



# Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power

## Citation

Duncan Kennedy, Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power, 41 Md. L. Rev. 563 (1982).

## Published Version

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# Maryland Law Review

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VOLUME 41

1982

NUMBER 4

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## DISTRIBUTIVE AND PATERNALIST MOTIVES IN CONTRACT AND TORT LAW, WITH SPECIAL REFERENCE TO COMPULSORY TERMS AND UNEQUAL BARGAINING POWER

DUNCAN KENNEDY\*

### INTRODUCTION

The goal of this article is to get at two generally unacknowledged motives that lie behind legislative, judicial and administrative choices about what kind of law of agreements we should have. These are my most important points: First, distributive and paternalist motives play a central role in explaining the rules of the contract and tort systems with respect to agreements. Second, these motives explain far better than any notion of rectifying unequal bargaining power the widespread legal institution of compulsory contract terms in areas such as the allocation of risk. Third, the notion that paternalist intervention can be justified only by the "incapacity" of the person the decision maker is trying to protect is wrong — the basis of paternalism is empathy or love, and its legitimate operation cannot be constricted to situations in which its object lacks "free will."

My approach will be capacious in some respects, and in others quite narrow. I want to discuss contract, tort, and statutory rules about agreements together, hoping thereby to overcome some of the parochialism of scholarship in each field.<sup>1</sup> I plan to try to integrate doctrinal

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\* Professor of Law, Harvard Law School. I presented a part of this article as the Sobeloff Lecture at the University of Maryland Law School on April 27, 1982. Thanks to Jerry Frug and Steve Shavell.

1. The main base of materials I used in writing this article consists of the following books: E. CLARK, L. LUSKY & A. MURPHY, *CASES & MATERIALS ON GRATUITOUS TRANS-*

discussion with economic and "policy" analysis,<sup>2</sup> and all three with "fancy theory," by which I mean a melange of critical Marxism, structuralism, and phenomenology.<sup>3</sup> But I will have nothing to say about the impact of "institutional competence" considerations on the motives for lawmaking I discuss. I assume that the only grounds for distin-

FERS: WILLS, *INTESTATE SUCCESSION, TRUSTS, GIFTS & FUTURE INTERESTS* (2d ed. 1977); C. GREGORY & H. KALVEN, *CASES & MATERIALS ON TORTS* (2d ed. 1969); C. GREGORY, H. KALVEN & R. EPSTEIN, *CASES & MATERIALS ON TORTS* (3d ed. 1977); C. HAAR & L. LIEBMAN, *PROPERTY & LAW* (1977); F. KESSLER & G. GILMORE, *CONTRACTS, CASES & MATERIALS* (2d ed. 1970); I. MACNEIL, *CASES & MATERIALS ON CONTRACTS: EXCHANGE TRANSACTIONS & RELATIONSHIPS* (1971). This article is an attempt to develop ideas sketched in Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976), and Kennedy, *The Structure of Blackstone's Commentaries*, 28 BUFFALO L. REV. 205 (1979).

2. On economic and policy analysis, see G. CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970); R. POSNER, *ECONOMIC ANALYSIS OF LAW* (2d ed. 1977); see also Baker, *The Ideology of the Economic Analysis of Law*, 5 PHIL. & PUB. AFF. 3 (1975); Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 323 (1980); Kelman, *Choice and Utility*, 1979 WISC. L. REV. 769 (1979); Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387 (1981); Kennedy and Michelman, *Are Property & Contract Efficient?*, 8 HOFSTRA L. REV. 711 (1980); Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451 (1974); Tribe, *Policy Science: Analysis or Ideology*, 2 PHIL. & PUB. AFF. 66 (1972). See generally *Symposium on Efficiency as a Legal Concern*, 8 HOFSTRA L. REV. 485 (1980); *A Response to the Efficiency Symposium*, 8 HOFSTRA L. REV. 811 (1980).

3. This article has been strongly influenced by the work of scholars in the critical legal studies movement. The Conference on Critical Legal Studies (most members are law teachers, law students, lawyers, or social scientists) tries to bring together Marxist and non-Marxist radical approaches to law. For a partial survey, see Note, *'Round and 'Round the Bramble Bush: From Legal Realism to Critical Legal Scholarship*, 95 HARV. L. REV. 1669 (1982). For information about the Conference and/or a copy of a Bibliography of Critical Legal Studies (#9, 3/1/82), write Professor Mark V. Tushnet, Georgetown Univ. Law Center, 600 New Jersey Ave. N.W., Washington, D.C. 20001.

A useful introduction to "fancy theory" is the first two chapters of A. GOULDNER, *THE TWO MARXISMS: CONTRADICTIONS AND ANOMALIES IN THE DEVELOPMENT OF THEORY* (1981). The works that have most influenced me are: M. FOUCAULT, *POWER/KNOWLEDGE: SELECTED INTERVIEWS AND OTHER WRITINGS 1972-1977* (Gordon trans. 1980); A. GRAMSCI, *SELECTIONS FROM THE PRISON NOTEBOOKS* (Q. Hoare & G. Smith trans. 1971); G. HEGEL, *THE PHENOMENOLOGY OF MIND* (J. Baillie trans. 2d ed. 1949); G. HEGEL, *THE PHILOSOPHY OF RIGHT* (T. Knox trans. 1942); W. KOHLER, *GESTALT PSYCHOLOGY* (1947); K. KORSCH, *MARXISM AND PHILOSOPHY* (F. Halliday trans. 1970); C. LEVI-STRAUSS, *THE SAVAGE MIND* (1966); K. MANNHEIM, *IDEOLOGY AND UTOPIA: AN INTRODUCTION TO THE SOCIOLOGY OF KNOWLEDGE* (1936); H. MARCUSE, *REASON AND REVOLUTION: HEGEL AND THE RISE OF SOCIAL THEORY* (2d ed. 1963); I. K. MARX, *CAPITAL* (B. Fowkes trans. 1976); K. MARX, *CRITIQUE OF THE GOTH A PROGRAMME* (1939); K. MARX, *ON THE JEWISH QUESTION*, in *EARLY WRITINGS* 211 (R. Livingstone and G. Benton trans. 1975); J. PIAGET, *PLAY, DREAMS AND IMITATION IN CHILDHOOD* (C. Gattegno and F. Hodgson trans. 1962); J.P. SARTRE, *BEING AND NOTHINGNESS: AN ESSAY IN PHENOMENOLOGICAL ONTOLOGY* (H. Barnes trans. 1956); J.P. SARTRE, *THE PROBLEM OF METHOD* (H. Barnes trans. 1963); Lukacs, *Reification and the Consciousness of the Proletariat*, in *HISTORY AND CLASS CONSCIOUSNESS: STUDIES IN MARXIST DIALECTICS* 83 (R. Livingstone trans. 1971).

guishing between courts, legislatures and administrative agencies as lawmakers are (i) that the false consciousness of the public requires it or (ii) that the decision maker has a quite specific theory about how his or her particular institutional situation should modify his or her pursuit of political objectives.

I likewise assume that it makes little or no difference whether we are talking about very particular doctrines, like the rule that performance of a pre-existing duty cannot be consideration for a promise, or about general standards such as the invalidity of unconscionable contract terms. Finally, I take it for granted that no one has yet developed an account of the existing rules about agreements that relates them convincingly to a general moral theory, or to a general theory of rights. More: there are extant no theories of moral conduct or of rights that convincingly indicate even in their own terms what the rules about agreements *should* be.

On this basis, I will proceed as follows. The first part provides a descriptive and conceptual framework for the discussion. The second explores the place of distributive and paternalist motives in our current discourse about the law of agreements. The third introduces the compulsory term or nondisclaimable duty as an important, indeed central institution within that body of law. The fourth part examines the distributive and efficiency consequences of this institution, and the fifth criticizes the unequal bargaining power rationale for its existence. The sixth part defends paternalism, with respect to compulsory terms and in general, against the claim that it is inconsistent with or inappropriate to the legal order.

#### I. A CONCEPTUAL FRAMEWORK: THE SOCIAL BACKGROUND, FREEDOM OF CONTRACT, THREE KINDS OF MOTIVES

This part sets the stage for the rest of the article by presenting the basic assumptions and concepts I will use throughout. First, since I will be talking about the motives of decision makers making changes in legal rules, I need to give an idea of the world in which they operate — the social background of the analysis. I will use a much more specified context than is usual in economic analysis, though a much less specified context than is typical of doctrinal work. Second, I present the baseline contract/tort regime — “freedom of contract” — which I imagine my decision maker to be working with. It is this regime, rather than the state of nature or the contract/tort regime of a socialist economy, that I imagine him to be able to change. Third, I define the three kinds of motives with which the analysis will deal: distributive, paternalist, and efficiency motives.

### A. *The Social Background*

I am going to be imputing motives to a rather abstract character. He is a decision maker in a legal system — a private law and criminal law regime — that is at least generally similar to that of the nineteenth and twentieth century United States, or to that of any Western European country during this period. This is a national legal system, and the economy of the nation is, speaking loosely, capitalist or “mixed,” with various welfare state kinds of rules in effect. It has been industrializing for a long time.

The decision maker has the power to modify the contract and tort and criminal law groundrules of this system. He can shift the rights and privileges that come with ownership of property or with being a person, and he can modify the rules about what agreements are enforceable and on what terms. But he can't just take large quantities of “stuff” away from some specific people and give it to other specific people (or groups or classes). He has no power to tax, and he can't nationalize or collectivize resources by abolishing private property in them.

The decision maker looks out at a society that has been operating for some time under more or less stable rules of the game. Using common knowledge, intuition and social science research data, he can identify outcomes of the game played according to these rules. The outcomes are the experiences of all the people who are pursuing their lives as participants in the economy. These vary greatly from person to person, and vary in many dimensions. Some people have great wealth, others middling wealth, some no wealth at all. Some have high incomes, some middling and some little or no income from employment.

Beyond monetary measures of valued experiences, there are other indices of attainment and of equality — differences in educational level and in skills that seem to reflect differential success in attaining goals everyone agrees are desirable rather than differences in taste among possible attainments. Furthermore, the decision maker will have some sense of the historical evolution of the national economy, its prior successes and failures in providing large quantities of valued experiences — he knows something about changes in the gross level of output as well as something about its distribution.

All this is taking place in a context of class division, patriarchy and racialism. These three systems have several things in common. Classes, racial groups and to a lesser extent men and women live apart, unto themselves, but are also interrelated through a system of division of labor that makes them interdependent and gives them all kinds of experiences of one another. Second, there are differences in capacities and differences in valued experiences linked to class, race and sex, but

mediated by the market — you aren't paid less "because" you are a woman in a formal status sense, but because of the combination of relative lack of economic power and of "prejudice." Third, members of groups have experiences of intersubjectivity, of shared identity, communication, intimate mutual knowledge that set them apart from each other, yet all groups are part of a regional and a national culture, and so identify themselves vis-à-vis "foreigners."

Fourth, everyone knows that race, sex and class differences are not just "differences." These terms refer to hierarchical arrangements of groups. Men dominate women; whites dominate blacks and Hispanics; upper classes dominate lower classes. In each case, there is a "traditional" interpretation of this hierarchy as natural and legitimate, and as the appropriate basis for differential rewards. There is also a conflicting interpretation of hierarchy as illegitimate because all are or should be equal, and a third interpretation that emphasizes the superiority of the previously inferior (along with the desirability of their separation from the rest of the nation).

People in this social world experience their level of welfare as in part determined by their class, sexual and racial identities, in part determined by intrinsic qualities of the self, but in every case as the product of a struggle or competition for the "good things of life." In this perspective, people want more or less the same things, and they want them in as great quantity as possible. The groundrules therefore govern situations that are both cooperative and zero sum. In every transaction between buyer and seller, there is an issue of how well one can do at the expense of the other. The relations of workers among themselves are based on competition for jobs, for wages and for advancement, as well as on solidarity. Capitalists have their common interests, but they also constantly battle among themselves. Consumers of different kinds of goods bid against one another for resources. These lines of conflict and common interest sometimes correspond and sometimes don't correspond to class, sexual, racial, and regional divisions. Group conflict and economic conflict almost always overlap to some extent, and are almost never fused in a single conflict.

How much the economy produces, just in terms of the raw output of things that just about everyone wants some of, and also how well each person does in the economic struggle within civil society — both of these are in part a function of the set of property, contract and tort rules (with legislative and administrative elaborations) within which the struggle takes place. These rules are by no means the only factor. So long as we're talking about a system that's part of the family of Western European mixed capitalist regimes, the choice of a particular

set of groundrules is obviously far less important than the initial distribution of wealth *within* the groundrules. Endowments of natural resources count for countries and regions; relatively fixed (by adulthood) capacities, skills, talents, disabilities, genius, count for individuals. Group spirit counts for groups. But the groundrules exist; they are invoked from time to time, and they have *some* influence on the level of output, on its composition, and on its distribution. The decision maker decides in this context.

B. *The Base Line for Assessing Rule Changes: Freedom of Contract*

The decision maker acts within a legal as well as a social context. He is making changes in a previous regime that is not the state of nature (no state, no positive law, and no system of enforced rights). If it were the state of nature, the question would be how much law to add to a background of no law. But the changes I want to discuss in what follows are changes in an already existing system which I will loosely call freedom of contract. Since about the beginning of the nineteenth century, discourse about what rules should be in force has taken something like this regime as its starting point.

1. *The Rules that Compose a Regime of Freedom of Contract* — As I will be using the term, a regime of freedom of contract is a set of rules about agreements within a domain of pre-existing property rights. In other words, we presuppose a set of decisions to the effect that land, for example, can be “owned” by individuals or groups, that people can “sell” their labor, and so forth. (I recognize that the definition of a domain of property rights may require us to refer, in circular fashion, back to the question of freedom of contract, but this difficulty is irrelevant for the limited purposes of this paper.) It may be helpful to lay out the rules that make up free contract in a schematic way:

(a) People are free *not* to make agreements to do things that fall within the domain. You don’t have to contract. This means there are the following rules:

(i) The state will not punish you for refusing to enter agreements within the domain, no matter how much your potential partner wants you to and no matter how obvious it may be to the decision maker that you *ought* to.

(ii) There are criminal law and/or tort rules in effect that are intended to prevent people from using force, stealth or fraud to just *make* you do things you won’t freely agree to do.

(iii) There are a set of contract rules in effect that reduce to a nullity (or make “voidable”) agreements that only appear to



have been freely entered into. In other words, in contract actions there are defenses of fraud, duress and incapacity.

(b) People who have legal capacity are free, within the domain, to bind themselves. You don't have to make binding contracts, but you can if you want to. This means that there are the following kinds of rules, in each case to be enforced only where the parties do not indicate to the contrary:

(i) There are rules specifying what conduct is necessary in order to create a binding obligation — to get the judges to enforce the agreement.

(ii) There are rules about what constitutes a breach of a legally binding obligation.

(iii) There are rules about what happens to you if you breach.

(c) There is a general rule against the state requiring or prohibiting any particular terms in contracts. It's not just that you don't have to contract, and can contract if you want to: you can contract on any terms you want to as well.

## 2. *The Constitutive Character of the Exceptions to Enforcement* —

We have freedom of contract if the decision maker enforces agreements, one might say. But this would be an inadequate specification of what must be going on if we are to "have" this institution. The decision maker must, indeed, enforce agreements, but he must also *refuse* to enforce agreements. If he enforces the wrong ones, those that shouldn't be enforced, then we are as far from freedom of contract as we would be were he to refuse to enforce agreements at all. The institution, in other words, is as much constituted by the exceptions to enforcement as by the practice of enforcement. It is there so long as the decision maker maintains his balance between the two extremes of non-intervention and over-intervention in the affairs of civil society.

The goal of the balancing act is two distinct kinds of freedom. First, there is the freedom of one private actor from legally backed imposition by the other. If there were no defense of duress, strong parties could bind weak parties in spite of the fact that the weak parties didn't really want to be bound — hadn't really agreed. Without a defense of fraud, crafty liars would get away with murder. If there were no defense of incapacity, unscrupulous people would soon separate children and the insane from their possessions. But the point about private imposition applies as well to the more general principle that you are not bound unless you affirmatively intended to be bound. If other people can force you into contracts merely by asking you, or merely by asking you while at the same time presenting you evidence of their vulnerability to harm should you fail to contract, then we have something less than freedom of contract.

This means that in order to be true to the institution, the decision maker must not enforce agreements that are the product of the superior power of one party, rather than of the consent of both. And he must not enforce agreements that the stronger party should have but did not enter with the weaker party. The injunction not to enforce "unfree" agreements protects the strong against the weak, as well as the weak against the strong.

Freedom of contract is freedom of the parties from the state as well as freedom from imposition by one another. The decision maker must not condition contract enforcement on the lighting of candles for the salvation of his soul (or the soul of the monarch). So long as they have legal capacity he is also prohibited from conditioning enforcement on the parties adopting his particular view of what their relationship should be like. He must let them deal only for the short term, though he believes they should bind each other for the long haul; he must let them buy and sell at whatever price they like, and on whatever terms, so long as the agreement meets the test of voluntariness. He must not use his power to make one party sacrifice or share with the other party beyond her willingness to do so of her own free choice.

These substantive judgments about what acts were truly voluntary and about which intentions were whose are simply inescapable so long as it is freedom of contract the decision maker is trying to achieve.

### *C. Three Types of Motive in Setting the Groundrules*

A decision maker may change (or refuse to change) a rule for many different reasons other than like or dislike of freedom of contract. In particular, he may believe that his act will have desirable distributive, or paternalist, or efficiency consequences. Here I will briefly define these in turn, in each case using the word motive to mean, loosely, just goal, or purpose, or objective, rather than anything more technical or precise.

The decision maker acts out of distributive motives when he changes a rule (or refuses to change a rule) because he wants to increase the success of some group in the struggle for welfare, expecting and intending that this increase will be at the expense of another group (the groups may overlap). The decision maker acts out of paternalist motives when he changes a rule in order to improve someone's welfare by getting them to behave in their "own real interests," rather than in the fashion they would have adopted under the previous legal regime. The decision maker acts out of efficiency motives when he changes a rule so as to induce people to reach agreements that correspond to

those they would have reached under the previous legal regime had it not been for the existence of transaction costs.

1. *Distributive Motives* — The first hallmark of distributive motive is that the decision maker accepts the beneficiary's definition of what will make the beneficiary better off. The notion is that the decision maker finds two people engaged in a struggle over the distribution of something that each values. They are operating under the previous regime. He changes the regime in a way that helps one. The second hallmark is that the decision maker sees the situation as zero sum: helping one means hurting the other. Some examples of issues that get discussed in distributive terms are: should secondary boycotts by labor unions be tortious? Should there be a minimum wage? Should issuers of securities have to give potential investors more, or more accurate information than was required by the common law of fraud as it stood in 1929?

A decision maker might resolve these specific issues (and any others as well) without regard to issues of distribution. He might be unaware that his decision would have a cognizable distributive impact, or he might not care about distribution in general, or about distribution as between the particular parties likely to be affected. Or he might believe that it was both possible and somehow required that the decision be made by looking to the fairness or the moral character of the conduct involved, or to the "rights" of one party or the other (or of both parties) to the dispute, in each case with the belief that decision by reference to these considerations specifically excludes even considering the distributive effects likely to follow.

As I conceive the category, there are many kinds of distributive motives. The pursuit of distributive goals, moreover, may or may not be instrumental to the attainment of more "ultimate" goals. One might modify the groundrules with the sole object of making the distribution of income between two groups more equal or less equal. One might have the idea that everyone has a "right" to a particular absolute or relative income share, or that such a distributive pattern would further the goal of civil peace. One might think it immoral for a person to reap more than a particular relative share of the benefits of a transaction, or that a particular class of people have a hereditary right to be twice as wealthy as anyone else in civil society. What makes the motive distributive is that the decision maker sees changing the rule as a means to changing distributive shares, and whatever ulterior motives exist are to be attained by this route.

The decision maker operating from distributive motives changes the groundrules so as to change the balance of power between the vari-

ous groups in civil society. The change in the rule may operate directly, as in a change in the law of duress that allows one party to do things to the other that were previously illegal (e.g., the legalization of picketing or lockouts), or it may be indirect, as where the prohibition of secondary boycotts changes the balance between a union and its primary target, or a law against monopolistic combinations changes a firm's relations with customers. But the issue is power.

2. *Paternalist Motives* — By contrast, where motives are paternalist, the issue is false consciousness. As in the distributive case, the decision maker changes a rule because he believes that under the new regime the objects of his benevolence will end up with a set of experiences that will be "better for them" than those they would have ended up with under the previous regime. What makes this change paternalist rather than distributive is, first, that those who have supposedly benefitted do not agree that they are better off, and would return to the previous regime if given a choice in the matter. Second, if there are good or bad consequences for others through the paternalist change, these are seen as side effects, rather than as part and parcel of the decision maker's program.

As I am using the term, all paternalist interventions involve overruling the preferences of the beneficiary in his own best interest, but not all such overrulings are paternalist. One might, for example, refuse to enforce contracts made under duress, thereby overruling the preferences (at the time of contracting) of both parties, but do this in the belief that it would, over the long run, make the weaker party richer at the expense of the stronger. Weak parties, looking at the matter in the abstract rather than at gunpoint, might agree that over the long run a contract defense of duress would be a good thing for them. So long as there is no disagreement as to the values or moral vision on which to act, the decision maker is not acting paternalistically.

Some issues that have often been addressed with paternalist motives are the legality of the possession of prohibited substances; whether there should be required terms in various types of contracts, such as marriage or consumer sales contracts; and the extent to which infants, idiots and seamen are subject to the same contract regime as "normal" people. As in the case of distributive motives, each of these issues can be resolved through the application of tests that do not involve paternalism. One might try to settle each by appeal to distributive considerations, as well as by appeal to fairness, morality, or rights.

3. *Efficiency Motives* — A decision maker acting from efficiency motives accepts the rules of the previous regime as legitimate from the

point of view of fairness, morality, rights, distribution or whatever. His goal is to modify one of these rules so as to make everyone affected better off, by their own criteria of better-offness, than they would have been under the old dispensation. This will be possible where transaction costs of one kind or another have prevented parties under the previous regime from making an exchange. If the decision maker knows that this exchange would have occurred, he may be able to induce the parties to perform it by the right modification of the background rules.

Some examples of issues that decision makers often approach with efficiency motives are: whether there should be nondisclaimable warranties attached to consumer goods in circumstances where consumers can't cheaply acquire information that would allow them to assess product safety, and sellers have incentives not to provide this information; what should be the rules of damages for breach of contract; whether sports arenas should be liable for damage inflicted by one fan on another. Of course, each of these issues can be approached with quite different motives, or with a set of motives that lead to conflicting resolutions.

Efficiency motives differ from paternalist motives because their premise is that the affected parties will prefer the new situation to the old, so they would not choose to "waive" the benefits the decision maker has attempted to confer on them. The decision maker is not trying to decide what is "really" best for them, without regard to their own views of the matter. On the other hand, an intervention grounded in efficiency concerns will always involve speculation about what the parties "would have done" had they not been prevented by transaction costs.

This is a form of second-guessing that goes considerably beyond what is required when a decision maker acting from distributive motives tips the scales in favor of one combatant and against the other. It falls short of paternalism because the decision maker sees second-guessing as an unfortunate expedient necessary only because of market imperfections, and will abandon an intervention if convinced that the supposed beneficiaries don't want it. By contrast, the paternalist is identified precisely by his willingness to persist when it's clear his contribution is not wanted.

We might distinguish between efficiency and distributive motives on the ground that the first involve making both parties better off, while the second involve helping one at the expense of the other. However, I want to fudge this distinction, and treat as motivated by efficiency some interventions that have negative effects on some actors. In particular, I will treat as motivated by efficiency the following type of action: the

decision maker imposes a term in a contract in the belief that if the parties had full information almost all sellers would offer it at a price that almost all buyers would accept. In this case, there are some negative distributive impacts, on those who wouldn't have offered the term and on those who wouldn't have paid for it had we not changed the rule to make them do so. But the motive of the intervention is to make the great mass of buyers and sellers better off by facilitating the deal they would have made absent transaction costs. The negative distributive impact is a side effect, like the side effects of paternalist intervention, rather than the whole point of the enterprise.

4. *A Borderline Case (on all three borders)* — It may be helpful in clarifying what I intend by my types of motive to consider a case that seems to fall at the intersection of all three. Suppose a decision maker asked to enforce a contract between an employer and an individual worker, by which they agree that the worker will not join a union, and in exchange will receive a wage and benefit package superior to that now offered union members. The decision maker might decide that this agreement was unenforceable (or even enjoined) and explain the decision by referring to its expected consequences. Suppose all agree that prohibiting the contract will strengthen the hand of the union as against the employer, and increase the total sum he pays as wages. It will hurt the particular worker in the short run, since he could have made more through his separate deal than he can make by bargaining collectively, even through a now stronger union. The decision maker believes that in the long run the strengthening of the union means that the worker will receive more income than he would have had the decision maker allowed him to contract separately. But there is no question that he would waive these benefits if the law permitted it, and make his separate peace.

If we take the most capacious version of my definition of efficiency motives, we can fit this case under that rubric. Transaction costs include not just the cost of aggregating interests and the costs of working out the details of agreements, but also the costs of obtaining information. We could argue that if the worker had accurate information about the consequences of his actions, he would realize that his "free-loading" on the continued existence of the union will eventually destroy it, leaving him worse off than he would have been had he settled for half a loaf in the first place. Looked at from the point of view of workers as a group, transaction costs lead to market failure and the workers end up without an agreement (to act together through the union) that would have made all of them better off. Moreover, the negative distributive consequences for the employer that flow from disal-

lowing the yellow dog contract are collateral side effects of the goal of efficiency.

The first problem with this interpretation is that it strains the distinction between making people better off in their own terms and choosing for them to protect them from their own false consciousness. The case is efficiency-like in that the decision maker doesn't quarrel with the worker's goal of maximizing his income, but it looks paternalist in that the decision maker has made for the worker what looks like an intrinsically subjective, uncertain judgment about what strategy will best accomplish the goal of maximization. He is overruling the worker's choice between short term and long term gains.

The second trouble is that the case strains the distinction between efficiency and distributive motives. Suppose we accept that the worker is making a mistake in his own terms, as a result of the difficulty of obtaining accurate information about the longer term consequences of his actions (so that intervention is not paternalist). We still face the question whether the losses the decision maker is inflicting on the employer are mere side effects of greater efficiency, or rather part of the whole idea of the intervention. There is no simply logical or analytic answer to this question, so long as we don't want to confine the category of efficiency motives to the desire to make everyone better off without hurting anyone at all. It's a matter of degree, with clear polar cases and a lot of obscure cases in the middle.

Finally, suppose we decide it just doesn't make sense to describe the decision maker's motives as having to do with efficiency. Is what he's doing paternalist or distributive? To my mind, it depends on a rather subtle distinction, which may be hopelessly unclear in a particular case. If the decision maker thinks workers make yellow dog contracts because they have a high preference for current income, little concern about the "long run" in which the conduct of people like them will destroy the union, and no feelings of solidarity with co-workers, then disallowing the contract looks like paternalism. If, on the other hand, the decision maker thinks most workers contract only because of a fear that others will if they don't, believing everyone would be better off if no one did, and with feelings of anguish at betraying their comrades, then the intervention looks distributive — designed to help this group achieve its goals in the competitive struggle rather than to impose a particular conception of how to live.

## II. THE THREE MOTIVES IN CONTEXT

This part describes the process by which it has gradually come to be expected, if not accepted, within our social context that decision

makers will take account of distributive but not paternalist consequences when they make choices about the law of agreements. The first section describes a (perhaps mythical) earlier situation in which the idea of freedom of contract was supposed to provide an exhaustive guide to decision making, resolving in itself all distributive and paternalist issues. The second section describes the breakdown of confidence, again, within this particular milieu, that implementation of freedom of contract could be the single motive for legal action. The third section describes the situation "after the fall" in which we now live, comparing efficiency (proxy for the old regime) and paternalism (still a pariah) with the semi-legitimate status of the distributive motive.

A. *Freedom of Contract as the Sole Motive in Decision Making*<sup>4</sup>

There is a strand of social and legal theory that argues for freedom of contract as a coherent guide to decision making about the law of agreements, and as the sole legitimate basis for such decision making. The opponents of this position have tended to represent it as having once been the dominant ideology, to castigate it as the conventional wisdom of an earlier period. It is not important for our purposes whether such an earlier period actually existed. The position itself certainly exists, albeit as the view of a minority, and proponents of other views tend to treat it as polar — as one of the extreme or pure cases with respect to which they define themselves. (The other polar position is that thought to be held by "communists" who believe in the collectivization of everything.)

The view I am talking about asserts that it is possible to decide cases involving the law of agreements by reference to the basic principles of free contract that I described in Part I above. When there is a gap, inconsistency, or ambiguity in the specific rules of agreement, the decision maker can refer to the idea that people don't have to contract, to the idea that they can bind themselves if they want to, and to the idea that they can pick the terms of their contracts, and come up with a solution that will implement freedom of contract by applying it to these particular circumstances. If, for example, the authorities conflict with respect to contract damages, we can consult the underlying notion that people can make binding promises and come up with expectation damages as the presumptively appropriate measure, since the expectancy is the closest we can get to actually carrying out the intention of the parties (short of specific performance, of course).

Supposing that it is possible to resolve all disputes about the law of

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4. See generally P. ATIYAH, *THE RISE & FALL OF FREEDOM OF CONTRACT* (1979).



agreements by applying the basic principles of free contract, there are, in the view I am describing, quite a number of different reasons why we ought to. (One might accept one of these and quite emphatically reject the others.) One might believe that people have a natural right to the outcomes of a free contract regime (with or without a proviso that someone should make sure the initial distribution of property is fair), or that it is immoral to break promises. One might believe that free contract is presumptively (or analytically) efficient, and that the goal of all decision making should be efficiency. Or that the people (through the Constitution or otherwise) have stated their will that freedom of contract be the rule for all decision makers.

It is common when attacking this polar position to assert that it is blind to the distributive consequences of letting people agree to anything they want, and also insensitive to the need to protect people against their natural propensities to error or weakness. But for a believer, one of the greatest strengths of the free contract position is that it takes these objectives explicitly into account, and claims to accomplish them in a manner far more rational than that proposed by the critics. Remember that the exceptions to the enforcement of agreements made for cases of fraud, duress and incapacity are *constitutive* of the model of free contract. This means that before we decide to enforce an agreement, we have to make a judgment that neither party was overborne by the other, nor tricked by the other, nor so weak or immature in judgment that he lacked free will. To claim that freedom of contract doesn't take into account unequal bargaining power or possible monopoly of information or the congenital folly of some types of contracting parties is just wrong. Allowance for these situations is part of the very definition of the institution.

But it is also part of this polar position that the judgments about coercion, fraud and capacity to contract that are built into the free contract regime should be the *only* judgments on these subjects made by a decision maker administering the law of agreements. The test of legitimacy is voluntariness. If the transaction is voluntary, the decision maker ought not to bring to bear any *further* criteria of distributive justice or paternalist concern. Once he has made the distributive and paternalist judgments implicit in the constitutive exceptions, he should let well enough alone.

### B. *Critiques of Freedom of Contract*

I think it is fair to say that all the critiques of freedom of contract within our social context are motivated either by objections to the distributive outcomes of nineteenth and twentieth century economic life,

or by the sense that the masses under capitalism have used what freedom they have against their own best interests. The first idea is that the inequalities all around us, both between racial, class, sexual and regional groups and within those groups, are unjust, irrational and repulsive. But the critical intelligentsia has had to concede a measure of freedom from naked coercion in the choices of the mass of people. There is a sense in which there has never been a culture more the conscious and intelligent product of the mass of people — a more democratic culture — than that of late capitalism. It just isn't plausible to attribute the spiritual vacuity and desolation of that culture (*or* its vitality, openness and heroic quality) solely to "the profit motive," or even to the "cultural hegemony of the ruling class." There is as well a problem of mass error, of cultural error as judged against an asserted transcendent standard of the true, good and beautiful (a standard that aspires to be free of racist, sexist and class blindness).

While the critique of inequality and the cultural critique are at the root of the assault on freedom of contract, the strictly legal critique has had its own form, a form designed to soften or obscure the embarrassing absolutism of the underlying position. The first version of the legal critique accepted the inner logical coherence of freedom of contract but argued on a variety of grounds that though coherent it was undesirable. The second version rejected the claim of coherence itself. Both were based on the emergence toward the end of the nineteenth century of a specifically regulatory conception of free contract.

1. *Freedom of Contract as a Regulatory Regime*<sup>5</sup> — One way to defend freedom of contract is to argue that it just enforces the will of the parties, and that enforcing the will of the parties ensures that transactions in civil society take place at prices that reflect the "natural" or "real" values of commodities (such as labor and capital). An important beginning in the attack on freedom of contract was to assert, with the support of modern economics, that there simply are no natural or real values for commodities, including capital and labor. Values (prices) depend on supply and demand, which depend in turn on the contingent variables of taste and technology, and on the competitive structure of markets. They also depend on the choice of a particular set of alternatives among many possible legal regimes. *No* outcome is natural in the sense of being somehow prior to the legal rules in force.

Undermining the claim that there are natural economic values that the legal system should try to bring into being doesn't, all by itself,

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5. See generally 1 K. MARX, CAPITAL, *supra* note 3, at 163-87; Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933).

invalidate freedom of contract. It is still possible to believe in it for other reasons, such as that people have natural rights, or that it is moral to let them make agreements, on whatever terms they want to, about things we have decided are their own. But undermining the claim of naturalness does open up discussion about the distributive effects of legal regimes. In so much as we are going to be for or against freedom of contract on account of the results it produces for the different groups engaged in the economic struggle of civil society, we are now invited to assess freedom of contract as one among a set of possibilities no one of which can lay claim to the special virtue of naturalness. This choice seems at first to be that between the "logic" of property and contract and the opposed "logic" of collective action.

2. *Freedom of Contract as "Logical but Wrong"*<sup>6</sup> — There are a number of different grounds on which critics have rejected freedom of contract while nonetheless conceding (often with relish) its internal coherence. In each case, the critic takes it for granted that the regime in force corresponds to that which was required by the abstraction (free contract) and that it is a major factor in determining distributive outcomes. For example, there is the notion that the regime was appropriate to the "individualistic" and "agrarian" economy of the United States before the Civil War, because in that economy the actors were small timers dealing in technologically simple commodities in a situation of relative independence of one actor from another. By contrast, the critic is likely to assert, we now live in a complex urban/industrial age of interdependence, to which the regime of freedom of contract is no longer appropriate.

Though this argument has had a great vogue, it seems to me quite silly. I don't think one could show that the economy was any less "interdependent," commodities any less "complex," or people any more "individualist" in the early than in the late nineteenth or mid-twentieth century. To my mind, the claim that the system was good in an earlier time but not good now was just a way for reformers to sweeten the pill of renunciation of the *rhetoric* of frontier individualism. In so much as there was a coherent point, it was that freedom of contract produced a set of results, in the early nineteenth century, conditioned by the degree of equality in the distribution of wealth and the level of competition in labor, capital and product markets. The very same set of rules of agreement will produce quite different results when applied to transactions between parties of greatly differing resources in markets where

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6. See, e.g., R. ELY, PROPERTY AND CONTRACT IN THEIR RELATIONS TO THE DISTRIBUTION OF WEALTH (1914).

the richer parties tend also to be concentrated into a small number of large units by comparison with the atomization of their poorer bargaining partners.

The critique of freedom of contract as logical but pernicious was associated with a program of law reform presented either as a "social" regime, or as a way to replace "merely formal" with "substantive" freedom. The program included apparent departures from each of the principles that supposedly determined the shape of the law in a free contract regime, and was a part of the larger enterprise of creating a regulatory-welfare-corporate state in place of the supposedly weaker state of laissez-faire. The program for the law of agreements included measures that were overtly distributive in intention, such as compulsory contracts for businesses affected with a public interest, and regulation of their rates as well as of the terms on which they provided services. Antitrust and labor laws are sometimes described today as motivated by the desire to improve efficiency, but at the time it was obvious to everyone that they represented attempts to change the balance of economic power among the constitutive groups of a modern industrial society. That the "social" program often involved shifting transaction surplus among buyers or among sellers, rather than from one group to the other, didn't make the rule changes any the less distributive in intent.

In the political battles about these rule changes, the proponents often denounced freedom of contract as inhuman, for all its logic, and the defenders of the status quo often accused them of proposing apparently small innovations that, because they defied basic principles, would lead inevitably to the wholesale abandonment of capitalism. In retrospect, it seems that both sides misconceived what was going on. As the combatants grew more sophisticated in their understanding of the arguments, it gradually became apparent that freedom of contract had never existed and never could exist in quite the way that both its supporters and its opponents had been assuming it had and could.

3. *The Critique of Freedom of Contract as Incoherent and Therefore Incapable of Determining Outcomes*<sup>7</sup> — The real problem with freedom of contract is that neither its principles, nor its principles sup-

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7. See R. HALE, *FREEDOM THROUGH LAW: PUBLIC CONTROL OF PRIVATE GOVERNING POWER* (1952); Cook, *Privileges of Labor Unions in the Struggle for Life*, 27 *YALE L.J.* 779 (1918); Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 *YALE L.J.* 710 (1917); Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasonings*, 23 *YALE L.J.* 16 (1913); Holmes, *Privilege, Malice, & Intent*, 8 *HARV. L. REV.* 1 (1894). See generally A. CORBIN, *CORBIN ON CONTRACTS* (1952); G. GILMORE, *THE DEATH OF CONTRACT* (1974).

plemented by common moral understanding, nor its principles supplemented by historical practice, are definite enough to tell the decision maker what to do when asked to change or even just to elaborate the existing law of agreements. This is not to say the principles or the actual elaborated body of law have *no* meaning and no influence. Of course they have both. But of course there are also gaps, conflicts, and ambiguities, and in an area like that of the law of agreements the parties themselves will often have a motive for drafting themselves into these areas of uncertainty.

Confronted with a choice, the decision maker will have available two sets of stereotypical policy arguments. One "altruist" set of arguments suggests that he should resolve the gap, conflict, or ambiguity by requiring a party who injures the other to pay compensation, and also that he should allow a liberal law of excuse when the injuring party claims to be somehow not really responsible. The other "individualist" set of arguments emphasizes that the injured party should have looked out for himself, rather than demanding that the other renounce freedom of action, and that the party seeking excuse should have avoided binding himself to obligations he couldn't fulfill.

The arguments on each side take different forms — some are utilitarian, others appeal to rights or fairness, still others work by evoking stylized images of the social world, or by appealing to common moral sentiments, like self-sacrifice and self-reliance. Because the arguments are symmetrical, few in number, and repeated endlessly in different legal contexts, the legally sophisticated decision maker is unlikely to see them as *in themselves* powerful determinants of his own views about proper outcomes.

The experience of gaps, conflicts, and ambiguities within the institution of freedom of contract, and of the availability of two rhetorical modes for arguing about proper resolution of such situations, puts in question the whole structure of rules. Our decisionmaker has the power to modify the law of agreements as well as to specify it where there is doubt. The same problem of being "unmoored" that exists when all agree the case is one of first impression exists as well whenever someone asks him to look at a *settled* rule as open to question and objection. There will be arguments in favor of changing the status quo in the direction of more altruism, and others in favor of restricting the range of duty to give actors more freedom. The system as a whole is radically underdetermined, at least when viewed as the product of a rational decision process rather than of the brute facts of economic or social or political power.

We have seen already that through the constitutive exceptions for

fraud, duress, incapacity and "no intent to be bound," the law of freedom of contract claimed to resolve basic issues of distribution and paternalism. Yet these constitutive exceptions refer ultimately to the abstract notion of voluntariness or freedom, which is among the most manipulable and internally contradictory in the legal repertoire. The historical treatment of the issues has produced a mass of conflicting precedents and ambiguous pseudo-resolutions. The flow of social and technological development means that new cases arise regularly, and the new cases may be very important in a practical way even if they seem to be about mere details of the law. It follows that even if he accepts without question that he should put into effect the distributive and paternalist outcome mandated by freedom of contract, the decision maker cannot do so, because the mandate is just too vague.

For example, without doing violence to the notion of voluntariness as it has been worked out in the law, the decision maker could adopt a hard-nosed, self-reliant, individualist posture that shrinks the defenses of fraud and duress almost to nothing. At the other extreme, he could require the slightly stronger or slightly better-informed party to give away all his advantage if he doesn't want to see the agreement invalidated when he tries to enforce it later. If we cut back the rules far enough, we would arrive at something like the state of nature — legalized theft. If we extended them far enough, we would jeopardize the enforceability of the whole range of bargains that define a mixed capitalist economy (capital/labor, business/consumer, and small/large business deals). In either extreme case, we would have departed from freedom of contract — the concept has some meaning and imposes some loose limits. But staying well within those limits, the decision maker's choices in the definition of voluntariness can have substantial distributive effects.

Take the case of fraud. When two parties are bargaining over the distribution of a transaction surplus, information is a crucial element of power, particularly information about the real properties of the commodity in question or about market circumstances affecting its value to others than the two involved. Suppose you know, but the buyer does not know, that the war has ended so that the value of your merchandise is almost certain to fall precipitously as peacetime trade is restored. Do you have to tell the other about the peace treaty? If so, you'll make less from the deal, and he'll make more, than if you could keep silent. Suppose the other party asks you outright if you have any news. Can you keep silent? Evade? Can you put out an advertisement quoting the war-time price "because of current conditions," when you know those conditions have ceased to exist?

One way to understand this issue is in terms of the extent of private property in information. As we push the law of fraud from caveat emptor to liability for concealment, then to liability for negligent failure to disclose, to liability for non-negligent failure to disclose, and finally to a duty to generate the information as well as to share it, we are "socializing" a resource. The result will be to reduce the bargaining power of one party vis-à-vis the other, and to change the distribution of transaction surplus between them. This will be the case whether or not the market is competitive. When we make sellers, for example, reveal information detrimental to their position, we reduce the demand for the product at any given price. As a result of having the new information, some people won't transact at all. Those who do transact will pay less now that they know more. All buyers regard themselves as better off with the information than they would be without it. Their new knowledge brings about a price reduction that directly reduces the welfare of sellers.

The decision maker might resolve issues of this kind without reference to the distributive consequences. He could try to determine, for example, the intrinsic fairness or morality of withholding information, without looking at the division of transaction surplus between the parties. Or he could do an analysis of property rights in information, based on a theory of the "original position," rather than on concern about the particular parties before him. There would be nothing irrational about such an approach. And it would be no more and no less consistent with freedom of contract than to undertake a careful analysis in terms of distributive objectives each time a rule came up for consideration. The demise of freedom of contract as a powerful, operative determinant of legal outcomes does not require the decision maker to embrace distributive motives. It merely permits him to do so without appearing to violate a basic institutional arrangement. The supposedly basic arrangement no longer tells him what to do one way or another.

This development has rendered obsolete the old debate between those who adored and those who abhorred the "strict logic" of free contract. The social or collective principle that the opponents put forward as an alternative to contract turns out to have been well established *within* contract from the very beginning. It is possible, for example, to argue on the most technical grounds for strict scrutiny of the voluntariness of consumer agreements, and for compulsory terms and set prices wherever voluntariness is in doubt. If one takes this approach seriously, there is little of the reformers' program that can't be restated as the implementation of freedom of contract, rather than its displacement by a new regime.

### C. *The Hierarchy of Motives "After the Fall"*

One might think from the gradual emergence of arguments that *sound* distributive that the milieu of the decision maker had become sharply politicized, at least by contrast to the situation a hundred years ago. This impression would be false. The acceptance of the distributive motive into the discussion of what rules of agreement should be in force has never been more than partial and oblique. This will become clearer when we consider the limited correspondence between an altruist bias in setting the rules and an egalitarian program for the redistribution of wealth. We will then be in a position to compare the status in legal discourse of our three "post-contractual" motives.

1. *Altruism Does Not Equal Egalitarianism* — Over the whole spectrum of rule changes that have distributive consequences, advocates will argue in terms of the rhetorics of individualism and altruism. This is true for fraud and duress, for the question of how hard or easy it should be to bind another party, for all the issues about the structure of combinations, and for compulsory terms and price fixing. Moreover, this same rhetoric gets applied to lots of other contract issues that are distributive as between the two parties to the dispute, even if they have no obvious long term significance for distribution between social groups. For example, people argue about whether it should be easy or hard to establish excuses for performance by appealing to ideas like sharing, forbearance and forgiveness, as well as to ideas like self-reliance, the right to be let alone, and so forth.

In all these cases, it is easy to confuse the question whether the decision leads to a more equal distribution of income between two groups with the question whether it intensifies duties of mutual regard, sharing, and sacrifice as between contractual partners. That the change in the rule is in the direction of greater altruistic duty does not mean that the rule promotes more equal distribution between groups; nor does the fact that the change in the rule eliminates or reduces people's obligations to look out for one another mean that it will make the distribution of income less equal. The person invoking altruistic rhetoric may be the stronger party, begging the court to make the weaker disclose the few bits of "inside" information that allow him to survive in the face of an otherwise overpowering adversary. When the court goes ahead and honors the ideal of altruism by imposing a duty on the weaker party to disclose, the weaker party may be forced to the wall.

Some disputes about the rules appear to the participants and to observers to have enormous consequences for the system. The parties pour large quantities of resources into the battle, and the rhetoric of the



advocates suggests the most exalted principles and the vastest stakes. For many participants in legal culture, these cases provide emblematic instances of the inescapably distributive character of law making. Yet they often involve questions which, when looked at in terms of the long term structure of the game, are close to meaningless. The focus on these "great" cases is, paradoxically, a sign that the decision making process is only superficially politicized. People see law as occasionally, if dramatically distributive, but as in the main an almost invisible neutral background.

Take, for example, the question whether a sale of land in which the seller reserves a right to a share of the profits from every future sale of the land is void as a restraint on alienation. It is obvious that if such clauses are void, sellers who previously used them will no longer use them, but will find some other way, marginally less satisfying perhaps, to extract a share of the long term appreciation of the value of the land. Perhaps they will merely lease rather than sell. If, on the other hand, such clauses are upheld, it is conceivable that there will be an effect on the rapidity of land turnover somewhat analogous to that of the capital gains tax, and equally difficult to assess empirically. Certainly the future of capitalism is not at stake.

Nonetheless, the case in which the question of the validity of the lease is decided, and a series of other cases like it, may have large distributive effects, just because of their one-shot impact on the wealth of the parties. Such decisions are retroactive. It may be that *after* the decision, landlords will quickly find a new way to exploit their tenants. But all those tenants only bound through this particular clause are now free, and the landlords are impoverished by legal disaster just as they might be by a flood. It is little comfort that they will return to the fray with only the most marginal legal disadvantage. What they care about is that a part of their capital has been handed over to the tenants. A series of such decisions can have an effect on distribution not because it "stacks" the rules in favor of the underdog, but because it enriches underdogs who use their gains to avoid finding themselves again on the bottom.

On the other hand, the most widely heralded victory of this type may do the underdogs no good at all if the actual one-shot transfer is small, or if they don't know how to use it effectively in playing the game under rules that are only marginally different than they were before. Even a long string of such victories will be to no avail if each successive accretion of wealth is inadequate to make the subordinate group truly independent, or if the long-run terms of trade are against it,

or if it fails to find a way to profit from striking innovations, or if . . . there are no guarantees of success in the struggles of civil society.

But what if the rules were changed in such a way as to deliberately bring about an egalitarian outcome? It is clear that it is possible to change the rules to such an extent that distributive outcomes are changed not just casually, but decisively. Such a set of changes would systematically eliminate all altruistic duty of the weaker groups to the stronger, while increasing the duties of the strong to the weak to the point of actually impoverishing them. Where gaps, conflicts, and ambiguities in the rule system had left the relative wealth of groups uncertain, such a policy would settle the rules to enrich the poor. Where this wasn't enough, systematic imposition of compulsory contracts and price controls would reduce the wealth of the rich to meaninglessness by depriving them of legal backing for its effective use. The mere statement of this alternative should make it clear how limited has been the acceptance of the distributive motive.

2. *The Partial Legitimation of the Distributive Motive* — The demise of freedom of contract has been accompanied by a distinct increase in self-consciousness about the various kinds of consequences of choosing basic rules about agreements. In our social context, actual power to make decisions about the rules usually belongs either to moderate conservatives or to moderate liberals. The liberals have embraced, in a qualified and ambivalent way, the distributive motive, while the conservatives, with equal qualifications and ambivalence, tend to reject it. By contrast, both liberals and conservatives accept efficiency as a good reason for setting a rule one way or another (though they argue about how to define it, and about whether and how to "trade it off" against other goals). Also by way of contrast, neither liberals nor conservatives acknowledge that paternalism (beyond that implicit in the constitutive exceptions to the enforcement of agreements) is a legitimate goal in setting the rules. The distributive motive falls between the general acceptance of efficiency and the general rejection of paternalism. In order to understand this hierarchy of motives, one must relate it to the social context described in Part I.

The appeal of efficiency rhetoric is that it recreates the aura of unproblematic legitimacy that once characterized freedom of contract. The goal of the decision maker is to make everyone better off. He can therefore claim that he is not taking sides in the desperate struggles between social groups. However things were distributed before he acts, he has no intention of disturbing that distribution. Second, the whole basis of his action is figuring out how people would have contracted had they not been prevented by the altogether nonpolitical impediment

of transaction costs. The decision maker can present himself as a mere facilitator of what everyone wanted all along, like a motorist giving a ride to a hitchhiker or a neighbor helping out in a flood. No one likes transaction costs; everyone would like to eliminate their effects; if the parties would have made an agreement, there can be no objection to the decision maker forcing them to that outcome, and the upshot is that everyone is happier than they were before.

Efficiency was initially a liberal slogan, with some of the same "radical" overtones that distribution has today. But as the liberals developed it and the conservatives argued against it in contexts like the battle for workmen's compensation or for strict products liability, it became clear that it could be given a capacious definition useful to either side. And each side had reason to exploit it, since it allowed the proponents and opponents of changes to deny that they had any distributive or paternalist motives at all. One can formulate efficiency as, say, "wealth maximization." This concept is so manipulable as to permit the analyst complete leeway to smuggle distributive and paternalist (or anti-paternalist) motives into the analysis without acknowledging them.

There are some negative overtones to its acknowledged pursuit as a goal. It is associated with a preference for the "technical" (or "quantitative" or "mechanical" or "material" or "individualist") over the "human" and the "communal." It is on the side of the engineers and against the poets in the *kulturkampf* of modernity. Poetry vs. engineering easily becomes the worker vs. the factory owner, the farmer vs. the railroad. Nonetheless, it is striking how little strong negative connotation efficiency carries, at least by contrast with distributive and paternalist motives.

Distributive motives are more or less suspect depending on how they are put, but they are always more suspect than efficiency motives. The decision maker operates against a background of class, sexual, racial and regional division and hierarchy; there is some (though never perfect) correspondence between economic interests at stake in rule changes and these group interests; and all groups conceive themselves as engaged in competitive struggle with all other groups. The decision maker is tipping the scales, when he acts distributively, between these groups. But he himself is a member of groups, and has economic interests. Those who don't see him as "one of us" will suspect, the minute he begins to speak of distribution, that he is more of a player than a referee, and those of his group begin to worry that he will go over to the enemy.

These are not minor concerns. In the society of which we speak, the unequal distribution of rewards, with its clear though never perfect

correspondence to the historical system of class, sexual and racial hierarchy, is the subject of passionate dispute. Peace and happiness seem to require that most of the time we not think at all about the justice of distributive shares. Otherwise, we risk falling into depression, or into a rage, and, in either case, out of sympathy with one another. Or worse yet, we may fall into the kind of sympathy — intense but selective — that leads to civil war. There is therefore a taboo on the explicit consideration of distributive consequences, let alone distributive goals. Law students blush if asked to discuss these matters in the publicity of the classroom.

While these implications of open discussion of distribution make it seem more prudent to put one's decisions on grounds of efficiency (or fairness, or rights, or morality), they also influence the manner in which distribution is mentioned when there's no way to avoid it. On the one hand, the distributive motive is always egalitarian, at least so far as one can tell from the overt discussion. No one advocates a change on the ground that it's regressive. On the other hand, no one advocates a change just because it takes money away from one group and gives it to another less well off. It is much preferable to find a way to describe what one is doing that refers to formal legal equality, or to equality of bargaining power between people identified in terms of their market roles (buyer vs. seller), rather than to the concrete facts of group membership.

My sense is that paternalism is if anything more taboo than distribution as a subject for open discussion in the literature of decisions about rules. And again this is rooted in the realities of group identity and hierarchy. It is not hard to imagine a society in which everybody agreed that there were particular classes of people who were likely to make choices not in their best interests, and that the legal system should protect them from themselves. Indeed, with respect to children and the insane, this is the condition of our society (though the consensus is beginning to break down). The objects of this protection might be in complete agreement that it was necessary. Or imagine a society in which everyone agreed that in particular situations or states of mind, everyone was likely to make mistakes and needed to be protected from themselves. The category of paternalism might come up mainly with strong positive connotations of loving care for others.

What makes it such a hot issue for us is that the system of class, sexual and racial hierarchy derives from an earlier historical experience in which it was not only material rewards but also knowledge, honor and virtue that seemed to be distributed according to the hierarchy. In this earlier system, upper class males believed (and so did most every-

one else) that they had superior knowledge, honor and virtue to those below them. They also believed they had a duty to educate those below them to accept the hierarchical system. There was apparently a hierarchical distribution of true consciousness as well as of material welfare, and an element in true consciousness was acceptance of the legitimacy of hierarchy. Upper class males designed the legal order to preserve both the hierarchy of wealth and power, and that of true consciousness, all the while claiming that they acted in the true interests of those subordinated.

The decision maker operates in a state of society in which the submerged groups have achieved juridical equality as citizens of the nation, and in which the official ideology proclaims moral equality as a fact, political equality as a goal attained, and economic equality as a possibility open to all. But the situation with respect to knowledge, honor, and virtue is much more complex. Formerly subordinate and still hierarchically inferior groups have asserted through the course of their struggles that the claim of the old elites to true consciousness was a lie. They (or their self-appointed representatives among the intelligentsia) have argued that all groups have equal access to the enlightenment once claimed exclusively by the elite. Or that there are different forms of enlightenment, corresponding to the consciousnesses of different groups, and that all are equally true. Or that the whole notion of true consciousness is wrong, so that there just isn't any way to compare the relative levels of enlightenment of groups. Running throughout is the theme that the consciousness of the old elites was in fact particular to them, rather than universal, and at least as distorted, at least as false, as the modes of consciousness they once rejected (and perhaps still silently reject) as worthless.

When a decision maker explains his action by pointing to the false consciousness of a purported beneficiary, who needs her choices controlled in her own best interests, many people who identify with historically oppressed groups will feel a chill, likely to be followed with a flush of rage, at what looks at least potentially like the repetition of historic injustice. The injustice was (is) twofold, consisting at once of denying practical freedom to the members of the supposedly beneficiary group and denying the validity of their psychic being, their particular experience of intersubjectivity. The word paternalism directly evokes patriarchy, but calling this kind of intervention "parental" or "maternal" wouldn't make anything but a cosmetic difference.

Should the decision maker turn to those who identify with earlier elites, or who see themselves as the elites of the moment, he will find no support at all for paternalist rhetoric. Modern elites rest their claim to

an unequal share of wealth and power on the supposed neutrality as between groups of the groundrules of economic struggle. They would doubly undermine that claim were they to applaud the introduction of paternalist motives into legal justification. Paternalism would suggest that they lacked a proper respect for those they dominate. And the rhetoric of paternalism, while focussed on the true interests of the beneficiary, is, in the context of agreements, a rhetoric of the restraint of power — the power of the contractual partner of the beneficiary to exploit the beneficiary's incapacity for his own advantage. It suggests the validity of interventions with distributive consequences that would be directly contrary to the interests of the elites.

Everyone in our world is aware that there is another world — that of the communist countries of Eastern Europe — in which the concept of true consciousness has been asserted with particular vehemence. It is the ideological basis for a bureaucratic, state socialist, oligarchic form of society that denies the pluralist expressive values of the West. The communist elites have justified their power with the claim that orthodox or scientific Marxism is the true consciousness of the proletariat, in whose name the party rules society in the interests of all humanity. They denounce the institutions on which Western elites base their unequal shares of wealth and power as the products of bourgeois class interest misrepresented by bourgeois ideology so as to produce false consciousness in the masses. The rhetoric of paternalism thus smacks today of communism as well as of feudalism. It is small wonder that, except in the cases of children and the mentally incompetent, it is *never* an acknowledged motive for changing the rules about agreement.

### III. COMPULSORY TERMS: DEFINITION AND TYPOLOGY

This part presents a description and analysis of a particular type of rule change — the imposition of compulsory terms or nondisclaimable duties — which is far more prevalent and more central to contract/tort ideology than any of the types of changes discussed thus far.

#### A. *Contract vs. Tort Duties*

Compulsory terms are duties (or sometimes exposures<sup>8</sup>) that come into existence for a legal actor as a consequence of entering some kind of relationship with another legal actor. The other legal actor cannot

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8. For example, courts have struck down lawyers' attempts to limit by contract a client's right to discharge without cause. The parties to a marriage contract were not, traditionally, allowed to modify the regime of inter-spousal tort immunity. These are nondisclaimable exposures.

waive the benefit of these duties. Some examples are the duty of good faith performance that arises in every contract under section 1-203 of the Uniform Commercial Code. Section 1-102 specifies that this obligation cannot be disclaimed, although the parties can specify what shall constitute compliance, so long as the specification is "reasonable." Common law courts have, on occasion, refused to allow parties to waive their right to sue for fraud, and declared their unwillingness to permit the parties to "work a forfeiture" even by the most explicit contractual language. Another example is the seller's warranty against physical injury from product defects. Section 2-719 makes a disclaimer of this warranty *prima facie* unconscionable — i.e., it is not waivable.

Compulsory terms also get imposed through tort law, without explicit relation to the provisions of a contract, i.e., without any pretense that the court is merely interpreting the will of the parties or engaging in the mysterious operation of making "necessary implications." Five areas of recent rapid development of nondisclaimable duties are warranties arising independent of contract (including warranties on services not covered by the Code), landlord duties to tenants with respect to the maintenance and repair of residential property, the duties of physicians, doctors, and other professionals to avoid malpractice, the duties of insurance companies to insureds, and the duties of employers to avoid wrongful discharge of workers hired at will.

It may make a lot of difference in a given lawsuit whether the nondisclaimable duty is thought of as "in tort" or "in contract," since the two causes of action have somewhat different rules about the statute of limitations and about damages. For example, it seems likely that abusive discharge sometimes gives rise to a tort rather than to a contract action (on an implied promise not to discharge in bad faith) at least in part because damages for emotional harm have recently become a respectable item in tort law, but are still suspect in contract. Moreover, the tort cause of action is associated with "the will of the state" rather than the will of the parties, so it is somewhat more plausible that tort duties should be nondisclaimable than is the case for contract duties. For several decades now, tort has been a domain of intense innovative activity openly based on "social policy," whereas contract law has come over the same period to stand for "rigor," "analytic precision" and individualist bias in much the way real property law did in the nineteenth and early twentieth centuries. There are doubtless other differences as well. From our point of view, they are all mere anachronisms, relics of an earlier form of legal false consciousness. If one thing is clear it is that whether the action is called tort or contract *should* have no impact whatever on the outcome.

This situation of total overlap of contract and tort — to the extent that the judge nowadays has a practically completely free choice as to which way to characterize a new compulsory term — is a recent phenomenon. It was apparently once so obvious when a duty was in tort and when in contract that it was rarely necessary to go into the matter (though even in the mid-nineteenth century some analytic jurists recognized the existence of a puzzle). The general notion was that tort and quasi-contractual duties were created by the state, and ought to be sufficiently general so that they would exist between strangers. All *further* duties than those that exist between strangers could come into existence only through the will of the parties, binding themselves to obligations one to one, or through the law of status. Status obligations were state-imposed. Indeed, they were the prototypical nondisclaimable duties. For example, the parties to a marriage contract cannot set their own terms for its dissolution, nor modify their obligations to one another. But status was a field apart. This conceptual scheme didn't *require* any particular outcomes, since the contract and status notions were highly manipulable, and in practice there were tort obligations that didn't fit into it. But the substantive state of the law was in fact that there were relatively few of these tort duties, and the courts seemed to assume that they shouldn't create new ones.

The course of the law has been to fill in this gap between highly abstract tort duties applicable between strangers and the very specific duties formally adopted by parties to a contract. From the contract side, the courts have used the device of "implication" of terms to give content to the informal agreements they are now more willing to enforce. From the tort side, it has been a matter quite simply of creating duties tailored (under the overarching negligence rubric, or the general injunction against intentional injury to temporal interests) to a series of particular situations that "just happen" to arise only in contractual relationships. Rather than interpreting the lease as a conveyance accompanied by a minimal implied contractual covenant of quiet enjoyment, the courts can imply a warranty of habitability with consequential damages for breach. Or they can declare that a landlord breaches a tort law duty of care in so maintaining the building as to create unreasonable danger of injury to the tenant.

There is no obvious stopping place. A court holds a diamond merchant liable for the death by suicide of another merchant when the defendant got possession of a diamond under an oral agreement, and then converted the stone, informing the decedent that he would not return it and would deny having possession of it. The court held that the conversion directly caused the suicide (*Hadley v. Baxendale* doesn't



apply to intentional torts), and just ignored the breach of contract.<sup>9</sup> In another case, a court held that when an insurance company refused, in bad faith, to pay on a disability policy, it committed the tort of bad faith refusal to settle a valid claim, thereby laying itself open to liability for unforeseeable consequential damages, and also the tort of intentional infliction of emotional harm.<sup>10</sup> In each case, the plaintiff obtained redress that would not have been available in a conventional contract action, unless, of course, the court had decided to make its innovations using contract language instead of tort language.

The creation of a new tort duty in a contractual situation can have three distinct kinds of consequences. It may merely add new remedies in situations where previously there would have been a finding of breach of contract but little or no basis for a damage recovery. It may add a new "implied" term, for example giving new specificity to the general duty of good faith in the absence of party specification to the contrary. Or it may add to the number of situations in which the parties cannot control the substantive content of their relationship — it may create a nondisclaimable tort duty.

The imposed duty may be to do or not do something on purpose, as, for example, not to discharge "in bad faith," or not to sexually harass. In these cases, the nondisclaimable duty is analogous to more abstract tort duties not to commit intentional wrongs, such as trespass. But the duty may also be defined in terms of negligence or strict liability. For example, early warranty law made the sellers' nondisclaimable duty that of due care in manufacture, whereas developed warranty law imposes strict liability for "defects," whether or not the product of negligence.

There is generally a choice as to how far to go: in the insurance cases, it seems sensible to start with what amounts to a "malice" requirement in cases of refusal to settle a valid claim, but the courts may well move step-by-step to a duty not to refuse to settle "knowing" that the claim is valid, from there to a duty of due care in determining whether or not the claim is valid before refusing to settle, and finally to a duty in strict liability to compensate a beneficiary who is emotionally or materially injured by a non-negligent failure to settle. Each of these solutions will have a different set of effects.<sup>11</sup>

There are odd results of the allocation to tort law of the labor of expanding contract law. Most contracts teachers seem to have the im-

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9. *Cauverien v. DeMetz*, 20 Misc. 2d 144, 188 N.Y.S.2d 627 (1959).

10. *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

11. See Appendix A for a discussion of the choice between strict liability and negligence in compulsory terms.

pression that their field is undergoing a loosening of formation doctrines, along with controversy about the undefined doctrine of unconscionability, but that the general framework of freedom of contract remains firmly in place. From the point of view of a torts teacher, what is happening looks more like the invasion of the territory of covenant and debt by the tort action of *assumpsit*. There is no reason in legal logic why tort law shouldn't displace the action on the contract altogether, substituting a new vision of the significance for people's duties to one another of the fact that there was some kind of agreement between them.

### B. *Statutory Schemes*

There is a body of legislation going back to the progressive period, and now undergoing a revival, that imposes all kinds of compulsory terms in all kinds of specific contracts. The following list is meant to show that the general idea of fixing terms and conditions (while leaving parties free to adjust the price any way they want to) is as fundamental to legislative as it is to judicial policy.

Legislatures have regulated the safety features of food and drugs, airplanes, railroads and boats, automobiles, fabrics for children's clothing, and building materials. They have regulated the design of residential buildings, and of public buildings, in each case indirectly controlling what arrangements the owners of property could make with willing paying customers. They have regulated interest rates, the sale of securities, the structure of financial intermediaries and the contracts between corporations and their shareholders (both in and out of bankruptcy). They have developed whole panoplies of required terms for insurance contracts, the wages and hours of employment, occupational safety and health, occupational licensing, conditions of rental housing, terms of payment and non-payment of rent, consumer credit (truth in lending), security arrangements, door-to-door sales, franchising, sales of condominiums, condominium conversion, mine safety, pension and annuity contracts, union pension funds. They have required workers, as a condition of employment, to lay aside money for their old age, and required employers to join workmen's compensation schemes. This isn't meant to be an all-inclusive list; it's just what comes to mind by free association.

These regulatory schemes are similar, for our purposes, to the contract and tort schemes I discussed above. (Sometimes there is a direct overlap, as where an activist judiciary has reformed landlord/tenant law in partnership with the legislature.) The crucial similar features are: (i) the transaction is regulated rather than prohibited, (ii) the du-

ties imposed are nondisclaimable, (iii) either party remains free not to contract, and (iv) the parties are free to fix the price at which the regulated transaction will occur.

The differences are likely to be the following. Legislative schemes sometimes look to a public agency using mild criminal sanctions to enforce the compulsory terms, rather than relying on the sanction of private lawsuits for damages, or on the sanction of nullification of contracts containing illegal terms. Legislative schemes are more likely to fix quantitatively specific solutions (forty-eight hours to renege on a door-to-door purchase) rather than rely on ad hoc tests of "reasonableness." Legislative schemes are often restricted to a particular transaction type, whereas judicial schemes supposedly have as much analogical scope as they have analogical validity. For our purposes, the similarities are all-important and the differences inconsequential, and I will hereafter take examples indiscriminately from the two bodies of law.<sup>12</sup>

### C. *Nondisclaimability as a Relative Concept*<sup>13</sup>

Nondisclaimability is not an all-or-nothing matter. The decision maker may do no more than adopt a rule that form contracts are to be construed *contra proferentem*, that is, against the drafter, and thereby achieve some measure of control of terms. Or there may be a judicial rule of "clear statement" required if the parties are to waive a particular protective arrangement, and the requirement can be beefed up until it is very difficult indeed to make the statement clear enough. It may be that the requirement of clear statement solves the problem without the decision maker having to declare the term compulsory, if a clear statement would be embarrassing to ask for (e.g., do you waive your rights against sexual harassment when you take this job with only an at-will contract?). Or it may just be too expensive to hire lawyers to draft a

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12. There is a further interesting area of nondisclaimable duties that I will not discuss here. When a legislature creates a welfare program or a scheme governing the status of state employees, it must comply with the constitutional requirement of procedural due process before deprivation of a property right. When, as in *Goldberg v. Kelly*, 397 U.S. 254 (1970), the U.S. Supreme Court holds that you can't grant a particular benefit without providing a particular set of protections, it is doing to the relationship between state and citizen something very like what the courts and legislatures have done to the relationship between one citizen and another. It is interesting to note, among the common features, the frequent ambiguity as to whether the courts will permit an explicit waiver, the emphasis on protecting the weaker party's procedural, as opposed to his substantive contract rights, and the prevalence of the policy argument — against the imposition of constitutional requirements — that judicial meddling will simply reduce the supply of benefits and therefore hurt those it is supposed to help.

13. H. HART & A. SACKS, *THE LEGAL PROCESS* 251-56 (tent. ed. 1958).

disclaimer that will have a chance of standing up in court, so the party may revert to a standard form which will be largely within the control of the adjudicator if it ever comes into dispute. There are many shades between an intervention that provides a facilitative term, truly modifiable at the will of the parties, and outright nondisclaimability.

The decision maker will have choices to make in another dimension as well. He may want to single out a particular term in a particular kind of contract — an acceleration clause in a conditional sale contract, a waiver of the equity of redemption in a mortgage agreement — and flatly outlaw that term, no matter what the particular circumstances of the contract. Or he may state that a given term — say a waiver of a bailee's liability for negligence — will be valid under some circumstances and invalid in others, according to a general standard (overreaching, for example, or inequality of bargaining power, or gross disparity of information). Or the clause might be outlawed for some classes of parties but not others (lender's retaining security interest in all earlier acquired property valid as between merchants but not as between merchant and consumer). The decision maker can throw out a clause only when it appears in a particular form of document — say, in the boilerplate small print — but not when it appears in a separate box with a line for separate signature. A court can reserve power to strike down *any* clause, no matter how presumptively valid, if it is "unconscionable as applied."

For our purposes, what counts is that the decision maker imposes some significant costs on parties who want to bind themselves in a particular way. They may be costs from uncertainty about the validity of the clause, or costs of preparing a particular style of document, or the costs may consist of the sanction of nullity for the whole contract if the party attempts to enforce a part. These are all just variants of our archetypical case in which the decision maker decrees that a contract of a particular kind just has to have a particular provision in it, and will be enforced as though it contained such a provision no matter what the parties try to do in advance to prevent it. No matter how mild the sanction, if the goal is to discourage one provision and encourage another, we have the phenomenon we are trying to understand in terms of motives and effects.

#### IV. EFFICIENCY AND DISTRIBUTIVE MOTIVES FOR COMPULSORY TERMS

It is possible to make sense of many regimes of compulsory terms by reference to efficiency and distributive motives. This part shows how one does this, taking up, first, efficiency arguments based on the pres-

ence of transaction costs and, second, the various ways in which the distributive consequences of interference with freedom of contract might appeal to the decision maker. The role of this Part in the paper as a whole is to provide a perspective for assessing the "unequal bargaining power" argument which I will criticize in Part V, and to suggest that while there *are* good efficiency and distributive reasons for some compulsory terms, there is a lot left to explain even when these rationales have been stretched to their limits. I hope this will make Part VI's argument for an ad hoc paternalist explanation of this type of intervention more plausible than it would be otherwise.

A. *The Efficiency Motive for Compulsory Terms  
under Transaction Costs*

Assume it is costly to bargain. Further assume that there are great disparities of information among parties, and that it costs money to disseminate information. Assume that it is possible in any given bargaining situation for holdouts and freeloaders, each acting in their narrow self-interest, to cause negotiations to collapse altogether, so a deal that would have benefitted everyone doesn't come off. It may now be plausible to explain particular regimes of nondisclaimable duties as motivated by the desire to reduce the efficiency losses these costs create. I will illustrate the way such arguments are constructed, suggest that they depend on easily manipulable factual assertions, and then argue that the efficiency rationale is very often no more than a screen for other motives.

1. *Two Classic Efficiency Arguments for Compulsory Terms* — By now you must be tired of my style, so just for variety I'll introduce the efficiency argument with excerpts from other peoples' treatments. Perhaps the single most familiar argument that the imposition of a compulsory term can lead the parties to the outcome they would have achieved in the absence of transaction costs is the following:

[C]onsumers may lack knowledge of product safety. Criticisms of market processes based on the consumer's lack of information are often superficial, because they ignore the fact that competition among sellers generates information about the products sold. There is however a special consideration in the case of safety information: the firm that advertises that its product is safer than a competitor's may plant fears in the minds of potential consumers where none existed before. If a product hazard is small, or perhaps great but for some reason not widely known (e.g., cigarettes, for a long time), consumers may not be aware of it. In these circumstances a seller may be reluctant to advertise a safety improve-

ment, because the advertisement will contain an implicit representation that the product is hazardous (otherwise, the improvement would be without value). He must balance the additional sales that he may gain from his rivals by convincing consumers that his product is safer than theirs against the sales that he may lose by disclosing to consumers that the product contains hazards of which they may not have been aware, or may have been only dimly aware. If advertising and marketing a safety improvement are thus discouraged, the incentive to adopt such improvements is reduced. But make the producer liable for the consequences of a hazardous product, and no question of advertising safety improvements to consumers will arise. He will adopt cost-justified precautions not to divert sales from competitors but to minimize liability to injured consumers.<sup>14</sup>

This argument is so familiar in the products liability context that it seems obvious. But it is trickier than it seems. In order for it to make sense, we have to assume the following. First, we must be able to determine that the reason for the failure to offer a safety feature is indeed fear of loss of sales to competitors rather than that buyers won't pay the cost of the precaution. This would make out the type of market failure associated with "freeloading": all sellers, and also all buyers, would be better off if they all together added the precaution, but no seller will do so for fear that none of the others will, so that if one goes ahead he will lose sales to the others. Second, we have to decide how we feel about the differential impact on buyers of the compulsory term. Some of them might have preferred the product without the precaution even under conditions of perfect information. These buyers will now either stop buying, or find themselves forced to take something they really and truly don't want. Moreover, there may be some sellers who could have stayed in business just by selling to those buyers, but who are forced out when the decision maker in effect outlaws sale of this product without the precaution. Third, there are distributive consequences for buyers and sellers who stay in the market: it is very possible that sellers will be able to pass along only part of the new cost, so that buyers get the improvement for less than it costs sellers.

It is in the nature of the efficiency motive as I have been defining it that it will require the making of these judgments about the factual situation (what the parties "would have done absent transaction costs") and about the significance of the distributive side effects of the initiative. To get an idea of how much leeway they create for the decision

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14. Posner, *Strict Liability: A Comment*, 2 J. LEG. STUD. 205, 211 (1973).

maker, consider the following extension of the argument from products liability to the law of wrongful discharge of an at-will employee:

[H]igh information costs may be responsible for the failure of parties to establish job security terms. Employees may for a variety of reasons misperceive their best interests at the outset of the employment relationship. For example, employees may tend to discount substantially the risk of wrongful discharge, and as a result systematically undervalue job security. This reflects a common psychological response; since most people prefer not to think about the possibility of disaster, employees understandably tend to disregard the possibility of job loss. In addition, most employees have only limited access to information about personnel relations in a firm and are unable to "shop around" by comparing the firm's relative turnover rate and firing histories. Companies further contribute to the employee's predicament by promoting an image of job security that is not completely accurate. Either a false sense of security or a failure to realize the risks involved may therefore lead employees to seek wage increases rather than forgo some immediate benefits in return for an appropriate level of job protection. Thus, the employees' situation is comparable to the situation of consumers facing a complex product market without adequate information about safety hazards from defective products. In that context, because consumers systematically fail to obtain protection against these risks, products liability law provides them the protection they would purchase were sufficient information available.<sup>15</sup>

The argument here is that there should be a nondisclaimable duty not to discharge wrongfully an employee hired at will, with wrongfulness defined in terms of "bad faith." While a change from the current American law to such a rule would do no more than bring this country into line with the rest of the industrialized world, it seems implausible that anyone would make such a momentous intervention on the basis of speculation about what workers "would have" bargained for if better informed. The author's flat denial of distributive or paternalist intent seems implausible if not downright disingenuous. Nonetheless, there is no *formal* problem with the argument. It is a matter of empirical and normative judgment whether it is valid in this case.

2. *Extending the Efficiency Argument* — The bargain-that-would-have-been depends on what kind of relationship we imagine between buyers and sellers. The following examples illustrate how positing the right attitudinal background can help to produce formally correct effi-

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15. Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816, 1831-32 (1980) (footnotes omitted).

ciency arguments that could justify almost anything.<sup>16</sup> In each situation, assume that a few sellers face a large number of middle-class, well-educated consumers. Sellers are specialists in providing the commodity in question, and engage in many transactions. Consumers engage in few transactions of this kind. The deal is a complicated one: there are lots of things that can go wrong with the product, and it is being sold on credit. It pays sellers to invest a little in lawyers who master this complexity, but a *rational* consumer might conclude that it is just not worth it to do likewise.

The term we are concerned with would make sellers liable if a particular event occurred with respect to the product. This event will not happen to all consumers; consumers have only limited knowledge of the probabilities that apply to them at the time of making the contract. There are many other unexpected disasters that might also afflict them, and they may *rationally* decide that spending even a little time on the terms of legal protection from each would be a waste of effort. Assume that buyers also suspect that sellers in general tend to lie about the contract terms they offer, and that even when they have legally assumed an obligation to buyers, they tend to resist honoring it if it falls due, so that the consumer may have to pay more in legal fees than the value of the injury if he wants to enforce a contract clause covering anything less than a major catastrophe.

Given all of the above, well-educated middle-class consumers in this market have decided that the risk of being cheated, injured or abused by sellers is one of the inevitable risks of life in our economy, and that it is not worth it to invest time or money in the obviously futile enterprise of fighting over contract language. It is more rational simply to ignore the terms and hope that you have happened on an honest seller who is more interested in building a reputation for fair dealing than in extracting the maximum possible gain from each individual transaction.

Here are three ways in which, under these circumstances, we may

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16. See Kennedy, *supra* note 2 for an argument that the efficiency motive will be relevant and also highly manipulable in any situation where there is a class of people affected by a contract, but not parties to it, and transaction costs prevent these people from bribing the parties to adopt some particular set of terms. Suppose there was no transaction cost obstacle to each member of the television audience watching the aftermath of a mine disaster instantaneously making a tiny bid to the employer for better mine safety precautions. Since transaction costs do unquestionably block this kind of deal, there will always be a formally correct efficiency argument that the decision maker should impose nondisclaimable safety precautions in order to bring about the result that would have occurred in a costless universe. What makes this kind of argument so easy to manipulate is that our view of the bargain that "would have happened" depends in a major way on what kind of general character we attribute to large numbers of people of whom we have little concrete knowledge.



end up with an outcome that might be made more efficient by the imposition of a compulsory term:

(a) *The Simple Information Cost Case* — All sellers are honest. Moreover, they know that if buyers fully understood the benefits to them of the term in question, they would willingly pay a price premium that would make it worth the seller's while to write the term into all contracts. Sellers also know that if they band together to carry out an educational drive, they can convince buyers to pay the premium. *But* this campaign will be expensive, given the consumer attitudes just described, with consumer distrust likely to be intensified by outrage that the sellers have all along been selling the product without a "necessary" protection. Once buyers are persuaded, the payoff on providing the term will be more than its cost, but that payoff is not great enough to give a reasonable return on the capital investment for a joint seller campaign of information. So no one provides the term. The occasional buyer who asks for it is told to take or leave the standard contract that omits it, since it is uneconomical to settle these matters case by case.

(b) *Simple Freeloader Case* — This situation is like the "simple information cost" case, except that the cost of the educational campaign is small enough so that it would be well worth undertaking *if* the firm that did it could get all the new business it would generate. But the seller who does the educating finds that other sellers, who have invested nothing, are able to jump on the bandwagon, offer the new contract term, and retain their old customers plus their proportional share of the new business. Although undertaking the campaign makes sense from the point of view of the industry as a whole, it makes sense from the point of view of each seller to sit tight and let someone else do it, hoping to move in to reap unearned benefits when they do. As a result, no one undertakes the campaign.

(c) *The Case of "Competitive Pathology"* — Thus far, we have two cases in which sellers do not assume added obligations in spite of their belief that consumers would pay more than they cost, if consumers were better informed. Now suppose that the practice in the industry has been to sell under a contract that does offer the term in question, although buyers know nothing about it (until disaster strikes) because they make no attempt to understand their contracts. One seller discovers that he can disclaim this liability (or simply eliminate the term) without losing any customers. He also discovers that when the disaster at which the term is directed occurs, he can stand on his new right not to compensate the particular affected buyer, without buyers as a class finding out about it or changing their attitude toward him as a seller of

the product. Since he can charge the old price and sell the old quantity of a newly degraded product (degraded by subtraction of the contract term), he makes more money.

Whether he decides to reduce prices and increase his market share, or just increase salaries or dividends, his course of conduct will put pressure on his competitors. They, too, have market shares, employees and stockholders to protect, and he is threatening all three. They may believe that his disclaimer policy is immoral, or that in the long run it will reduce industry revenue, but it may well be the case that there is no way for them to persuade buyers that there is any difference between the contract they offer and the one the "chisler" offers at a lower price. To preserve their market shares, employees and stock prices, they may find themselves "forced" to disclaim as well. If the industry is competitive, there will then be a flurry of price cutting until all the gains from disclaimer have been passed on to consumers.

Perhaps the seller who began the cycle will try to preserve his ill-gotten gains by further devaluing the contract, eliminating what duties remain. Maybe his competitors try briefly to expose him through an advertising campaign, but no one believes them, and soon all sellers are forced to offer the worst contract permissible under the law. Consumers congratulate themselves on across the board cuts in the price of the commodity; the sellers as a group are slightly worse off than before, since they are selling less product. The seller who started it all may be *much* better off, if he has held on to his initial gains from each devaluation of the contract, and his success is a lesson to knowing businessmen in other fields.

(d) *False Case of Competitive Pathology* — When people make a case to the decision maker for compulsory terms, using the efficiency analysis of competitive pathology, the supposed chisler or bad apple sometimes appears to argue against the change. He will typically admit that if things were as the proponents say, there would be a case for nondisclaimable duties. But, he will protest, his ability to cut prices and increase his market share had nothing at all to do in fact with the degradation of the consumer contract. He will claim either that the consumer waiver is fully knowledgeable or that the term was not cost-justified — it raised prices by an amount greater than the amount it saved its eventual beneficiaries, supposing one accurately valued the supposed benefits. He will argue that he charges less than his rivals because he is a more efficient producer and operates on a lower profit margin per unit than they. He will point out that those arguing for compulsory terms have argued in the past for occupational licensing, that they are the least efficient, highest-priced sellers, and that their real

goal is to drive him and others like him out of business by driving up their costs.

Who is right? It all depends on empirical data that no one ever seems to have ready to hand.

3. <sup>1</sup>*General Reflections on the Appeal of Efficiency Arguments* — Once they have at least somewhat mastered the technical apparatus, people just love to argue for their favorite proposals on efficiency grounds. For years, it was mainly a liberal fad, then it fell into favor with the conservatives, and the liberals are now trying to reappropriate it. Given a choice, almost everyone seems to prefer to cast a difficult rule change proposal in these terms rather than in those of paternalism or redistribution. The paradox is that the standard objection to paternalism and distribution as motives is that they are intrinsically “subjective,” “uncertain,” and therefore political and controversial. What this means is that they evoke the unresolved conflicts between groups within civil society about who deserves how much and what is the nature of true consciousness. Regimes of compulsory terms are part of that battle, no matter how carefully we refer to efficiency as the only motive for imposing them, and efficiency arguments are, if anything, even more subjective, uncertain, and therefore potentially controversial than the other kinds. Why is it that the patent manipulability of efficiency arguments does not impair their attractiveness, while distributive and paternalist arguments, which are actually easier to grasp and to apply, seem excessively fuzzy?

At least part of the answer, I think, is that the move to efficiency transposes a conflict between groups in civil society from the level of a dispute about justice and truth to a dispute about *facts* — about probably unknowable social science data that no one will ever actually try to collect but which provides ample room for fanciful hypotheses.

Such a transposition from one level to another makes everyone, just about, feel better about the dispute. The move from a conflict of interests or consciousnesses to a conflict about facts makes it seem — quite falsely — that the whole thing is less intense and less explosive. That it is *imaginable* that someone could one day actually produce the factual data makes it seem irrelevant that no one is practically engaged in that task, or ever will be. In this sense, the transposition to the cognitive level allows efficiency to act as a mediator of the intensely contradictory feelings aroused by disputes about the shares of groups and the validity of their choices — a mediator that defuses rather than resolves conflict.

It seems obvious to me, but maybe I'm just wrong, that efficiency is

also attractive because it legitimates the pretensions to power of a particular subset of the ruling class — the liberal and conservative policy analysts, most of whom are lawyers, economists or “planners” by profession. Efficiency analysis, like many another mode of professional discourse, is an obscure mix of the normative and the merely descriptive; it requires training to master; it provides a basis for an internal hierarchy of the profession that crosscuts political alignments. Its high value in legitimating the outcomes of group conflict in “nonideological” terms is the basis for the professional group’s claim to special rewards and a secure niche in the good graces of the ruling class as a whole.

### B. *The Effects of the Imposition of Compulsory Terms*

When one first begins to think about what difference it would make if the decision maker imposed a compulsory term in some type of contract (say, a nondisclaimable tenant right to withhold rent if the landlord breached a nondisclaimable warranty of habitability), it is tempting to take at face value the rhetoric of altruism in which such duties are almost always justified. The duty runs from the landlord to the tenant; the law has imposed it in order to benefit the tenant, and the expense will fall on the landlord. It seems to follow that the imposition of the duty helps the tenant and hurts the landlord.

For many years, this initial, oversimplified picture of what’s going on has been countered by an equally oversimplified response, often called by the shorthand tag, “the landlord will raise the rent and evict the grandmother.” By this it is meant that in our case of compulsory duty, the parties remain free not to deal, and free to deal at any price they choose. The critic of compulsory terms will likely claim that their only effects will be (a) to raise the price of the commodity as the seller “passes along” his increased cost (from having to fulfill the new duty) to buyers, and (b) a reduction in supply as sellers realize that it has become more costly and therefore less profitable to provide the commodity in question.

Neither the position that the compulsory term benefits the beneficiary at the expense of the obligor, nor the position that compulsory terms simply raise the price to the beneficiary and reduce the supply, is correct. Each is far too broad. In fact, it is not possible to predict a priori what consequences will follow when the decision maker imposes a nondisclaimable duty. It all depends on the particular conditions of the market for the commodity in question, and its relation to other related markets. The most one can do, while remaining at the level of abstraction of this paper, is to give a kind of typology of the factors that

will influence the course of events after the decision maker acts. This discussion aims to abstract to the level of compulsory terms in general a number of more particular discussions.<sup>17</sup> I will begin with what happens when there are no costs of transacting in the market in question (by which I mean that bargaining is costless, that there is perfect information, and that we don't need to worry about market failure through "freeloading").

1. *The Analogy to a Tax on the Transaction* — As a first step, imagine that the compulsory term is one that buyers — all buyers — would pay absolutely nothing for (the lighting of candles for the salvation of the monarch, say). From the point of view of buyers and sellers, having to have this term as part of the transaction is a pure loss: it is loosely analogous to having to pay the state a tax for each transaction. From the point of view of the seller, the term is an added cost of doing business. He adds it to his cost per unit, and sellers as a group incorporate it into the industry supply curve (which is moved upward by the amount of the cost).

What happens next depends most significantly on two aspects of the situation, each of which is difficult to describe otherwise than in technical economic terms. The first is the degree of elasticity of the supply and demand curves for the commodity. I will illustrate with two extreme cases. Suppose that even a very small price increase will cause a very sharp drop in demand for the product, while even a large fall in price will cause only a small reduction in the supply. In other words, sellers press forward to transact even as what they receive declines, and buyers desert in droves at even the slightest hint of an increase. Under these conditions, the compulsory term (analogous to a tax) will lead to a small increase in the price — an increase less than the duty costs the sellers — but will lead to a sharp reduction in sales. Many buyers will reduce their quantity of purchase or stop buying altogether: they have been priced out of the market. Sellers will either go out of business or lose a lot of volume, and their profits will decline. The buyers who stay in the market have gotten sellers to "eat" most of the duty/tax, but a lot of them have left.

Now imagine that buyers will not reduce their purchases even if

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17. E.g., Leff, *Injury, Ignorance and Spite, The Dynamics of Coercive Collection*, 80 YALE L.J. 1 (1970); Markovits, *The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications*, 89 HARV. L. REV. 1815 (1976); Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. (1980); see also S. Kelman, *Prohibiting Unconscionable Contract Terms: The Poor May Pay Less* (1981) (unpublished paper) (on file at Univ. of Md. L. Rev.).

prices rise dramatically (the item is a "necessity," or just something that has previously been a great bargain), while sellers will cut back supplies dramatically if the price declines only a little (there is little fixed capital involved; it is easy to vary supply as prices shift). Under these circumstances, it is likely that the price will rise by almost the full amount of the cost to sellers of the new duty, and that relatively few buyers will leave the market. They have had to eat the duty/tax, and sellers find themselves not much worse off than they were before.

In between these extreme cases, there will be some increase in price and some reduction in volume. Just how much depends on the particular circumstances.

The second important factor in determining what happens is the structure of the market — that is, the degree to which buyers or sellers are few enough in number to be able to exert some conscious influence on price. Again, I'll illustrate with extreme cases. First, suppose that there are many sellers and many buyers, and that each seller is making just exactly enough to stay in business. When the duty/tax is imposed, every one of these sellers will have to add the whole cost to his price, since he has no margin that can absorb even part of it. But this will cause *some* decline in industry sales, as buyers are priced out of the market. The decline in sales will put some sellers out of business, leaving fewer, but still a lot, each still making just enough to stay in business. Those buyers who buy absorb the whole cost of the duty/tax.

Oddly enough, the situation may be somewhat more favorable to a numerous buyer group if they are dealing with a monopoly. The monopolist looks as though he has total power to set the price, since he has no competitors, but in fact he has to deal with "substitutes" and with the income constraint on his buyers. In other words, even a monopolist of a necessity cannot charge an infinitely great price. He faces a downward sloping demand curve, and at some point raising his price will cause him to lose total profits, as lost sales more than counterbalance increased profits on each unit sold. Under these circumstances, the monopolist who has to provide a compulsory term will make a conscious decision about how much of the price to pass along. He *could* pass it all along, but the result might be that he would lose more profits, through lost sales, than he would if he absorbed some of the costs of the duty, raised his price less, and hung on to more of his customers. Exactly where he ends up, between passing it all along and eating it all, will depend on the elasticity of demand, discussed above. The more likely it is that sales will fall drastically, the less of the price he will pass along.

In the more common cases arising in our social context, there is

some degree of market power on the side of sellers, falling short of monopoly, so that the outcome is altogether a matter of degree between the possible extremes. The one thing one can say with great assurance is the following: no flat, a priori judgments about the price and quantity effects of compulsory terms are possible — it all depends on the shapes of the curves and the structure of the market.

2. *Why Don't Buyers Bargain for the Duty?* — A basic objection people raise to the tax analogy is that compulsory terms directly benefit buyers, whereas a tax on a transaction benefits them indirectly if at all. The decision maker is likely imposing a duty that all buyers would happily accept if it were free. But if the compulsory term was worth more to buyers as a group than it would cost sellers to provide it, why didn't the market produce the desired outcome without the help of coercion by the decision maker? The tax analogy highlights that the compulsory term is worth less to the buyer than it costs the seller. The extent of this difference is the extent of the analogy to a tax.

People often object at this point that the reason why the term was not included in contracts prior to its imposition by the decision maker was that buyers as a group lacked enough bargaining power to force sellers to agree to it. This kind of argument is particularly frequent in the area of landlord/tenant: isn't it obvious that the reason landlords didn't provide a warranty of habitability was that they controlled the housing market and tenants were helpless to impose the warranty on them? Or in the case of products liability, it may seem obvious that consumers have always wanted strict products liability, but lacked the bargaining power necessary to impose it on oligopolistic sellers.

At least in the form stated, this argument is just wrong. If tenants were willing to pay the cost to landlords of a warranty of habitability, why would landlords, operating in a capitalist economy in which profit is supposedly the motive of economic activity, refuse to provide it? It seems clear that in the actual housing market, *some* tenants, in exchange for very high, luxury rents, obtain levels of landlord service far in excess of those required by any nondisclaimable warranties. If landlords are just perversely, or cruelly, or irrationally unwilling to provide these terms even though tenants will pay for them, how can the luxury rental market exist? I think the conclusion is inescapable that under the assumption that there are no problems of information or other transaction costs, the beneficiaries of compulsory duties could have those duties written into contracts, if they were willing to pay the obligors what they cost (plus a "normal" profit). Under these circumstances, the decision maker makes the duties compulsory or non-

waivable precisely because he believes that people value them so little they won't buy them of their own accord.

It is no answer to protest that landlords or automobile manufacturers have market power, or even that the industry in question is a monopoly. It is no answer to protest that a single buyer of a product, or a single worker dealing with a large employer, can't haggle over the terms and will be told simply to take it or leave it. It is no answer that the seller's lawyers write the contracts. These points are all true, but they are simply irrelevant to the only question here: is it or is it not the case that consumers (under the assumptions) would get the terms if they were willing to pay for them? To take the hardest point first, even a monopolist has an interest in providing contract terms if buyers will pay him their cost, plus as much in profit as he can make for alternate uses of his capital. The presence of a monopoly will generally mean that consumers get less of the product and must pay more for it than would be the case under competition, and this will be true for contract duties as well as for the underlying commodity. But this is not an argument that the unavailability of the term reflects any peculiar unwillingness of sellers to give buyers what they want.

The basic point is that if both sides have good information, it makes no difference that consumers can't haggle in particular transactions, and it makes no difference that the sellers' lawyers draft the contracts. The profit motive will induce them to provide *any* legal duty consumers will pay for. Consumers exercise power in the market not through their conduct during individual transactions, but through the mechanism of *demand*, backed by dollars. They can control according to their desires what is offered for sale even if each of them is individually powerless in every single transaction.

But demand, of course, is limited by income. If buyers had a lot more income, they might well demand all the duties the decision maker is now requiring them to purchase. Buyers as a group may regard a transaction without these duties as a moral horror. They may buy only with deep regret, believing that they have a right to the commodity-plus-the-duty rather than just the commodity. They may believe that a just society would allocate them enough purchasing power so that it was open to them to buy the commodity-plus-the-duty without having to sacrifice some other good they regard as a necessity. In all these senses, it is true that consumers lack the bargaining power to make the sellers provide the duty. Consumers are *too poor*, given the other things they want to do or have to do with their money, to induce sellers to provide something that, under the free contract model, sellers don't have to provide unless the price is right.



3. *Weakness of the Analogy* — While it is true that under our assumptions the compulsory term must be worth less to buyers than it costs sellers (or sellers would provide it without compulsion), it is also true that the term will almost certainly be worth *something*. Buyers would, in a free market, pay more for the commodity with the duties attached than for the commodity alone, though not enough to make it worth while to add them. This means that the compulsory term will cause more of an increase in price and less of a reduction in sales than would a tax of the same amount. These effects make the factual analysis of any particular case of nondisclaimable duty much more complicated than they are for a tax. They also make it possible to argue for and against particular regimes of nondisclaimable duty on distributive grounds that are irrelevant when discussing a tax that is of no (direct) benefit either to buyers or sellers.

### C. *Compulsory Terms and the Rectification of Inequality*

The imposition of a regime of nondisclaimable duties on contractual parties will have a host of distributive effects. For example, to the extent that the term is unwanted, its cost will be distributed between the parties, impoverishing sellers and buyers differentially according to the elasticities of supply and demand curves and according to the competitive structure of the market. There will also be distributive effects on third parties. There are third party strangers, for example, who are better off as a consequence of compulsory safety precautions because those precautions reduce the risk of injury to bystanders as well as to buyers.

Then there are third parties who pay into social insurance funds that would compensate injured buyers had the decision maker not forced buyers to insure against injury through the sales contract. There are those dependent on the beneficiaries of nondisclaimable duties, such as children whose housing situation is determined by parents. When sales of the regulated commodity fall, there will be workers (and their dependents) in the industry who will lose their jobs or take pay cuts, as well as owners who lose profits. When buyers are priced out of the market, they spend their money on other things, and owners and workers in those industries benefit at the expense of those in the regulated industry.

At least as a general matter, people don't favor or oppose compulsory terms because of these tax-like or third-party effects. What the decision maker really cares about, probably, is the possibility that the class of buyers will get something they want without having to pay the

full price, with the difference made up by sellers who are impoverished for their benefit.

A first case in which it is intuitively plausible that a compulsory term can work such a real redistribution is that in which the beneficiaries are so desperately impoverished that they cannot — simply cannot — pay more for the commodity with the term than they did for the commodity without the term, and sellers have some significant surplus from transacting with this impoverished group. Suppose the seller is an employer offering a starvation wage and that the decision maker compels him to improve working conditions or go out of business. *If* the business is profitable, he may not fire many (or any) workers, and they may end up substantially better off.

A second case is that in which sellers pass along no price increase at all because they are able to modify their own or their employees' behavior, in response to the term, in a way that has no impact on their costs. Take the case of the firing of at-will employees for refusal of a supervisor's sexual advances. The employer who is liable in tort for "abusive discharge" or "bad faith" is unlikely to increase the price of his product, or demand that workers take a wage cut, to compensate for a lost privilege. He is much more likely just to order supervisors to desist.

In this case, the redistribution is between two classes of workers. But in other cases, there may be a weakening of the sellers' position, but one that they can correct by changes that end up not increasing costs. Where there is periodic product redesign, the addition of a safety feature may have a negligible impact on price. The reason why the feature was not included before was not that it was expensive but that the seller simply didn't care about safety, and had no motive to figure out how it could be incorporated at minimal cost. While in pure theory the seller has devised the minimum-cost way to produce his product, so *any* modification must increase his costs, in fact there is always a large element of the random and the sloppy in production. This means that even quite large benefits for the buyer may be effected at minimal cost. These cases are only barely redistributive under our definition.

My fourth case is the most important and most interesting because most clearly at odds both with the standard economists' treatment and with the usual formulation of inequality of bargaining power. It is the case in which the condition of the market is such that the imposition of compulsory terms leaves (most) buyers better off in their own view (so that once it is imposed they would not waive the new regime) and this improvement is directly at the expense of sellers as a class. This case was first developed in Bruce Ackerman's important article about en-

forcement of housing codes.<sup>18</sup> Here I abstract it to compulsory terms in general.<sup>19</sup>

Suppose that a significant part of the demand for the product comes from buyers who don't care much about it — who would switch to other things if its price increased only a little. Suppose further that these marginal buyers don't put much value at all on the benefits of the compulsory term. In the housing market case, suppose that there are a number of tenants who tend to double up or move away in response to small variations in local rents, and that these tenants just don't care much about housing amenity — they'll pay close to the same rent for good housing and bad. Now suppose as well that there are a large number of highly competitive sellers who have a large fixed investment in what they sell, so the supply of the good won't change much with moderate increases or decreases in price. Under these conditions it may not be possible for sellers as a group to pass on much of the cost of the compulsory terms.

Buyers who stay in the market after the marginal indifferent characters have left may put a high value on the good offered and also a high value on the new term, and get both at a price far below what they would be willing to pay. In an extreme case, everyone who is buying the good at the new price feels that they are paying less for the new term than it is worth to them. Although buyers as a group wouldn't pay what the term costs sellers, they are delighted to have it at the subsidized price. Sellers end up simply poorer — a part of the value of their business has been expropriated through a successful forced transfer without price control.<sup>20</sup>

We are dealing here with a true distributive effect, like that of a change in the rules of duress or of fraud or of combination so as to help

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18. Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 YALE L.J. 1093 (1971).

19. It is important to distinguish this redistributive case from that in which buyers gain at the expense of other buyers, rather than of sellers. For example, suppose there were some buyers willing to pay \$10 apiece for a term that, if provided *only to them*, would cost sellers \$15 per buyer. But suppose that if they were providing the term for *all* buyers, it would cost sellers only \$9 per buyer. Sellers still might not provide it without compulsion, if 90% of buyers would only pay \$5 apiece for it, given a free choice. If the decision maker imposes the term, 90% of buyers are paying \$9 apiece for something they think is worth only \$5, but the group of buyers who would have paid \$10 are getting a bargain.

Now you are free to change these figures around any way you want — or, rather, the particular fact situation may yield, on careful social scientific investigation, any particular constellation of figures. If there were a lot of buyers who would be made better off, by quite a bit, by the imposition of the term, and those buyers were people you wanted to help, and the losers, both among sellers and among buyers, were people you didn't mind impoverishing to help the others, you might favor the compulsory term on distributive grounds.

20. See Appendix B(1) for a graphical treatment.

one side and hurt the other. However, it is crucial to understand the peculiar mechanism by which the decision maker has been able to bring it off. First, in order for the effect to run in favor of buyers and at the expense of sellers, there must exist this touchy marginal class who flee at the slightest price increase and hold the compulsory term to be of little value. Second, on the other side we must have a marginal group of sellers who are, by comparison, locked into providing the commodity in question, and who are unable to combine with other sellers to form a coalition with market power. Though it is all a matter of degree, it is only when there is some combination of these circumstances that the strategy will work.

If we reverse the circumstances, imposition of the regime of nondisclaimable duties will impoverish buyers, and in the most extreme case will enrich sellers at the expense of buyers. The way this works is that buyers at the margin like the new term a lot, so much so that they would have purchased it on the open market had transaction costs or some other factor not prevented them. But *most* buyers value the term at less than it costs. Marginal sellers are fly-by-night and will get out if their profits fall at all. When the decision maker imposes the new term, marginal sellers raise the price the full amount of its cost, and marginal buyers actually increase their purchases. Most buyers are now close to indifferent to the product — ready to flee — but they still get just enough out of it to stay in the market. Sellers are now selling more product, and making more on each unit. Transaction surplus has been redistributed in their direction. If buyers as a group were asked whether they would like a repeal of the compulsory term, they would answer yes, but sellers would answer no.<sup>21</sup>

What this means is that there is a fundamental difference between changing fraud or duress rules and changing the regime of compulsory terms. In the fraud and duress case, we can be quite sure who we're helping and who we're hurting by a given change. At least in the short run, there is no probability that employers gain by the legalization of secondary boycotts. But in the case of compulsory terms, we need a sophisticated economic analysis before we can be sure we are helping the purported beneficiaries (those to whom the nondisclaimable duties run — buyers, in our cases). If we get this analysis wrong, then it may well be that an initiative that is supposed to redistribute from rich sellers to poor buyers does exactly the opposite (or hurts both).

There are three further complexities that will make the factual judgment a hard one. The first arises from the fact that our marginal

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21. See Appendix B(2) for a graphical treatment.

buyers or sellers who flee the market have thus far been portrayed as "indifferent" or "fly-by-night." But what if this subclass of buyers, whose willingness to leave the market keeps sellers from raising prices, are the most impoverished, the most desperate of the buyer group? In every case, the ability to redistribute between buyers as a group and sellers as a group depends on actually hurting a subcategory of buyers, and that subcategory may be exactly those the decision maker would most like to help. Thus the question whether the marginal buyers are the richest or the poorest may reverse our view of the distributive outcome.

If there are transaction costs, and in particular if buyers have limited information about how valuable new terms will be to them, there will be the further complexity of systematic buyer underestimating of the value of the compulsory regime. The decision maker may impose the regime in the belief that it will in fact bring about a substantial redistribution even though buyers as a group, with their imperfect information, wouldn't pay voluntarily what the new terms will initially cost them. So long as he acts on the belief that after they find out how groovy the terms are they will see the outcome as positive, the decision maker is still distributively motivated.

Finally, whenever it is the case that buyers with adequate information would not buy the term without compulsion, and the decision maker goes ahead nonetheless, he is achieving his distributive goal less efficiently than he could achieve it had he available the technique of after-the-fact, administratively costless taxation. The reason for this is that even if the term is worth more to buyers than it costs them in increased prices, it is not, by hypothesis, worth more to them than it costs the sellers. If we had some way to just pluck away from sellers the resources they are going to spend on providing the term, and directly transfer them to the buyers, we could make both buyers and sellers better off than they will be at the end of a redistribution through nondisclaimable duties. It is, of course, impossible for this decision maker to tax at all. Even if he could tax, he could not tax by simply plucking away resources after the fact, without any impact on the future behavior of those enriched and impoverished. Any *real* system of taxation will involve exactly the same kinds of waste that are involved in imposing compulsory terms. There would therefore be an empirical question of great difficulty for a decision maker who could choose between making a given redistribution in one way rather than in another.

My conclusion is that a regime of compulsory terms may make perfect sense as a distributively motivated intervention, but that in or-

der for it to do so the decision maker will have to deal (at a minimum) with the following questions:

- (1) Are the shapes of the curves and the competitive structure of the market such that sellers will have to absorb a large part of the cost of the term?
- (2) Would buyers willingly buy the term at the price they will have to pay after compulsion?
- (3) How do we assess the negative distributive impact on the group of buyers priced out of the market, whose loss is necessary if the other buyers are to gain?
- (4) Are there transaction/information costs that prevent buyers from making an accurate advance judgment about how much good the term will do them?
- (5) Could the distributive objective be accomplished more cheaply in some other way?

My own belief is that it will often make sense for a decision maker to make rough intuitive assessments of all these factors and then go ahead and act on distributive grounds. It is also possible that he will feel that there is a good chance that he will either accomplish a purely efficient change, making everyone better off, or that he will bring about a desirable redistribution on the model of this subsection. If he thinks the chances are small that he will actually make buyers worse off, he may be happy to proceed on the ground that the only people he is likely to hurt are sellers. When we add the factor of paternalism, considered below, there may be a strong case for intervention even with sketchy information and a lot of uncertainty about just how the effects will play themselves out.

## V. INEQUALITY OF BARGAINING POWER

The most common justification for compulsory terms — in tort law as well as in contract — is that there was inequality of bargaining power between the parties. This simple phrase has been used in dozens (perhaps hundreds) of judicial opinions as though it quite fully explained disallowing contract language so as to restore the background regime, or interpolating a term the parties most definitely did not agree to.<sup>22</sup>

There are two disparate strands to the rhetoric of unequal bargaining power. First, because the parties were not equal in power there was no “real” assent — the terms of the contract were dictated by the

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22. For a representative case with elaborate citation of authorities, see *Tunkl v. Board of Regents*, 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

stronger party — and it is therefore not legitimate to sanctify the bargain by appealing to the idea of free contract. This point is purely negative: now we know there was no real assent, but what follows from that? The decision maker could respond by throwing out the agreement, leaving the parties to their non-contractual remedies, as may happen when a contract is invalidated because of fraud or duress or illegality. But the second element to this body of thought is that what the decision maker does is to rectify the balance not by throwing out the contract as a whole, but by throwing out the offending term, and reading in a term that is more favorable to the weaker party.

What this means is that there is an ambivalence in the way people assert unequal bargaining power to justify compulsory terms. On the one hand, they usually sound as though they were committed to the system of freedom of contract, and to the market system in general. If the objection to this contract is lack of “real assent,” it seems to be implied that there is nothing wrong with contracts between people who are on an equal footing. On the other hand, the advocate of compulsory terms will almost always indicate a clear desire to help the weaker party at the expense of the stronger. The rhetoric of unequal bargaining power is distributionist in that it asserts the desirability of intervention in favor of the weaker party in situations where there is nothing like common law fraud, duress or incapacity.

The first section below examines critically the notion that unequal bargaining power is an appropriate test for deciding when to impose compulsory terms. The second speculates about the ideological significance of the rhetoric of unequal bargaining power in a society divided by class, sex and race.

#### A. *Inequality of Bargaining Power in Light of the Distributive Consequences of Compulsory Terms*

There are a number of different things people seem to be referring to when they identify a situation as involving unequal bargaining power. What I will do here is to show in very summary fashion that none of these subtests is likely to help us pick out situations in which compulsory terms will help the weak at the expense of the strong. In other words, I want to show that if you just went about finding all the situations that, according to these subtests, represent unequal bargaining power, and in each case imposed on the stronger party the duty the weaker party is asking for in the lawsuit, you would act more or less at random from the point of view of the distributive interests of the bene-

ficiary class (“buyers”).<sup>23</sup> I will take up the following tests: the industry is “public”; the terms were drafted by the seller and offered on a take-it-or-leave-it basis; the seller is a bigger entity than the buyer; the sellers have monopoly power in the relevant market; the commodity in question is a necessity; and there is a shortage which permits sellers to exploit buyers.

The public interest category seems to me of little use, simply because we no longer have a viable conception of what distinguishes the public from the private. Everything is public from some points of view; everything is private from other points of view. The label “public” is, these days, more likely to represent another name for the conclusion that it is OK to impose nondisclaimable duties than it is to represent an actually operative element in the analysis. “Publicness” seems only randomly correlated with the factors, such as the shapes of supply and demand curves, that will determine the appropriateness of using compulsory terms for distributive purposes.

Neither the drafting of the terms by the seller, nor the seller’s offering them on a take-it-or-leave-it basis, nor the absolute size of the seller affects the buyer’s power in any sense we should care about. If there is competition among sellers, and good information about buyer preferences, sellers will offer whatever terms they think buyers will pay for. We cannot test the ability of buyers to influence the content of the bargain by the ability of an individual buyer to dicker with an individual seller. There may be no bargaining because bargaining is expensive, and buyers as a group are unwilling to pay the increased cost of individualized transactions. Further, in a truly competitive market, no one gets to negotiate terms with anyone else. You can’t argue that market power skews bargains and then object in those very situations where, because of competition, no one gets any individualized say at all.

The notion that size, the knowledge necessary to draft the contract, and the practice of imposing take-it-or-leave-it terms give sellers the

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23. Of course, one would not at all be acting randomly from the point of view of the distributive interests of the class of people who become plaintiffs in lawsuits of this kind. In other words, one would be working a (perhaps) substantial redistribution in the direction of people who find themselves injured and in need of the benefit of the duty that they are now asking the court to impose. An intervention imposing compulsory terms will *always* help this group of successful plaintiffs at the expense of whoever has to pay the bill. The intervention is distributive, in our lingo, only if this help is at the expense of sellers. If the distributive effect of a compulsory term is merely to force those buyers who are not injured to contribute to compensating those who are injured, or to make those who would not be injured contribute to safety precautions that prevent harm to those who would otherwise be injured, then the intervention is paternalist (or possibly motivated by efficiency). It is interference with freedom of contract based on the idea that buyers don’t know what’s good for them. We’ll take up this kind of thing in the next section.



power to dictate to buyers is belied by recent experience all over American industry, from automobiles to typewriters. It is ironic that path-breaking cases like *Henningsen v. Bloomfield Motors*<sup>24</sup> justified compulsory terms for auto warranties by emphasizing that the customer was helpless in the face of gigantic bargaining opponents. Those helpless buyers have somehow induced a proliferation of seller warranty experiments, and then more or less destroyed the auto industry by their preference for foreign cars. Detroit can no longer serve as the textbook case of seller omnipotence. While there is a powerful subjective experience of impotence for most buyers in the market for most goods, it is irrational to translate that experience, *without more*, into a preference for intervention.

But what about the distributive effects of using a test of seller size combined with seller dictation of contract terms? Would such a test lead us to impose compulsory terms in those cases where they would redistribute wealth from sellers to buyers? Or would the test lead to higher prices, impoverishing both groups, or even to the enrichment of sellers at the expense of buyers? There's no way to know. The test has no obvious relation to the presence of marginal buyers, quick to get out of the market in response to price hikes and also indifferent to the things the state usually offers in the way of compulsory terms. Size and dictation of terms tell us nothing about whether sellers can easily reduce supply in response to an attempt to stick them with the cost of nondisclaimable duties. Systematically applied, a test of this kind would have random distributional effects between buyers and sellers.

The concept of bargaining power is most obviously useful in understanding markets in which there are only a small number of buyers or sellers. It makes sense to say that the monopolistic seller has more bargaining power than the seller who is one of many, and that there is inequality of power when a single seller faces many buyers (or vice versa). In these cases, the test of equality is that there should be about the same degree of competition on each side of the transaction. Unfortunately, the case of market power on the side of sellers is one of those where it is least likely that compulsory terms will have a redistributive effect.

This is intuitively obvious in the case of a monopolist facing many buyers. The monopolist may refrain from passing along the whole cost of a nondisclaimable duty, since at some point he loses more on volume than he gains on price. But the mere existence of marginal sellers who flee the market will have little influence on his behavior. If there are

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24. 32 N.J. 358, 161 A.2d 69 (1960).

lots of buyers who value the product highly and also think the compulsory term would be a good deal at just a little less than it costs, the monopolist will raise his price substantially, knowing that these customers will keep on buying. By contrast, competitive sellers may find themselves absorbing the whole cost of the term because the departure of a relatively small number of marginal buyers keeps the price down.

This is not to say that compulsory terms can never redistribute from a monopolistic seller to his buyers. The point is just that there is no guarantee that this will be the outcome. And there will be markets where the strategy of redistribution is particularly hopeful but there is no substantial market power on the seller side. If our concern is redistribution, this test seems as random as that of size/dictation. If our concern is with the other consequences of monopoly power, then the remedy of compulsory terms seems curiously inapt. Whatever effect they may have on buyer income, they have no effect at all on the other aspects of concentration.

I'm all in favor of splitting up concentrated economic powers, and in favor of public control of those it seems inappropriate to split up. If the choice is between having large sellers (monopolistic or not) dictate the terms of contracts and having the courts do it, I don't have the slightest preference for the sellers. If in a particular case it looks like the official decision maker will look after the interests of buyers better than the seller, then the decision maker should go ahead and do what he thinks will work. My point is that the situations in which it is desirable to impose compulsory terms can't be identified by looking for unequal bargaining power, if that term is defined either in terms of size/dictation or in terms of market power. These factors invalidate the seller's free contract claim without indicating what the appropriate response should be.

Neither the notion of a necessity nor that of a shortage is any more useful. Both are likely to be second-string answers to the question, what do you mean by unequal bargaining power? Answers that point to dictation of contract language or to seller market power undermine the legitimacy of almost all the important bargains people make in a modern economy. If we took them seriously as tests, we would impose compulsory terms just about everywhere. By contrast, the beauty of necessities and shortages as triggers for official action is that they leave most of economic life intact, i.e., in the hands of sellers.

But the fact that a good is a necessity — say, food or shelter — does not mean that sellers have more power to dictate price or terms than sellers of other goods, such as luxury yachts. If there are many sellers of a necessity, none of them will be able to charge more than the

going package of price and terms without losing all his buyers. If there are few sellers of a luxury item, they will have substantial power to set price and terms, even though there is not a single person who would be materially worse off if the industry went out of business altogether. Moreover, that a good is a necessity does not mean that buyers will necessarily tolerate larger price hikes without reducing demand than they would tolerate in the case of a luxury. One can go on consuming most necessities, and particularly food and housing, long after one has passed the stage at which they are "necessary." The price of vegetables may be determined at the margin not by buyers who must buy at any price or starve, but by those who are deciding between a surfeit and absolute gorging. They will go for a mere surfeit if the price gets too high. Where the marginal buyers *are* the poor, it may be particularly difficult for a monopolist to pass costs along, because poor marginal buyers may be quick to reduce their consumption when prices rise.

In other words, sellers of necessities may have more, less, or the same ability to pass on costs as sellers of other commodities. Ironically, a regime of compulsory terms will be most likely to redistribute wealth from sellers to buyers in those cases where sellers have *least*, not most, of this ability. The rhetoric of necessities will therefore give the decision maker the wrong signal if it indicates he should impose compulsory terms where seller power looks greatest to him.

References to a shortage usually mean that a change in supply or demand is causing a rise in the price of a commodity, so that people who had come to expect to buy it are threatened with having either to do without it or to reduce their consumption of other things. Shortages often give rise to demands for price control, either to limit the ability of sellers to make windfall profits on short term fluctuations, or to guarantee the position of those who were consuming the good at the old price against those who now threaten to bid the good away from them. But people also often invoke the idea of a shortage to explain why the buyer's consent to a contract term reflected unequal bargaining power, so that the court should disallow the bargain and impose a regime of nondisclaimable duties instead. It should be clear from the foregoing analysis that *without price control*, the compulsory terms may or may not work to the advantage of the buyer class. That buyers are invoking the idea of a shortage suggests that they feel pressed to accept terms they would earlier have resisted. If this is true, sellers will pass along all or close to all the cost of nondisclaimable duties, rather than absorbing some part themselves. If this happens, intervention defeats its own purpose, just as conservatives argue it will.

Again, I am in favor of guaranteeing people access to the necessi-

ties of life, and it strikes me as absurd to allow sellers to reap windfall gains from temporary increases in price (just as I wouldn't put them out of business as a sacrifice to random reductions in price). If the question is whether people should have necessities, the answer is clearly yes. But the question here is whether one gives an intelligent explanation for imposing compulsory terms by pointing out that the good regulated was a necessity or was in short supply. I've been arguing, as in the case of market power, that necessariness or shortage may well delegitimize the market solution without legitimating this form of intervention as an alternative.

### B. *The Ideological Significance of the Doctrine of Unequal Bargaining Power*

It seems a reasonable conclusion from the above that the notion of unequal bargaining power is of little use to a person seriously committed to achieving distributive objectives through law. I would go further: there is little behind the idea in the way of an intelligent analysis of the general problem of equality, let alone the problem of the quality of life under our form of capitalism. It is nonetheless the case that the idea has great appeal. Why?

The notion of unequal bargaining power is unintelligible except in the context of the perennial conflict between liberalism and conservatism, the center-left and center-right positions within the politics of welfare-state capitalism. In the center-right version of private law, inequality of bargaining power has no place, because problems of power are adequately dealt with by the law of fraud and duress — power issues reduce to issues of voluntariness, and are settled by the late nineteenth century formalization of contract law.

Liberals, on the other hand, argue for a dual law of voluntariness. They agree that fraud and duress should be treated as a stable background regime, but argue for ad hoc legislative and judicial intervention outside their bounds. The liberal position is, as I said earlier, phrased in terms of freedom of contract (inequality of bargaining power vitiates consent) but quite overtly distributively intended. When, but only when, the test is met, judges should intervene to help the weak against the strong. It is understood that "weak" and "strong" in terms of bargaining power are stand-ins for rich and poor, privileged and oppressed, within civil society.

To understand the doctrine of unequal bargaining power, one must understand that the liberal position is *center-left*, rather than left. Its essence is that reform of exceptional cases and intelligent response to abuses are all that is needed to meet the just demands of the disad-

vantaged and thereby to relegitimate the overall system of distribution and the overall quality of life. This is a left position in so much as it acknowledges a problem of justice between groups and a problem of the quality of existence, and denies that these problems are solved simply by the neutral administration of the free contract regime. But it is centrist in that it insists (a) that consent (achieved when bargaining power is equal) is the only criterion of the justice of social arrangements (as opposed, say, to actual equality, or the idea of a virtuous life for the citizenry), and (b) that consent in fact validates the overarching structure of our form of capitalism. It follows that whatever one may think of this or that transaction, one sees the basic allocation of power between capitalists, workers, managers, and government bureaucrats, along with the basic cultural underpinnings of family and social life, as beyond the scope of political action.

In this context, the doctrine of unequal bargaining power has the appeal that it presupposes that most of the time there is equal bargaining power, so that freedom of contract is the appropriate norm. It is an exceptional doctrine, unthreatening to basic arrangements, however critical of particular cases. Indeed, the existence of a doctrine that courts will impose compulsory terms where bargaining power is unequal has, along with its left message, a strong centrist message as well. It says that so long as the liberals don't let the idiot conservatives *exaggerate*, it is possible to make a market system like ours work well. When judges and legislatures have corrected the abuses caused by inequality of bargaining power, everything will be OK.

This implicit message of equality conveyed by appealing to inequality is a classic example of the apologetic functions of doctrine. The equality is of "power," so that though we willingly interpolate terms favoring the buyer into an insurance contract, we don't see that as committing us in any way to equalizing peoples' actual enjoyment of the material things everyone is struggling over. Eliminating inequality of bargaining power, as liberals conceive it, has nothing to do with eliminating factual inequalities. It has no direct reference either to equality in the actual division of transaction surplus between buyer and seller, or to the actual division of social product among the warring groups of civil society. It nonetheless gives a very good feeling.

In this sense, it resembles efficiency: it transposes the deadly fights of social groups to a plane where the issue is merely formal (for efficiency, merely factual). It is not that people are trying to take things away from one another because they think they have been unjustly distributed, or that people are destroying themselves by making wrong choices. It's just that the rules of the game of bargaining have not

worked in this particular case, and the outcome is therefore outside the otherwise automatic legitimation of the bargain principle. Given this state of affairs, liberals can be quite unequivocally on the side of the weaker group against the stronger, without abandoning a stance of benevolence or tolerance toward the social order as a whole.

The vagueness of the slogan appeals to two different currents within the larger stream of liberalism. The first is the sense of disenfranchisement of the liberal intelligentsia, which sees itself as morally and intellectually superior to the managerial and plutocratic classes, but relatively impotent by comparison with them. This intelligentsia can easily identify with similar complaints from those less privileged. The second is the rhetoric of populism, which claims that factual inequality stems from cheating or biases in the rules of the game, rather than from the game itself. Within this strand, people argue that they and others like them would be richer and more powerful, while the rich and powerful would be less so, if only the "interests" hadn't perverted the system of individual effort under freedom of contract. Both critiques respond to two fears: the fear of degradation if one were to accept the outcome of the struggle of civil society as representing one's true worth, and the fear of losing to those below if the rhetoric of equality were to pass beyond form to substantive proposals for *leveling*.

So understood, the doctrine of unequal bargaining power represents a partial acceptance of distributive motives into the domain of contract law, but an acceptance that is rhetorical rather than real — intended to disarm. It would fail of its purpose if the application of the doctrine led to a substantial change in the actual distribution of the good things of life. It would also fail of its purpose if it turned out to be absolutely and totally meaningless. But in fact it does not fail. So long as the parties remain free to fix prices, it would be absurd to believe that regimes of compulsory terms, even taken to great lengths, could be a major engine of redistribution. On the other hand, they sometimes work quite effectively to redistribute transaction surplus between buyers and sellers under particular conditions of supply and demand. The poor may benefit substantially in some of these cases, and might benefit a good deal more if liberal decision makers took their own program more seriously. Seen in this way, the doctrine has a lot in common, in its ambivalence, with other familiar elements of liberal politics, such as sponsorship of land reform within oligarchic Latin American societies or affirmative action for blacks and Chicanos in higher education.

But it does more than directly legitimate a set of liberal initiatives. It has a particular structural place in the liberal vision of legal order, a place as a mediator of contradictions between the basic elements of that

vision. First, the doctrine of unequal bargaining power is the “public” element within judge-made private law. Because it is there, it is plausible to treat the *other* private law rules — about duress and fraud, for example — as truly neutral. Their application involves the “normal” judicial role, while unequal bargaining power is only a semi-legitimate, quasi-legislative excursion into “policy” or “social engineering.” Use of the doctrine thus admits the inescapably public aspect of the operation of setting the groundrules, but places that aspect in a special domain where judges will be scared of it, will not feel they can do it wholeheartedly. Meanwhile, the real distributive work of the common law rules is done more or less unconsciously through the true distributive interventions of the supposedly neutral background regime.

Second, the doctrine minimizes conscious recognition of the distributive motive in private law. It refers only to the “procedural” aspects of the relationship between a buyer and seller. Thus it points us to facts that are quite removed from the real political motive of the liberal decision maker. He doesn’t care about “bargaining power” or even about the distribution of transaction surplus between buyer and seller *except* as a way to shift income between the warring groups of civil society. But for all the doctrine tells us, it is equally applicable to rich and poor, white and black, men and women. It is only in its ad hoc applications that it turns out to be a way for the liberals to help the oppressed (a little bit) against their oppressors.

Third, the doctrine justifies compulsory terms without any reference at all to paternalism. The squabble within the center about whether even a tiny modicum of distributive motive is acceptable distracts attention from what is probably the most consistent and important effect of these regimes: the overruling of preferences on the basis of a particular substantive moral vision of how people should deal with risk in their lives. As we saw earlier, the paternalist motive is even more difficult to acknowledge, and *prima facie* even less legitimate than the distributive. Inequality of bargaining power masks it by presenting as a defense of the weak what is often in fact a critique of their spending habits.

Finally, I should say something positive about the motives of the liberal lawyers, judges and legislators who developed the doctrine of unequal bargaining power. The doctrine exists not in a vacuum but as a weapon in the war against the conservative program of reinforcing all kinds of social hierarchy. It may be internally incoherent, and it may achieve only rather randomly good results even when used skillfully. But it is a weapon on the side of equality, of the left and not of the right, however imperfect.

The development of the doctrine is part of the continuous liberal project of working out principles that will tell us just how much inequality we must tolerate in the name of individual autonomy. When the notion of voluntariness, all by itself, seemed to lead to grotesquely hierarchical and degraded social outcomes, the center-left developed two critiques. First, they trashed the conservative claim that the groundrules were merely logical deductions from the idea of freedom. Second, they developed the notion that agreement must be more than voluntary: it must also reflect the very limited form of equality they call equality of bargaining power. The problem lies not in the utopian intention behind this project, but with what *seems* (no one can prove it one way or another) to be the hopelessness of trying to avoid intuitive, immediate judgments, based on intersubjective group identity as well as on aloneness, about the acceptability of any given social arrangement. My belief is that we revolt because we are revolted, not because we have figured out that a set of outcomes can't be justified in terms of the liberal principles. But I honor the attempt to subject anarchic sentiment to the test of reason, however happy I may be each time it fails.

## VI. PATERNALISM

This part begins by suggesting that when we take into account the desirable paternalist effects of compulsory terms, the case for them is a good deal stronger than when we look at them only in terms of efficiency and distribution. The second section argues that a frank acknowledgement of paternalist motives in creating nondisclaimable duties would not be inconsistent with the rest of the law of agreements, which is full of legal arrangements that seem patently paternalist in intent. Common law institutions provide a rich typology of reasons for paternalist intervention, as well as experience with defining the duties of the obligor toward the beneficiary in ways that protect against the abuse of power. The third section argues that paternalism is desirable as well as pervasive. Its basis is intersubjectivity rather than incompetence, and its appropriate scope is limited by our capacity for empathy, rather than by an abstract principle of the free will of the beneficiary.

### A. *Paternalism and Compulsory Terms*

1. *How Compulsory Terms Work as Paternalism* — In a sense, paternalism is the most obvious of motives for compulsory terms, though because of its pariah status it is usually mentioned last, if at all. A compulsory term requires people to make particular contracts when they would rather make different ones. Because the term typically creates a duty for one party that, on its face, helps the other party, the



situation bears at least a superficial similarity to classic protective relationships. And because the seller/promisor/obligor is allowed to raise the price in response to imposition of the nondisclaimable duty, there may be no redistributive effects between buyer and seller, so that a distributive motive is not necessarily present.

Paternalism involves compelling a decision on the ground that it is in the beneficiary's best interest. Regimes of compulsory terms typically involve duties that fit easily into this general conception: people often say that it is in your best interests to take the warranty rather than a lower price; to insist on a lease with a landlord's duty to maintain the premises, rather than just signing whatever he hands you; to demand full disclosure before consenting to surgery; to get yourself some job security rather than working on an at-will basis; and so forth.

For an intervention to be paternalist, the distributive effects have to be "side effects" rather than the purpose of the initiative. It may not be obvious whether a particular change following intervention should or should not count as a side effect. For example, the intervention means, in the typical case where the term reduces or insures against a risk, that those who get compensated (or saved from injuries that would otherwise have befallen them) because they were compelled to buy protection gain at the expense of those who, it turns out, don't need the protection but had to pay for it anyway. In other words, if we analogize the term to insurance, those who wouldn't have self-insured but are injured gain at the expense of those compelled to insure against things that never happen to them. But we have to subtract from this distributive effect the benefits to the uninjured in the way of psychic security that come from knowing they are covered (even though the coverage is compelled).

A second distributive effect is that some buyers are priced out of the market now that sellers have raised their price in an attempt to recoup the cost of the compulsory term. From a paternalist perspective, this may not be an undesirable side effect, but a part of the paternalist program. If we really believe that those buyers were not acting in their best interest when they bought the commodity without the term, then they may be better off priced out of the market than they were when we let them stay in it.

We can distinguish in a rough way between compulsory terms that "just allocate a risk" about whose placement the decision maker is worried, and terms that enforce his moral notions of appropriate conduct. In the first category, strict products liability allocates to the seller the job of insuring through the price against injuries from non-negligent defects in his wares. The notion is not to condemn the existence of

non-negligent defects (after all, we couldn't have avoided them even with due care), but to make sure the consumer gets protection against losses they cause. At the other extreme, a nondisclaimable employer duty not to discharge an at-will employee for refusing sexual favors does more than "just allocate a risk." The same is true of the husband's nondisclaimable duty to support his wife. In the latter cases, the duty is supposed to make the "seller" behave as a seller *should* behave (at least according to the decision maker) even in the absence of any legal sanctions.

When he imposes strict liability for product defects, the intervention is paternalist to the extent the decision maker anticipates that the whole cost of insurance will be passed along through the price, or thinks that only a little will be borne by the seller. It is paternalist as well where there is only limited pass-along, but the decision maker regards cost absorbed by the seller as a misfortune that must be suffered in order to bring about the benefit to the buyer. He might regard the redistribution as an unfortunate side effect because he thought the buyer *ought* to have to pay for his own protection against risk, or because the effect was regressive from the point of view of his distributive objectives.

I think we should also regard as paternalist an intervention in which the decision maker actively disapproves seller conduct that is barred by the compulsory term. Such a term is distributive in that it is supposed to put an end to bad seller behavior and thereby improve the buyer's lot. But the mechanism is the overruling of the buyer's choices — we force the buyer to protect himself against the seller's badness. Moreover, one way to understand what's going on is to say that we force the seller to behave in an altruistic fashion toward the buyer because the buyer is in need of the seller's protection, being too dumb to protect himself. The issue is not power, but rather the false consciousness of the buyer who doesn't think to write in the compulsory term on his own.

There remains the case of mixed motives where imposing the term redistributes wealth from sellers to buyers, which is just what the decision maker wants to happen, while simultaneously forcing them to buy something he thinks they should have been willing to pay for without compulsion.

2. *Varieties of False Consciousness "Cured" by Compulsory Terms* — To say that an intervention is paternalist doesn't explain it, beyond identifying the problem as a mistake on the part of the beneficiary about his real interests, or as false consciousness. Decision makers in our society impose compulsory terms because they think buyers suffer

from a number of quite specific kinds of false consciousness. For example, buyers underestimate the seriousness of risks of injury from products or situations. The tendency to underestimate risk goes far enough beyond mere misinformation so that when we intervene we can't claim to be achieving an efficient outcome blocked by transaction costs. It amounts to a cognitive bias, a systematic tendency to misinterpret or ignore information, to generate fantasies of safety, to repress unwanted information. It has to do with babyishness, not ignorance. When the decision maker makes the buyer pay for protection against the non-negligent injury, or makes the buyer buy a safety precaution that will prevent injury happening at all, he may be doing so in response to a judgment about this kind of misperception.

But it may be that he is concerned not with a misperception of risk, but with willingness to take risks — with recklessness rather than with babyishness about the facts. He may decide that looking at the buyer as a person with a continuous existence in time, as a life rather than as an instant, he can make the buyer better off by forcing him to give up a little now in order to avoid catastrophe later on. That the buyer doesn't think so may be a mistake that seems just a matter of character, or it may be possible to develop an interpretation of the buyer's situation that makes the mistake easy to understand. For example, the buyer may appear to the decision maker to be suffering from addiction, not in the narrower opiate sense, but in the larger sense of needing a continuous flow of commodity fixes in order to keep at bay the pain of being dominated at work or in the family.

Buyers make a third kind of mistake when they fail to obtain guarantees of nonarbitrary treatment. Take the case of consumer remedies and consumer defenses waived by contract, or of extremely favorable creditor remedies written into contracts, or of clauses by which one party determines the venue of any lawsuit favorably to himself, or sets liquidated damages or conditions that create real risks of forfeiture. We have once again the two distinct errors of misperceiving the risk that the terms will be invoked, and of placing too high a discount on the possibility of future loss. But this case also involves a willingness to trust one's present partner to treat one fairly further down the road, when what now seem like congruent interests have begun to diverge. The buyer allows the seller to con him — to make it seem unlikely that there will ever be an occasion to which the terms would be relevant, and that if there were, the seller can be trusted to act reasonably in the circumstances, rather than standing on a legal right to treat the buyer unfairly.

A fourth type of mistake has to do with the long term conse-

quences of choosing a particular structure for a relationship. Recall the example of the buyers who agreed to give the seller a percentage of the appreciation any time they sold the land, a term struck down by a very conservative New York court.<sup>25</sup> This clause, along with the others in a purported "sale" in fee simple, was designed to, and to some extent did, bind the buyers to the land as though they had been (though, of course, in fact they were not) the feudal serfs of the great landlord patroon sellers. Or think of the systems of criminal penalties for violating a labor contract that the courts have from time to time struck down as peonage.<sup>26</sup> And why is it that, even before the fourteenth amendment, courts wouldn't enforce a contract of enslavement, though it met the most extreme tests of voluntariness? In all these cases, the objection is not to running a specific risk of loss, or to running a specific risk that the seller will treat the buyer unfairly. The objection is to the whole relationship — it is an objection to *feudalism*, a way of life, or to *slavery*, a way of life. It makes no difference that if we apply to their actions the same tests of voluntariness we apply to our own, some people may sometimes want to be peons. We won't let them be.

The false consciousness involved is in part that people who agree to work a whole lifetime for the same employer on an at-will contract without any provision for their retirement have underestimated how seriously dependent they will be. Had they not been mistaken, they would have risen in revolt, or they would have scrimped and saved. It is no answer to say that they just *couldn't* scrimp and save. Social Security made them, and then it turned out that they could in fact survive with a deduction that was (more or less) enough to provide for retirement. The problem was not that it was impossible to demand and win job security or a pension plan, but that the social world of day labor, for example, was based on the unspoken assumption that these things couldn't be had. It was based on a consciousness in which a higher wage in the short run was preferred to what the middle-class decision maker saw as the slighted human need for security, which would be in turn the necessary practical basis for the affirmation of equality with an otherwise all-powerful employer.

Or take the New Jersey case of *State v. Shack*,<sup>27</sup> in which the court held that a legal services worker and a federally funded anti-poverty organizer were privileged to enter a migrant labor camp to talk to migrant workers. The court neatly carved out an exception to the law of trespass, but found it necessary to carve out another exception as well.

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25. *De Peyster v. Michael*, 2 Seld. 467 (1852).

26. See L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 5-13, at 259 n.11 (1978).

27. 58 N.J. 297, 277 A.2d 369 (1971).

What if the employer/landowner got each migrant worker to waive the right (to be "reached") that the court had just painstakingly constructed for them? Why, then, such a waiver would be void because of inequality of bargaining power, and because the condition of "isolation" of migrant workers — as much cultural as physical — was just what the federal statutes establishing the programs of legal aid and community development were trying to break down. In other words, supposing that the migrant worker positively requested the owner of the camp to keep agitators off the premises, he couldn't succeed. The right to be agitated is inalienable.

Many working and middle-class people believe that employers pay their share of Social Security as a deduction from their profits, so that the creation of the program involved a big material concession by capital to labor — the imposition of a massive duty of benevolence on the stronger in favor of the weaker party. In *State v. Shack*, the court was careful to put the nonwaivableness of the right to be agitated on grounds of unequal bargaining power, though the discussion as a whole made it clear that it feared the migrants simply wouldn't understand how valuable the right might be over the long run. Especially when we are dealing with this fourth form of false consciousness, paternalist is less acceptable than distributive rhetoric. Middle-class members of the ruling elites — decision makers — must never claim that whole classes of people lower in the hierarchy than themselves have a just plain wrong understanding of their social situation, so that their choices are vitiated not by their weakness, but by their false understanding. And the closer the beneficiaries are to the middle class, the less permissible it is to claim to know their "best interests." For example, in the discussion above, it is more permissible to say that *State v. Shack* is really a case of judicial paternalism than to say that the whole Social Security system is paternalist.

3. *Conclusions About Compulsory Terms, and an Example* — There are efficiency, distributive and paternalist rationales for regimes of compulsory terms. These are not mutually exclusive. It may be that a given regime will improve efficiency, redistribute income, and "correct" choices all at the same time. But the extent to which compulsory terms accomplish any of the three objectives can be known (to the extent it can be known at all) only on the basis of a study of the particular situation in question. Nondisclaimable duties are perfectly capable of reducing efficiency, distributing income in just the wrong way, and correcting choices that were correct in the first place.

In the unlikely event that I were the decision maker, I would favor an adventurous and experimental program of left-wing compulsory

terms. Here is an example: the case of *Steelworkers v. United States Steel*<sup>28</sup> was incorrectly decided. In that case, the workers, represented by Staughton Lynd, argued that the steelworkers union and the Youngstown City Council had acquired an "easement" in the Youngstown plant, which the company had decided to close because it was unprofitable. The U.S. District Court and then the Court of Appeals decided that neither the workers nor the town had acquired, by contract or in any other way, any of the absolute property rights the company had in the plant.

The case was wrongly decided because the court should have implied into every contract of employment between the company and an individual worker the following term: As part payment for the worker's labor, the company promised that in the event it wished to terminate the manufacture of steel in the plant, it would convey the plant to the union in trust for the present workers (along with recently laid-off and retired workers). The company further impliedly promised to condition the conveyance so that if the union as trustee attempted to sell the plant or convert it to a use that would substantially reduce the economic benefit it generated for the town, the town would become the owner in fee simple. I would make this implied promise on the part of the company non-waivable, so as to achieve all three objectives discussed above.

Such terms are not now included in standard collective bargaining agreements because transaction costs, and particularly imperfect information, block the parties from reaching the agreement that would make all as well off as possible. Further, employers like U.S. Steel would find it impossible to pass along the full cost of this term, even if it were possible for them to calculate it accurately. It would therefore probably work a distributive benefit for workers at the expense of employers. Finally, a basic reason why workers have not in the past bargained for and won the kind of property interest in manufacturing enterprises that this term would represent seems to have been that they have miscalculated their true interests. They have underestimated the long-term value of worker control, and also the risks of capital flight and other forms of economic dislocation. They have overestimated the stability of basic arrangements between labor and management, and also overestimated the benefits of a relatively quiet life, with plenty of material goods and no responsibility.

Maybe all these judgments about efficiency, distribution and false

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28. *United Steel Workers, Local 1330 v. United States Steel Corp.*, 492 F. Supp. 1 (1980), *aff'd*, 631 F.2d 1264 (6th Cir. 1980).

consciousness are wrong. I certainly can't claim anything like the knowledge that would allow me to assert them with confidence. The point of my example is not to convince you of their truth. Rather, I am arguing that these are the kinds of judgments you would need to make to decide intelligently. It seems to me on balance likely — more than that I couldn't say — that a compulsory term of the type I've described would do more good than bad. Therefore, if I had been the district court judge in the case, I would have imposed it, with some trepidation and a great deal of curiosity about what would happen next.

### B. *The Pervasiveness of Paternalism*

Where would you go, if you were the decision maker, for a rationale for imposing a nondisclaimable duty of this kind? At first glance, it seems that our whole system of law is alien to the idea that the state can or should impose duties in order to make people do things "in their own best interests." In the dispute about whether or not it should be a crime to ride a motorcycle without a helmet, for example, both sides generally agree that paternalist intervention is highly exceptional and bears a special kind of justificatory burden. In this section I'll list in the most cursory way all kinds of legal institutions other than compulsory terms that seem to me best understood as paternalist, and then mention the sources available to judges who have to define a content for paternalist obligation.

1. *Types of Paternalist Intervention* — Robert Clark, in an article called *The Soundness of Financial Intermediaries*,<sup>29</sup> looked at the reasons for the complex of statutes governing banks, investment companies and other capital-aggregating institutions. The various explanations others offered for this body of regulations included unequal bargaining power and efficiency. But Clark came quickly to the conclusion that none of them was altogether plausible. Since the tenor of my argument for paternalism may seem a little cracked, I'll begin by quoting Clark at length.

That some public suppliers of capital literally could not comprehend government-sponsored ratings of financial intermediaries, so that no expenditure of resources would enable them to understand, seems to be more properly characterized as a reflection of human finitude, not of information costs. Even though all persons have finite abilities, it is hard to imagine that many people could not understand some feasible but simple rating systems. It seems more

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29. Clark, *The Soundness of Financial Intermediaries*, 86 YALE L.J. 1 (1976).

likely that some public suppliers of capital will deliberately ignore the ratings, apparently finding other uses of their time more productive. If we nevertheless feel a desire to protect them from the consequences of this choice, it would appear to reflect a belief that their preferences are wrong in some sense . . . .

The fourth reason for governmental protection of public suppliers of capital against very risky financial intermediaries is, therefore, that people need to be protected against themselves. Human finitude and normative error are the major sorts of personal imperfections: human beings have limited capacities to understand, to reason, and to predict, and they do not always know or choose the risks that under some moral theory they ought to prefer. That people have limited capacities is undeniable. But the proposition that a person's actual preferences for risk-taking should not be dispositive as a normative matter is not always accepted. Solely for purposes of reference, I will call this view the thesis of human fallibility. According to this thesis, human beings are by nature prone to something identified as sin, valuational error, non-adaptive behavior, false consciousness, or "objectively" wrong preferences . . . .

. . . [S]ince fallibilistic theories strike many persons as an insult to human dignity, inevitably there is pressure to disguise these theories when they do underpin regulation. One seeks the comforts of projection by attributing the limitations and imperfections that cause misfortune to abstract markets and not to people.

Protective legislation concerning financial intermediaries thus may be viewed as an example of fundamentally paternalistic legislation masquerading as a response to market imperfections.<sup>30</sup>

Much the same can be said of the rest of our securities law. The problem it addressed was not that companies issuing stock were forcing investors into bad deals, but that there were characteristic mistakes investors made. We can talk about these mistakes in the language of transaction costs — imperfect information and the like — but everyone knew that what was really at work was greed, gullibility, incurable optimism, the gambler's itch, the allure of something for nothing, all followed by addiction to the ticker, the secret diversion of the family's savings, the mortgaging of a small business, and then, when things turned down, increasing margin requirements, a desperate scramble to stay in the game just a little longer . . . ruin and a swan dive from a high window. What was going on in this fantasy drama of capitalism was not extortion. At worst, widows and orphans trust blindly in ap-

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30. *Id.* at 18-20.



parently upright advisors who turn out to be secret addicts themselves. It is a story of folly, not of duress. People are idiots.

This example mainly concerns adult white males who unquestionably possess "capacity to contract." Most of them are college graduates, hereditary members of the middle class. At the other extreme, paternalism is so obvious it is barely visible: there is a constitutive exception in the law of freedom of contract for people who lack "capacity." Today that includes children and the insane (once it included women and blacks and seamen as well). The contracts of children and the insane are unenforceable because, supposedly, they are incapable of voluntary choice. But why do we refuse to enforce an agreement made by a person who lacks the capacity for voluntary choice, and why does the law sometimes make such a contract merely voidable rather than void? The answer is that we void the contract in order to protect the infant or the lunatic from injury that he might invite in his state of undeveloped or false consciousness. When the contract is for "necessaries," when it's a contract we want him to make, we enforce it. Likewise when it's clearly to his advantage, and it's the other party who is pleading his incapacity. The law of incapacity, with its complicated subrules about unjust enrichment, reliance and fraud, creates a class of people judges are supposed to save from themselves.

The analogy between infants and the insane on the one hand, and the adult forbidden to make a contract on the other, was plain to late nineteenth century conservative judges, who used it with ironic relish against the reformers. When the Illinois court struck down maximum hours legislation for women, it put the decision partly on the ground that women had been fully emancipated, and that to treat them as incapable of deciding how many hours a day they wanted to work was consigning them again to the status of children.<sup>31</sup> Courts called minimum hours laws for men "demeaning," on the same ground.

Most paternalist interventions fall somewhere between incapacitating children and forbidding intelligent adults to pick the terms of their investments. Take the equitable doctrine of undue influence. Here there is neither fraud nor duress, but a kind of subversion of the mind of the weaker party so that he no longer "really" acts for himself, though he's an adult and not insane. Often it's "the situation" that supposedly vitiates the will, as in the cases involving mothers agreeing during post-partum depression to give their children up for adoption. Somewhat analogous is the doctrine that it is up to the court, rather than to the parties themselves, to decide when a fiduciary relation exists

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31. *Ritchie v. People*, 155 Ill. 98, 40 N.E. 454 (1895).

between them. This means that the court can invoke the fiduciary's obligation to make a substantively fair bargain with the beneficiary to invalidate a deal the parties thought was at arm's length (the crooked nursing home developer gets a naive sexagenarian to invest his life savings in a building worth half what he paid for it).

Courts using the doctrine of unconscionability like to put their decisions on grounds of unequal bargaining power (in spite of the comment to section 2-302 of the U.C.C.). But it's often obvious that they are concerned not with power but with naivete, or with lack of ability to make intelligent calculations about what one can afford on one's budget. People make mistakes about how much pleasure they will get out of a product — a deep freeze — and about how likely it is that they will be able to find five other people to whom to sell deep freezes in a pyramid scheme.

It's wrong, it seems to me, to treat a decision striking down a contract of this kind as closely analogous to a decision holding an employee's release of an insurance claim void for duress because the employer threatened to fire the insured if he didn't go along with the insurer. It is true that the goal of the cases I'm calling paternalist is often to prevent the impoverishment of the protected class, and that helping them hurts those who have been exploiting them. The crucial difference is that in the "power" cases all you need to do is give the beneficiary some weapons and she'll fend for herself, whereas in the false consciousness cases the decision maker has to take the beneficiary under his wing and tell him what he can and cannot do.

There are a good number of consideration cases that have this same quality. There is the contract for "conjuring" which the court won't enforce on the ground that conjuring has no "real" value, or the widow's promise to pay her late husband's now unenforceable debt to "save his honor." It may be that judicial hostility to output, requirements and exclusive dealing contracts also had a paternalist element, rather than merely reflecting ignorance of "commercial context." Where the court allows such agreements, it will sometimes be possible for one party to take advantage of a price shift to ruin the other party. To prevent shocking results, the court will have to read into the agreement an altruistic duty not to "speculate" against the other party by increasing requirements under a fixed price contract and then reselling on a rising market. Given a choice between the paternalism of such a compulsory "good faith" term, and the paternalism of not letting the parties bind themselves at all, the latter might have seemed safer.

In the above cases, the courts refuse to enforce an agreement because one party has made a mistake about his true interests that threat-

ens to impoverish him. But sometimes we won't enforce the agreement because we believe it will hurt one or both of the parties to perform it. These are the cases about gambling contracts, prostitution, agreements not to marry, agreements to be a slave. The superficial way to explain such cases is to say that we want to "deter" the conduct involved by refusing enforcement. But why do we want to deter the conduct? Sometimes there may be a sense that it's wrong in itself, an offense quite apart from the interests of the parties. But much of the time the decision maker quite consciously tries to help people by preventing them from doing bad things to themselves.

Another paternalist institution is legal formality. The decision maker declares that in order to make an enforceable agreement the parties must go through some ritual that will specially signal their intention. In other words, he declares that he will *not* enforce contracts in certain cases even though he is convinced that the parties did agree, and that they fully intended the agreement to be legally binding. He will enforce the agreement only if, along with intention, they can produce a peppercorn paid as consideration, or a writing, or a formal expression of acceptance, and the whole thing must meet a standard of definiteness.

It is customary to say that the formality "performs a cautionary function" (along with an evidentiary and, sometimes, a "channeling" function). The theory of the cautionary function is that people tend to be hasty, to commit themselves without really thinking things through, in the heat of the moment. By disallowing informal agreements we are acting in the long-run best interests of the people whose wishes we are presently disregarding. This is paternalism. Ironically, it is also paternalism to *disregard* the formalities, as courts often do, when particular parties seem unable to deal with them competently.

In a justly famous article on the doctrine of *culpa in contrahendo*,<sup>32</sup> Kessler and Fine demonstrated that there are a goodly dozen little sub-doctrines by which courts evade the requirements of form, and protect an innocent party too dumb to realize he hadn't done what he needed to do to get a binding obligation. Since the article was written, there has been an explosion of promissory estoppel doctrine, which functions in the same way. Rather than disallowing contracts not in the party's best interest, the paternalist court compels the contract she should have made. There is an analogy to compulsory contracts for public utility service, or compulsory contracts of common carriers, but only an anal-

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32. Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964).

ogy. In those cases, the concern is that the carrier or the utility has monopoly power which it may exercise unfairly. Here, the party trying to bind the promisor can't make a plausible claim that she lacked the *power* to obtain an agreement. Either it didn't occur to her that she needed one, or she bungled the attempt. The Wisconsin court made a franchisor reimburse a potential franchisee for reliance expended in preparation for a deal that never quite came off, even though the franchisor never intended to be bound, committed no fraud, and used a carrot rather than a stick to keep the plaintiff on the string.

2. *The Sources of Law for Paternalist Intervention* — Anti-paternalist rhetoric emphasizes that the beneficiary's "true" interests are unknowable. One strand asserts that this is just a matter of logic — that no person can know another's true interest (this might be called metaphysical anti-paternalism). Another argues that "value judgments" are "subjective," and therefore uncertain, or "political." The suggestion is that decision makers will inevitably act arbitrarily, and that arbitrariness could easily turn to tyranny, or at least to the obnoxious prejudice of ruling class judges deciding what's best for the lowly masses, or what's best for specific historically oppressed groups that have had plenty of that, thank you very much.

There are two distinct aspects to this attack. One objection is that we are creating a duty from one party to the other whose content the obligor will find hard to predict. This is a nuisance, perhaps an expensive nuisance that will discourage all kinds of desirable activity. A second objection is that a *state official* is claiming the power to invent and then impose the obligation, without any determinate standard. To put these claims in perspective, it is important that the legal system recognizes a whole range of fiduciary relationships such as trustee and beneficiary or guardian and ward, each of which involves one party in complex calculations of the best interests of the other. Courts have defined, over time, specific rules and a set of general maxims that give content to each relationship.

Neither the trust nor the institution of custody is a paternalist intervention in the law of agreements.<sup>33</sup> But the guardian and trustee provide the models against which the decision maker measures the be-

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33. The settlor of a trust voluntarily conveys the trust property to the trustee, who agrees in a general way that he will perform as a fiduciary. The court will have to decide, repeatedly, just what degree of altruism this entails, but squarely within the context of freedom of contract. There is paternalist intervention in our sense only when the court forbids the parties to modify fiduciary duties if they want to call the instrument a trust, or holds that agreements between trustee and beneficiary that benefit the trustee will be scrutinized to determine their substantive fairness in a way unheard of outside the fiduciary context. In

havior of the contractual party on whom he imposes a paternalist duty. Thus the condominium management company may be declared a fiduciary in relation to the condominium owners, and the resulting duties are nondisclaimable. The intervention is not standardless in the sense suggested by anti-paternalist rhetoric, any more than we are utterly ignorant of the kind of mistake the buyer makes when she agrees to pay twice its value for an encyclopedia she doesn't really want.

There is a second set of operations that provide content for paternalist intervention. In the case of compulsory terms, courts often use as a reference the term they would have interpolated had the parties made no provision at all for the situation that has arisen. We wouldn't have a working law of contract if the parties couldn't rely on the courts to interpret their agreements. But the filling-in function constantly involves the decision maker in substantive choices about just how much duty one party owes another. These choices can't be made by reference to the intent of the parties since, by hypothesis, we don't know the intent of the parties. The decision maker will have to refer to some conception of the morality of the particular situation. And there is no clear line between what the parties "would have decided had they adverted to this issue," "what reasonable people would have decided had they adverted to this issue," and "what the parties *should* have decided had they adverted to this issue."

Again, these rules or standards of construction are not paternalist interventions in our sense, since the decision maker applies them only when he is unsure what the parties intended. At least in theory he is not overruling their choices to make them better off, but operating in genuine ignorance of their choices. But the substantive judgment he makes in such a case is just a less obtrusive version of the judgment he makes when he decides to intervene more forcefully, say by making a term he invented earlier as a "fill-in" into a nondisclaimable duty. Further, there is no bright line between mere filling-in and imposing a compulsory term. There is a single judgment — about what people ought to do in their true best interests in the circumstances — and a series of finely graded steps between offering that judgment and making it an offer the parties can't refuse.

The decision maker who sets out to define paternalist duties thus has two rich bodies of common law experience to work with. There is the elaborated tradition of fiduciary law, and the elaborated tradition of contract interpretation to meet cases of mistake, impossibility, fail-

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the case of guardian and ward it is only in the most tenuous sense that the relationship can be seen as based on agreement at all.

ure of condition, obscurity as to remedy, the definition of performance, and so on. There is no objective way to fix the content of paternalist intervention, if by "objective" we mean a method of judgment without judgment. But there are plenty of sources of law, and the overall direction of the law is no more that of self-reliance than it is that of making everyone the beneficiary of everyone else's fiduciary concern.

### C. *Ad Hoc Paternalism*

In the milieu of our decision maker, almost everyone is a principled anti-paternalist, at least by their own account. In this section, I will argue against principled anti-paternalism, and in favor of an ad hoc approach. The basis of such an approach is acceptance of contradictory, or at least unprincipled reactions to particular instances of intervention that overrule people's choices in their own interests. Sometimes these seem not just good interventions, but necessary ones — it would violate a moral duty to neglect them. But sometimes they seem like naked aggression against the human dignity of the supposed beneficiary. To be an ad hoc paternalist is to admit that one has no powerful, overarching test that will allow one anything more than intuitive confidence (either before or after one acts) that one is on the right side of this line. This is not to say that we act at random. Indeed, our first task is to get a sense of what it is like to act paternalistically.

1. *The Phenomenology of Paternalism* — We can distinguish in a preliminary way between two variants of paternalism. The first, which one might call the strong version, arises from two circumstances in a relationship between the actor and the beneficiary. The actor feels he has intuitive access to the other's feelings and perceptions about the world, and that he participates directly in the suffering and the happiness of the other. In other words, the basis of strong paternalism is lived intersubjectivity. The actor is not in the position of "supposing" or "hypothesizing" that the other feels in a particular way — it's much more immediate than that. It feels like unity.

In this condition of unity, the actor comes to believe that the other is suffering from some form of false consciousness that will cause him to do something that will hurt him, physically or financially or morally or in some other way. The actor's sense that the other's consciousness is false is an intuition of error — that the clue to what the other is about to do is "having it wrong." The basis of this kind of intuition is one's own experience of being mistaken, and of having other people sense

one's mistake.<sup>34</sup>

It is almost never possible to verify the intuition in a positivist sense, and this has great significance. But it is also important that intuitive certainties are real knowledge. To my mind they are more real and more reliable than knowledge of the other built up by formulating and testing hypotheses and models (though that is a form of knowledge, too).

The actor will certainly try hard to persuade the other out of his false consciousness, and sometimes persuasion works. Or it may turn out that it is the other who persuades the actor that the actor was wrong, thereby removing any motive for paternalist action. But sometimes it doesn't happen that way: at the end of the discussion, the actor still feels that the other is mistaken, and is about to do something not in his best interests. Or perhaps there is a limited time or no time at all for persuasion, and the actor has either to act paternalistically right away or not at all.

The actor has to decide whether to act to prevent the injury he sees coming. In the strong kind of paternalism, he doesn't see this issue in terms of, say, "reduction in total utility" through the other's threatened behavior, but in terms of anticipated pain for the actor himself. The impulse to "save" the other is the impulse that caused parents, putting on the brakes before the era of safety belts and armored kiddie car seats, to reach across to keep their inattentive children from hurtling into the windshield. If they hurt themselves, you are hurt — that's the basic experience. Nonetheless, there are strong reasons for not acting.

The first is that your intuition that they suffer from false consciousness may be wrong. You may be mistaken in just the way you thought they were — it's all backwards, so to speak. This is the relatively "cognitive" version of mistake. The pea was really under the left-hand rather than the right-hand cup, so if you'd let them bet the way they wanted to, we'd all be millionaires now.

Another possibility is that their conduct was based not on the mistake you'd wrongly intuited, but on a larger plan you hadn't understood. They knew all along what you thought they didn't know, but

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34. If there is *unity* between the actor and the other, why doesn't he just change the false into true consciousness? At least as a matter of describing the experience of intersubjectivity, the answer is that the unity is in a context of disunity, or of real otherness, so that the actor can have an intuition of the other's mistake but no power to think the other's thoughts for him. It's just like the experience of the simultaneous unity and duality of the self: I can recognize that I'm hungry, or want a cigarette, or want a particular student to fall in love with me, even that I'm in danger of slipping into a characteristic state of blabby, confidence-betraying false chumminess with a particular person. But recognizing what's going on in me doesn't necessarily give me power to change my inner state.

because they had intentions you didn't grasp, their knowledge was perfectly compatible with what they were doing. You thought the developer tricked the condominium buyer into accepting a "sweetheart" contract with a management company. In fact, this contract, which eliminated just about all legal power of the condo owners to meddle in one another's lives, was one of the greatest attractions of this particular development. If you're wrong in one or both of these ways, your intervention will probably make things worse rather than better. If it will make things *much* worse if you're wrong, and only a little better if you're right, maybe intervention is too risky.

There is also the possibility that it would be best for the other to make the mistake and suffer the consequences. It may be a developmentally desirable mistake, with consequences limited enough so the other will survive to do better the next time. It may be more than that — it may be a mistake the other has to make if the other is to survive without the actor's constant paternalistic intervention to bail him out. In every case, the actor has to be aware of the possibility that intervention is breeding more intervention — perpetuating dependence and incompetence just as the apostles of self-reliance are always saying it does. Sometimes the actor must take the chance that the other will destroy himself, in the hopes that if he doesn't he will emerge at a new level of autonomy.

If the actor decides to act, the experience will be complex and contradictory. On the one hand, the action affirms intersubjective unity with the other. One acts out of the sense that one knows the other's mind, motivated by the fact that one suffers the other's pain. Sometimes these forms of knowledge are immediate and so intense that one feels no choice in the matter, any more than one does when acting out of the instinct of *self*-preservation. But even if it's a matter of reflection, paternalist action, when it works, has a strong positive connotation. Care is something we need; the ability to give care coercively but beneficently is one of the qualities we admire most intensely, whether in parents dealing with young children, in children dealing with aged parents, or in political leaders dealing with the base impulses and misguided beliefs of their constituents. When you feel you have done it right, you will feel fulfillment.

But there is a bad side to it as well, even when it works. The paternalist intervention is aggressive: it involves frustrating the other's project by force (or by fraud, in the case of withholding information in order to control the other's behavior or spare the other pain). Along with frustration, the other is likely to feel rage against unjust treatment. From her point of view, the actor has come along not only with force,



but with the self-righteous claim that the force is altruistic so she has no basis for objecting. Paternalist action is inherently risky because it will make someone you are intersubjectively one with furious at you, and they may be right.

If they are right, you will suffer twice: you will suffer with them the pain of the frustration of a valid project, and you will suffer on your own behalf the hurt of their anger at you, along with guilt that you have done them not just an injury, but an injustice. Even if it turns out that they were indeed suffering from false consciousness and that your intervention spared them a serious evil, they may not forgive you for taking things into your own hands. When you intervene in someone else's life, they may turn against you though you were in the right to do as you did. While we admire and honor some people in some roles for their successful paternalism, we quite rightly scorn and condemn other people for "playing God," for not minding their own business, for degrading and infantilizing those they are trying to help, and for acting out of selfish motives behind a facade of concern for others.

Now just a word about "weak" paternalism. It's like strong paternalism except that it's based on the notion of being responsible for the other person, and therefore under an obligation to look out for her interests. Weak is to strong paternalism as the legally compelled altruism of tort law is to the true altruism that causes us to put on the brakes rather than run down a pedestrian guilty of contributory negligence. In weak paternalism, the decision maker constructs a verbal model that is supposed to mimic the real thing, and then imposes sanctions on those who fail to act accordingly. This is not to denigrate it; it's often the best we can do and we often want people to act *as though* they experienced strong paternalist urges even when in fact they are indifferent to the welfare of the other. But weak is derivative from strong, and for present purposes needs no separate analysis. Our decision maker, at least for the moment, acts under the impulsion of the spirit rather than the letter.

In both the strong and the weak cases, paternalism as I've defined it — overruling a person's choice in their own best interest — is a variant of the larger phenomenon of intervening in people's lives in their best interests. The focus on "overruling," which suggests the definitive exercise of superior force, and on "choice," which suggests that the other has a well-formed project that is obliterated, is misleading. The same issues will arise for the actor in cases where his opportunity is just to influence the other, rather than flatly controlling him, and where the other has no developed, unequivocal intention about what to do.

For example, suppose that you have a friend, a fellow academic in

middle life. Dean Kelly calls from the University of Maryland Law School and asks who you'd recommend as Sobeloff lecturer, and you think of him. He won't want to do it. If you asked him whether to give his name, you're quite sure he'd say no. He'd hate writing the lectures (they have been expanded to three because the 1982 performance was so charming). But you think that if he doesn't confront his writer's block, he may never do the terrific work you're sure he's capable of. He wants to do that work — he is miserable in his blockedness.

You know he has trouble saying "no" to authority figures like Kelly, even when he's sure he ought to. You say to yourself that you'll be playing God with his life by mentioning his name, and that you'll also be playing God with his life if you let him tell you not to give his name. You go ahead. It could come out either way: he does the lectures, the Oxford University Press bids against NBC-TV for exclusive rights, and your friend begins a new life as a productive scholar; or at the end of the second lecture he realizes he has nothing to say in the third, and cancels it (he returns the whole fee). He never even tries to write anything again.

I don't think you could defend yourself in my example by protesting, first, that all you did was give Kelly a piece of information that you believed to be true, and, second, that your friend had a free choice whether or not to accept his offer. The issue isn't whether you've used a lot of force to overrule your friend's choice, but whether you should have contrived to defeat his project of failing as an academic, relying on your intuition that at some "higher" level he wanted to break out of his impasse and succeed. If you do that kind of thing, you have to take responsibility for the consequences, even though from the point of view of ideas like "overruling" and "choice," you did nothing at all. Indeed, it may be that you are responsible when all you've done is give advice on request. If you know the other attaches special weight to your view, so that a given plan proposed by you will be accepted when the same plan proposed by another would be rejected, then you are in a position that is on the same continuum with the case of overruling choice.

2. *Critique of Principled Anti-Paternalism*<sup>35</sup> — The principled anti-paternalist admits readily that one sometimes has to overrule another's choice in his best interest, but argues that those cases are explained by incapacity, or perhaps by another similar principled exception to the general idea that people are autonomous. (Likewise,

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35. I found Luban, *Paternalism & the Legal Profession*, 1981 WIS. L. REV. 454, and Davis, *Critical Jurisprudence: An Essay on the Legal Theory of Robert Burt's Taking Care of Strangers*, 1981 WIS. L. REV. 419 very helpful here.

the principled paternalist will argue that there are some cases in which people should be allowed to choose on their own — the two positions are indistinguishable for the purposes of my argument here.) The plausibility of principled anti-paternalism is therefore linked to the ability to dismiss or explain away cases in which one wants to act paternalistically but can't rationalize the action in terms of incapacity. My basic argument is that when one collects the cases of paternalist intervention that can't be plausibly explained by a notion like capacity, it becomes clear that we can't be any more than ad hoc in our opposition to intervention.

The idea of incapacity will *sometimes* help in explaining the actor's decision to intervene. Sometimes one feels that the other has really and truly lost selfhood, become a walking automaton or disintegrated, so that someone has simply to take care of them, make decisions for them, control their lives. As the actor, you have to worry that you will make bad custodial decisions, but not that you will be criticized for intervening at all. But those are extreme cases, and the difficulties with paternalism arise in situations where you have occasion to act without being able to appeal to any such blanket permission as is afforded by the other being just crazy.

Suppose that you are spending the weekend at the house of an old woman — perhaps but not necessarily your mother, perhaps but not necessarily someone you love deeply — who is in the terminal stages of cancer. She has an attack of breathlessness. Gasping, she tells the people present that she doesn't want to go to the hospital, but to stay put and die "with dignity" in her own bed. The others are simply paralyzed by this demand, and by the tone of building hysterical fear in which she expresses it (you think; you may be wrong). You want to take the woman to the hospital. You tell her you are going to do so, whether or not she agrees. She looks you carefully in the eye, and then, without any positive indication of assent, begins giving instructions about what she wants taken along with her in the car. She goes to the hospital, but is back at home in a day or two, and some weeks later she does die with dignity in her own bed.

After it was over, you might tell the story this way: the old woman had thought about that moment a lot in advance, and she was much less upset by her breathlessness than any of those around her. I felt a cold band of panic around my chest. I was on the phone to the ambulance service while the others were trying gently to persuade her. Then they started yelling at each other. She looked at us with contempt and resignation as her death worked its infantilizing effect on us. I intervened forcefully. In the car, she was silent, already in the grip of the

humiliation and fear she knew she would feel in the emergency room and then in her private room after they hooked her up to the machines. She came home a few days later, but her spirit was sort of broken (not completely) and she didn't really trust us that much any more. She let us have our way with her death.

The problem with the notion of capacity in a setting like this one is not that it's positively wrong — just that it doesn't help. The strategy is to divide the decision into two parts, hoping that will make it easier than if the question whether to act is treated as a single whole. First, we try to decide whether the other possesses a trait or quality called "ability to determine her own best interests." If she does, we accede to her wishes even if in that particular case we are convinced that her action is *not* in her best interests. If it were truly easier to decide the presence or absence of the quality of capacity than to decide on balance whether we should intervene, treating that question all together, then capacity would be useful. But the question of capacity is hopelessly intertwined with the question of what the other wants to do in this particular case.

First, there is no such "thing" as capacity, and there can be no such thing as its "absence" either. We ask the question of capacity already oriented to the further question whether we will have to let the person do something injurious to herself. There is no other reason to ask the question. Now, if you ask me to *answer* the question without knowing what the potentially injurious thing is, it seems to me I should refuse. I don't believe that capacity exists except as capacity-to-make-this-decision. But as soon as I am deciding the issue of capacity-to-make-this-decision, I find myself considering all the factors, testing my intuition of the other's false consciousness, the severity of the consequences, the possibility that I want to render the other dependent through paternalism, just as I would if I frankly admitted at the beginning that it's just a big mess, with no principled way to find your way through.

I come back to ad hoc paternalism, by which I mean that in fear and trembling you approach each case determined to act if that's the best thing to do, recognizing that influencing another's choice — another's life — in the wrong direction, or so as to reinforce their condition of dependence, is a crime against them. Of course, I haven't *proved the impossibility* of a principled anti-paternalist stance. I think I've undermined the idea that we can decide when to act and when not to act through a notion like: "Do not overrule the choice of a person who has the capacity to choose on their own," but that doesn't prove there aren't other principles, or that someone won't soon discover other principles even if none are currently extant. My strategy is not one of proof, but

of offering a lot of material to make it plausible that principled anti-paternalism is a shallow view. This seems a good point at which to bring all that material together.

First of all, it is impossible for a decision maker operating within a regime of freedom of contract to adopt a stance of neutrality in the conflict between paternalist and anti-paternalist tendencies. The paternalist notion that contracts shouldn't be enforced if one party lacks capacity is constitutive of the institution of freedom of contract. We don't have a system based on voluntariness without it. In other words, for the decision maker to do his job of applying the background regime, even supposing he has no desire to change the rules of free contract, he will have to decide whether any given case falls within the constitutive exception that exempts agreements from enforcement on paternalist grounds, or within the part of the doctrine that insists people have the right to make any contract they want to. If it turns out the decision maker can't be either a principled anti-paternalist or a principled paternalist, he will have to be an ad hoc paternalist, just in order to carry out his job of filling gaps, resolving ambiguities and settling conflicts about the rules of the free contract regime.

In the discussion above, I tried to offer a picture in which the standard anti-paternalist principled approach leaves one hanging without a clear resolution. At the same time, I tried to show that paternalism is a more pervasive issue in private life than people will generally admit. It is really just a special case of the more general issue of when one ought and when one ought not to influence other people's lives. It is common to recognize that there are no simple solutions to this larger issue. The discussion was therefore supposed to widen one's perception of the pervasiveness of the problem of paternalism while at the same time reducing one's confidence that normal principled approaches can solve it.

Earlier, I argued that paternalist interventions are pervasive in the fields of contract and tort, though the rules in question are not usually characterized as such. The goal was to multiply examples that one would have to reject or rationalize in order to maintain the anti-paternalist stance: does one really want to do away with the rules of promissory estoppel that have gradually de-formalized contract formation rules? At the same time, I meant to weaken your resistance to the paternalist motive by pointing out that the idea of acting coercively in another's interest is familiar through institutions like custody and trusteeship.

The single most important piece in the quilt of arguments in favor of ad hoc paternalism is the pervasiveness of compulsory terms, in contract, in tort and in statutory schemes. These make up a large part of

our whole legal order. So long as one can see them as responsive to unequal bargaining power, they don't raise any issue of paternalism. But unequal bargaining power is of little use in understanding why we like them. They may redistribute income in a desirable direction. But given the peculiarity of the conditions that must obtain if they are to have this effect, and given the hopeless fluidity of the efficiency arguments on their behalf, it seems clear that a large part of the burden of justifying them falls on the general notion of paternalism. The principled anti-paternalist will have to give an account of each nondisclaimable duty in terms of incapacity, or of some other principled exception, or restore freedom of contract.

My hope is that the accumulating weight of the examples will drive the principled anti-paternalist at last into the camp of the ad hoc. Paternalism everywhere, coming out of the woodwork, suggests that the satisfying clarity of one's initial anti-paternalist reaction is made possible only by excluding most of the problem from consideration. Principled anti-paternalism is a defense mechanism. One way to deal with the pain and fear of having to make an ad hoc paternalist decision — one way to deny the pain and fear — is to claim that you "had" to do what you did because principle (say, the principle of incapacity) required it. That the principle doesn't really work is less important than that it anesthetizes.

There are some cases we can't seem to decide the way we want so long as we adhere to our principled anti-paternalism, even given the manipulability of the notion of capacity. We decide these cases paternalistically, to our credit, but then bury them under other rubrics, such as protection from "unequal bargaining power," so we won't have to confront their challenge to our supposed consistency. The truth of the matter is that what we need when we make decisions affecting the well-being of other people is correct intuition about their needs and an attitude of respect for their autonomy. Nothing else will help. And even intuition and respect may do no good at all. There isn't any guarantee that you'll get it right, but when it's wrong you're still responsible.

3. *Paternalism in Public vs. Private Life* — When issues of paternalism arise in the context of "private life," the actor is likely to know the other, even to know the other well, and to have a claim to intuitive understanding based on common experience. But the decision maker whose dilemmas we have been examining throughout this essay is a state official deciding cases for people in the abstract, people situated each in his or her particular way in a society divided by class, race, and sex. One might concede that in the private context of intimate knowl-

edge of the other, ad hoc paternalism is unavoidable, but still favor a rule against it in this more complicated situation.

It is no more than a partial response to point out that so long as it is built into free contract through the requirement of capacity, and so long as the concept of capacity has the incoherent quality I sketched just a moment ago, there can be no "rule" against paternalism. Even without a rule, we could be less paternalist in public than in private life. Even if there are no coherent conceptual boundaries we can invoke, it may make sense to move along the continuum in response to the situation of our particular decision maker.

Nor is it an adequate response to reject the public/private distinction as incoherent. It is true that there is no difference in kind between the graduated coercions exercised by our decision maker and the graduated coercions the actor exercises in my example of the woman dying of cancer. If the actor simply picks her up and takes her to the hospital, he will be acting a good deal *more* forcefully than our decision maker can manage even in very extreme cases. State action is not intrinsically more violent than private. But what makes it seem at least conceivable that the state official should be more chary of paternalism than the private actor is that the state official acts on people he doesn't know, which is just a euphemistic way of saying that he acts on people who belong to class, racial and sexual groups different from his own. It is quite likely, moreover, that these groups have a history of oppressive subordination to his own.

The basis of paternalism is intersubjective unity of the actor with the other; it is identification and intimate knowledge. But the most fundamental characteristic of social life in our form of capitalism is social pluralism, which is a euphemism for social segregation and consequent ignorance and fear of one group for another. In the context of segregation, ignorance and fear, the risks of paternalist intervention are multiplied far beyond what they are in private life.

Since private life takes place in a context of social segregation, if the actor is a white middle class person acting paternalistically, the other is also likely to be a white middle class person. But in his public role, the decision maker will act out of his ignorance, bred of that same personal life lived in segregation, in a context where the others may not be of his group and may have reason to fear and possibly hate him. It is less likely that his intuition of false consciousness will be correct, less likely that his intuition of the consequences of his action will be correct, and less likely that the others will forgive him his aggression if his intervention fails, or even if it succeeds. It is this rather than any abstract conceptual distinction between state and civil society that makes it

plausible for our decision maker to hold back in his government office when he would push forward at home.

The farther apart they are culturally, the more likely it is that the actor will perceive "mistakes" or false consciousness on the part of the others that they won't recognize as such no matter how much data he lays on them, because they involve basic premises about the world, truth, and the good. Paternalist intervention based on a strong intuition that the supposed beneficiary is wrong on this level — say, in believing that the way to mourn her husband is to throw herself on his funeral pyre — has the unfortunate property of being simultaneously the most imperatively required (*when* it is required) and the most imperatively forbidden (when it's wrong or officious). In other words, as we move from the personal, private level into the area of relations between large groups that are parts of a single society, the stakes get higher — both for action and for inaction.

It is that the risks escalate *on both sides* that for me ultimately undermines the case for anti-paternalism in public life. This is a difficult point; I want to put it tentatively. It seems to me that the decision maker setting the groundrules as a state actor in a society such as ours, riven by group divisions that are divisions of consciousness, is one of the few people of whom we can demand that he represent our collective commitment to the transcendence of pluralism in the name of truth.

Of course, he also has to represent the ideal of pluralism in a way almost never demanded of decision makers in more homogenous situations. But tolerance is only half the story. The other half is that life in our form of capitalism conspires to drive its constituent groups so far from each other that they can't communicate very well. It creates a situation in which the working class, the middle class and the welfare class, for example, inhabit incommensurable moral domains, and treat each other as Victorian missionaries treated South Sea islanders, or as Junkers treated German peasants, or as the Japanese treated early visitors from the West.

A decision maker who will not take the risk of imposing housing codes and then enforcing them through tenant remedies — just on the grounds that people are wrong to submit to these conditions — because he doesn't feel confident about what the poor "really want," has let a constituent group slip outside his capacity for intimate intuitive knowledge. Since refusing to act paternalistically involves him in applying state force to execute the law of contracts or torts against those who would have been the beneficiaries of paternalism, he can't claim he's practicing benign neglect. What he's doing, if he tries to be a systematic anti-paternalist in public life, is denying his knowledge of the rela-



tive incapacity of groups, of their characteristic mistakes. He is acting to deepen their incapacity by treating them as entitled to their mistakes, and then bringing to bear the apparatus of the state to evict them from their subcode apartments, exclude them under the law of trespass from power over the means of production they created through their labor, and leave them to beg for crumbs when accidents they didn't provide for befall them after all.

In short, the decision maker should be damned if he doesn't as well as damned if he does. Let's face it: he's almost certainly a middle or upper middle class person, or a person who identifies with those classes in his heart. If he is concerned about failures of intuition, about the limits of empathy, he has two alternatives he should try before declaring himself a public life anti-paternalist and passing by on the other side. The first is to investigate the consciousness of those he isn't supposed to mess with. This means breaking down the barriers of segregation by knowing others, rather than just making rules for them.

The second is to go beyond exploration to the task of helping mobilize the groups on whose part one may have to act paternalistically. So long as one is a decision maker playing God with the lives of people of other races and classes and sexes, the dilemmas of ad hoc paternalism are inescapable. The only way to reduce the risk of making mistakes for which one is responsible no matter how good one's intentions is to deal with people who are not at a great distance, who are not strangers. If the others in whose interest you have to act are mobilized, it's more likely that you will have some intuitive knowledge of them, because they will have the means of group expression. It's more likely that they'll be able to tell you what to do and correct you when you do it wrong, so that you don't make mistakes on their behalf. And if they're mobilized, there's more chance they will be able to dispense with your services. That is the true paternal goal: that the other should surpass you both in knowledge and in power, and share both.

## APPENDIX A

*Strict Liability vs. Negligence in Compulsory Terms*

As a matter of fact (rather than of logic), a very large number of the regimes of compulsory terms in our social context are concerned either with the taking of precautions to avoid injury, or with the allocation of losses from the miscarriage of the contract activity, or with both. Compulsory terms figure heavily in the general law about risk, both its control through investment and its allocation (as between those on whom losses fall initially and various possible reimbursing parties). Regimes that deal with risk have a set of effects that will not be present — at least not quite in the same way — when the compulsory term relates to some form of fully intentional behavior.

One way to get a handle on this subcategory of effects is by comparing caveat emptor with a compulsory negligence regime, and then with a compulsory strict liability regime. The two crucial variables are investment in safety and allocation of the losses that occur in spite of safety precautions. It is probably easiest to understand this abstract topic through the example of products liability, but the analysis applies as well in cases like that of the insurance tort of refusal to settle a valid claim, the insurance tort of refusal to settle a third-party claim against the insured (where the third party subsequently wins a judgment for more than the limits of the policy), the liability of employers for sexual harassment of employees by other employees, the tort of medical malpractice (understood to include the problem of non-negligent injuries arising out of medical treatment), and so on indefinitely. A court recently had to decide whether a landlord's nondisclaimable implied warranty of habitability made him strictly liable for failure to provide heat, when he had not only adequately maintained the apartment building furnace, but done everything in his power to repair a breakdown as quickly as possible after it occurred.

Under caveat emptor, still supposing that there are no transaction costs and everyone is perfectly informed about risks, buyers will bargain to individualized contracts with sellers respecting risks associated with the commodity in question. They will ask for and pay for specific investments in safety (e.g., design modification, factory procedures to catch defective items) whenever the particular investment in safety is worth more to them than it will cost the seller. They will also be willing to pay something for insurance through the sale contract against various kinds of injuries associated with use of the commodity. Sellers may or may not be willing to provide investment in safety and/or insurance at prices buyers are willing to pay. If no bargains about safety or insur-

ance are struck, we can conclude that the services were not worth to consumers what it would have cost to provide them.

The bargains struck or not struck will reflect the buyers' risk preferences. If buyers were aware of a risk, say of 10%, that the commodity would cause an injury worth \$100, and that injury could be prevented by a precaution that would cost only \$5, they might or might not be willing to pay the \$5 to get the seller to take the precaution. They might prefer \$5 in hand to elimination of a 10% chance of losing \$100. If that's the case, then they are "risk preferers." If buyers are willing to pay \$12 in advance to avoid a 10% chance of losing \$100, they are "risk averse." The issue of risk preference arises both with respect to investments in safety, which reduce the risk of accidents, and to payments for insurance against whatever accidents occur in spite of precautions. Risk preferers will not insure at even money; the risk averse will gladly pay more in premiums than they expect to save in losses.

There is another reason why a particular buyer — even a risk neutral buyer — might be unwilling to invest \$5 to eliminate a 10% chance of a \$100 loss. The buyer might feel that he could achieve the same benefits on his own at less cost. For example, he might calculate that a product that was dangerous to most people, because most people are ignorant and careless, was not dangerous to him, because he was knowledgeable and careful and would use it safely. Or he might plan to modify the product himself for less than \$5. Or he might prefer not to buy insurance from the seller because he could get his own personal injury and lost wages insurance for less than it would cost to buy it from the seller. Or he might be confident that, if injured, he would be compensated from other sources (family, social insurance, charity) and have no interest on gambling on a windfall *gain* from injury.

Under caveat emptor, supposing no transaction costs, the general outcome is that buyers buy what they want — no one makes them pay for protection they don't want. A nondisclaimable negligence duty imposed on the seller changes this situation quite drastically (supposing that it's enforceable). Under such a regime, a buyer can recover damages from the seller if the seller fails to meet a standard of "reasonableness" defined by a judge and jury. Suppose, to simplify things, that the content of the reasonableness standard turns out to be something like the Hand formula. Judges and juries find negligence liability when they think the seller could have reduced expected accident costs by X dollars by taking a precaution that would have cost less than X dollars. Expected accident costs are the jury's estimate of the value of the losses (most of which are in such categories as pain and suffering and short-

ened life expectancy) discounted by the improbability of their occurrence.

*If* the risk preferences and the risk valuations of buyers and sellers have corresponded in the past to those of judges and juries under the nondisclaimable negligence regime, there will be no change at all in the market after imposition of the term. Buyers will have been buying just the precautions that the state now requires them to buy. But suppose that the whole reason for imposing the duty is that seller and buyers have been waiving negligence liability in the sales contract, and that buyers have been grabbing up products that, according to judges and juries, could be made much safer for very small investments in safety. We now have a situation in which the compulsory term requires buyers to pay for something they don't want — the tax analogy is apposite — and the outcome will be different than it was under freedom of contract.

Under such a regime, the seller will go ahead and take precautions that cost less than the accident losses they prevent, and thereby avoid liability for those losses. But he will not invest in safety where the expected reduction in his liabilities for negligence is less than the cost of the precautions. There he will do only what buyers pay him to do — i.e., for precautions that cost more than they save the seller, and whose neglect is therefore not negligence, the parties still operate as though under caveat emptor. Moreover, the new negligence regime does not require buyers to pay for insurance against non-negligently caused injuries.

The sellers will attempt to pass along the cost of added precautions to buyers by raising their prices. The outcome will vary according to the scheme laid out above: everything depends on the shapes of the supply and demand curves, and on the competitive structure of the market. There will probably be some increase in price, though probably buyers will get an increase in precautions for a smaller increase in the price than would have occurred had they bargained voluntarily for them. There will probably be some reduction in volume, as buyers leave the market or buy less, and sellers cut back output or go out of business altogether. But it all depends on the particulars.

Note that there are at least four groups of buyers affected: (1) there are those whose risk preferences and valuations have been overruled, who end up paying for precautions they don't want; (2) there are, possibly, buyers who wouldn't pay the full costs of the precautions but are delighted to get them at a reduced price because of incomplete pass-along; (3) there are those who have the same risk preferences as the state but figured that they could avoid accident losses more cheaply

through their own precautions than through the seller's; and (4) there are those who are priced out of the market and purchase their next most favored good rather than this one. A paternalist may justify forcing the first group to be more provident and the last group to go elsewhere if they won't pay for protection. It may be desirable for distributive reasons to help out the second group. But the third group then appears to be a necessary casualty of the effort to act on behalf of the other three.

Now move to a strict liability regime. Buyers get, along with the product, a nondisclaimable duty to pay for all losses "caused" by a "defect." Sellers will continue to take precautions that cost less than the liability they prevent from happening, just as under the nondisclaimable negligence regime. But if we assume that buyers were previously paying nothing at all for insurance against non-negligent injury from product defects, we will have a new set of changes in the product market. The first thing to remember is that the imposition of strict liability will *not* cause the seller to increase his investment in safety precautions, unless (as is very likely) the earlier nondisclaimable negligence regime wasn't working right. If it *was* working right, the seller had already invested up to the point where further precautions cost more than they saved in losses. Under strict liability, it will be cheaper for him to let the injured party sue him, and pay the judgment, where the only way to prevent the accident would be to increase precautions beyond where they are under negligence. (That is, since precautions beyond the negligence level cost more than the losses they prevent, it won't make sense for the seller to take them, even under strict liability.)

Since the seller now has to compensate the buyer for non-negligent injuries, the buyer is getting insurance along with the product. The analysis of the consequences should by now be familiar. The insurance is worth less to buyers than it costs sellers. Sellers will try to pass along the cost; they will probably only succeed to some extent, though how much is indeterminate. Buyers get the insurance, probably, for less than it costs. Some buyers leave the market; some sellers lose volume or go out of business. From a paternalist point of view, we have "corrected" buyers' preferences with respect to insurance against non-negligent injury, just as we earlier corrected their preferences about negligently manufactured products. Once again, those who refused to buy insurance not because they were "risk preferers" but because they could get insurance cheaper elsewhere, or accurately believed they ran less risk of injury than the average buyer, are forced to buy something they don't either want *or* need. There will be distributive conse-

quences, possibly but not necessarily including enriching part of the buyer group at the expense of other buyers and sellers.

APPENDIX B

*Graphical Presentation of Distributive Effects of Compulsory Terms*

1. *The Case in Which Imposing the Term Enriches the Buyer Group at the Expense of Sellers (Figure 1)* — This case comes about because marginal buyers of the commodity have no interest in the term, while infra-marginal buyers value it very highly relative to what it will cost them at the new equilibrium.

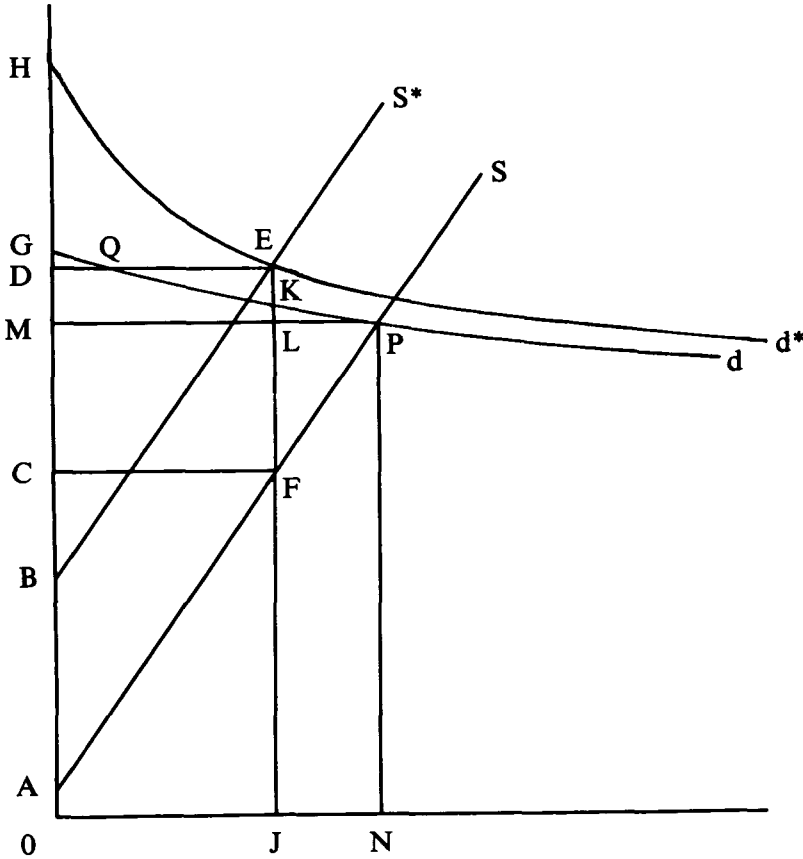


Figure 1

d is the demand curve without the compulsory term.  
 d\* is the demand curve after imposition of the compulsory term.  
 s is the industry supply curve for the commodity.  
 s\* is the supply curve for the commodity with the term.  
 AB (=FE=CD) is the cost (per unit of commodity) of providing the term.

CDEF is the total cost of providing the term at the new equilibrium price and quantity represented by point E.

GH is smaller than AB, so no buyer would voluntarily purchase the term — it is worth less to all of them than it costs sellers.

However, it is worth *something* to buyers. At quantity OJ, its value is GHEK — the area between  $d$  and  $d^*$ . When the decision maker imposes the term, the buyers who stay in the market receive this benefit (GHEK) at a cost of MDEL, equal to the price increase of MD times the quantity OJ.

In the diagram, GHEK is greater than MDEL, so those buyers still in the market have gotten the term for less than they would have paid for it, and are therefore better off.

Those sellers still in the market have shouldered the cost of the term — CDEF — but have been able to raise price only by MD, so they are providing the term at a loss of CMLF.

Furthermore, sellers have lost volume — in the amount NJ — and corresponding producers' surplus FLP, making a total loss of CMPF.

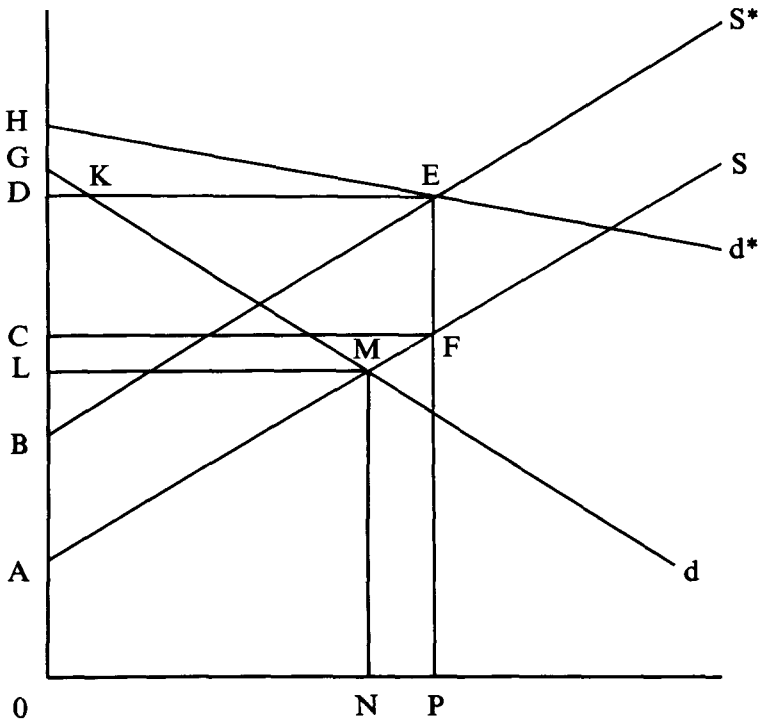
Buyers have lost consumers' surplus on this reduction in quantity to the extent of LKP.

The overall changes in surplus for all buyers are a loss of DQPM and a gain of GHEQ. If this represents a net gain, the decision maker must decide whether it is worth the loss of CMPF to sellers.

The decision maker must also decide whether or not to treat buyers and sellers as homogeneous classes. It may be that he can distinguish the winners from the losers among them, and that this will be relevant in deciding whether the imposition of the term is on balance desirable as a redistributive move.

2. *The Case in Which the Compulsory Term Redistributes from Buyers to Sellers (Figure 2)* — What makes this perverse effect possible is that after imposition of the term there is not only a rise in price but also a rise in quantity. For this to be true, there must be marginal buyers who would all along have paid more for the term than it costs sellers, supposing that sellers are providing it to everyone. Sellers, we suppose, failed to provide the term to this group either because it was more expensive to provide in small quantities than it will now be to provide it to everyone (see text, at p. 611, n.19) or because of one of the transaction cost effects discussed in Part IV A above.





*Figure 2*

$d$  is the demand curve without the compulsory term.

$d^*$  is the demand curve with the term.

$s$  is the supply curve without the term.

$s^*$  is the supply curve with the term.

$AB$  ( $=FE=CD$ ) is the cost (per unit of commodity) of the term.

$CDEF$  is the total cost of providing the term at the new equilibrium price and quantity represented by point  $E$ .

$GHEK$  represents a gain in consumer surplus for buyers as a result of imposition of the term.

$LDKM$  represents the loss of consumer surplus that follows the increase in price from  $OL$  to  $OD$ .

Because  $LDKM$  is larger than  $GHEK$ , buyers as a group have lost through the imposition of the term.

Sellers have increased their output from  $ON$  to  $OP$ . Even after paying

out the full cost of the term (CDEF), they have increased producers' surplus from ALM to ACF, for a net gain of LCFM.

The imposition of the term has therefore reduced the welfare of the buyer group and increased that of the sellers. As in the case of Figure 1, it may be possible to assess the distributive effects more precisely by distinguishing winners and losers within each group.