice of deciding contract disputes by evaluating the bargaining process that preceded the contract.

This conclusion contradicts the traditional view that courts resolve contract disputes by evaluating the integrity of the bargaining between the parties, and refrain from evaluating the terms of exchange. The conclusion is used to criticize a selection of theories and histories of contract law.

The academic debate about contract law reflects the influence of two fundamental principles for resolving contract disputes. The "bargain principle" holds that courts should rescind contracts which are marred by defects in the process by which the parties came to agreement. The "fairness principle" holds that the courts should rescind contracts if the terms are unequal. Traditional theories of contract law are variations on these two themes. Most of these theories are grounded on the bargain principle, but academics and judges from time to time argue that the fairness principle plays some subsidiary role in the resolution of contract disputes.

This essay, however, argues that the fairness principle is the dominant principle of contract law. Taking as a sample the contract cases decided by the Supreme Court of Michigan between 1900 and 1950, the essay argues that the pattern of contract decisions is more consistent with the fairness principle than with the bargain principle. Part I discusses the bargain principle and the fairness principle and develops a method for testing these principles against the case law. Part II presents a brief history of Michigan during the first half of the twentieth century and discusses its suitability as a sample. The bulk of the essay examines Michigan contract cases to see whether the pattern of decisions conforms more closely to the bargain principle or to the fairness principle. Parts III-VII discuss the doctrines of mistake, implied warranty, duress, incompetency, consideration, unconscionability, and penalty; and conclude that the Supreme Court's use of these doctrines conforms more closely to the fairness principle than to the bargain principle. Part VIII uses this conclusion to criticize a selection of theories and histories of contract law. Part IX briefly discusses the normative implications of this essay.

I. The Bargain Principle and the Fairness Principle.

A. The Analytic Distinction.

The bargain principle focuses the court's attention on the *process* through which the parties come to an agreement. The court enforces a contract if the process is not defective. Possible procedural defects include mental deficiency of a party, a relationship of trust between the parties, fundamental and mutual mistakes, deception, and coercion. These contingencies are considered defects because they hinder the free operation of the wills of the parties and can cause them to agree to contracts that do not serve their interests.

One can describe the procedural defects as information costs, because avoiding them requires an investment of resources.[1] If the information costs to entering a contract were zero, the parties would always agree to an exchange in which the liability for loss caused by contingencies is assigned to the party that can more cheaply prevent the contingency.[2] Since the cost of bargaining is never zero, the parties will often fail to assign to the cheaper cost-avoider liability for losses caused by certain contingencies. The parties will fail expressly to assign liability for the loss caused by certain contingencies when the cost of predicting the contingencies and of expressly assigning liability for the contingencies exceeds the loss caused by the contingencies discounted by the probability that the contingencies will occur. When such information costs prevent the parties from assigning liability to the cheaper cost avoider, the bargaining process is

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[1] Although for convenience I use economic concepts to describe bargain principle analysis, the bargain principle analysis is not the same as economic analysis. Economic analysis is a version of the bargain principle approach. This issue will be discussed in part VIII.

[2] This statement is not true for contracts in which the cheaper cost-avoider is risk averse.

considered "defective." At the suit of the worse cost-avoider the court discharges the contract.[3]

The fairness principle focuses the court's attention on the *substance* of the parties' agreement. The court enforces a contract if the terms of the contract are fair. The word "fair" is used in this essay in a technical sense that excludes its connotation of redistribution. A contract is "fair," in this technical sense, if each party receives the equivalent of what he gives. Deciding the fairness of a contract is relatively easy if the transaction occurs in a competitive market, because the product will have a market price. A contract occurring in a competitive market is fair if the product or service is exchanged for a consideration equivalent to its market price. If the transaction does not occur in a competitive market, then the fairness principle requires the court to use other factors than market price for evaluating the exchange. These factors include the cost of creating the products or services and the amount of wealth that can be generated by the products or services. If the court determines that an exchange is unequal, then it rescinds the contract at the suit of the injured party.[4]

The fairness principle, as used in this essay, refers to the ex ante fairness of an exchange, not to the ex post fairness of an exchange. A contract is fair if the promises, goods, or services exchanged by the parties have an equal value at the time of the contract. For example, payment of $80 for a television set that is worth $100 if it works, but has a 20% chance of not working, is a valid contract under the fairness principle, even though after the exchange one party might have $80 and the other party might have a worthless, broken television set. If the price reflects

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[3] *See* C. Goetz and R. Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 Yale L. J. 1261 (1980); R. Cooter, Unity in Tort, Contract, and Property, 73 Calif. L. Rev. 1 (1985).

[4] *See* M. Eisenberg, The Bargain Principle and Its Limits, 95 Harv. L. Rev. 742 (1982); *cf.* F. Hayek, Law Legislation and Liberty 21 (1973) (discussing the medieval roots of the belief that that the just price of a product is determined by the market).

the ex ante risks, the court enforces the contract; the ex post manifestation of the risks is irrelevant.

A common criticism of the fairness principle is that courts cannot accurately measure the equivalence of exchanges in a world of shifting, subjective values.[5] But this criticism can be turned on the bargain principle: courts cannot accurately detect flaws in bargaining processes in a world of ambiguous actions. The response to both criticisms is the same. Courts should rescind contracts only if the unevenness of the terms (under the fairness principle) or the defects in the bargaining process (under the bargain principle) are extreme. But one cannot assume that the bargain principle handles ambiguity more effectively than the fairness principle does. The problems with this assumption will be further discussed in Part VIII.

In order to illustrate the difference between the two principles, suppose that a seller sells some land to a buyer for $1000. The buyer later discovers that the soil is unfit for farming. The buyer brings suit to rescind the contract, perhaps arguing that the seller deceived him or failed to correct an obvious mistake. According to the bargain principle the court rescinds the contract if deception or a fundamental mistake marred the bargaining process. If the seller could have informed the buyer of the condition of the soil more cheaply than the buyer could have inspected the soil, the court rescinds the contract. If, however, the seller shows that the buyer could have discovered the poverty of the soil more cheaply than the seller could have, then the court enforces the contract. The former case might describe the contract if the seller is a farmer. The latter case might describe the contract if the seller is, say, an heir, the land in question had never been cultivated, and the buyer is a farmer. Evaluation of the contract turns on the relative information costs of the parties.

The fairness principle does not require the court to take account of information costs. To convince the court to rescind

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[5] *See* M. Cohen, The Basis of Contract, 46 Harv. L. Rev. 553, 581 (1933).

the contract, the buyer must show that he paid the market price of fertile land. If the market price of fertile land of the same kind and of the same area as the land in dispute is $1000, then the court rescinds the contract. The court rescinds the contract, because the buyer paid $1000 for land worth less than $1000. If the market price, say, of barren land of the same kind and same area is $1000, then the court enforces the contract. The court enforces the contract, because the buyer paid $1000 for land worth about $1000. The question of the fairness of the terms turns on the conformity of the transaction price with the market price.

Some legal scholars believe that contract law is based on the bargain principle.[6] They think that courts do or should enforce contracts only if the bargaining process is valid. Other scholars argue that a variety of factors cause courts to enforce some contracts rather than others.[7] These factors reflect the conflicting interests of various commercial groups.[8] None of these factors can be singled out as essential to an enforceable contract. A third group of scholars identifies, at a greater level of generality, the bargain and fairness principles, or analogues thereof, as complementary or conflicting determinants of enforceable contracts.[9] The hypothesis of this essay, however, is that the fairness principle exerts more influence on the outcome of contract cases than the bargain principle does. Despite the frequent use of the rhetoric of the bargain principle, courts usually discharge contracts not because of defects in the bargaining process, but because of the unfairness of the terms.

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[6] *See* Holmes, The Common Law 227-240 (M. Howe ed. 1963); 1 Williston, Contracts §§17-21 (1957); C. Fried, Contract as Promise: A Theory of Contractual Obligation (1981).

[7] *See* Fuller & Perdue, The Reliance Interest in Contractual Damages, 46 Yale L. J. 52 (1936); Kessler & Fine, Culpa in Contrahendo, Bargaining in Good Faith and Freedom of Contract: A comparative Study, 77 Harv. L. Rev. 401 (1964); G. Gilmore, The Death of Contract (1974); P. Atiyah, Contracts, Promises and the Law of Obligations, 94 L. Q. Rev. 193 (1978).

[8] *See, e.g.*, K. Llewellyn, On Warranty of Quality, and Society, 36 Colum. L. Rev. 699 (1936), 37 Colum L. Rev. 341 (1937).

[9] *Compare* M. Eisenberg, *supra* note 4 *with* D. Kennedy, Form and Substance in Private Law Adjudication, 89 Harv. L. Rev. 1685 (1976).

The explanatory power of the bargain principle and the fairness principle result from the apparent ease with which contracts can be analytically divided into their bargaining process and their substantive terms. The bargaining process can be evaluated independently as defective or valid. The terms can be evaluated as unfair (unequal) or fair. Each contract, then, falls into one of four possible categories.

		terms	
		fair	unfair
process	valid	(1) enforced	(2) ?
	defective	(3) ?	(4) rescinded

Categories 1 and 4 undoubtedly represent most cases. Most contracts that have fair terms result from valid bargaining processes (1). These contracts are enforced under either the bargain principle or the fairness principle. Most contracts that have unfair terms result from defective bargaining processes (4). These contracts are rescinded under either the bargain principle or the fairness principle. Because the bargain principle and the fairness principle generate the same result in these cases, the latter cannot be used for testing the hypothesis that the fairness principle has more influence than the bargain principle on contract decisions.

One can compare the influence of the fairness principle and the influence of the bargain principle only by looking at the marginal contracts that fall into categories 2 and 3. Contracts resulting from valid bargaining processes but that have unfair terms (2) are rescinded under the fairness principle and enforced under the bargain principle. Contracts resulting from defective bargaining processes but that have fair terms (3) are enforced under the fairness principle and rescinded under the bargain principle. The hypothesis of this essay is that sum of rescinded category 2 contracts and of enforced category 3 contracts exceeds the sum of enforced category 2 contracts and of rescinded category 3 contracts. This is simply a careful way of saying that courts

more often rescind or enforce contracts on the basis of the fairness of their terms than on the basis of the validity of their bargaining processes.

In order to test this hypothesis, I will examine contract cases that came before the Michigan Supreme Court between 1900 and 1950. For every contract, the bargaining process is defective if the information costs of the breacher are greater than the information costs of the breachee, and the contract assigns liability to the breacher. The terms are unfair if the ex ante value of the promise, good, or service that the breacher exchanges exceeds the ex ante value of the consideration he receives.

B. Methodology.

Two points about methodology must be made. The first point concerns the randomness of the sample of cases. The second point concerns problems in the interpretation of the cases themselves.

The sample consists in 500 Michigan Supreme Court contract cases taken from the pool of Michigan Supreme Court cases decided during the period comprising roughly the years between 1900 and 1950. A few influential cases decided shortly before or after this period are also in the sample. Although I tried to select the cases randomly, two constraints limit the randomness of the sample.

First, most of the cases were chosen with the help of the West Digest. The "contracts" category in the West Digest does not refer to all the contract cases. Contract cases also appear in such categories as "sales" and "bills and notes." Many contract cases were probably placed in more obscure categories or left out altogether. And many of the categories did not come into existence until halfway through the period under analysis. Although I selected cases from all the relevant categories, not just the "contracts" category, the use of these categories might have led to the overrepresentation of some kinds of contract cases in the sample and the underrepresentation of others. Thus the sample could contain a bias reflecting the mysteries of the West classification system.

The extent of the bias produced through the use of West is unclear, because the extent to which the sample represents a significant portion of the total contract cases is unclear. The following chart shows the number of cases categorized as "contract" cases and the number of cases in which the word "contract" is mentioned, for each of the first five decades of the twentieth century.

Decade	Categorized as a contract case	Mentions the word "contract"
1900-1910	0	1,973
1910-1920	0	1,923
1920-1930	18	2,107
1930-1940	160	1,945
1940-1950	115	1,013

The number of cases dealing with issues of contract law must be greater than the number of cases categorized by West as "contract cases," because West puts many ordinary contract cases in non-contract categories, like "sales." The number of contract cases must be less than the number of cases whose report mentions the word "contract," because a lot of cases involving contracts do not involve issues of contract law, but involve torts, taxation, and other issues for which the existence of a contract is an unimportant aspect of the factual background.

West did not start using the contract category until the mid-1920's; but if the ratio of cases mentioning the word contract to the cases categorized as contract cases would have been the same for cases from 1900 to 1930 as it was for cases from 1930 to 1950, then West would have categorized between 400 and 500 cases from 1900 to 1930 as contract cases. For the whole fifty year period, then, about 750 cases would have been categorized as contract cases. The number of cases from this period in which the word "contract" is mentioned, is 8,961. Since the number of cases involving contract issues must have been greater than the number of cases categorized by West as contract cases, and must have been

less than the number of cases whose report mentions the word "contract," the number of cases involving contract law issues must have been greater than 750 and less than 8,961.[10] The bias produced by West is low if the cases concerning issues of contract law approaches the lower limit of 750, and high if the number of cases concerning issues of contract law approaches the upper limit of 8,961.

The second constraint on the randomness of the sample results from the inclusion of cases frequently cited as precedents of cases chosen through West. This device for choosing cases was used to offset any bias created by the use of the West Digest, but this device also introduced a bias of its own. The cases selected because they are cited as precedents reflect the attitudes of the justices toward Michigan law and do not necessarily represent a random sample of the cases concerning contract law. The justices might have ignored contract cases that they did not find useful for supporting their decisions. The correct proportion of these cases might not appear in the sample.

Even if the two constraints on the randomness of the sample are insignificant, the conclusions based on the sample are limited by two interpretive constraints. First, it is difficult to draw an accurate picture of the facts from the opinions of the Supreme Court, because it is impossible to tell if judges leave out or distort important facts. And yet the method of testing the essay's hypothesis depends heavily on the possibility of separating the underlying facts from the Court's reasoning. One must make assumptions about the facts; and these assumptions are open to dispute.

A second interpretive constraint arises from the use of appellate cases rather than trial court cases as the object of analysis. The conclusions of this essay describe the activity of the justices of the Supreme Court. They do not necessarily

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[10] The total number of cases faced by the Michigan Supreme Court between 1900 and 1950 was 22,555.

describe the activity of trial court judges, which, presumably, has more to do with the everyday practices of the litigators.

A third interpretive constraint concerns the relation between a court's use of the bargain principle or fairness principle to assess evidence and the principle of justification, or theory, used by the court to justify its enforcement or rescission of contracts. One might assume that the bargain principle implicates a liberal, autonomy-based principle of justification, and that the fairness principle implicates a non-liberal principle of justification. But this assumption is not necessarily true. A judge committed to a liberal theory of contract might think that in some cases -- like exchanges occurring in a competitive market -- the fairness of the terms is better evidence of autonomous bargaining than is evidence concerning the mental competence or intentions of the parties. A judge committed to a non-liberal theory of contract might think that in some cases -- like exchanges occurring in a non-competitive market -- evidence about the bargaining process is better evidence of fair terms than are the terms themselves. Thus the conclusion that the outcome of the Michigan contract cases is more consistent with the fairness principle than with the bargain principle does not necessarily mean that the justices of the Michigan Supreme Court did not believe in a liberal theory of contract. I will return to this matter in Part VIII.

II. Michigan, 1900-1950.

Cases decided by the Michigan Supreme Court were chosen for this sample on the assumption that Michigan in the late nineteenth and early twentieth centuries was typical of the American states. Its economic, demographic, and political development paralleled that of many states.

Until 1900 Michigan's economy centered around farming, logging, and mining.[11] Businesses mined coal, salt, copper, iron ore, and gypsum; quarried sandstone and limestone; and drilled for oil and natural gas. Railroads were built to transport lumber and minerals, and by 1900 Michigan had a highly developed railroad system. Most people, however, were farmers. Michigan had 206,960 farms in 1910.[12] But farming, logging, and mining peaked around the turn of the century, and their importance to the state economy diminished rapidly. In 1900 33.5% of the workers worked on farms; in 1930 12.8% worked on farms.[13]

Manufacturing became the chief economic activity of the state. In 1900 the state had 16,807 factories employing about 25% of the working population. The most important industries were food-processing, agricultural machinery, furniture, wagons and carriages, paper, chemicals, cement, drugs, steamboats, and stoves. With the development of the automobile industry and the demand for ships and motorized vehicles in World War I and World War II, Michigan became heavily industrialized.

The population of the state rose from 2.4 million in 1900 to 6.3 million in 1950.[14] Before 1900 most of the foreign-born inhabitants had come from Canada, Germany, England, Ireland, and the Netherlands. The rapid increase in population after 1900 was due mainly to immigration of Poles, Italians, and Russians. Blacks from the South also came to Michigan. The immigrants came for the factory jobs, and settled in the cities. The fraction of the population in cities rose from 40% in 1900 to 70% in 1950.

While Michigan politics had had a progressive strain since statehood in 1847, serious political reforms began only in the early 1900s. The state government rationalized elections; imposed taxes on some businesses; passed regulations on railroads, food processing, and child labor; and increased expenditures on

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[11] Except where otherwise noted, the source of the material in this section is W.F. Dunbar, Michigan: A History of the Wolverine State (1980).
[12] R. Santer, Michigan: Heart of the Great Lakes 228 (1977).
[13] M. Quaife, Michigan: From Primitive Wilderness to Industrial Commonwealth 335 (1948).
[14] *Id.*, at 158.

education. Later legislation concerned local self-rule, the rationalization of the state bureaucracy, the establishment of a mechanism for public referenda, worker's compensation laws, the liberalization of criminal punishment, and care for the sick. The depression saw the creation of welfare programs, increased taxation, and increased regulation. The government was dominated by Republicans until the depression, and Democrats thereafter.

Like its economy, demographics, and politics, Michigan's judicial system was largely unremarkable. The Michigan Supreme Court consisted of eight justices. Elections for the position of justice occurred every two years. The Supreme Court had appellate jurisdiction over all cases decided by the lower courts. Most of the lower courts were called Circuit Courts. The Circuit Courts had original jurisdiction over all civil and criminal actions. The judges of the Circuit Courts had both legal and equitable powers. There were also various specialized courts.[15]

Any study of a single jurisdiction can be accused of parochialism. But, although the history of Michigan is doubtlessly unusual in certain ways, its development is similar to that of the country as a whole. The growth in manufacturing, the rise of progressive politics, the immigration of different ethnic groups, and the expansion of the cities characterize most American states in the late nineteenth and early twentieth centuries. The legal doctrines and issues in Michigan paralleled contemporary legal thought in other states.[16] Although the conclusions of this analysis hold for Michigan alone and do not necessarily hold for other states, it is difficult to imagine reasons for believing that Michigan contract law was substantially different from the law of other states.

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[15] Mich. Stat. Ann. tit. 29, §§11665-11931 (1913).

[16] *Cf.* L. Friedman, Contract Law in America (1965), some of whose conclusions about Wisconsin are similar to my conclusions about Michigan, as I discuss in Part VIII.

III. Mistake.

The doctrine of mistake allows courts to strike down a contract when one or both of the parties were significantly mistaken about the terms. The court generally does not strike down a contract on account of a unilateral mistake, unless the non-mistaken party had good reason to suspect the other party's mistake. The court often strikes down a contract on account of mutual mistake about an important term.

The mistake doctrine is nicely explained by the bargain principle. The court does not strike down a contract that results from a unilateral mistake, because usually the mistaken party can more cheaply detect its mistake than the non-mistaken party can predict the mistake. The mistaken party usually has more information about its affairs than the non-mistaken party does. The court assigns liability to the non-mistaken party only when the latter could reasonably have detected the first party's mistake; i.e., when the non-mistaken party could have detected the mistaken party's mistake more cheaply than the mistaken party could have. When the non-mistaken party expends a lot of resources to learn of the thing about which the other party is mistaken, however, the court will not impose a duty to disclose. The investment in resources is a hidden cost; it renders the cost of disclosure, which would be low to a party that casually discovered the information, high for the party that invests in discovery of the information. The court strikes down a contract on account of mutual mistake, when the non-breaching party could have detected the mistake more cheaply than the breaching party could have detected the mistake.[17]

The fairness principle treats the doctrine of mistake as a device for detecting unfairness in contracts. The allegation of mistake permits the court to scrutinize the terms of a contract,

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[17] A. Kronman, Mistake, Disclosure, Information, and the Law of Contracts, 7 J. Leg. Studies 1 (1978). For other analyses based on the bargain principle, *see* Williston, 13 Contracts §§1544 ff.; Rabin, A Proposed Black-Letter Rule Concerning Mistaken Assumptions in Bargaining Transactions, 45 Tex. L. Rev. 1273 (1967).

but the court will not strike down a contract with fair terms simply because one or both parties made a mistake. The fairness principle requires the court to enforce such a contract. Moreover, one would expect a court inspired by the fairness principle to invent mistakes in order to justify rescission of an unfair contract which resulted from an apparently valid bargaining process.

Some of the cases in which a party seeks rescission on the ground of mistake concern implied warranties.[18] Implied warranty cases are analytically identical to mistake cases. The buyer argues, in effect, that he was mistaken about the quality or fitness of the product, but that the seller had a duty to detect and correct the buyer's mistake, because the seller could detect the buyer's mistake more cheaply than the buyer could detect his own mistake. The doctrine of implied warranty distinguishes cases of unilateral mistake where the mistaken party is presumptively but not necessarily the worse cost-avoider. All mistake cases except for those involving the doctrine of implied warranty will be discussed in Section A; cases involving the doctrine of implied warranty will be discussed in Section B. The discussion of mutual and unilateral mistakes concludes that the fairness principle provides a better explanation of the pattern of mistake decisions than the bargain principle provides. The discussion of implied warranty cases concludes that neither the fairness principle nor the bargain principle provides a clearly better explanation of the pattern of implied warranty decisions.

A. Mutual and Unilateral Mistakes.

Among the contract cases in which the court appeared seriously to consider the possibility of mutual or unilateral mistake, the court's judgment was often consistent with both the bargain principle and the fairness principle. Some of these cases are

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[18] The common law doctrine of implied warranty was codified in the Uniform Sales Act, which was adopted by Wisconsin in 1929. Mich. Stat. Ann. tit. 19, §§ 241 ff. (1929). The Uniform Sales Act, unlike the Uniform Commercial Code that followed it, did not depart from the common law. *See* R. Henson and W. Davenport, 4 Uniform Laws Annotated 22-24 (1968).

discussed in section (1). Section (2), however, discusses contracts whose bargaining process was marred by mistakes, but which were nonetheless enforced because their terms were fair. And section (3) discusses contracts whose bargaining processes were not marred by defects, but which were nonetheless struck down -- on the ostensible basis of the mistake doctrine -- because their terms were unfair.

(1) Cases consistent with both principles.

Many mutual mistake cases are consistent both with the bargain principle and with the fairness principle. In *Nester v. Michigan Land & Iron Co.*[19] the plaintiff agreed to buy all the timber on defendant's land for $27,000. The plaintiff's decision to accept this price was based on an estimate made by an agent the plaintiff had sent onto the land. Defendant had revealed to the plaintiff its own estimate of the amount of timber on the land, but during three months of negotiations the defendant repeatedly refused to provide a guarantee. When it transpired that less timber was available than the buyer's agent had predicted, the buyer sued for the $12,798 difference between the amount of money he paid and the value of the timber that he acquired. The court held for the defendant. This decision is consistent with the bargain principle, because the plaintiff was probably the cheaper cost-avoider. The plaintiff's acquiescence in the defendant's refusal to provide a guarantee suggests that both parties thought that the plaintiff could make a more accurate estimate than the defendant could. This decision does not necessarily violate the fairness principle, because the price might have reflected the risk that plaintiff would receive less than $27,000. As the court pointed out, the terms of the contract would have given the plaintiff a great profit if he and the defendant had underestimated the amount of timber on the land.

In *Richardson Lumber Co. v. Hoey*[20] the plaintiff sold 11,500 cedar ties to the defendant, leaving them on the plaintiff's land

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[19] 69 Mich. 290, 37 N.W. 278 (1888).
[20] 219 Mich. 643, 189 N.W. 923 (1922).

for the defendant to pick up. Unknown to both parties a fire was burning on the seller's land, and it destroyed the remaining ties after the buyer had picked up only 1,721 of them. The buyer refused to pay for the destroyed ties and the seller sued. The court held in favor of the buyer on the ground that both parties had assumed that the ties were safe. The decision reflects the bargain principle, inasmuch as the seller could probably have discovered the fire on his own land more cheaply than the defendant could. If the parties had thought of requiring someone to insure the ties, they would have imposed that duty on the seller. This decision does not necessarily violate the fairness principle, because the price of the cedar ties might have included a premium reflecting the cost of the seller of insuring them.

In *Schwaderer v. Huron-Clinton Metropolitan Authority*[21] the plaintiff agreed to clear the defendant park district's land for $59,000. The defendant told the plaintiff that its studies showed 298 acres that needed clearing. Plaintiff discovered in the course of clearing the land that 545 acres needed clearing. He cleared the total area in order to receive payment, and sued for $32,000 more. The court held in favor of the plaintiff. The defendant, which had employed aerial photography and other exotic devices to survey the land, was in a better position to estimate the amount of land needing clearing than the plaintiff was. Consistent with the bargain principle the court assigned liability to the cheaper cost-avoider. But the court also said that the contract price "was materially less than a fair compensation."[22] In conformity with the fairness principle the court rescinded the contract because the plaintiff received less than the value of his services.

Many unilateral mistake cases are also consistent both with the bargain principle and the fairness principle. In *Retan v. Clark*[23] the seller agreed to sell property to the buyer for $8000 if the buyer paid the accumulated unpaid paving taxes. The plaintiff

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[21] 329 Mich. 258, 45 N.W.2d 279 (1951).
[22] 329 Mich. at 264, 45 N.W.2d at 285 (1951).
[23] 220 Mich. 493, 190 N.W. 244 (1922).

neglected to include in the contract a provision requiring the buyer to pay these taxes, and the defendant declined to inform the plaintiff of his mistake. Similar facts occurred in *Holbeck v. Williamson*[24], except that in this case the buyer drafted the contract and used a technical term to mislead the seller into thinking that the contract required the buyer to pay certain taxes. In *Walter v. Walter*[25] a father conveyed land to his son on the mistaken assumption that his son had an interest in the land through his mother's will. There was some evidence of deception in this case, too. In *Barryton State Savings Bank v. Durkee*[26] the buyer of some land agreed to reserve to the seller a one half interest in the mineral rights; but when the buyer paid, the seller's cashier forgot to put the reservation in the receipt, and the buyer refused to correct the error. In all of these cases the non-mistaken party could have more cheaply avoided the loss by informing the other party of the mistake. In *Holbeck* and *Walter*, the evidence of fraud strengthened the mistaken party's case. These cases are thus consistent with the bargain principle. These cases are also consistent with the fairness principle, because the non-mistaken party received something from the mistaken party for less than the price agreed on, presumably, the market price.

Other cases, however, are not so simple. In *Abbott Voting Machine Co. v. Eaton Rapids*[27] the plaintiff offered to sell voting machines to defendant city at $350 each. The city responded to the offer by ordering three machines and passing an ordinance conditioning payment on the contingency that no taxpayer objects in writing to the purchase. The company did not seem to have known about the ordinance. When, two years and two elections later, the city refused to pay for the machines and offered to return them, the plaintiff sued. The court rescinded the contract on the ground that "the minds of the parties had not met."[28]

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24 255 Mich. 430, 238 N.W. 269 (1931).
25 297 Mich. 26, 297 N.W. 58 (1941).
26 325 Mich. 138, 37 N.W.2d 892 (1949).
27 165 Mich. 625, 131 N.W. 71 (1911).
28 *Id.* at 627, 131 N.W. at 73.

Though the court thus used the rhetoric of the bargain principle, it is not clear that it assigned liability to the cheaper cost-avoider. The city could probably have informed the seller of the ordinance more cheaply than the seller could have monitored the lawmaking of this and every other city to which it sold voting machines. And yet the decision does not conform to the fairness principle, because the city got two years' use of plaintiff's voting machines for nothing.

(2) Contracts enforced despite bargaining defects.

The pattern of decisions in the preceding mutual and unilateral mistake cases are consistent with both the bargain principle and the fairness principle. However, the bargain principle does not explain all the mutual mistake cases in a satisfactory manner. The following cases can be explained better by the fairness principle.

In *Sherwood v. Walker*[29] a farmer agreed to sell his cow to a banker. Both parties had assumed that the cow was sterile; upon discovering that his cow was with calf, the farmer refused to deliver the cow and to accept payment. The banker sued. The cheaper cost-avoider was probably the farmer, because he had a chance to inspect the cow; the banker bought the cow without looking at it. Because the breaching farmer was the cheaper cost-avoider, the bargain principle would require enforcement. But in violation of the bargain principle the court rescinded the contract, permitting the farmer to keep the cow.[30]

Rescission, however, is consistent with the fairness principle. The banker paid the market price of a beef cow, $80. Since most beef cows were probably male or old, the market price of beef cows did not reflect the chance that the cows were fertile. No evidence in the opinion suggests that the price included a premium representing the chance that the cow was fertile. Thus the exchange gave the banker, in return for $80, a cow worth $80 (as beef) plus some probability of its being fértile multiplied by the

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[29] 66 Mich. 568, 33 N.W. 919 (1887).

[30] *Cf.* R. Posner, Economic Analysis of Law 90 (3rd ed. 1986).

value of a fertile cow (between $750 and $1000, according to the opinion). Because of the unevenness of the exchange the fairness principle requires rescission.

In *State Savings Bank of Ann Arbor v. Buhl*[31] a woman paid the defendant to keep her valuable seal-skin sack in his store and to insure it for $300. When the woman came to reclaim the sack, the defendant could not find it and instead gave her a check for $300. Later the defendant found the sack, returned it to the woman, and canceled the check.[32] In the ensuing litigation the court ruled that the defendant was not liable for the $300. Yet the defendant was probably the cheaper cost-avoider, because its business was to store things and presumably its expertise lay therein. Rescission violated the bargain principle, because no evidence showed defects in the bargaining process.

It is possible that the bargain was ex ante unfair: the amount of money the woman paid the defendant might have been less than the supposed $300 value of the sack multiplied by the probability that the defendant would lose it (plus the cost of storage), if the defendant, in calculating insurance rates, had not accounted for the contingency of employee error, as happened here. This interpretation of events, according to which the fairness principle would explain the decision, is at least possible; whereas no interpretation of events could explain how the bargain principle would have justified the decision.

Another fairness-based rationale for the decision focuses on the ex post value of the exchange. The court says that the sack was worth less than $300. Forcing the defendant to pay $300 to the woman instead of allowing it to give her a sack less than $300 is unfair. The court might have rescinded the contract, because the exchange left the defendant with something worth a lot less than it paid.

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[31] 129 Mich. 193, 88 N.W. 471 (1901).

[32] Actually, the defendant canceled the check and was sued by the bank at which the woman cashed the check. These inessential procedural complexities are ignored for the sake of brevity.

In *Heath Delivery Service v. Michigan Mutual Liability Co.*[33] the plaintiff bought insurance from defendant for its fleet of twenty trucks at a cost of $669. The insurance company inadvertently omitted to put one of the trucks on the policy and the delivery service failed to notice the omission. The truck was damaged in an accident. The court held that the insurer was liable for the damages, even though the truck was not technically covered by the policy. It is unclear whether the insurance company could have more cheaply prevented the error through careful preparation than the delivery company could have prevented the error through examination of the document it signed. The opinion mentions no evidence that would lead to one conclusion rather than to the other. Thus the bargain principle does not lead to a determinate conclusion. The fairness principle does dictate the court's result, because the delivery company had paid the price of the insurance and no evidence indicates that the premium was discounted to reflect the chance of a mistake.

In *Farhat v. Rassey*[34] the plaintiff sued to dissolve a partnership. The parties settled the suit for $1,400 moments after the trial court had, unknown to them, handed down a judgment finding plaintiff entitled to $3,933. The Supreme Court upheld the trial court on the ground that a basic assumption of the settlement was incorrect. Because the evidence does not reveal whether the plaintiff or defendant could more cheaply have discovered their mutual mistake, the bargain principle does not lead to a determinate result. If the parties were equally unable to discover the mistake, the bargain principle would have required enforcement of the contract. In violation of the bargain principle the court enforced the contract. However, the decision is consistent with the fairness principle, because the trial court's award probably approximated the defendant's debt more closely than the settlement amount did. Since the trial court had already handed down its judgment, the plaintiff did not gain

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[33] 257 Mich. 482, 241 N.W. 191 (1932).
[34] 295 Mich. 707, 294 N.W. 707 (1940).

anything by settling that could justify reducing the debt by two thirds. The settlement violated the fairness principle, because the plaintiff, in effect, gave the defendant $2,533 in return for nothing at all.

In *Standard Oil Co. v. Murray,*[35] a unilateral mistake case, the defendant sold an option to buy her land for $7500 to the plaintiff. The plaintiff exercised the option. The seller refused to convey the deed, on the ground that she was mistaken about the contract. She testified that she did not know what an option was and her agents failed to give her an explanation. Although the trial court believed the seller's testimony and refused to grant specific performance, the Supreme Court reversed. It dismissed her testimony as self-serving. But its assertion that merely having the "opportunity open to the party to have full information" is sufficient to make a contract enforceable implied that the seller did not understand the contract. The court did not consider the possibility that the buyer should have informed the seller that she did not understand her agent and the contract, if her confusion was clear. In any case, the court said that the "price fixed in the option appears to have been a fair one at that time and within $500 of the amount [the seller] had been for some time trying to sell the premises, but after the date of the option there was a sharp rise in the value of the premises."[36] This rationale shows the influence of the fairness principle, because the seller must have been trying to sell at a price above market price if she could not find many buyers. The court's belief in the fairness of the exchange prevented it from taking seriously the allegations of defects in the bargaining process.

In *Mayor v. Sanders,*[37] another unilateral mistake case, defendant had invested $4900 and plaintiff had invested $1295 in a partnership. Over the next several years, the plaintiff invested no time in the partnership (because he had been deported to Canada) and the defendant invested much time and energy in the

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[35] 214 Mich. 299, 183 N.W. 55 (1921).
[36] *Id.* at 300, 183 N.W. at 56.
[37] 286 Mich. 45, 281 N.W. 532 (1938).

partnership. He also dissolved the partnership and incorporated the business. When plaintiff returned from Canada, he threatened to sue for his $1295. Instead, he released defendant from liability in return for promissory notes for $1295. Later, the corporation became insolvent, and plaintiff sued to rescind the release on the ground that he was mistaken about the financial condition of the corporation when he signed the release. The court refused to rescind the release because it felt that the insolvency of the corporation was partly plaintiff's fault; if he had worked harder, it and his notes might still be worth something. Consistently with the fairness principle the court enforced the contract. By taking notes from the corporation in an agreement requiring him to do work for the corporation, the plaintiff agreed to bear the risk that the notes would be rendered worthless by insolvency. The court alluded to the bargain principle by noting that the plaintiff had ample opportunity to understand the business. But the defendant probably had a better idea of the condition of the corporation, since he had directed it for many years. Thus the bargain principle suggests that the contract should be rescinded, because the knowledgeable party implicitly guaranteed the validity of the notes.[38] However, the court enforced the contract.

The court's reliance on the fairness principle is also evident in a unilateral mistake case in which it enforced a contract despite procedural defects. In *Story v. Page*[39] plaintiff asked the court to rescind a release. Defendant truck driver had hit and killed plaintiff's son. On the day of the funeral the defendant's insurer approached plaintiff with an offer for a release. Plaintiff agreed to release the truck driver in return for the costs of the funeral. Although the plaintiff's grief-stricken state of mind, his failure to retain a lawyer, and some evidence that the insurer misled him into thinking that the document was not a release indicate possible defects in the bargain process,

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[38] *Cf.* Veenstra v. Associated Broadcasting Corp., 321 Mich. 679, 33 N.W.2d 115 (1948) (discussed in part IV).

[39] 280 Mich. 34, 273 N.W. 384 (1937).

the court refused to rescind the contract on the ground that the plaintiff was educated and should have understood the contract. Under a strict application of the bargain principle one would expect courts to require insurers to wait a few days after the funeral, because waiting a few days does not cost the insurer much, while it gives the insured a chance to ponder matters and seek a lawyer.

The fairness principle offers a more convincing explanation for rescission: "the testimony does not bear out the claim that the [plaintiff was] overreached by the insurer, particularly *when there is a very grave question as to whether there was any liability whatsoever.*"[40] The court's decision rested on its belief that the defendant was not negligent, and therefore that defendant owed the plaintiff nothing. The payment of plaintiff's funeral expenses sufficiently compensated him for the remote chance that he could win a damage award against the defendant. The fairness principle explains the court's enforcement of the release better than the bargain principle does.

(3) Contracts rescinded despite the validity of the bargaining processes.

The court's reliance on the fairness principle is more obvious in cases in which the court struck down contracts that appeared to have no defects in the bargaining process. For example, in *Van Norsdall v. Smith*[41] a recent widow bought her brothers'-in-law and sisters'-in-law one-half interest in her deceased husband's estate, worth $2300, for $675. She also agreed to buy a $300 tombstone for her husband. When the siblings demanded the money, she refused on the ground that she had been mistaken about the value of the property. After the subtraction of the $675 to the siblings, the $300 for the tombstone, and more money for various debts and fees, the one-half interest gained the widow only $400. Moreover, the brother-in-law with whom she had negotiated refrained from telling her of a $691 debt owed to him by the

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[40] *Id.* at 36, 273 N.W. at 386 (emphasis added).
[41] 141 Mich. 355, 104 N.W. 660 (1905).

deceased, a debt that rendered the deal worthless to the widow. The court rescinded the contract.

The bargain principle would not have required rescission. The widow was not helpless, but was the administratrix of the estate, and familiar with her deceased husband's business and debts. She had the advice of her father and her brother. The brother-in-law negotiator could not have predicted that the widow did not know of his or any other debts. Because the information costs to the widow were not substantially lower than those to the siblings, the bargain principle would probably have required enforcement of the contract. But unlike the bargain principle, the fairness principle clearly dictates rescission. Because of the widow's agreement to pay for the tombstone and to pay various debts and fees, she ended up paying more than the market price of the one-half interest. The court rescinded the contract in conformity with the fairness principle and in violation of the bargain principle.

In *Kutsche v. Ford*[42] a school district asked for bids on a construction contract for a new school building. It accepted the plaintiff's bid of $63,660; then plaintiff refused to perform because an error had led it to underestimate its costs by $6400. Plaintiff sued for return of a $3200 deposit, which according to the contract he had forfeited by withdrawing the bid. The court held for plaintiff. The bidding contract specifically provided a forfeiture of 5% of the contracting price in case of withdrawal. Because the bargaining process was not defective, the bargain principle would have precluded rescission. However, the court said, "to compel plaintiff to forfeit his deposit, because of his mistake, would permit the school district to lessen the proper cost of the school building at the expense of plaintiff."[43] The court recognized that the plaintiff's forfeiture vastly exceeded the reliance costs of the school district; and the unfairness of this result rendered irrelevant the mutual intention to transfer

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[42] 222 Mich. 442, 192 N.W. 714 (1923).
[43] *Id.* at 445, 192 N.W. at 717.

the risk of mistake from the school to the bidder. The court rescinded the contract in conformity with the fairness principle and in violation of the bargain principle.

In *Federal Land Bank of St. Paul v. Edwards*[44] a farmer mortgaged his property to a bank for $2300, agreeing to insure it. Several years later, in 1931, the bank commenced foreclosure on the mortgage. Two months later the farmer bought insurance worth $4300. While doing so the farmer failed to inform the insurance company of the impending foreclosure, despite the latter's request for a "just, full and true exposition of all the facts and circumstances affecting the risk of the property ensured."[45] On the night before the foreclosure sale a fire damaged the property, leaving the property worth only $1000. Ignorant of the fire the bank bought the property at foreclosure at the $2300 mortgage price. When the bank discovered the damage, it brought suit to rescind the sale and restore the mortgage. The insurance company cross-billed to cancel the insurance. Both parties alleged different mistakes. The bank mistakenly assumed that the property was not destroyed by fire. The insurance company mistakenly assumed that the insured property was not about to be foreclosed. The court rescinded the sale but refused to set aside the insurance.

The bargain principle would have required enforcement of the foreclosure sale, because at a foreclosure sale the "seller," the indebted farmer, generally does not participate and is not expected to make representations about the property. Yet the court enforced the foreclosure sale. The bargain principle would have required rescission of the insurance contract, because the farmer deceived the insurer. The farmer could have told the insurer of the foreclosure more cheaply the insurer could have done a title search of the farmer's property. Yet the court enforced the insurance contract. The bargain principle explains neither decision.

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44 262 Mich. 180, 247 N.W. 147 (1933).
45 *Id.* at 181, 247 N.W. at 148.

The fairness principle explains these decisions a little better than the bargain principle does. At the foreclosure sale the bank paid $2300 for property worth only $1000. Because the exchange was unequal, the fairness principle would have required rescission. The insurance company might have supplied a $4300 insurance policy in return for an appropriate premium, or it might have charged less than it would had it known of the foreclosure. The opinion does not say. But the court was clearly concerned with the fairness of the exchange, holding that enforcement was justified because it did not unconscionably injure the insurer.

In summary, the cases involving mistakes lend more support to the fairness principle than to the bargain principle. The marginal cases involving conflicts between the fairness of the terms and the validity of the bargaining process were usually decided on the basis of the fairness of the terms.

B. Implied Warranty.

Under the bargain principle courts imply a warranty[46] for a contract if the parties intended to make the seller liable for defects in the product.[47] The parties intended to make the seller liable but failed to include an express warranty if the discounted loss caused by a defect in the product is less than the information costs of agreeing to an express warranty. Under the fairness principle courts imply a warranty for a contract if the amount paid by the buyer includes a premium reflecting the amount of replacing or repairing the product discounted by the probability of defect.

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[46] The Michigan Supreme Court speaks of implied warranties of identity or title, quality or condition, and fitness. An implied warranty of identity or title is a warranty that the seller owns a title to the thing he sells, rather than an interest in a fraction of it or an interest in it for a certain length of time. An implied warranty of quality or condition is a warranty that the product is not worse than other products of the same kind that the seller sells. An implied warranty of fitness is a warranty that the product is capable of performing the function for which the buyer wants it. Unless otherwise noted, in this essay the phrase "implied warranty" refers to implied warranty of fitness.

[47] *Cf.* G. Priest, The Theory of the Consumer Product Warranty, 89 Yale L. J. 271 (1984).

It is difficult to evaluate the explanatory power of the fairness principle in implied warranty cases, because the opinions rarely say whether the contracts in which the court implied warranties stipulate a price that includes a premium reflecting the prevailing market value of a warranty; or whether the contracts in which court declined to imply warranties stipulate a price that does not include a premium reflecting the market value of a warranty. Unlike the mistake cases discussed in the previous section, which provided clues about the values of the goods involved, the implied warranty cases cannot be used to test the validity of the fairness principle.

However, the implied warranty cases can be used to test the bargain principle because the opinions reveal plenty of evidence about defects in the bargaining process. If the court attaches the same weight to the same kind of procedural defects in different cases, then one may conclude the bargain principle determines the evaluation of the contracts in question. But if procedural defects that are used to justify the implication of warranties in some cases are not used to justify the implication of warranties in other other cases, then one must conclude that hidden influences different from the bargain principle account for pattern of decisions.

The Michigan Supreme Court looked at nine characteristics of contracts when deciding whether or not to imply a warranty: the sophistication of the parties; failure by the buyer to perform a reasonable inspection of the product; conformity of the product with the buyer's specifications; buyer's use or resale of products before suing; misuse of products; express refusal by seller to guarantee fitness of product; sale by manufacturer; sale of food to consumer; and reliance by buyer. Each characteristic will be examined in turn, and theses examinations will suggest that the implied warranty cases are fairly consistent with the bargain principle.

(1) Sophistication of the parties. The court often said that it refused to imply a warranty because the parties were sophisticated actors. But differences in the sophistication of

the parties do not distinguish the cases in which the court implied warranties and the cases in which the court did not imply warranties. In most of the cases both parties were sophisticated; yet the court implied warranties as often as it refused to imply warranties. *Remy, Schmidt & Pleissner v. Healy*[48] held that a clothing manufacturer did not implicitly warrant to a retailer the fitness of the clothes. But *West Michigan Furniture Co. v. Diamond Glue Co.*[49] held that a glue manufacturer did implicitly warrant to a furniture manufacturer the fitness of its glue. *Baker v. Kamantowsky*[50] held that a farmer did not implicitly warrant to a meat wholesaler the edibility of the meat. But *Columbus & Hocking Coal & Iron Co. v. See*[51] held that a coal mine did implicitly warrant to the retailer the quality of the coal. *Salzman v. Maldaver*[52] held that one aluminum dealer did not implicitly warrant the fitness of the aluminum he sold to another aluminum dealer. But *Cox-James Co. v. Haskelite Mfg. Corp.*[53] held that the manufacturer of waste conveyance systems did implicitly warrant the waste conveyance system he installed in the buyer's factory. Although the court often said that it would not imply a warranty between two sophisticated parties, the court did imply such a warranty as often as it did not.

One would expect a doctrine that placed importance on the sophistication of the parties to play a role in disputes between consumers and businesses. But the court did not imply warranties on products sold to consumers any more often than it implied warranties on products sold to dealers. The court implied a warranty in about half the cases brought by consumers.[54] The

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[48] 161 Mich. 266, 126 N.W. 202 (1910).
[49] 127 Mich. 651, 87 N.W. 92 (1901).
[50] 188 Mich. 569, 155 N.W. 430 (1915).
[51] 169 Mich. 661, 135 N.W. 920 (1912).
[52] 315 Mich. 403, 24 N.W.2d 161 (1946).
[53] 255 Mich. 192, 237 N.W. 548 (1931).
[54] For cases in which the court declined to imply warranties at the suit of consumers, *see, e.g.*, Potter v. Shields, 174 Mich. 121, 140 N.W. 500 (1913); Kolodzcak v. Peerless Motor Co., 255 Mich. 47, 237 N.W. 41 (1931). For cases in which the court implied warranties at the suit of consumers, *see, e.g.*, Little v. G.E. Van Syckle & Co., 115 Mich. 480, 73 N.W. 554 (1898); Wade v. Chariot Trailer Co., 331 Mich. 576, 50 N.W.2d 162 (1951).

sophistication of the parties alone cannot explain the court's refusal to imply warranties; and the buyer's lack of sophistication cannot explain the court's willingness to imply warranties.

However, the fact that the court's decisions never turned on the sophistication of the parties does not really cast doubt on the bargain principle, because traditionally the bargain principle demands a greater defect in the bargaining process than the lack of sophistication of one of the parties. Sophistication is so difficult to measure that the court would imply a warranty on this ground only in the case of gross disparity in the sophistication of the parties. These cases will be discussed in the section on the doctrine of incompetency. Moreover, sophisticated parties will deliberately fail to agree to an express warranty when the cost of drawing up an express warranty is high and the expected loss is low. The bargain principle would then require an implied warranty, the parties' sophistication notwithstanding. Still, the contrast between the court's frequent insistence on the importance of the sophistication of the parties and its refusal to rescind contracts on the basis of unequal sophistication suggests that the court's use of the bargain principle is more rhetorical than substantive.

(2) Lack of reasonable inspection. The court refused to imply a warranty most often when the buyer failed to perform a reasonable inspection of the product before buying it or accepting delivery of it. In *Buick Motor Co. v. Reid Mfg. Co.*[55] the buyer failed to inspect some motors he bought before putting them in his cars. In *Baker v. Kamantowsky*[56] a meat wholesaler did not inspect the meat he bought from a farmer. In *E.P. Stacy & Sons v. Moher*[57] a retailer did not inspect eggs bought from a wholesaler before they were put in storage. In *Salzman v. Maldaver*[58] an aluminum dealer failed to open the sheaths of aluminum to check for rust.

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[55] 150 Mich. 118, 113 N.W. 591 (1907).
[56] 188 Mich. 569, 155 N.W. 430 (1915).
[57] 200 Mich. 81, 166 N.W. 849 (1918).
[58] 315 Mich. 403, 24 N.W.2d 161 (1946).

In all of these cases the court refused to imply a warranty, because the buyer failed to make a reasonable inspection. Conversely, in *Copas v. Anglo-American Provision Co.*[59] the court implied a warranty because a pork packer had a better opportunity to inspect the pork than the butcher who bought the pork did. In *Phelps v. Grand Rapids Growers*[60] the court implied a warranty because the farmer could not have distinguished the white onion seeds he received from the yellow Globe onion seeds he ordered. When a reasonable inspection would not have revealed the defect or the seller could have checked for a defect more cheaply than the buyer could have, the court implied a warranty. When the buyer failed to perform a reasonable inspection, the court refused to imply a warranty for defects.

The bargain principle can explain the doctrine of reasonable inspection as a practical limit on all implicit warranties. Information costs prevent parties to some contracts from including a warranty; in the absence of information costs the parties would have included a warranty only if the seller can detect defects more cheaply than the buyer. The doctrine of reasonable inspection guarantees that the buyer will inspect when it is cheap to do so.

The cases support this interpretation, with the possible exception of *Salzman*. In *Salzman* the court refused to imply a warranty because the plaintiff aluminum dealer did not inspect the aluminum at issue before agreeing to buy it from the defendant aluminum dealer. The report stresses the difficulty of inspecting the aluminum, because it was tightly packed and covered. Thus it would have been expensive for the buyer to inspect the aluminum for rust; whereas the seller, who had packed the aluminum, probably already knew its condition. The parties would have intended that the cheaper inspector, the buyer, inspect the aluminum; yet the court refused to imply a warranty.

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[59] 73 Mich. 541, 41 N.W. 690 (1889).
[60] 341 Mich. 62, 67 N.W.2d 59 (1954).

The fairness principle explains the doctrine of reasonable inspection as an attempt to ensure that when the parties do not expressly assign the risk of defect to one of the parties, the loss is borne by the one who is paid to bear it. In any transaction the buyer and seller must decide who shall bear the risk of a defect. When the parties do not expressly assign the risk of defect to one of the parties, the court can figure out who bears the risk by comparing the transaction price to the market price of the product. Whether or not the court decided to imply warranties on the basis of a fairness-type analysis of price, rather than on the basis of a bargain-type analysis of the transaction, cannot be determined, because the court never mentions the relevant market prices in its opinions.

(3) Specifications for products. Sometimes the court refused to imply a warranty because the defects in the product resulted not from the seller's negligence, but from defects in the instructions to the seller provided by the buyer. In *Remy, Schmidt & Pleissner v. Healy*[61] the buyer ordered clothing on the basis of a sample provided by the seller. The buyer's customers complained about the stitching and the buyer sued the seller. The court refused to imply a warranty because the seller provided the buyer with exactly what the buyer ordered. In *Gill & Co. v. National Gaslight Co.*[62] the buyer requested and the seller provided the kind of glass globes that the buyer had earlier purchased from another firm. The buyer sued because the glass globes were too fragile. The court refused to imply a warranty because the globes were no more fragile than the globes produced by the other firm. In *Damman v. Mercier-Gryan-Larkins Brick Co.*[63] and *Outhwaite v. A.B. Knowlson Co.*[64] the court refused to imply a warranty because the buyer ordered and received a product identified by a trade name. In *Beaman v. Testori*[65] the court refused to imply a warranty

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61 161 Mich. 266, 126 N.W. 202 (1910).
62 172 Mich. 295, 137 N.W. 690 (1912).
63 235 Mich. 392, 235 N.W. 194 (1931).
64 259 Mich. 224, 242 N.W. 895 (1932).
65 323 Mich. 194, 35 N.W.2d 155 (1950).

for a coil-cleaner mold whose defects were caused by the directions supplied by the buyer, not by the seller's negligence. In all these cases the court refused to imply a warranty because the buyer got what he requested.

These cases conform to the bargain principle. The court honored the express directions of the buyer, and refused to save the buyer from his mistakes. The buyer can detect defects in his specifications more cheaply than the seller can. Implying a warranty would defeat the intentions of the parties, because the parties would intend the cheaper cost-avoider to bear the risk of defects.

The fairness principle could also explain these cases. When the buyer provides specifications to the seller, the buyer assumes the risk that the specifications are defective. The seller does not know what use the buyer will put the product to. Implying a warranty would shift the risk to the seller without compensating him for the risk.

(4) Use or resale of products. The court repeatedly held that the buyer waives an implied warranty if he uses the product after discovering the defect. In *Columbus & Hocking Coal & Iron Co. v. See*[66] a coal retailer resold coal he bought from a coal company, and then sued the coal company on the ground of breach of implied warranty because the quality of the coal received was two thirds of the stipulated quality. In *John D. Gruber Co. v. Smith*[67] a farmer used a tractor he bought from the seller for two years, despite its continual breakdowns, before suing for breach of implied warranty of fitness. In *Dinovo Fruit Co. v. McClintick & Co.*[68] a retailer resold the defective melons he bought from seller, and then sued on the ground of breach of implied warranty for the difference between the market price of the good melons he ordered and the price he got for the defective melons. All three plaintiffs lost.

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[66] 169 Mich. 661, 135 N.W. 920 (1212).
[67] 195 Mich. 336, 162 N.W. 124 (1917).
[68] 214 Mich. 620, 183 N.W. 87 (1921).

The bargain principle does not appear to offer a convincing explanation for this doctrine. The buyer should be able to sue for the difference between the market value of the products he requested and the price he received for the products he got. The fact that the buyer recovers a part of the value of the product through resale does not diminish the defectiveness of a bargaining process in which information costs precluded an express warranty.

The fairness principle might hold that use or resale indicates that the buyer extracted some value from the product; and if he did not sue immediately, the value must have been close enough to the amount he paid to constitute a fair exchange. The buyer's failure to sue until after use or resale might suggest that the buyer was not disappointed by the quality of the product (the seller's risk) but that the buyer misused the product (the buyer's risk).

(5) Misuse of products. The court did not imply a warranty for the fitness of products for negligent or unconventional uses. In *Kolodzcak v. Peerless Motor Co.*[69] the buyer crashed his new car and accused the seller of having produced an unfit car. The court found that the express warranty for parts and labor superseded the implied warranty for fitness. As I will explain shortly, however, I do not think that the court was swayed so much by the express warranty as by the suspicion that the buyer was trying to make the seller subsidize his carelessness. In *Cheli v. Cudahy Bros. Co.*[70] a consumer died of trichinosis after eating raw pork. The court held that the seller does not implicitly warrant products for unusual uses, such as the consumption of raw pork.

Under the bargain principle a warranty is not implied for products that are misused because the seller's cost of designing a perfectly safe product is infinite, whereas the buyer's cost of not misusing a product is small. In *Cheli*, for example, the seller probably could not have sterilized the pork and the buyer could have avoided trichinosis simply by cooking her pork. The

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69 255 Mich. 47, 237 N.W. 41 (1931).
70 267 Mich. 690, 255 N.W. 414 (1934).

court must have assumed that the consumption of raw pork is sufficiently rare that a warning label would not be cost-justified. Under the fairness principle a warranty is not implied because sellers cannot and do not insure themselves against damages caused by any conceivable misuse of a product. It would be unfair to allow a plaintiff who has misused a product to recover from the seller, because the price the seller received did not include premium for insurance against such a misuse.

(6) Express refusal to warrant a product. The court often said that it does not imply warranties for products under express warranty. It frequently violated this precept by finding an implied warranty of fitness aside an express warranty of quality. In *Burkett v. Oilomatic Heating Corporation*[71] the buyer bought an automatic heating device for his apartment building. In *Dunn Road Machinery Co. v. Charlevoix Abstract & Engineering Co.*[72] the buyer bought a road-finishing machine. Both devices were free of defects. But the heating device failed to warm the whole apartment building; and the road-finishing machine failed to finish roads as the buyer requested. In both cases the bargain principle would require the court to imply warranties of fitness because the seller could more cheaply discover the capacities of their products than the buyer could. The opinions in both cases emphasized the accuracy with which the buyer described the purpose to which the product was to be put. With this information and knowledge about his product the seller was in the better position to predict the fitness of the product than the buyer was.

The fairness principle presents a less ambiguous explanation for these cases. The heater and the road-finishing machine were not perishable products and could be resold by the seller. The cost of reselling the products would be much cheaper for the sellers than for the buyers, because the sale of such products is the sellers' business. The court was willing to extend implied warranties of quality to implied warranties of fitness for sales

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71 241 Mich. 634, 217 N.W. 897 (1920).
72 247 Mich. 398, 225 N.W. 592 (1929).

of durable goods, because such a policy would burden sellers less than would the opposite policy burden buyers. Other cases involving a suit for an implied warranty of fitness despite an express warranty of quality support this interpretation, because in these cases the product was perishable and thus the cost of replacement was high.[73]

In *Lutz v. Hill-Diesel Engine Co.*[74] commercial fishermen bought an engine for their new boat. The engine had no defects, but was not powerful enough to move the boat. The contract included a clause that said, "it is expressly agreed ... that this contract constitutes the only agreement between the parties thereof and that no other verbal contracts or agreements exist between said parties."[75] The court nevertheless implied a warranty of fitness. In *Phelps v. Grand Rapids Growers*[76] a farmer bought some seeds from a seed merchant. He discovered when they did not grow properly that the seed merchant had supplied him with a different seed from the kind he requested. The merchant had printed on the sack of seeds, "no implied warranty" and "not responsible for the crop." The court held in favor of the farmer on the dubious ground that the merchant had breached the contract, not the warranty. He had delivered the wrong seeds, rather than defective seeds.

Lutz and *Phelps* resist the bargain principle interpretation because the warranties suggest that the parties did not want the court to veto their arrangements. *Lutz* involved a $9,350 transaction and buyers for whom the engine must have consumed a substantial part of their resources. Surely they would have insisted on a warranty of fitness, or refused to sign the contract; or perhaps they could not afford a warranty of fitness and decided to take the risk. In *Phelps* the farmer depended on the seeds for his crop. (He won $1894 on a $72 purchase). Surely

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[73] *See, e.g.*, Potter v. Shields, 174 Mich. 121, 140 N.W. 500 (1913) (replacement of boiler would require expensive work on pipes); Kolodzcak v. Peerless Motor Co., 255 Mich. 47, 237 N.W. 41 (1931) (warranted car destroyed in accident).

[74] 255 Mich. 98, 237 N.W. 546 (1931).

[75] *Id.* at 99, 237 N.W. at 547.

[76] 341 Mich. 62, 67 N.W.2d 59 (1954).

he would have paid more for a warranty. The bargain principle requires that courts, which cannot know the values that parties attach to products, defer to the parties' arrangements. But the Michigan Supreme Court intervened and implied warranties of fitness.

These cases might also violate the fairness principle. The question of whether they do depends on information not revealed in the opinions. These cases conform to the fairness principle only if the market price of the engine and of the seeds included a warranty.

(7) Sale by Manufacturer. The court often implied warranties for sales by manufacturers. *West Michigan Furniture Co. v. Diamond Glue Co.*[77] held that a glue manufacturer implicitly warranted the fitness of the glue it sold to a furniture manufacturer. *Reed v. David Stott Flour Mills*[78] held that a flour miller implicitly warranted the quality of the flour it sold to a retailer. *F.M. Sibley Lumber Co. v. Schultz*[79] held that a lumber mill implicitly warranted the quality of the plywood it sold to a builder. These decisions are consistent with the bargain principle because usually the manufacturer can detect defects in a product more cheaply than the buyer can. These decisions follow from the fairness principle if the buyer paid for protection against the risk of defect.

(8) Sale of food. The court occasionally implied warranties for sales of food by stores to consumers. *Hertzler v. Manshum*[80] held that a store implicitly warrants the quality of the flour it sold to a consumer. The flour was contaminated with lead and the consumer died. The bargain principle explains this case, because a retailer, who sells flour supplied by a flour mill, can more cheaply detect lead poisoning that the consumer can. This case is consistent with the fairness principle if illness or death

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77 127 Mich. 651, 87 N.W. 92 (1901).
78 216 Mich. 358, 185 N.W. 715 (1921).
79 297 Mich. 206, 297 N.W. 243 (1941).
80 228 Mich. 416, 200 N.W. 155 (1924).

resulting from the sale of adulterated food is common enough that retailers increase prices to offset possible liability.

(9) Reliance. *Little v. G.E. Van Syckle & Co.*[81] held that by selling a piano to a consumer the retailer implicitly warranted its fitness, because the consumer would not be able to tell that it would go out of tune within a few days of playing. *Phelps v. Grand Rapids Growers*[82] held that a seed merchant implicitly warranted that the seeds he sold to the farmer were yellow globe onion seeds, not white onion seeds, because the seller could more cheaply keep his seeds in order than could the farmer distinguish yellow globe onion seeds from white onion seeds. Because in both these cases the information costs to the buyers probably prevented them from insisting upon an express warranty, both cases are consistent with the bargain principle.

But some reliance cases are not consistent with the bargain principle. In *Veenstra v. Associated Broadcasting Corp.*[83] the sale of a corporation of $10,000 worth of stock to three sophisticated shareholders was held to contain an implied warranty that the stock would be approved by the Michigan Securities Commission (it was not and rendered worthless). In *Wade v. Chariot Trailer Co.*[84] the sale of a home trailer for $2904 was held to contain an implicit warrant of quality, permitting the buyer to recover after the home trailer fell apart. Because in neither of these cases did the seller seem to be the cheaper cost-avoider, they are not easily explained by the bargain principle. Yet, they could be consistent with the fairness principle if the price reflected a warranty that the stock or trailer was not worthless.

In summary, the court usually implied warranties only if the bargaining process was defective. But in several cases the court's decision violated the bargain principle. Because the opinions do not reveal the whether the price of the products in question included a premium for a warranty, one cannot tell

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81 115 Mich. 480, 73 N.W. 554 (1898).
82 341 Mich. 62, 67 N.W.2d 59 (1954).
83 321 Mich. 679, 33 N.W.2d 115 (1948).
84 331 Mich. 576, 50 N.W.2d 162 (1951).

whether the decisions were consistent with the fairness principle. Consequently, one does not know whether some or all of the decisions that were consistent with the bargain principle were also consistent with the fairness principle. This section can conclude only that the implied warranty cases do not clearly cast doubt on the bargain principle; but they also do not cast doubt on the fairness principle.

IV. Duress.

Although litigants seeking to escape contracts pleaded duress as a matter of course, very few cases in Michigan turned on this doctrine. After the seminal case of *Hackley v. Headley*[85] in 1881, twenty-two decisions discussed the issue of duress. Of these decisions, only four held that one of the parties had entered a contract under duress. But despite their uncommonness the duress cases are useful for examining the bargain and fairness principles.

The doctrine of duress permits the court to rescind a contract which resulted from coercion. The paradigmatic case of such coercion is the use by one party of physical force in order to make the the other party sign an unfair contract. The bargain principle justifies rescission on the ground that the threatened party cannot avoid the contingency -- of receiving a product he does not want in return for a large payment -- but at great cost.[86] He would have had to invest in resources that would have enabled him to foresee the likelihood of coercion and to take steps to avoid it. The threatening party can avoid the contingency simply by refraining from making the threat. Since the party that seeks rescission had greater information costs than the party that resists rescission, the court rescinds the contract. The fairness

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[85] 45 Mich. 569, 8 N.W. 511 (1881).

[86] For analyses of duress based on the bargain principle, *see* Dalzell, Duress by Economic Pressure, 20 N. C. L. Rev. 237 (1942); Hale, Bargaining Process, Duress, and Economic Liberty, 43 Colum. L. Rev. 603 (1943); Aivazian, Trebilcock, Penny, The Law of Contract Modifications: The Uncertain Quest for a Benchmark of Enforceability, Osgoode Hall L. J. 22 (1984).

principle, in contrast, justifies rescission of a coerced contract only when the terms are unfair.[87] The fairness principle requires the enforcement of coerced but fair contracts and the rescission of uncoerced but unfair contracts.

Most of the duress cases in Michigan concerned two kinds of threat: the threat of nonpayment of a debt; and the threat of fine, prison, or civil suit. Dicta regarded the threat of physical harm or of any other illegal act as duress; but the court was never faced with such an allegation. In the next two sections cases involving each kind of threat will be examined; in none of these cases did the party claiming duress prevail. In the third section the successful duress cases will be examined. We will see that the outcomes of the duress cases are more consistent with the fairness principle than with the bargain principle.

(1) Threat of nonpayment of a debt. In *Hackley v. Headley*[88] the plaintiff logger signed a release of what he alleged was a $6200 debt owed to him by the defendant logger in exchange for only $4000. The plaintiff agreed to this uneven exchange, because, as he told the defendant prior to the agreement, he needed cash right away; and the defendant refused to pay even the amount he agreed that he owed to the plaintiff, unless the plaintiff signed the release. The court held that the refusal by a debtor to pay the undisputed portion of a debt in order to force a creditor in need of cash to agree not to litigate the disputed portion of the debt does not constitute coercion. The court said that allowing parties to avoid contractual obligations that they assumed while having financial difficulties would insert an unacceptable level of uncertainty into contract-making.

In order to analyze this case one must distinguish the logging contract and the release. The plaintiff did not contend that he signed the logging contract under duress. The plaintiff contended that he signed the release under duress. The release gave the

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[87] For analyses of duress based on the fairness principle, *see* Dawson, Economic Duress and Fair Exchange in French and German Law, 11 Tul. L. Rev. 345 (1937), 12 Tul. L. Rev. 42 (1937); Dawson, Economic Duress -- An Essay in Perspective, 47 Mich. L. Rev. 254 (1947).

[88] 45 Mich. 569, 8 N.W. 511 (1881).

plaintiff present payment of a portion of the disputed debt and gave the defendant resolution of the $2200 dispute in his favor. The defendant knew of the plaintiff's pecuniary distress and apparently recognized that it did owe the plaintiff at least $200 of the $2200 that it refused to pay.[89]

The contingency toward which the release was directed was the possibility that the plaintiff would sue for the disputed amount. The plaintiff wanted, when he signed the release, to have the opportunity to sue for the disputed amount; but he signed the release because the cost of not signing the release -- bankruptcy -- was too high. The plaintiff could not have invested resources necessary to avoid the situation in which he was vulnerable to a threat of nonpayment. The defendant could have avoided this situation quite cheaply, simply by declining to make the plaintiff sign the release. The defendant could have paid the undisputed debt of $4000 without conditioning it on a release. Because the defendant could have declined to coerce the plaintiff into signing the release more cheaply than the plaintiff could have foreseen and taken steps to avoid the coercion, the court's decision to enforce the release violated the bargain principle.

The court's decision did not violate the fairness principle. In order to understand why, one must look at the other issue faced by the court. The plaintiff had claimed that the cost of his logging services should be measured by the "Scribner rule"; but the court agreed with the defendant that the "Doyle scale" had been implicitly agreed on. The plaintiff had sued for $6200 under the Scribner rule; but the application of the Doyle scale meant that defendant's debt was only $4200, $200 more than he paid. The court could have thought that so small a sum as $200 -- less than 5% of the debt -- represented the value to the plaintiff of avoiding the cost and delay of litigation. Thus the release could have been fair, as the time and expense saved by avoiding litigation could be considered equal to $200. However, the court

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[89] *Cf.* Dalzell, Duress and Economic Pressure, *supra* note 86 (1940) (criticizing Hackley v. Headley for violating the bargain principle).

declined to decide whether this exchange was fair, and remanded for determination of this issue.

On remand the jury found $200 was an unreasonably high price for the release. On appeal, in *Headley v. Hackley,*[90] the Supreme Court approved this result. The cases are consistent, because in the first the jury's calculations were based on the wrong numbers (they believed the debt to be $6200, and the plaintiff's loss to be $2200). The Supreme Court, finding that the loss was only $200, remanded for a determination of whether this loss reflected the value of avoiding further litigation. In the second case the court deferred to the jury's judgment that even $200 was too high a price for avoiding litigation that was necessitated by the defendant's dishonesty.[91] The release was rescinded because the terms were unfair. The fairness principle provides a better explanation for both cases than the bargain principle does.

Other cases involving the threat of nonpayment of a debt are also better explained by the bargain principle than by the fairness principle. In *Goebel v. Linn*[92] during a particularly hot summer an ice company threatened to stop delivering ice to a beer company unless the latter agreed to pay $3.75 per ton, rather than the $1.75 to $2.00 per ton agreed to. The beer company paid the amounts demanded and later sued for rescission on the ground of duress: the ice company knew that if the beer company did not receive ice, it would have gone out of business. The court refused to rescind the modification of the contract. This decision violates the bargain principle, because the ice company could have declined to insist on a change in price more cheaply than the beer company could have avoided it. The parties had agreed in the original contract that the ice company could raise the price by 25¢ in the event of a hot summer; the court should

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90 50 Mich. 43, 14 N.W. 693 (1881).

91 Headley v. Hackley was not, however, decided on the basis of duress, but on the basis of inadequate consideration and bad faith. Headley v. Hackley, 50 Mich. 43, 14 N.W. 693 (1981).

92 47 Mich. 489, 11 N.W. 284 (1882).

have deferred to these arrangements, rather than allowing the ice company unilaterally to raise the price by $2.00.[93]

The court held that the price increase was fair. If the defendant was charging higher than market price, the beer company would have bought ice from another ice company. The beer company's failure to switch suppliers suggests that the unusually hot summer caused an increase in the market price of ice of more than the 25¢ stipulated in the contract. In conformity to the fairness principle the court enforced the contract because the beer company paid the market price of the ice that it received.

Two cases involving construction delay are also of interest. In *Laidlaw v. Detroit*[94] a construction company completed its obligations 45 days behind schedule. The contract had provided that the construction company would pay a fine for each day of delay. The city refused to pay the construction company for its work unless the company agreed to pay $700 in penalties for 28 of the 45 days of delay. The company paid under protest, and later sued on the ground that the delay was due to obstructions that the city had failed to remove. The court held that the city's threat of nonpayment did not count as duress. The court apparently thought that the contract was a reasonable compromise: the construction company paid $700 to avoid a risk of losing $1125 and to avoid the costs of litigation.

In *Norton v. Michigan State Highway Department*[95] a highway construction company agreed to release the state from further debt in return for payment for work. Later the company claimed that the state owed it $31,000. The court thought that the plaintiff's new claim was groundless, since it had not sought this money at any time before signing the release. The court enforced the release, because it did not cost the construction company a valuable claim. The construction company lost a very weak and

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[93] *See* Dalzell, *supra* note 86 (1940) (criticizing Goebel v. Linn); *but cf.* Posner, Gratuitous Promises in Economics and Law, 6 Journal of Legal Studies 611 (1977).

[94] 109 Mich. 699, 67 N.W. 967 (1896).

[95] 315 Mich. 313, 24 N.W.2d 132 (1946).

probably worthless claim, and gained immediate payment undiminished by the risks of litigation.

Norton and *Laidlaw* say little about the bargaining process. But it is doubtful that either plaintiff would have released the defendants in return for reduced payment, if the defendants had not threatened them with nonpayment. Whether or not the bargain principle would have required rescission, a court influenced by the bargain principle would have discussed evidence relevant to the question of coercion. However, the Michigan Supreme Court did not look at such evidence, and, in conformity with the fairness principle, enforced the contracts because their terms seemed even.

(2) Threat of fine, imprisonment, or civil suit. The court said repeatedly in dicta that threatening someone with immediate imprisonment unless he pays a sum of money constitutes duress. But in almost all the cases involving this kind of threat, the court did not believe the plaintiff and his witnesses. As a result, few people succeeded in proving duress.

An interesting feature of this class of duress cases is the frequent disagreement within the court. Most of the decisions of the Michigan Supreme Court were unanimous. Between 1900 and 1950 justices dissented in only 7% of the cases.[96] In the cases involving threats of fine, imprisonment, or civil suit, justices dissented in a third of the cases (four of twelve). None of these dissents concerned questions of law; all of them resulted from different interpretations of the facts. I will argue that these disputes over the facts reflected a larger dispute about the fairness principle and the bargain principle. The following four cases do not individually appear to support one principle rather than the other; but taken together they suggest the hidden influence of the fairness principle.

In *Lewis v. Doyle*[97] the plaintiff gave her inheritance to her husband's employer in exchange for a promise not to prosecute her

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[96] According to a Westlaw search justices dissented in 1592 of 22,555 cases. Searches within more limited parameters (like contracts cases) yielded similar proportions.

[97] 182 Mich. 141, 148 N.W. 407 (1914).

husband for embezzlement of $1900. She later sued for rescission. At the trial the plaintiff testified that the employer threatened to prosecute her husband unless she immediately transferred her inheritance to the employer. The employer and three interested witnesses testified that the employer had not threatened to prosecute. The majority by a four to three vote held that plaintiff had not acted under duress. The majority believed the employer and disbelieved the plaintiff. The dissent believed the plaintiff.

In *Voorhees v. Nelson*[98] the plaintiff and defendant were involved in a race-fixing scheme. Both of them ended up providing evidence to the state; but defendant also threatened to sue the plaintiff for swindling him, unless the plaintiff paid him $2,279. The plaintiff paid, then sued for the money back. By a three to two vote, the court held that plaintiff did not sign the release under duress, because the defendant did not really threaten him. The dissent said that the defendant was obviously threatening the plaintiff, because the plaintiff knew that a suit by the defendant would bring evidence to light with which the state could prosecute the plaintiff.

In *Holmes v. Banker's Life Co.*[99] the plaintiff accepted single indemnity of $5000 from the insurance company for the death of her husband, and signed a release. Under the policy the beneficiary receives double indemnity for an accident to the insured, single indemnity for a suicide by the insured. Although at the time of payment the insurance company had good reason to think that suicide was the cause of death, it later became clear that the death was caused by an accident. By a vote of five to three the court held that the plaintiff did not sign the release under duress. The dissent noted that the plaintiff was sick, old, depressed, and lying in the hospital; was encouraged to sign by her doctor, who was afraid she would not pay her medical bills;

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[98] 189 Mich. 684, 155 N.W. 708 (1916).
[99] 271 Mich. 460, 266 N.W. 747 (1935).

was hurried and pressured by the insurance agent; and was able to speak little English and unable to read the release.

In *Karl v. Zimmer*[100] the plaintiff was hit and injured by a truck. While in the hospital he signed a release. By a vote of five to two the majority held that the plaintiff cannot get out of a contract by saying that he cannot remember signing it. The dissent noted that the plaintiff signed the release shortly after having a concussion; that the plaintiff, being indigent, was pressured by his doctor to accept the insurance company's payment of the medical bills; that the plaintiff was told that the release was just the doctor's bill; and that the plaintiff could not read the release because of an eye injury. The jury awarded the plaintiff damages of $950; but the trial judge set them aside and the Supreme Court affirmed.

The decisions in *Lewis*, *Voorhees*, *Holmes*, and *Karl* probably violated the bargain principle, particularly if one believes the dissents' interpretations of the facts. In all of these cases the defendant used the threat of prosecution or litigation in order to encourage the plaintiff to sign a release. These threats made it difficult for the defendants to make considered judgments; whereas the plaintiffs could easily have given the defendants a few days to make their decisions. One could argue that it is impossible to refrain from exercising coercion when negotiating releases from prosecution, simply because the fear of prosecution causes people to react irrationally. But this argument merely shows that the bargain principle is inappropriate for this kind of transaction, and that courts must resort to the fairness principle.

The court's decisions can better be explained by the fairness principle. In *Lewis* the report does not say how much the husband embezzled; but it is likely that the husband embezzled an amount greater than the plaintiff's inheritance. In *Voorhees* the majority ruled against the plaintiff because the plaintiff's problems resulted from his own fraudulent activity. The court appeared to think that paying back what one stole rather than

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[100] 274 Mich. 331, 264 N.W. 391 (1936).

going to jail is a fair deal, even if a coerced one. In *Holmes* and *Karl* the court might have thought that single indemnity and immediate payment, in the first case, and medical costs and immediate payment, in the second case, sufficiently compensated the plaintiffs for the loss of the right to sue.

The enforcement of fair contracts that result from coercion is controversial -- more controversial than the rescission of unfair contract whose bargaining processes were valid -- and explains the frequent dissents. The dissents recognized the defects in the bargaining processes and, influenced by the bargain principle, urged rescission. The majorities played down the defects in the bargaining processes because they thought the contracts fair.

Another case that shows the influence of the fairness principle in an instructive way is *Hanson v. Loescher.*[101] The employer of the plaintiff's daughter agreed not to have her prosecuted for embezzlement in return for a large payment from the plaintiff. The parties reached their agreement in the presence of the chief of police and the prosecuting attorney, whom the employer had invited to the meeting. The court rejected the claim of duress on the ground that no threats had actually been made. This reasoning is not convincing, because the court had said many times that threat of immediate imprisonment constitutes coercion,[102] and in *Hanson* the presence of the chief of police and prosecuting attorney certainly constituted a de facto threat of immediate imprisonment. The court's insistence to the contrary was disingenuous, because the presence of the police officer and attorney could not have any conceivable reason but that of suggesting a threat of imprisonment. Enforcement of the release violated the bargain principle, because the threat of immediate imprisonment raised the cost of the plaintiff of making a rational decision, like that of retaining a lawyer.

The real ground for the decision is found in the court's observation that the value of the property that the plaintiff

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[101] 221 Mich. 30, 192 N.W. 30 (1922).

[102] *See, e.g.*, National Surety Co. v. McLeod, 240 Mich. 360, 215 N.W. 341 (1927).

conveyed to the employer ($4000) was substantially less than the amount his daughter embezzled ($6,629). The court must have thought that the plaintiff had no reason to complain, since he secured his daughter's release for an amount less than the amount his daughter stole. The court's claim that the bargaining process was not defective was a pretext; the court enforced the contract because it was fair.

3. Successful claims of duress. Three cases illustrate situations in which the court manufactured a duress defense out of a valid bargaining process in order to justify the rescission of an unfair contract.

In *Clement v. Buckley Mercantile Co.*[103] the plaintiff was a director and the bookkeeper of a corporation. Over several years he either lost or stole $556. When the corporation accused the plaintiff of embezzlement and threatened to prosecute him, the plaintiff agreed to pay the employer $800 in cash and stock. The plaintiff and his wife also agreed as joint tenants to convey their $2000 homestead to the corporation. The court held that the corporation could keep the $800 but had to return the homestead. The court said that because the plaintiff was experienced and had time to think, his conveyance of $800 was not coerced. Because the plaintiff's wife did not know the details of the accusation and panicked, her agreement to convey the homestead was coerced. This reasoning is unconvincing. The wife simply relied on her husband's advice; and if he acted rationally, then so did she. The court makes the more significant observation that a release from a possible $556 liability is inadequate consideration for payment of $2800. The court's ruling reduced the corporation's receipt to $800, a more reasonable payment for a release from a $556 liability and criminal prosecution. In conformity to the fairness principle, the court rejected the husband's claim of duress because his payment roughly equalled the value of the release; but accepted the wife's claim of duress because the value of her conveyance exceeded the value of the release.

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[103] 172 Mich. 243, 137 N.W. 657 (1912).

In *Saginaw v. Consumers Power Co.*[104] consumers of a gas company sued for a refund of the amount they paid for gas above the legally prescribed rate. The court held that the consumers' payment of the illegally inflated prices was made under duress, because the alternative was to have their gas shut off. The court's decision rested on its perception of the unfairness of paying illegally high prices. The court could not have constructed a rationale for a judgment on the basis of the bargain principle, because a bargain did not occur. Characterizing one bargain between consumers and a monopolistic utility (i.e., payment for overpriced gas) as defective would mean characterizing all bargains between consumers and the utility as defective. The fairness principle required rescission, because the consumers paid higher than the legal price for the gas.

In *Lafayette Dramatic Productions v. Ferentz*[105] the plaintiff sued to rescind a collective bargaining agreement that required that he hire the members of a musicians' union. The plaintiff had entered the agreement in response to a threat by the stagehands of his theater to go on strike on opening night. The plaintiff had just invested $10,000 in the theater's rehabilitation. The court held that the strike was illegal because it did not have a valid object, such as seeking improvement in the stagehands' wages, hours, or conditions; and the court held that an illegal strike is coercive. Even if the strike had been legal, however, it would have been no less coercive. The court's concern was that the plaintiff, who produced comedies and dramas, had to pay $450 per week to a group of musicians in return for nothing at all. This conclusion violates the fairness principle.

One could argue that rescission of the contract is not consistent with the fairness principle, because a valid exchange occurred: the plaintiff received the continued work of the stagehands, and the stagehands received greater bargaining power through the solidarity of the musicians' union. This objection

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104 304 Mich. 491, 8 N.W.2d 149 (1943).
105 305 Mich. 193, 9 N.W.2d 57 (1943).

might show that the court decided this case inconsistently with the fairness principle as well as the bargain principle. But the court was clearly influenced by an intuitive sense of fairness. It did not seem fair that the musicians received $450 per week from the plaintiff without having to work.

Clemont, Saginaw, and *Lafayette Dramatic Productions* obliquely suggest that the court sometimes used the pretext of duress to rescind a contract with unfair terms, though the bargaining process is no more defective than processes the court has endorsed. These cases show the influence of the fairness principle more strongly than they show the influence of the bargain principle.

The cases discussed in sections (1) and (2) show that the court would refuse to apply the doctrine of duress in order to rescind coerced but fair contracts. In the cases involving threats not to pay a commercial debt and in the cases involving threats to prosecute, the court repeatedly upheld a fair agreement despite its coercive origin. Rather than admitting that it enforced these contracts because of the fairness of their terms, the court pretended to find non-defective processes. But the bargaining processes were defective. The bargain principle appeared in the rhetoric of the duress opinions; but the pattern of the decisions can better be explained by the fairness principle.

V. Incompetent Parties and Fiduciary Relationships.

Courts generally do not enforce contracts if a party is incompetent.[106] The bargain principle explains the defense of incompetency as a consequence of the recognition that an incompetent person has high information costs. The cost to him of discovering that the contract into which he intends to enter will make him worse off is very high. The competent party can usually avoid this contingency more cheaply by refraining from entering the contract, as long as the incompetent party's incompetence is

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[106] *See* 2 Williston, Contracts §§ 250-1 (1959).

easily recognizable. If the incompetent party's incompetence is mild and difficult to recognize, then often the competent party is the worse cost-avoider. In these cases the bargain principle requires the court to enforce the contract. Regardless of the level of incompetence, the court disposes of a contract according to the relative information costs of the parties, not according to the fairness of the contract. Thus under the bargain principle we would expect the court sometimes to strike down contracts on the basis of the incompetency of one of the parties, even if the terms of the contracts are fair.

Under the fairness principle the competency of the parties is a tangential issue. The court evaluates a contract by looking at the fairness of the terms. Under the fairness principle we would expect the court not to strike down contracts that have fair terms and that resulted from a bargain struck by an incompetent.

Because the court never admits that one of the parties to a contract it decides to enforce is incompetent, we must discover whether the court uses a consistent standard for determining incompetency in the cases in which it enforces contracts and in the cases in which it rescinds contracts. In order to elucidate this standard it is useful to distinguish the characteristics of a person the court points to when questioning his competency to make bargains. The court typically refers to irrational behavior, age and physical infirmity, and trust in another party, as evidence of incompetency. We will find that the fairness principle explains these cases better than the bargain principle does.

(1) The court repeatedly faced conflicting evidence about the rationality of the party seeking rescission. The cases yield only ambiguous criteria for distinguishing irrational and rational parties.

The court held that the following persons were competent: in *Davis v. Phillips*[107] a man who had always managed his affairs, but who depended on the advice of others and was according to a doctor

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[107] 85 Mich. 198, 48 N.W. 513 (1891) (doctor's judgment was based partly on observation and partly on his theory that intelligence is proportionate to body size).

an imbecile; in *Beadle v. Anderson*[108] a man whom laymen called sane and experts called insane; in *Weickgenant v. Eccles*[109] a man who claimed he had nervous disorders at the time of the contract; in *Griffith v. Fuller*[110] a man who had a disease which caused him to suffer occasional bouts of insanity; in *Grand Rapids Trust Co. v. Atherton*[111] a woman whose stepson filed and then withdrew a petition to have her adjudicated mentally incompetent shortly after she conveyed a deed to some property to him; and in *Barrett v. Swisher*[112] a woman whose business sense was judged "astute," though apparently not astute enough to tell her to reserve a life-estate for herself in a gift of land to another person. The only consistent element of these decisions was the court's aversion to the opinions of experts.

The court held that the following persons were incompetent: in *Gates v. Cornett*[113] a man who was "by no means an idiot," had gone to school, and was capable of managing ordinary business and making loans and investments, but whose mind was "weak," and who proved incapable of starting up a large-scale farm; in *Bilman v. Kolorik*[114] a man with a sixth-grade education; in *Beattie v. Bower*[115] a man who thought the children of the neighborhood were out to get him; in *Sprenger v. Sprenger*[116] an old brother and sister, with fifth-grade educations, but who had run their affairs for many years; and in *Low v. Low*[117] an old woman who was nervous and forgetful. In *Bennett v. Fleming*[118] the court also held an old man incompetent while admitting that the evidence did not clearly support this conclusion.

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108 158 Mich. 483, 123 N.W. 8 (1909).
109 173 Mich. 695, 140 N.W. 513 (1913).
110 181 Mich. 553, 148 N.W. 345 (1914).
111 276 Mich. 56, 267 N.W. 593 (1936).
112 324 Mich. 638, 37 N.W.2d 655 (1949).
113 72 Mich. 420, 40 N.W. 740 (1888).
114 234 Mich. 689, 209 N.W. 88 (1926).
115 290 Mich. 517, 287 N.W. 900 (1939).
116 298 Mich. 551, 299 N.W. 711 (1941).
117 314 Mich. 370, 22 N.W.2d 748 (1946).
118 207 Mich. 278, 174 N.W. 131 (1919).

One might with great effort be able to find criteria for distinguishing these cases on the basis of characteristics of the allegedly incompetent person.[119] But such an effort is probably not worth the trouble. This brief summary makes the court's decisions look more orderly than they are. In some of these contracts the information costs of the allegedly incompetent party of avoiding the loss and the information costs of the other party in detecting the incompetency of the first both are high, and not different enough to yield a determinate result.

For example, in *Bennett* a sick, old man conveyed his property to the plaintiff, a new friend, in return for care for the rest of the old man's life and for arrangement and payment of a funeral and burial. The old man died eleven days later and when the plaintiff brought suit to reform the contract because it gave a faulty description of the land, the old man's heirs resisted the suit on the grounds of fraud and undue influence. The court ruled against the plaintiff on the ground that the old man was incompetent. But it is impossible to say whether the old man could more cheaply have sought the advice of another person before entering the contract or the friend could more cheaply have detected the old man's irrationality (if he was irrational) before entering the contract. The terms of the contract were not so unequal as to alert the friend of the old man's incompetence. While the court found that the short expectancy of the old man's life was "evident" at the time of the contract, the friend could plausibly have thought that the old man did not have heirs or did not like his heirs, and therefore preferred to convey his property to the friend. The court could not -- and did not -- decide this case on the basis of the relative information costs of the parties.

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[119] For example, one could argue that some of these cases can be distinguished by the fact that the party in question was not incompetent at the time of the transaction, even if he was incompetent before or after it. However, the court often uses evidence of the party's mental condition before and after the transaction as evidence regarding his mental state during the transaction.

The court based its decisions in *Bennett* -- as we will see shortly -- and the other cases on the fairness of the deal. Let us first look at the cases in which the court rejected the claim of incompetency.

In *Davis* the court found competency despite the evidence to the contrary because the allegedly incompetent party bought the patent at a reasonable price, though later events rendered the patent worthless. In *Beadle* the court reversed a lower court's finding of incompetency because the unequal conveyances by the father to his sons shortly before his death was justified by the profligacy of the one son as compared to the thrift of the other. In *Weickgenant* the court found competency because the sale of a store allegedly during a nervous disorder was at a price that reflected the value of the store. "Whatever may be the truth as to [the seller's] mental condition at the time the contract was made, the record shows that complainant paid all the stock was worth.... [The seller's] own testimony since recovery shows that he was and is now satisfied with the sale, and that he has never made any complaint of its unfairness...."[120] In *Griffith* the court found competency despite the deceased's occasional bouts of insanity because the conveyance by the deceased of his house to his housekeeper justly compensated her for her services. In *Grand Rapids Trust* the court said "we find nothing contrary to natural justice in [the alleged incompetent's] turning over $1100 worth of property to Ernest, who was so dear to her."[121] The court upheld the conveyance even though Ernest filed a petition to have the old woman adjudicated mentally incompetent a couple days after the conveyance. (He later withdrew his petition and the old woman was not adjudicated mentally incompetent until another two years had passed.) In *Barrett* the court found competency because the deed to one son rather than to the other rewarded the goodness of the first. The court held that grantor, an old woman, had "astute business sense." But it also held that she had mistakenly

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120 173 Mich. at 697, 140 N.W. at 515 (1913).
121 276 Mich. at 57, 267 N.W. at 594 (1936).

forgotten to reserve a life interest in the estate, and it reformed the deed. The old woman apparently was not astute enough to reserve a place to live. Yet the court held her competent because once the life estate was implied the deed was fair. The court's determinations that parties were competent was not based on an independent evaluation of the parties' mental conditions. The court repeatedly, though sometimes covertly, called a party competent and enforced the contract, when it found the contract fair.

Conversely, the court called a party incompetent not because of evidence demonstrating the defective mental condition of the party, but because the contract was unfair. In *Gates* the court found incompetency despite the party's earlier success in administering his mother's estate and in making investments, because the party exchanged unsecured notes for secured notes at great disadvantage to himself. In *Bennet* the court found incompetency despite ambiguous evidence because the deceased had conveyed all his property in return for funeral expenses and care that lasted only the eleven remaining days of his life. "Under the undisputed facts shown, and evident short expectancy of the life of grantor when the deed was made, the claimed consideration, left in parole, was so grossly inadequate as in itself to be evidence of overreaching and undue influence."[122] In Bilman the court found incompetency because the plaintiff conveyed land worth $1600 for only $100. In *Sprenger* the court held the brother and sister incompetent because "the testimony in the instant case falls far short of satisfying us of the fairness of the transaction."[123] While the dissent in *Sprenger* argued that the parties were intelligent and entered the trust agreement only after long discussion and consideration, the majority held that the trust agreement benefited the trustees more than the brother and sister. In *Low* the court held the mother incompetent because she had given up her right to care and support, that she had

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122 207 Mich. at 281, 174 N.W. at 134 (1919).
123 298 Mich. at 558, 299 N.W. at 718 (1941).

received as part of the consideration for conveyance of an earlier deed to her son, in return for nothing. The common element in the cases in which the court rescinded a contract on the ground of incompetence was not a clearly incompetent party. The common element was the substantive unfairness of the contracts.

The court would find the parties competent if the terms were fair; and it would find one of the parties incompetent if the terms were not fair. The cases turned on the dictates of the fairness principle, but they were clothed in the rhetoric of the bargain principle.

(2) The court commonly dealt with contracts in which old and sick people gave away their property for consideration as minimal as "care"; either they suffered at the hands of their Gonerils and Regans and brought suit for rescission, or more commonly they died and their heirs sought rescission. As in the cases just discussed, the court had trouble distinguishing competent old and sick people from incompetent old and sick people. We saw in *Beadle*, *Grand Rapids Trust*, and *Barrett*, that the court often found old and sick people competent. It also did in *Olson v. Rasmussen*.[124] But in *Low* the party's age and infirmity rendered her incompetent. And in *Clement v. Smith*[125] a 70-year-old widow was held to be incompetent. Thus the court sometimes found a party incompetent because of his age and infirmity, and sometimes found a party competent despite his age and infirmity.

The contrast of *Olson* and *Clement* illustrates this claim. Both cases involved the conveyance of property by a very old person in return for care. In *Olson* the grantor was a 78 year old man, who died shortly after the conveyance. In *Clement* the grantor was a 70 year old woman, who was still alive at the time of the suit. In *Olson* the grantee was one of the grantor's two sons; the grantor reserved a life estate and received in consideration a promise to care for him and pay his funeral expenses. In *Clement* the grantee was a trusted friend of the grantor; the grantor

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[124] 304 Mich. 639, 8 N.W.2d 668 (1943).
[125] 293 Mich. 393, 292 N.W. 343 (1940).

reserved a life estate and received in consideration a promise to pay her medical bills and funeral expenses. In *Olson* the court refused to rescind the contract in response to a suit by the old man's other son; it held the old man to have been competent. In *Clement* the court rescinded the contract in response to a suit by the old woman; it held that she was incompetent when she signed the contract. It is difficult to distinguish these cases on the basis of the competency of the grantors. The old woman, the *Clement* court noted, had poor health, a bad memory, and bad eyesight. But it is hard to believe that the 78 year old man in *Olson* did not also have poor health, a bad memory, and bad eyesight. After all, he died shortly after he signed the contract. The old woman lived long enough to bring suit. Moreover, the evidence regarding the old woman's competence was conflicting; and she had at least enough competence to have the deed formally drawn up by an attorney and registered.

To distinguish these cases one must compare the terms of the deal. The old man in *Olson* liked the grantee more than his other son. The grantee had taken care of the old man before, and the court found that the old man probably wanted to make sure that the grantee would continue to take care of him as he approached death. The court also pointed out that the grantee assumed the risk that the old man would live for a long time and drain more resources than he conveyed to the grantee. The *Olson* court upheld the contract because it was fair. But the contract in *Clement* was unfair. The court said that "the conveyance left plaintiff without any security for her future support, for her life estate in the property would be practically unmarketable."[126] Unlike the case of *Olson*, in *Clement* the grantor received much less than she conveyed. The court rescinded the contract because it was unfair. In the cases involving old and sick people the court again showed itself more influenced by concerns about fairness than by concerns about the validity of the bargaining process.[127]

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[126] *Id.* at 393, 293 N.W. at 343.

[127] *But see,* Wroblewski v. Wroblewski, 329 Mich. 61, 44 N.W.2d 869 (1950) (court held old couple who conveyed property to son in return for care,

(3) The court's decisions to strike down contracts because of violation of confidential relationships are also better explained by the fairness principle than by the bargain principle. The court distinguishes confidential relationships that appear identical from the bargain principle perspective. In *Scheibner v. Scheibner*[128] a widow and her two sons each received a third interest in the deceased's estate. The widow conveyed her interest for no consideration to one of the sons, who also happened to control all of her financial affairs. The court enforced the deed. Likewise, in *Knight v. Behringen*[129] a man conveyed his property to his daughter shortly before his death; although she agreed to pay him by installment, his death released her, giving her the land for almost nothing. Although the daughter lived with her father and assisted him with financial affairs, the court held that she had no fiduciary relationship because she did not give him confidential advice. The court enforced the deed.

But in *Smith v. Cuddy*[130] the court rescinded a deed conveyed from a woman to her brother, who managed her financial affairs. In *Noban v. Shoup*[131] the court rescinded a deed from the deceased to one of his sons rather than the other. The court said that the son who received the property had an obligation to guard his father's interest. We saw similar decisions in *Clement* and *Sprenger*.

Smith and *Noban* are more clearly distinguishable from *Scheibner* and *Knight* on the basis of fairness than on the basis of the validity of their bargaining processes. In *Smith* the woman had conveyed a deed to her property to her brother in order to disinherit her husband; but now wanted reconciliation. The court held that the brother failed to prove that the conveyance was

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attention, and support worth $160 per month were not incompetent. The court invoked consideration doctrine in response to the old couple's argument that the contract was unfair. The report does not say whether the court thought that the contract was fair or unfair).

128 220 Mich. 115, 189 N.W. 913 (1922).

129 329 Mich. 24, 44 N.W.2d 852 (1950).

130 96 Mich. 562, 56 N.W. 89 (1893).

131 171 Mich. 191, 137 N.W. 75 (1912).

fair. In *Noban* the court held that a father's conveyance of his property to one son, shortly before his death, rather than the other son resulted from an invalid bargaining process, because the first son violated his duty to protect his father's interests. But the court has frequently permitted conveyances between a parent and one child to the detriment of another child[132]; and the rationale for this decision must have been the absence in this case, unlike in the other cases, of a reason to believe that the father preferred the receiving son to the other son. The conveyances in both *Smith* and *Noban* were rescinded because they were unfair.

In contrast, the conveyances in *Scheibner* and *Knight* were enforced because they were fair. *Scheibner* is an example of a case in which the court permitted a conveyance from a parent to one of two of her children. Although the receiving child had charge of all of his mother's financial affairs -- a clear defect in the bargaining process -- the court upheld the contract because of evidence that the mother preferred this son to the other. In *Knight* the court upheld a contract in which a father sold his house to his daughter for $5000 in installments of $75 per month, with a provision that the debt would be forgiven if the father died. He died before the daughter paid the full amount and his other heirs sued. The court found no confidential relationship because the daughter "assisted" her father with his financial affairs, rather than "advising" her.

Whatever one thinks of the court's linguistic gymnastics, it is clear that in these four cases the information costs resulting from the grantors' relations of trust with the grantees were not significantly different. The court rescinded the contracts in *Smith* and *Noban* because these contracts were unfair; the court enforced the contracts in *Scheibner* and *Knight* because these contracts were fair.

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[132] *See, e.g.*, Beadle v. Anderson, 158 Mich. 483, 123 N.W. 8 (1909); Barrett v. Swisher, 324 Mich. 638, 37 N.W.2d 655 (1949); both cases were discussed above.

One would expect in cases involving fiduciary or confidential relationships that the information costs to the vulnerable party would be high because of his dependency on the advice of another. To avoid entering a bad deal between himself and the fiduciary the vulnerable party must invest in a new fiduciary to advise him on that deal. Moreover, the information cost to the original fiduciary of predicting the vulnerable party's future unhappiness with the contract should be low, because the former knows the latter's preferences and capacities. Since the vulnerable party's information costs exceed those of the fiduciary, the bargain principle requires rescission of contracts between fiduciaries. But the court did not rescind all such contracts. In most of the incompetency cases the court preferred evaluating the fairness of the deals to estimating the competency of the party in question.

A supporter of the bargain principle could argue that these cases are not a strong blow to the bargain principle. The difficulty of evaluating the mental states of parties makes it necessary to review the terms. Fair terms create a rebuttable presumption of competency; but competency is ultimately the issue in which the court is interested. Nonetheless, the fairness principle provides a simpler explanation for the pattern of the incompetency cases than the bargain principle does. The bargain principle does not do any analytical work, because it defers to the analysis of the fairness principle.

VI. Consideration and Unconscionability.

The Michigan Supreme Court ostensibly adhered to the doctrine of consideration. It said many times that the court does not inquire into the adequacy of consideration. "Mere inadequacy of consideration, unaccompanied by other elements of bad faith, will not warrant cancellation of a contract, unless so inadequate as to furnish convincing evidence of fraud."[133] Contracts granting one party a benefit without requiring of him an obligation must be

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[133] Wroblewski v. Wroblewski, 329 Mich. 61, 62, 44 N.W.2d 869, 870 (1950).

rescinded as gifts. All other contracts must be enforced, regardless of any inequality in the terms, as long as each party receives some benefit.

The consideration doctrine is a queer amalgam of the bargain principle and the fairness principle. On the one hand, the consideration doctrine follows the bargain principle by forbidding the court to rescind contracts because of inequality of the terms, as long as both parties gain something of value. On the other hand, the consideration doctrine follows the fairness principle by allowing the court to rescind contracts in which one party gains nothing of value.

Some argue that the rescission of contracts lacking consideration is based on concerns about the purity of the bargaining process.[134] The bargain principle recognizes that people make promises without really intending to bind themselves to a future action. The cost to the promisor of editing his speech so as not to make inconsiderate promises usually exceeds the cost to the promisee of insisting on a formality before relying on these promises.[135] The court upholds such promises only when the promisee reasonably relies on the promise to his detriment -- i.e., the cost to him of discovering the promisor's true intention exceeds the cost to the promisor of speaking with more care.[136] While enforcement of genuine gifts might improve the joint utility of the donor and donee, consideration doctrine expresses the assumption that a bright-line rule against gratuitous contracts prevents more inconsiderate gratuitous promises than it prevents intended gratuitous promises.

But if this argument is valid, then one would expect contracts struck down by the consideration doctrine to have suffered from some bargaining defect, however inchoate. The consideration

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[134] See Fuller, Consideration and Form, 42 Colum. L. Rev. 799, 800 (1941) (discussing the use of consideration doctrine to prevent "inconsiderate action"). *Compare* R. Posner, *supra* note 93 *with* S. Shavell, An Economic Analysis of Deferred Gifts, Discussion Paper No. 40, Program in Law and Economics (1980).

[135] *See* R. Posner, *supra* note 30 at 86-7 (3rd ed. 1986).

[136] *See also,* Patterson, An Apology for Consideration, 58 Colum. L. Rev. 929 (1958); Holmes, *supra* note 6 at 230; 1 Williston, Contracts §100 (1957).

doctrine would be a kind of catch-all doctrine for rescinding contracts marred by procedural defects that do not fit neatly into any of the other doctrinal categories.

In order to compare the influence of the bargain principle and the fairness principle in consideration cases, we shall look at contracts with unequal terms that resulted from valid bargaining processes. Enforcement of these contracts despite the consideration doctrine shows the influence of the bargain principle. Rescission of these contracts shows the influence of the fairness principle. Rescission of these contracts can also show the influence of the bargain principle if there is evidence of procedural defects. We will see that the Michigan Supreme Court usually follows the fairness principle and rescinds contracts with unequal terms.

It is worthwhile to begin with the cases most often cited by the Michigan Supreme Court as precedent for the doctrine of consideration. One would expect these cases to provide strong support for the bargain principle interpretation of consideration doctrine, but they do not. *Van Norsdall v. Smith*[137] was discussed in the section about the mistake doctrine. The discussion concluded that the court rescinded the contract between the widow and the deceased's siblings, despite a valid bargaining process, because the terms of the contract were unfair. One might argue that the bargaining process was defective, because one of the siblings failed to tell the widow about a debt owed by the deceased to him. But this argument is weak, because the sibling had no reason to think that the widow, as administratrix, was ignorant of the deceased's debts. The court cited the doctrine of consideration, because the contract gave the widow nothing in return for her payment to the siblings. *Van Norsdall* is better explained by the fairness principle than by the bargain principle.

Three other leading cases on consideration doctrine, *Olson*, *Harris*, and *Wroblewski*, have also been discussed.[138] None of these

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[137] 141 Mich. 355, 104 N.W. 660 (1905).

[138] *See* Part V.

cases supports the bargain principle in a clear way. *Olson* enforced a contract in which an old man conveyed his property to one of his sons in return for care and maintenance. *Wroblewski* enforced a similar contract. *Harris* enforced a contract in which a landlord reduced the rent by 50% in return for the right to collect rent directly from the lessee's commercial subtenants in case of default. All three of these decisions said that the court does not rescind contracts because of inadequacy of consideration. The *Olson* and *Harris* courts immediately followed this statement with an analysis of the adequacy of consideration -- as though the justices had forgotten that they had just invoked the doctrine of consideration. And all three cases are easily explained by the fairness principle, as well as the bargain principle: not only were the bargains valid, but they were fair. In *Olson* and *Wroblewski* the defendants committed themselves to caring for old men in return for property; since the defendants assumed the risk that the old men would live much longer, they cannot be denied the profit caused by early demise. In *Harris* the landlord made a sensible investment in response to the events of 1929. By reducing the rent of the lessee, she reduced the risk of default by the lessee and she reduced the risk of great loss in the event of default by acquiring the right to collect from the tenants. Olson, Harris, and Wroblewski do not lend exclusive support to the bargain principle interpretation of consideration doctrine, but are also open to interpretations based on the fairness principle.

Another case is more consistent with the fairness principle than with the bargain principle. In *Radloff v. Ruggles Motor Truck Co.*[139] a farmer bought 100 shares of stock in a corporation from an agent of the corporation. The farmer gave the agent two notes worth $5500. At trial the farmer testified that the agent told the farmer that the second note was a receipt for the purpose of record-keeping and had no value, and that the farmer had no obligation to pay the first note, but could rescind the deal at any time. Other evidence suggests that the agent might have

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[139] 229 Mich. 139, 201 N.W. 200 (1924).

misled the farmer at the time of the deal; but the agent did send the farmer a letter confirming a commitment by the farmer to pay $5500 at the corporation's demand, a letter which the farmer did not protest. When the corporation tried to cash the note, the farmer sued to enjoin. The court rescinded the contract even though the farmer was literate and intelligent. The court found it difficult to believe the farmer would have agreed to pay $5500 for 100 shares of stock when all his property was worth only $5000, and therefore the agent must have defrauded the farmer.

This reasoning is not convincing. While the agent might have induced the sale through a stratagem, for all the court knew the farmer was gambling that the price of the stock would rise before the corporation tried to cash the notes. The bargain principle cannot explain this case adequately, because the existence of defects in the bargaining process is ambiguous. But the fairness principle justifies rescission on the ground that the terms were not fair. Admittedly, the farmer might have paid the market price of the stock; but, given the farmer's financial position, the court must have felt that the farmer overestimated the probability of an increase in price. In violation of the bargain principle the court rejected the farmer's original valuation of the bargain, and, substituting its own, found the terms of the contract unfair.

Only a few consideration cases appear to lend support to the bargain principle. In *Hake v. Youngs*[140] a farmer traded his farm and other interests to the defendant for property worth between $10,000 and $20,000. The day after the deal the farmer's agent reported that he had found someone who would buy the farm for $40,000. The court refused to rescind the contract so that the farmer could sell to the third party. After invoking the doctrine that "mere inadequacy of consideration ... is not ground for rescission,"[141] the court said that the farmer had been trying to make the trade for defendant's land for years. Evidence showed that the $40,000 was closer to the market price of the farm than

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140 254 Mich. 545, 236 N.W. 858 (1931).
141 *Id.* at 546, 236 N.W. at 859.

was the value of defendant's property. This case is consistent with the bargain principle, because the defendant's cost of finding the third party who would outbid him would have exceeded the farmer's cost of waiting another day. The farmer misjudged the value of defendant's property, probably assuming its value to be $30,000 or $35,000. The fairness principle would have required rescission of the contract. But the court did not rescind the contract.

In *Engle v. Engle*[142] two brothers had agreed years before their father's death to an uneven division of his estate. The plaintiff was to receive the land, worth $4000, and the defendant was to receive the deceased's personal property, worth only $800. Upon the death of the father the defendant refused to convey his interest in the land, and the plaintiff sued for specific performance. The court granted specific performance because it found no defects in the bargaining process. Thus the court obeyed the bargain principle that contracts resulting from valid bargaining processes must be enforced. This case, however, is also open to an interpretation based on the fairness principle. The court said, "frequently, the apparent necessities of one heir cause the others to conclude that he should, as a matter of fairness, not of legal right, receive a greater share than the others."[143] Family members attach values to goods and services that are not the same as the market price. Often these values reflect altruistic attempts to even out old debts. The court assumed that these nonmarket factors made the deal a fair one.

In *Robinson v. Solomon*[144] the owner of a sawmill sold his mill at the scrap value of $5000 to the defendant, because he could not afford to transport it to the site of defendant's lumber. The defendant moved the sawmill itself at a cost of $50,000, but then used it at great profit. The owner sued to have the sale reformed as a mortgage, claiming that defendant took advantage of his debt to force the sale. The court refused to reform the sale, because

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142 209 Mich. 275, 176 N.W. 547 (1920).
143 *Id.* at 278, 176 N.W. at 550.
144 222 Mich. 618, 193 N.W. 209 (1923).

the owner was a sophisticated businessman who knew what he was doing. The court thus justified enforcement by appeal to the bargain principle. But the court also alluded to a justification based on the fairness principle. Because the owner was nearly insolvent, the risk that transportation of the mill would result in failure was more expensive than he could afford. He sold that risk to the defendant; and the court held that $5000 was a fair price. The court must have felt that if the parties had agreed to a mortgage rather than a sale, the fair rate of interest would be so high that the owner would have profited as little from the mortgage as he profited from the sale.

Of the cases involving the doctrine of consideration -- the paradigmatic doctrine of the bargain principle -- only *Hake* lends unambiguous support to the bargain principle. The other cases are open to explanations based on the fairness principle. In contrast, the court struck down several cases on the basis of the paradigmatic doctrine of the fairness principle, the doctrine of unconscionability. The doctrine of unconscionability is difficult to reconcile with the bargain principle. One attempt to reconcile the two makes a distinction between procedural and substantive unconscionability.[145] A contract should be rescinded as procedurally unconscionable if the bargaining process has a serious defect. A contract should not be rescinded, however, on the ground that the terms are unequal. This attempt to reconcile the doctrine of unconscionability with the bargain principle simply turns unconscionability into a superfluous device for detecting procedural defects -- superfluous because the doctrines of mistake, fraud, and duress can catch any conceivable bargaining defect. If the bargain principle thesis describes the case law, one would expect no cases in which the court strikes down contracts with valid bargaining processes and unfair terms as unconscionable. But there are several cases of this kind.

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[145] Leff, Unconscionability and the Code -- The Emperor's New Clause, 115 U. of Penn. L. Rev. 485, 532-41 (1967). *Cf.* Pomeroy, Specific Performance of Contract (1896), which is sometimes cited by the Michigan Supreme Court.

In *State Security & Reality Co. v. Shaffer*[146] a physician agreed to exchange his property in a small village for city property owned by the plaintiff. The physician's property was worth $11,800. When the physician discovered that the plaintiff's property was worth no more than $1500, he refused to convey the deed, and plaintiff sued for specific performance. The court held in favor of the physician. The court pointed to no procedural defects in the bargain. Nothing in the record suggested that the bargaining process was any different from the bargaining processes of any other valid contract. But the court refused to compel the physician "to transfer [his] property (be it worth little or much) to complainant practically for nothing."[147] The inequality of the terms of the contract justified rescission.

In *Albright v. Stockhill*[148] a farmer conveyed $8,025 worth of personal and real property to the defendant, in return for a grain elevator, warehouses, an electric light plant, an implement business, and the stock in trade connected with the implement business, all apparently worth $8,775. When the farmer realized that there was a $2700 debt on the stock, he sued for rescission. The reasoning in the decision is difficult to follow; but the court appears not to have attached any weight to the farmer's claim of misrepresentation. The farmer had argued that the defendant misrepresented the cost of fuel for the electric plant and the property as unencumbered by debt. The court noted that the farmer was a sophisticated businessman, and he had an opportunity to investigate defendant's premises and talk to defendant's bookkeeper. The court said that the defendant's misrepresentations regarding the price of fuel were within the permissible bounds of negotiation; the court did not decide the issue of misrepresentation of the existence of debt. But the court did order the defendant to pay the debts he had assigned to the plaintiff because of gross inadequacy of consideration. The

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146 176 Mich. 639, 142 N.W. 1058 (1913).
147 *Id.* at 641, 142 N.W. 1060.
148 208 Mich. 468, 175 N.W. 252 (1919).

court's view of the bargaining process is murky; its decision was probably motivated by the inequality of terms.

In *Linsell v. Halicki*[149] the plaintiff transferred a land interest worth $1350 and $850 in cash to defendant in return for equity worth $4300. When defendant refused to convey the deed, plaintiff sued for specific performance. The court held in favor of the defendant. The court found it hard to believe that plaintiff could have made such an easy $2200 profit as a result of honest dealing. But the court could not point to any defects in the bargaining process. The court struck down the contract because the terms were unfair.

In *Johnson Realty & Investment Co. v. Grosvenor*[150] the plaintiff agreed to exchange his land in Florida for defendant's Michigan land. The defendant's land was worth $15,000. When defendant found out that the plaintiff's land was almost completely mortgaged, he refused to convey the deed to his land. The court refused to grant plaintiff's suit for specific performance. It was not able to point to fraud or misrepresentation, and based its ruling on "the simplicity, the credulity and lack of experience of [the] defendant."[151] The court did not say that the defendant was incompetent, or that the plaintiff could have discovered the defendant's simplicity at reasonable cost; the court must have inferred that the defendant was "simple" from the inequality of the transaction. The court struck down the contract because the terms were unfair.

The fairness principle can explain more of the cases involving consideration doctrine than the bargain principle can. The court enforced contracts with apparently unfair terms usually because of the difficulty of estimating market price. In these cases the court enforced the contracts because of the absence of defects in the bargaining process. But the court frequently rescinded contracts with apparently valid bargaining processes, when the terms were unfair. Despite its fondness for the rhetoric of the

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149 240 Mich. 483, 215 N.W. 315 (1927).
150 241 Mich. 321, 217 N.W. 20 (1928).
151 *Id.* at 323, 217 N.W. at 22.

bargain principle, the court must have been more concerned with the substantive fairness of contracts than with the purity of their bargaining processes.

VII. Penalties.

The penalty doctrine forbids courts to enforce contractual agreements to liquidated damages that are unreasonable. This doctrine presents problems for the bargain principle, because it permits courts to police contractual clauses and strike them down for unfairness. For this reason the doctrine also appears consistent with the fairness principle.

The bargain principle can explain the penalty doctrine only as a device for detecting hidden defects in the bargaining process. If the parties agreed to a contract stipulating ex ante unreasonable liquidated damages, one or both of the parties must have had high information costs. Thus the bargain principle predicts that contracts with (unreasonable) penalties result from a defective bargaining process.[152]

The fairness principle explains the penalty doctrine as a device simply for rescinding contracts that appear unfair. The fairness principle predicts that the court will strike down liquidated damages provisions that render one party's obligation, plus the discounted value of the liquidated damages in the absence of performance, more valuable than the other party's obligation.[153]

There is almost no evidence for the bargain principle thesis that courts find penalties only where contracts resulted from defective bargaining processes. Most cases in which the court found penalties involved contracts between sophisticated

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[152] *See* Rea, Efficiency Implications of Penalties and Liquidated Damages, 13 J. Legal Stud. 147, 160 (1987). *Cf.* Rubin, Unenforceable Contracts: Penalty Clauses and Specific Performance, 10 J. Legal Studies 237 (1981); Clarkson, Miller, & Muris, Liquidated Damages v. Penalties: Sense or Nonsense?, 1978 Wisc. L. Rev. 351 (1978); Goetz & Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, 77 Colum. L. Rev. 554 (1977).

[153] *Cf.* V. Goldberg, Readings in the Economics of Contract Law 161-3 (1989).

businessmen. *Decker v. Pierce*[154] found a penalty in a contract in which one businessman sold a movie theater to another businessman. *Biddle v. Biddle*[155] found a penalty in a contract in which a realty company agreed to pay liquidated damages if it did not fulfill its promise to buy a piece of property. *Fisher v. Waddell*[156] found a penalty in a contract in which a group of businessmen agreed to pay liquidated damages if it did not fulfill its promise to buy the inventory of a store. *Nichols v. Seaks*[157] found a penalty in a contract in which a business hired a financial analyst to develop a pension plan for it. None of the contracts in these cases involved unsophisticated parties, nor was there evidence of misrepresentation, mistakes, coercion, or any other characteristic of a defective bargaining process.

In only one case, *Orban v. Stelle*,[158] did the court find a penalty in a contract that could have resulted from a defective bargaining process. In *Orban* the defendant owned property subject to a mortgage. On foreclosure the bank bought the property and demanded possession. In a consent decree the parties agreed that the defendant would continue to live on the property as a tenant, paying $180 a month on the condition of a $1000 deposit. The defendant defaulted on the first month's rent and the bank had him evicted; then the bank sued for the $1000 as liquidated damages. The court held that the $1000 would be a penalty if considered liquidated damages for breach of the lease, and could be construed only as security against damages to the property. In this case one can imagine that the defendant, through ignorance or desperation, faced high information costs in the bargaining process; and that the court found the $1000 to be a penalty because it recognized the defect in the bargaining process. But the court did not mention the possibility of duress, mistake, misrepresentation, or any other sign of high information costs.

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154 191 Mich. 64, 157 N.W. 384 (1916).
155 202 Mich. 160, 168 N.W. 92 (1918).
156 227 Mich. 339, 198 N.W. 972 (1924).
157 296 Mich. 151, 295 N.W. 595 (1941).
158 292 Mich. 341, 290 N.W. 821 (1940).

The court simply calls the liquidated damages provision an "unconscionable penalty."[159]

The only other indication that the penalty cases turned on the bargaining process is the rule that forbids the court to find a penalty where the liquidated damages provision represents an honest attempt to estimate damages caused by breach. *Ross v. Loescher*[160] held that a supplier's bill to a builder, which would be reduced by $20 for each day that supply was late, could have been the result of an honest bargain. *Hall v. Gargaro*[161] held that a $10 per day lateness charge could have been the result of an honest bargain. Both these cases suggest that the court considered liquidated damages clauses invalid if they resulted from a dishonest bargaining process.

But other cases contradict this suggestion. *Nichols* held that a penalty agreed to as the result even of an honest bargain is void. The amount of liquidated damages to which the parties agree must be "reasonable" to avoid rescission by the court, regardless of the good faith of the parties. Thus the court repeatedly said that the intentions of the parties do not matter, if the liquidated damages provision has the "nature" of a penalty.[162] The rule that the court will not find a penalty in a contract resulting from an honest bargain has no force. Beyond the oblique reference in *Nichols*, *Ross*, and *Hall* to the honesty of the estimate of liquidated damages, the court never pointed to a procedural defect, such as duress, mistake, or misrepresentation, as the reason that a party agreed to a penalty clause. And in none of the cases does the court mention the absence of a procedural defect as the reason for finding no penalty. There is little evidence in the penalty cases that the court was concerned with the quality of the bargaining process.

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159 *Id.* at 342, 290 N.W. at 822.
160 152 Mich. 386, 116 N.W. 193 (1908).
161 310 Mich. 693, 14 N.W.2d 795 (1945).
162 Davidow v. Wadsworth Mfg. Co., 211 Mich. 90, 178 N.W. 776 (1920); Central Trust v. Wolf, 255 Mich. 6, 237 N.W. 29 (1931).

The court would strike down a liquidated damages provision as a penalty if the stipulated level of liquidated damages did not approximate the level of actual loss. In *Biddle* the court struck down the liquidated damages provision of a contract in which a realty company agreed to buy land an estate. The penalty of $1500 was five times the $300 losses the estate sustained in surveying the land and preparing the sale; the estate had been able to sell the property at a higher price immediately after the realty company's breach. In *Davidow* the court struck down as unconstitutional a state statute that required employers to pay employees 10% of their back wages per day that the wages remain unpaid. After two years the employer owed the employee $500 in interest on an initial debt of $12.32. The penalty was 4058% of the loss. In *Orban* the court held that forfeiture of a $1000 deposit because of default on a $180 rental payment counted as a penalty. The liquidated damages were 550% of the loss. In *Fisher* the court struck down as a penalty an agreement that the defendant forfeit a $1000 deposit if he failed to buy plaintiff's inventory, where plaintiff was able to auction off her inventory at $286 less than the contract price. Thus the stipulated level of liquidated damages was three and a half times the actual loss. This ratio of liquidated damages to actual loss was the lowest among the cases in which the court found a penalty.

In the cases in which the court could not accurately ascertain damages, it was more willing to uphold liquidated damages provisions. But it did so not on the basis of the quality of the bargaining process, but on the basis of guesses about the reasonableness of the level of liquidated damages. In *Calbeck v. Ford*[163] the court held that the stipulation of $1000 in liquidated damages was reasonable, because the plaintiff probably suffered more than $1000 in losses. In *Ross* and *Hall* the court thought that a $10 or $20 per day fine for late delivery of building supplies was reasonable, when, as in *Ross*, the onset of cold

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[163] 140 Mich. 48, 103 N.W. 516 (1905).

weather made fast delivery an exigency. In *Axe v. Tolbert*[164] the court held that liquidated damages equal to 2.5% of the sale of land for breach of an exclusive option that the farmer sold to a broker were roughly equivalent to the amount that the broker had spent in advertising. In *Jones v. Stainton*[165] the court held that $250 were reasonable liquidated damages when the plaintiff suffered $438 in losses supplying a talent group to the manager of a canceled show. In *Malone v. Levine*[166] the court held that liquidated damages of $5000 reasonably approximated the losses to a lessor who was building an apartment building in contemplation of a ten-year, $210,000 lease. In *Central Trust* the court came to the same conclusion regarding a $54,000 lease with $3000 in liquidated damages. In *Wilkinson v. Lauterman*[167] the court held liquidated damages of $1000 to be reasonable for breach of a $50,000 purchase of land. In all these cases the court directed its attention to the reasonableness of the liquidated damages provided by contract.

By "reasonable" provisions for liquidated damages the court meant that the stipulated level of liquidated damages approximately equals the actual loss of the breachee. This concern is expressed in the "principle of just compensation." The principle of just compensation requires the court to strike down liquidated damages clauses as penalties when they exceed the actual loss by a significant amount, regardless of the desires or intentions of the parties.[168] What counts as a significant amount is a difficult question. But the common element of the cases in which the court upheld the liquidated damages provisions was not the equivalence of the liquidated damages and the actual loss, but the court's uncertainty regarding the actual loss. Except for *Jones*, the court was unable to calculate actual loss. In all but two of the cases in which the court struck down the liquidated

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[164] 179 Mich. 556, 146 N.W. 418 (1914).
[165] 200 Mich. 694, 166 N.W. 966 (1918).
[166] 240 Mich. 222, 215 N.W. 356 (1927).
[167] 314 Mich. 568, 22 N.W.2d 827 (1946).
[168] *See* Decker v. Pierce, 191 Mich. 64, 157 N.W. 384 (1916); Nichols v. Seaks, 296 Mich. 151, 295 N.W. 595 (1941).

damages provision the court was able to calculate the actual loss. This pattern suggests that the court's reluctance to strike down many liquidated damages provisions was due more to uncertainty as to their unfairness, than to deference to the agreement of the parties.

While the bargain principle does not explain the pattern of penalty cases, one could argue that the fairness principle does not explain the pattern either. The fairness principle requires courts to take account of all aspects of an exchange, including the arrangements for the contingency of breach. Evaluating an exchange that has a liquidated damages provision requires adding the discounted value of that provision to the other elements of the exchange. Estimating the ex ante value of the liquidated damages provision is difficult because the court probably does not know the probability of breach and the probability of enforcement. Simply striking down liquidated damages provisions that do not approximate the actual loss will violate the fairness principle whenever the probabilities of breach and nonenforcement are high.[169] For example, suppose seller agrees to sell a gadget to buyer and to pay liquidated damages in the event of nondelivery. A purchase price of $100 for the gadget, when there is a 50% chance of delivery and only a 10% chance of enforcement in the event of nondelivery would require a $500 liquidated damages provision.[170] This deal is fair because each party acquires an ex ante obligation worth $100. But at first sight one would expect the Michigan Supreme Court to have struck down this liquidated damages provision, because the level of liquidated damages exceeds the loss by five times.

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[169] By "nonenforcement" I include the possibility that the court fails to award damages sufficient to compensate the breachee for hidden reliance costs.

[170] Without the liquidated damages provision the buyer pays $100 in advance for a promise worth only $60. The promise is worth only $60, because the buyer has a 50% chance of receiving the $100 gadget plus a 10% chance of receiving $100 in damages for nondelivery. In order to increase the value of the promise to $100, he must insist on liquidated damages of $500. The promise would equal 50% of the $100 gadget plus 10% of $500 liquidated damages.

One could thus argue that the Michigan court's rescission of liquidated damages clauses violates the fairness principle by reducing the ex ante value of the contract to the breachee to a level below the ex ante value of the contract to the breacher. But this argument is valid only for contracts in which there are high probabilities of breach and nonenforcement. When the probabilities of breach and nonenforcement are low, provisions for high levels of liquidated damages are not necessary. If the fairness principle truly describes the pattern of the Michigan penalty decisions, then we would expect that the court did not strike down liquidated damages provisions in contracts with high probabilities of breach and nonenforcement.

This expectation is borne out by the pattern of cases. In *Biddle*, *Fisher*, and *Orban* the probability of nonenforcement was low, because the breaching party had made a deposit. Because the breachee could simply keep the deposit when the other party breached, liquidated damages should not have exceeded the actual loss. In *Davidow*, *Decker*, and *Nichols* the ratio of liquidated damages to actual loss was so high, that it is hard to believe that the liquidated damages provision could have been justified by sufficiently high probabilities of breach and nonenforcement. Even if the parties in *Davidow* expected a probability of performance of as low as 1%, the $500 penalty could be justified only by a belief in a 97% chance of nonenforcement.[171] Such a belief must have seemed outrageous to the court. As the fairness principle would predict, the cases in which the court found penalties had low probabilities of breach and nonenforcement. Thus the suspicion that the fairness principle, in addition to the bargain principle, cannot explain the Michigan cases is unfounded.

In summary, the bargain principle fails to explain the pattern of penalty decisions, because the court found penalties even when the bargaining process was adequate. The fairness principle

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[171] ($12)(probability of no breach) + ($500)(probability of breach with enforcement) + ($0)(probability of nonenforcement) = $12, given a 1% probability of no breach, only if the probability of breach with enforcement equals 2% and the probability of nonenforcement equals 97%.

successfully explains the pattern of penalty decisions, because the court found penalties in contracts where the liquidated damages provision not only exceeded actual loss ex post, but ex ante, discounted by the probability of breach and nonenforcement, rendered the obligations on each side of the contract uneven.

VIII. Contract Theory and History.

The opinions rendered by the Michigan Supreme Court from 1900 to 1950 are those of justices who speak the language of the bargain principle, but who make decisions on the basis of the fairness principle. The justices may well have believed that contracts should be enforced only if they conform to the bargain principle. When the enforcement or the rescission of a contract conformed both to the bargain principle and to the fairness principle, the justices usually used the rhetoric of the former. But when the outcome demanded by the bargain principle and the outcome demanded by the fairness principle conflicted, the justices usually chose the outcome demanded by the fairness principle.

Doctrines traditionally considered to be devices for detecting defects in the bargaining process -- duress, mistake, implied warranty, incompetence, breach of fiduciary or confidential duties -- were really devices for detecting unequal obligations. When the terms seemed fair, the Michigan Supreme Court ignored elements of the bargaining process which, when the terms seemed unfair, would have been deemed coercive or fraudulent; the court enforced the contract by holding these doctrines inapplicable to the facts. When the terms seemed unfair, but the balance of information costs favored enforcement, the court rescinded the contract by applying whichever doctrine fitted the facts most closely. The fairness principle had more influence on the resolution of conflicts than the bargain principle had.

One must recall from Part II that this conclusion about the dominance of the bargain principle is a conclusion about a criterion for assessing evidence, not a conclusion about the

principle of justification underlying contract law. It might seem natural to conclude from the dominance of the fairness principle as a criterion for assessing evidence that the Michigan Supreme Court also embraced a non-liberal, reciprocity-based conception of contract. But this is not necessarily true. Considering the low number of cases for which the conflict between the bargain principle and the fairness principle made a difference, one could plausibly tell other stories. The justices of the Michigan Supreme Court might have adhered to a liberal theory of contract, and used the fairness principle to evaluate the evidence only because they believed that the evenness of the terms is good evidence for the validity of the bargaining process. Or the Supreme Court might have adhered to a liberal theory of contract and the bargain principle in the main, but departed from the outcome dictated by the bargain principle only when the outcome conflicted too much with the norm of reciprocity.

However one interprets the positive implications of the analysis of Michigan contract case law, this analysis has more definite negative implications on traditional theories and histories of contract law. These theories can be divided in two ways. First, one can divide them into materialistic and idealistic approaches. The materialistic approach describes legal doctrine as a product of socioeconomic forces. The idealistic approach describes legal doctrine as a product either of the structure of human consciousness or of an ideology. Second, one can can divide them into optimistic and pessimistic approaches. The optimistic approach sees legal doctrine as a producer or preserver of a social good. The pessimistic approach sees legal doctrine as a producer or preserver of social repression and exploitation. These two divisions create four categories of theories of legal history: pessimistic materialism, optimistic materialism, pessimistic idealism, and optimistic idealism.

(1) Historians of the school of pessimistic materialism see legal doctrine as a product of oppressive socioeconomic forces. Horwitz, for example, argues that the rise of capitalism sounded the demise of an equitable conception of contract that had existed

in English law since the middle ages.[172] Before the nineteenth century enforcement of contracts in England and America was justified by the fairness of the exchange.[173] By the middle of the nineteenth century enforcement of contracts was justified by the voluntary agreement of the parties. This justification permitted businesses to use their greater bargaining power to exploit the poor. Workers were forced by the exigencies of poverty to accept low wages or to pay extravagant prices. These unfair contracts would have been struck down by eighteenth century courts; but since the contracts appeared to result from the free exercise of the wills of the parties, the nineteenth century courts enforced them. Thus the bargain theory of contract justified the enforcement of contracts that enriched businesses at the expense of the poor.

Simpson argues that Horwitz's conception of eighteenth century contract law is romanticized. Eighteenth century contract law was no less harsh than, and in most ways not much different from, nineteenth century contract law.[174] The bargain principle had been used to justify enforcement and discharge of contracts as early as the sixteenth century. However much the English and American economies changed during the eighteenth and nineteenth centuries, contract law stayed much the same.

While Simpson criticizes Horwitz's description of eighteenth century contract law at the start of the putative transformation, the Michigan cases cast doubt on Horwitz's description of late nineteenth century contract law at the end of the transformation. The late nineteenth and early twentieth century Michigan cases did not center around the bargain principle, as Horwitz would claim. The pattern of decisions show that courts were influenced by the

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172 M. Horwitz, The Transformation of American Law (1973).

173 It is often not clear whether Horwitz means ex ante fairness or ex post fairness when he discusses the attention to fairness in the eighteenth century and the lack thereof in the nineteenth century. *Compare* M. Horwitz, *supra* note 172 at 165 (apparently ex ante) and at 198 (fairness as market value) *with id.* at 166 ("community's sense of [ex post?] fairness").

174 A.W.B. Simpson, The Horwitz Thesis and the History of Contracts, 3 U. Chi. L. Rev. 533 (1979).

equitable or fairness conception of contracts that Horwitz says had been abandoned one hundred years earlier.

For example, Horwitz argues that the nineteenth century courts, unlike the eighteenth century courts, refused to rescind contracts on the ground of inadequacy of consideration.[175] But we have seen several cases in Michigan in which the Supreme Court rescinded contracts because of inadequacy of consideration. Simpson argues that courts occasionally relied on inadequacy of consideration to discharge contracts in the early and mid-nineteenth century, just as they occasionally did so in the eighteenth century; we can add that courts also did so in the late nineteenth and early twentieth centuries. The equitable conception of contract was not abandoned, but perdured through several centuries.

Horwitz argues that nineteenth century courts also dropped the eighteenth century "sound-price doctrine." The sound-price doctrine held that payment of a "sound price" for a product gave the buyer the right to rescind the contract if the product had a defect.[176] The sound-price doctrine has the same effect as the doctrine of implied warranty. Horwitz argues that caveat emptor replaced the sound-price doctrine in the nineteenth century. Simpson says that the sound-price doctrine was not widespread prior to the nineteenth century, and was, in any case, a recent development.[177] Simpson also argues that Horwitz ignores the development of implied warranty, a doctrine that mitigates the harsh effects of caveat emptor. Simpson's argument is supported by Michigan case law. The Supreme Court had developed a sophisticated doctrine of implied warranty by 1900.[178] Although the later courts justified their rescission of unfair contracts by talking about terms implicit in the bargaining process, rather than fairness, the effect was the same. Late nineteenth century

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175 M. Horwitz, *supra* note 172 at 184.
176 *Id.* at 180.
177 A.W.B. Simpson, *supra* note 174 at 584.
178 *See, e.g.*, Little v. G.E. Van Syckle & Co., 115 Mich. 480, 73 N.W. 554 (1898); Blodgett v. Detroit Safe Co., 76 Mich. 538, 43 N.W. 451 (1889); West Michigan Furniture Co. v. Diamond Glue Co., 127 Mich. 651, 87 N.W. 92 (1901).

courts, no less than eighteenth century courts, would strike down unfair sales contracts.

A different tack within the pessimistic-materialist approach focuses on contract law as a device for legitimation. An article by Gabel and Feinman argues that contract law never has had the function of achieving substantive justice, not even in the eighteenth century.[179] Contract law has always had a legitimating function. By characterizing coercive social and economic relations dominated by capital as voluntary relations based on equal opportunity, contract law in the nineteenth century legitimated the oppressive order and encouraged people not to resist its preservation by the state.[180] "The courts could not easily have intervened to protect a party or to remedy unfairness without violating the ideological image that the source of social obligations rests only upon the bargain that the parties themselves have evinced."[181] Contract law does not so much give courts weapons for enforcing capitalistic oppression; rather, contract law is a part of an ideology that encourages everyone, judges and workers alike, not to resist the oppressive social order.

Gabel and Feinman's distinction between "ideological imagery" and "social reality" parallels the distinction between rhetoric and practice. To test Gabel and Feinman's thesis one must ask whether the rhetoric and practice of the Michigan Supreme Court conform to the rhetoric of voluntary relations and the practice of exploitation that Gabel and Feinman identify. We have seen that the court's rhetoric is usually, though not exclusively, that of voluntary relations (bargain principle). But despite its rhetoric the court did not enforce oppressive relations in any meaningful sense. In those cases where strict adherence to the bargain principle would require the enforcement of a unfair contract, the court rescinded the contract. The ideological imagery of

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179 P. Gabel & J. Feinman, Contract Law as Ideology, in The Politics of Law 172 (D. Kairys ed. 1982).
180 *Id.* at 182.
181 *Id.* at 178.

voluntary relations left room in the justices' minds for norms of fairness and reciprocity.

The preceding discussion should not mislead one into thinking that the court was unaware of the demands of the bargain principle; or that there was no relation between the court's rhetoric and its practice. The court would usually use the rhetoric of the bargain principle alone when the outcome of the case was consistent with both the bargain principle and the fairness principle. The court had problems only when the outcome demanded by the bargain principle and the outcome demanded by the fairness principle conflicted. When this happened, sometimes the court would misuse the bargain principle: it would, for example, discharge a contract on the ground of mistake even though the breacher was the cheaper cost-avoider.[182] Other times the court would appeal to fairness. Sometimes the appeal to fairness would be hedged: "while it is not controlling, we find nothing contrary to natural justice in her turning over $1100 worth of property to Ernest...."[183] Sometimes the appeal to fairness would be combined with an appeal to the bargain principle: "the price fixed in the option appears to have been a fair one at that time and within $500 of the amount she had been for some time been trying to sell the premises."[184] And sometimes the court would appeal to fairness alone: "The testimony in the instant case falls far short of satisfying us of the fairness of the transaction."[185] The court did not act as though social obligations rested only on bargains; and its occasional reference to fairness suggests that the justices realized that social obligations rested on norms other than the bargain principle. Against the thesis of Gabel and Feinman, the Michigan Supreme Court recognized the conflicting demands of the bargain principle and the fairness principle, and allowed itself to be influenced by the latter.

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182 *See* Sherwood v. Walker, 66 Mich. 568, 33 N.W. 919 (1887).
183 Grand Rapids Trust Co., 276 Mich. 56, 57, 267 N.W. 593, 594 (1936).
184 Standard Oil Co. v. Murray, 214 Mich. 299, 200, 183 N.W. 55, 56 (1921).
185 Sprenger v. Sprenger, 298 Mich. 551, 558, 299 N.W. 711, 718 (1941).

Pessimistic materialistic theories do not adequately explain Michigan contract law for three reasons. First, one cannot characterize contract law doctrine as a tool for the oppression of the poor, when both parties to the contract law cases were usually businesses.[186] Second, the court based its decisions more often on an evaluation of the fairness of a contract in dispute than on an evaluation of the bargain process. It is hard to conceive of these decisions as oppressive to a particular class of people. Third, a purely materialistic approach cannot explain the conflict between rhetoric and practice. An adequate historical theory would explain the source of these convictions and their persistence in the language of the opinions even as they exerted little force on the outcome of the cases.

(2) Optimistic materialism sees law as the product of liberating or wealth-increasing socioeconomic forces. This perspective characterizes the pluralist approach of Hurst[187] and Friedman[188] and the approach of the school of law and economics. The pluralist approach understands law as the product of compromises among competing interest groups. The economic approach holds that the common law is best explained as a set of rules promoting the efficient allocation of resources.

(a) The pluralist approach. In his history of Wisconsin contract law Friedman distinguishes contract law doctrine and the application of the doctrine to cases. This distinction is the same as the distinction between rhetoric and practice that is made in this essay. Friedman concludes that contract law doctrine expresses the ideology of liberalism, but that the Wisconsin Supreme Court applied the doctrine in many ways that violated this ideology.

Friedman argues that Wisconsin law is best understood not as the expression of the ideology of liberalism, but as a set of rules intended to promote a public conception of the common

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186 A.W.B. Simpson, *supra* note 174 at 600-601.
187 J. Hurst, Law and the Conditions of Freedom (1956).
188 L. Friedman, A History of American Law (2nd ed. 1985).

good.[189] Historical variation of the public conception of the common good is the source of the historical variation of the law. In the mid- and late nineteenth century people thought that economic growth served the common good. To the extent that people were new to Wisconsin, no traditional or communal values were threatened by the volatility of unrestrained competition. Because people thought that economy would grow most rapidly in a free market, their laws promoted the free working of the market.[190] Contract law policed the bargaining process to ensure that no constraints prevented the flow of resources to their most valuable uses. In the nineteenth century the bargain principle prevailed in Wisconsin contract law because of its effective promotion of economic growth.

By the early twentieth century people no longer thought that economic growth was the common good. They had wearied of the inequities caused by unregulated competition and now sought both to reduce competition and to ensure for themselves as large a portion of the existing wealth as possible. "The inner history of the Progressive Era might be written in terms of which groups succeeded in what ways in achieving legal or extra-legal support for their competitive position and why."[191] The unions sought restraints on big business. Big business sought restraints on unions. Consumers sought restraints on trusts. Friedman says that contract law began to reflect a concern with "fairness," in the sense of equality of bargaining power (not in the sense of equality of exchange). He interprets this development in contract law as a sign that the bargain principle was losing its influence on contract law.

By the mid-twentieth century a shift occurred in the conception of fairness as the norm of contract law. "The use of 'fairness' as a criterion for settling contract disputes meant the replacement of inherited legal concepts with current concepts of what was right. Particular disputes were to be judged in terms of

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189 L. Friedman, *supra* note 16 at 185 (1965).
190 *Id.* at 186.
191 *Id.* at 188.

current ethical standards."[192] The belief in economic growth as a common good revived, but was accompanied by a belief that its harsh effects should be tempered. Judges departed from the rigid growth-promoting rules of the bargain principle when they appeared to work injustice in a particular case. Judges adjudicated contract disputes on the basis of fairness, because the popular conception of the common good now reflected norms of fairness as well as norms of competition. The abstract rules of contract law had decayed into irrelevancies.

Friedman's story of Wisconsin contract law involves a tension. On the one hand, he argues that judges merely followed public opinion, that the law reflected the popular conception of the common good, and that in the nineteenth century the common good was considered economic growth. On the other hand, he argues that in the nineteenth century the Wisconsin Supreme Court often manipulated bargain principle contract doctrines in order to police the fairness of an exchange.[193] Why would the Wisconsin Supreme Court manipulate contract law doctrines for the sake of fairness even as early as the nineteenth century, when contract law was supposed to reflect a popular consensus about the primary importance of economic growth?[194] The answer must be either that the people did not think that economic growth was the primary social good or that the courts did not simply obey public opinion. Most likely, there was not, at any time, a single conception of the social good, and thus the court could not simply obey public opinion, even if it wanted to. Jurists probably understood that the popular conception of the social good had conflicting elements -- for example, beliefs in the importance of economic growth and in the importance of economic security, beliefs in the importance of individual freedom to make choices and in the importance of state protection against bad choices. Fashioning legal doctrines that captured these interests required principles of sufficient generality as to permit both the apparent acceptance of one idea

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192 *Id.* at 192.
193 *Id.* at 101 (fraud, mistake, misrepresentation), 103 (implied warranty).
194 *Id.* at 98-100.

and the covert resort to the conflicting idea when the first seemed to generate an unjust result. Friedman sees a gradual evolution in contract law from the bargain principle to the fairness principle, when all along, at least in Michigan, the two coexisted. If the bargain principle seemed the appropriate source of the opinion's rhetoric, the court resorted to the fairness principle in order to avoid unpopular results.

Friedman's story of the decline of the bargain principle conception of contract law was picked up by Gilmore, and in the context of British contract law fleshed out by Atiyah. As Gilmore puts it: "The decline and fall of the general theory of contract and, in most quarters, of laissez-faire economics may be taken as remote reflections of the transition from nineteenth century individualism to the welfare state and beyond."[195] As the administrative state rendered citizens more and more interdependent, the ideas of free will, consent, and arm's length bargaining became less and less relevant to any theory of civil obligation. When the state tells business what to produce and what price to charge, contract law has no function. The victimized consumer does not sue the business for breach of implied warranty, but complains to an administrative agency, which fines the business. People are not responsible for keeping their promises, but for inducing others to rely on their promises or for accepting benefits from others. These responsibilities do not derive from the exigencies of the market, but from the tort-enforced obligation to use reasonable care not to harm others by word or by deed. Thus we have seen the rise in the importance of promissory estoppel and quasi-contract and the decline in the executory mode of exchange.[196] Another scholar has argued that the decline in contract law is due to the historical shift from a society of one-shot deals for which contract law was suited, to a society of continuing contractual relationships, which require greater legal flexibility than traditional contract law

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[195] G. Gilmore, The Death of Contract 95-6 (1974); but *cf.* A.W.B. Simpson, Legal Theory and Legal History: Essays on the Common Law 329-333 (1987).
[196] P. Atiyah, The Rise and Fall of Freedom of Contract (1979) 716.

provides.[197] The different views converge on the idea that historical shifts in economic relations and social norms have rendered contract law in general, and the bargain principle in particular, irrelevant.

This story is not supported by the history of Michigan contract law. The historical changes in Michigan contract law doctrine do not correspond to a gradual shift from individualist to welfare ideology among the people of Michigan. Rather, the law shows the influences of individualism and of welfarism both in the late nineteenth century and the mid-twentieth century. The pluralist story exaggerates the individualism of the nineteenth century and the statism of the twentieth century. It discounts the persistence of communal norms of fairness into the nineteenth century[198] and the persistence of the norms of bargaining and consent into the twentieth century.[199] The tensions within contract law have always reflected and continue to reflect the tension between self-interest and community.[200]

(b) The economic approach to contract law refines the pluralist approach to the more rigorous (i.e., falsifiable), but perhaps less realistic, principle that the common law is efficient. One difficulty with the economic approach is the question of why the norm of efficiency would have influenced judges more strongly than other norms. The pessimistic materialistic approaches assume that judges served the interests of business; the pluralistic approaches assume that judges served the interests of various groups. Either of these assumptions can be entertained. But the economic assumption that judges served efficiency is hard to believe.

Some of the attempts to support this assumption argue that judges were not subject to political pressures.[201] But the

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197 *See* I. McNeil, The Many Futures of Contracts, 47 S. Cal. L. Rev. 691 (1974).

198 *See generally* A.W.B. Simpson, *supra* note 174.

199 *See* R. Speidel, An Essay on the Reported Death and Continued Vitality of Contract, 27 Stan. L. Rev. 1161 (1975).

200 *Cf.* D. Kennedy, *supra* note 9.

201 R. Posner, *supra* note 30 at 527-8.

justices of the Michigan Supreme Court were. The public could and did vote them out of office if it did not like their decisions. The justices had to win an election every two years in order to retain their positions.[202] At least one justice lost his seat because of an unpopular opinion. Justice Cooley, a well-respected jurist and author of such famous opinions as *Hackley v. Headley*[203] and *Goebel v. Lin*,[204] was attacked by a newspaper whose appeal he denied in a famous libel case. One of its editorials pointed out that Cooley had ruled in favor of corporations in 80 out of 81 cases. Cooley lost the election by a vote of 168,625 to 138,694.[205] While the justices probably felt less pressure when deciding run-of-the-mill contract cases, rather than notorious libel cases, the story of Justice Cooley suggests that justices felt no less political pressure than ordinary politicians. No evidence suggests that wealth-maximization was the least controversial norm.[206] Judges, like ordinary politicians, would have decided cases in favor of the most powerful interest groups.

Other attempts to support the assumption that judges make decisions that maximize wealth focus on the incentives of litigants.[207] Inefficient rules are more likely to be the subjects of litigation than efficient rules, because inefficient rules lead to more disputes.[208] Because more litigation concerns inefficient rules than efficient rules, inefficient rules will repeatedly be subject to modification while efficient rules do not change. But it is not obvious that the increased pressure on efficient rules is sufficient to overcome the ideological concerns that might have

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202 Mich. Stat. Ann. tit. 29, §11666 (1905).

203 45 Mich. 569, 8 N.W. 511 (1881).

204 47 Mich. 489, 11 N.W. 284 (1882).

205 G. Edwards, Why Justice Cooley Left the Bench: A Missing Page of Legal History, 10 Wayne Law Review 490 (1964).

206 In Wisconsin, at least, economic growth for its own sake was not considered the common good in the early twentieth century, although it apparently was so considered in the nineteenth century. *See* Friedman, *supra* note 16.

207 P. Rubin, Why Is the Common Law Efficient?, 6 J. Leg. Stud. 51 (1977); G. Priest, The Common Law Process and the Selection of Efficient Rules, 6 J. Leg. Stud. 65 (1977).

208 G. Priest, *supra* note 207 at 67.

inspired them in the first place. For example, litigation over penalties might be frequent because of the inefficiency of the penalty doctrine; but the norms of fairness are strong enough that judges do not modify the penalty doctrine.

It is possible that the mechanism of judicial decision-making must remain forever hidden. The efficiency hypothesis must be tested against the case law. In order to conduct this test, one must examine the relationship between the bargain principle, the fairness principle, and economic efficiency.

The bargain principle reflects the economist's postulate that in the absence of information costs resources will gravitate to their most valuable use. An agreement to exchange products occurs only when both parties prefer the product of the other to their own product. The movement of resources to their more valued uses represents an increase in the wealth of society. Resources do not move to their more valued uses as the result of an exchange only when high information costs prevent the parties from recognizing the value of the product to themselves. The function of the court is to reduce information costs in order to ensure the efficient transfer of resources. The court's willingness to enforce contracts reduces the cost of evaluating the trustworthiness of other parties and of erecting mechanisms, such as deposits, for reducing the risk of opportunistic breach. The court's willingness to rescind contracts that result from various kinds of misinformation reduces the cost of discovering and evaluating every contingency. The bargain principle promotes efficiency by requiring the rescission of contracts which, because of high information costs, do not increase the utility of both parties.

At first sight the fairness principle appears to hinder efficiency. Because it encourages the court to replace the parties' preferences with average preferences, it can lead to decisions that reduce the utility of idiosyncratic parties. But this problems should not occur in the adjudication of disputes arising from ordinary contracts involving goods for which there is a competitive market. If an exchange of a product occurs in a competitive market, the seller should receive the market price,

regardless of the idiosyncratic tastes of the seller or the buyer. If the seller receives greater than the market price, then information costs must have prevented the buyer from shopping around. If the seller receives less than the market price, information costs must have prevented the seller from seeking another customer. Enforcement of fair contracts means enforcement of contracts in which resources move to more valuable uses. Refusal to enforce unfair contracts means refusal to enforce contracts in which resources move to less valuable uses. The fairness principle promotes efficiency by requiring the rescission of contracts whose terms benefit one party and injure the other.

The bargain principle and the fairness principle each has its own costs and benefits. The problem with the bargaining principle is that information costs are very difficult to measure. The relative intelligence and experience of the parties, for example, cannot be quantified, yet clearly have a substantial impact on information costs. For this reason the bargain principle requires rescission only if the relevant information costs are very high.

The problem with the fairness principle is that the subjective values which the parties attach to the exchange are difficult to measure, especially in the absence of a competitive market. If a competitive market exists, one can say that a buyer would not pay more than the market demands, no matter how much the buyer values the product. But a piece of land with a unique view cannot be accurately valued. Moreover, subtle values enter in the price of goods: people are willing to pay more for products sold at a conveniently nearby store or at a fancy store, and for status associated with a particular brand of an otherwise ordinary product. For this reason the fairness principle requires rescission only if the contract price of a product and its market value differ considerably.

It is anyone's guess whether the evaluation of contracts on the basis of extreme inequalities in the terms or the evaluation of contracts on the basis of extreme defects in the bargaining process is the more accurate way of discovering whether contracts represent an increase in the wealth of both parties. However, one

can hypothesize that the fairness principle provides a better guide to a wealth-maximizing court for exchanges occurring in a competitive market; whereas the bargain principle provides a better guide to the court for exchanges occurring in the absence of a competitive market. So if the efficiency hypothesis is valid, we would expect the court to use the fairness principle to evaluate contracts occurring in competitive markets and the bargain principle to evaluate contracts occurring in uncompetitive markets.

The majority of transactions in the Michigan cases occurred in competitive markets, and I have argued that the fairness principle best explains these cases. The only transactions that did not occur in competitive markets involved releases from criminal or civil liability and conveyances between friends and relatives. I argued that the fairness principle explains the pattern of decisions regarding both of these transactions better than the bargain principle does. Although the evidence does not dispose of the issue, it suggests that courts were not exclusively concerned with economic efficiency. The reason that the concept of efficiency can be used to explain much of the common law of contracts is that in most cases -- when the bargaining process is valid and the terms are fair, when the bargaining process is defective and the terms are unfair, and when the demands of the bargain principle and the demands of the fairness principle conflict, but the transaction occurs in a competitive market -- the use of the fairness principle and the use of the bargain principle both lead to an efficient result.

Although optimistic materialism is a useful approach to the history of contract law, two defects make it inadequate for explaining Michigan contract law. First, there is no evidence that Michigan contract law became increasingly liberating or wealth-generating with the passage of time. Much of the law probably reflected the influence of various economic interests, but the changes in the law did not correspond in an obvious way to changes in the influence of the economic interests. Much of the law reflected the interest in efficiency, but this reflection was

limited by the extent to which the demands of efficiency and the demands of fairness coincided. Second, the optimistic-materialistic approach does not explain the dichotomy between the rhetoric of the opinions and the practical effect of the judgments. It does not explain why justices would usually use the rhetoric of the bargain principle while deciding cases on the basis of the fairness principle.

(3) Pessimistic idealism interprets law as an oppressive product of the "legal consciousness." Legal consciousness refers to the way that judges and lawyers think about disputes. While it is influenced by traditional ideologies and socioeconomic forces, it has a distinctive, autonomous structure. The law can better be explained by the structure of legal consciousness than by the underlying ideologies and socioeconomic forces, because the inner logic of the legal consciousness transforms these initial influences.[209] Kennedy identifies three systems of legal consciousness. In the antebellum period (1800-1870) courts decided cases chiefly on the basis of traditional (altruistic) morality, though recognizing that economic development sometimes required concession to the demands of efficiency.[210] In the period of classical individualism (1850-1940) courts decided cases solely on the basis of the bargain principle. In the period of modern legal thought (1900 to the present) the courts reject the classical belief that the bargain principle explains all legal institutions, continue to believe in the ethic of individualism, but also recognize the demands of altruism. Kennedy sees the history of legal consciousness as a conflict between individualism and altruism.

The justices of the Michigan Supreme Court had a classical conception of law. They usually explained their decisions as compelled by the bargain principle. As Kennedy puts it, "people were responsible for themselves unless they could produce evidence

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[209] D. Kennedy, Toward an Historical Understanding of Legal Consciousness, 3 Res. L. Soc. 3 (1980).

[210] D. Kennedy, *supra* note 9 at 1725 (1976)

that they lacked free will in the particular circumstances."[211] But Kennedy would not be able to explain why the justices usually chose the fair outcome over the bargained outcome, when the two outcomes conflicted. Perhaps, he could argue that modern legal thought was emerging in Michigan as early as the 1880s. But one does not find the truly modern recognition of the conflict between individualism and altruism in Michigan until the 1950s.[212] The striking thing about the Michigan decisions is the covert way in which the justices ensure a fair result. They used the rhetoric of the bargain principle; but the rhetoric did not compel outcomes consistent with the bargain principle.

The problem with Kennedy's thesis as applied to the history of Michigan contract law is that he attributes more influence to legal consciousness on the outcome of cases than it appeared to have. The bargain principle was ignored or misused in cases in which the bargain principle would lead to an unfair result. But legal consciousness is a convenient concept for explaining the conflict between rhetoric and practice in Michigan contract case law. One can speculate that the rhetoric reflected a legal consciousness of classicism, which in turn expressed norms of individualism that no longer exerted the power that they once did. The practice of rescinding unfair contracts reflected the now dominating norms of fairness which had replaced the earlier individualistic norms. Another possibility is that the rhetoric of the opinions is simply an extreme and simplified version of prevailing norms. The rhetoric expressed the more individualistic norms of the time and ignored the norms of fairness, perhaps because the individualistic norms were slightly stronger. The rhetoric endorsed individualistic norms to the exclusion of norms of fairness in order to make its decisions look like unassailable deductions from first principles. But the individualistic norms were not exclusive; and the norms of fairness prevailed in

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211 *Id.* at 1730.

212 *See, e.g.*, Comstock v. General Motors Corp., 358 Mich. 163, 99 N.W.2d 627 (1959) (striking down the privity requirement in breach of contract complaints).

practice when the individualistic norms led to very unfair results.

(4) Optimistic idealism interprets law as the product of moral principles intrinsic to human nature. One theory holds that courts enforce contracts in order to promote individual autonomy.[213] Thus courts rescind contracts only when defects in the bargaining process prevent one or both of the parties from making an agreement that serves his interests. This theory implicates the bargain principle as the criterion for assessing evidence, because the bargain principle focuses the court's attention on and encourages it to guard the purity of the bargaining process. The fairness principle, in contrast, can encourage the court to overlook the preferences of the parties.

One can imagine another theory inspired by optimistic idealism, a theory which holds that courts enforce contracts in order to promote reciprocity. Courts rescind contracts only when the terms are unequal. This theory naturally implicates the fairness principle as the criterion for assessing evidence.

Neither of these theories is strongly supported by Michigan contract law. The autonomy-based theory is contradicted by the decisions that enforce or rescind contracts in violation of the bargain principle. But the fairness-based theory also is not plausible. If fairness was such a compelling norm, why did the justices so rarely use it as a justification for their decisions? The conflict between rhetoric and practice casts doubt on the claim of a monolithic moral system to which all, justices and others, adhere. The conflict suggests historical shifts in interests and norms which the justices were struggling to accommodate.

In their efforts to draw a lesson from history the optimists and pessimists simplified historical material to the point of rendering it unrecognizable. The optimistic materialists rejoiced in the wealth or liberty increasing effects of the law and the

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213 *See, e.g.*, C. Fried, *supra* note 6 (1981).

pessimistic materialists despaired about the oppressive effects of the law, by ignoring the extent to which the law reflects slow-changing norms -- such as those of fairness and autonomy -- which together exerted an uncertain influence on the amount and distribution of wealth and liberty. The optimistic idealists rejoiced in the morality of the law and the pessimistic idealists despaired about the ideology of the law, by ignoring the extent to which the law responds to fluctuating interests. The lesson to be learned from the history of Michigan contract law, from 1900 to 1950, is to beware of seeking lessons in legal history.

IX. Conclusion: Normative Implications.

This essay has argued that the fairness principle provides a better explanation of the pattern of Michigan contract law decisions between 1900 and 1950 than the bargain principle does. The normative implications of this argument are ambiguous because of the complexity of the relation of principles of justification and criteria for assessing evidence. One can discern four possible theses.

First, the bargain principle both is the principle of justification and provides the criteria for assessing evidence. Judges decide cases in such a way that honors the preferences of the parties; they do so by focusing on the relative information costs of the parties. This thesis assumes that deciding cases on the basis of information costs is the best way of ensuring enforcement of the parties' true preferences. This thesis is consistent with such individualistic ethics as natural rights and utilitarianism, and assumes that courts evaluate information costs better than they evaluate substantive terms.

Second, the bargain principle is the principle of justification and the fairness principle provides the criteria for assessing evidence. Judges decide cases in such a way that honors the preferences of the parties; but they do so by comparing the value of each party's obligation. This thesis assumes that deciding cases on the basis of a comparison of the substantive terms is the

best way of ensuring enforcement of the parties' true preferences, because rational parties would never agree to incur unequal obligations. This thesis is consistent with individualistic ethics, and assumes that courts evaluate substantive terms better than they evaluate information costs.

Third, the fairness principle is the principle of justification and the bargain principle provides the criteria for assessing evidence. Judges decide cases in such a way that ensures an equal exchange; but they do so by focusing on the parties' relative information costs. This thesis assumes that comparing information costs is the best way of ensuring enforcement of equal exchanges, because equal exchanges always result from agreements between parties with low information costs. This thesis implicates a non-liberal, reciprocity-based theory of obligation and assumes that courts evaluate information costs better than they evaluate substantive terms.

Fourth, the fairness principle both is the principle of justification and provides the criteria for assessing evidence. Judges decides cases in such a way that ensures an equal exchange; and they do so by comparing the substantive terms of the contract. This thesis assumes that deciding cases on the basis of substantive terms is the best way of ensuring enforcement of equal exchanges. This thesis implicates a non-liberal theory of obligation and assumes that courts evaluate substantive terms better than they evaluate information costs.

The Michigan case law suggests that the fairness principle was usually used to assess the evidence, and thus that the first and the third theses are wrong. But the fact that the fairness principle was usually used to assess the evidence does not provide a basis for deciding between the second and fourth theses. The second thesis is supported in a loose but suggestive way by the bargain principle rhetoric that the court usually employed to justify its decisions. But this rhetoric might have been pure superstructure having no influence on the actual content of the decisions. The fourth thesis depends on the assumption that a court motivated by the fairness principle would more likely look

to the fairness principle for criteria for assessing the evidence than to the bargain principle. This assumption might seem plausible but cannot be verified.

However, since Michigan contract law casts doubt on the first and third theses, one can draw a narrow conclusion. Modern judges faced with a contract dispute should not feel that history and precedent requires them to evaluate the bargaining process exclusively and to refrain from evaluating the terms of exchange. Evaluation of the terms of the exchange is a powerful and historically justified tool for adjudicating contract disputes, whether or not one adheres to an individualistic theory of obligation.