MODERN LAW OF DEEDS TO REAL PROPERTY

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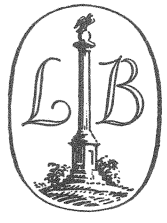

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CHAPTER 19

HYPOTHESIS ON THE PRINCIPLES OF PRIVATE LAW

§19.1. INTRODUCTION

> "The laws of physics should be simple," said Einstein, lecturing at Princeton. "But what if they are not simple?" came a voice from the audience. Replied Einstein: "Then I would not be interested in them."[1]

This book has made frequent references to the principles governing the administration of justice between private citizens — the private law, of which most of deed law is a part. Like the laws of physics, the principles governing private law should be simple. They should be simple so judges can select among them quickly and inexpensively; so the people to whom they apply can understand them; and so that legal systems may be integrated more readily in a global economy.

The academic fashion today is to deny any basic simplicity underlying the law — to assert that the law is unknowable or "indeterminate." It is jarring to realize, however, that only a few decades ago the same was commonly said of the stock market. Observers of the market generally believed that neither the market nor individual stocks could be valued accurately. For this reason, brokerage houses did not issue "buy" or "sell" recommendations.[2] It could not be denied that some investors had enjoyed consistent stock market success, but this success was attributed to luck, intuition, or "feeling."[3] To a few perceptive

§19.1. [1]C. Fadiman, ed., The Little, Brown Book of Anecdotes 188 (1985).
[2]See generally A. Bernhard, The Evaluation of Common Stocks 31-35 (1959).
[3]According to Mr. Bernhard,

> When you press the consistently successful investor to the point, he usually tells you that he has an intuition about these things, or "a feeling." This betrays the fact that he does actually apply a standard of value but has not found a disciplined way to express it. Id. at 35.

observers, however, consistent success implied that there were knowable principles underlying the market, even if those principles remained unenunciated.

Modern securities analysis was founded by a small group of pioneers, of whom the best known were Benjamin Graham, Arnold Bernhard, and T. Rowe Price. These men, and others like them, spent years poring over the historical record, calculating, forming hypotheses, and testing and retesting their hypotheses against the continuing action of the market.[4] In the end, they identified basic principles of valuation that, while incapable of predicting the exact price movement of individual stocks, have proved remarkably powerful in forecasting the general direction of the market, and of stocks and stock groups, over the medium and long terms.

Legal observers find themselves in the position of stock market observers sixty years ago. The governing principles have not been enunciated, but the success of skilled practitioners belies the notion that those principles are nonexistent, unknowable, or "indeterminate."

The principles of private law, once identified, undoubtedly will share two characteristics with the principles of stock valuation. First, they will not be able to predict the results of every case. Their value will lie in predicting probabilities and the general course of litigation over time. Second, even if the principles are simple, *application* of them to any particular set of facts may not be. Whether one is a securities analyst or a lawyer, collecting, organizing, and weighing the evidence so as to apply the relevant principles can be an exacting and intellectually demanding task.

This chapter offers a hypothesis on the principles of private law. The proposition is that in private law cases, the primary judicial goals are to protect from and compensate for nonconsensual loss, consensually inflicted. Considerations of

[4]See C. Ellis, ed., Classics: An Investor's Anthology (1989) for an overview of this process.

public policy, as that term generally is understood, have little influence in private law cases.[5]

§19.2. DEFINITION AND CONTEXT OF PRIVATE LAW

Private law is the law governing the rights and remedies of two or more private parties whenever some engage in conduct or threaten to engage in conduct of a kind significantly affecting the welfare of the others. Private law is distinguished from *public law* in that the parties either are nongovernmental or are governmental entities acting in private capacities.

In the following discussion, the parties are designated by

[5]The term "policy" or "public policy" can be used in any of at least three ways.

1. In its most common usage, "policy" refers to considerations, supposedly considerations of the wider common good, largely outside the case at hand, that color the way in which a judge decides a specific controversy. The implication is that if the consideration were absent, or if the judge had a different vision of the common good, the case might be decided the other way. This usage of the term includes redistributionist policies, the policy of discouraging litigation, the policy of redressing harm irrespective of fault, policies promoting economic growth, and so forth.

2. Some writers employ the term to include the judicial administration of the specific case. For example, a court may elect to award damages instead of specific performance because the case is such that the court could not enforce adequately a decree of specific performance.

3. Some writers use the term so broadly as to state that *any* disposition of a case is based on "policy." Thus, they refer to a "policy" of freedom of choice, a "policy" of compensating injuries, and so forth. This usage often is adopted to advance wider political agendas, for if one can reduce justice between litigants to just another "policy," then justice between litigants has no special status over any advocated policy in category (1). In response to this kind of attack, some courts and writers employ the third usage defensively.

This chapter uses the meaning outlined in (1), the most common understanding. Policy considerations, therefore, are considerations of the common good arising from points of reference outside the case with at least the theoretical potential of changing what otherwise would be its result. The second usage of "policy" is not employed because it is a factor only insofar as it affects the court's practical ability to prevent and compensate. For example, when judges recognize that the legal system has difficulty quantifying certain kinds of loss in money terms the "policy" is to award specific relief instead of money. See §19.14.

the letters A and V. A is always the actor, the person or group that engages in conduct or threatens to engage in conduct. A usually is a potential defendant. V, and sometimes V-1 and V-2, are persons (victims) whose interests are affected or endangered. They usually are potential plaintiffs. Using these letters, we can describe some typical private law situations:

1. A bestows a gift on V or threatens to revoke a gift already given.
2. A demands performance of an express agreement with V, as when A insists that V deliver goods pursuant to V's contractual promise.
3. In the absence of a contract in which V has agreed to suffer a loss, A inflicts or threatens to inflict loss on V. For example, A may attempt to take possession of V's property or A may so operate his automobile as to run over V.
4. In the absence of V's agreement to pay A for a wealth transfer, A demands compensation for a benefit he has conferred on V.
5. A, the board of directors of a corporation in which V-1 and V-2 are shareholders, makes a management decision for the corporation without obtaining approval from V-1 or V-2.

Most lawyers and judges do not think of private law as a unit, and in fact the rules governing each of the foregoing examples are assigned to different substantive departments of the law. Thus, an attorney searching for the rules governing the first example would consult a treatise or digest on the law of property or donative transfers. A lawyer looking for rules governing the second example would study the law of contracts. The third example is resolved by the law of torts, the fourth by the law of restitution (or some branch of restitution, such as quasi-contract), and the fifth by the law of business enterprises. A thesis of this chapter is that all of these departments are governed by the same underlying principles and that these principles are relatively few in number and can be stated in specific

and usable form: It is unnecessary to resort to such vague terms as "justice" and "fairness" to describe how the courts decide private law disputes.

In our legal system most cases are private law cases.[1] This is because our judges believe (despite occasional protestations to the contrary) that the state and the general public have no interest, or only insignificant interests, in these interactions. Nor is the modern trend necessarily to the contrary. To be sure, over the past century public policy concerns increasingly have been felt in the law of torts. But other substantive areas, such as the law of business enterprises, trusts, and nonprofit entities, have become less public and more private.

§19.3. THE SUBSTANTIVE BASIS OF PRIVATE LAW

In this book the term *nonconsensual loss* means loss imposed on a victim (V) without the victim's consent where the actor (A) imposing the harm acts consensually. Thus, in using the term *nonconsensual* loss, we are speaking from the point of view of the victim.

The underlying purpose of American private common law, a purpose served by most private law rules, is to prevent or

§19.2. [1]Some areas of the law, such as constitutional interpretation and administrative, municipal, and criminal law, are inherently public. In practice, if not in theory, these areas are dominated by Hobbesian sovereignty notions, which subordinate private interests to those of the state — or, as the euphemism goes, to the "public interest." Typical of public law are governmental immunity from suit, inapplicability of the doctrine of adverse possession against the government, and the pervasive powers over property now lodged in the administrative state.

The founders of the American system did not attempt to change the Hobbesian basis of our method of government. Instead they sought to bridle it with procedural requirements, such as the Due Process Clause of the Fifth Amendment to the United States Constitution. They imported several substantive protections from private law as well, including the Contracts, Takings, and Ex Post Facto clauses.

For a modern example of a court being drawn to private law principles in a public law context, see Salt Lake County v. Kartchner, 552 P.2d 136 (Utah 1976), where by a 3-2 majority the court refused to specifically enforce a zoning ordinance for lack of actual notice.

compensate for nonconsensual loss. Further, the courts prevent and compensate for nonconsensual loss even when to do so seems contrary to the common good. In other words, when faced with a choice between utilitarianism and protection of the victim, judges usually protect the victim. When judge-created rules get in the way, the courts avoid the rules. This is true even in cases in which the court states it is enforcing public policy.[1] When the applicable public policy has been enunciated by the *legislature*, the court is more likely to enforce that policy at the expense of the victim, but often does not do so.[2]

The courts implement the goals of protecting and compensating victims of nonconsensual loss by applying three basic principles: (1) the principle of consent, which rests on two components, actual notice and assent;[3] (2) the principle of prevention;[4] and (3) the principle of compensation.[5]

These principles operate through four paradigmatic cases:

1. A, having assented to conduct,[6] threatens to impose nonconsensual *special loss*[7] on V. The court grants specific relief to V. This is the pure specific relief paradigm.

2. When nonconsensual loss threatens wherever the court places the entitlement, the court grants specific relief to the party with the *smaller* potential loss from the other's conduct if a bargain among the parties seems to be the most feasible way of assuring full compensation. This is the bargain-*stimulating* paradigm.

3. A, having assented to conduct, threatens to impose (or already has imposed) nonconsensual *quantifiable loss*[8] on V. The court orders A to compensate V. The amount and nature of the

§19.3. [1]See especially §19.24 and §19.25.

[2]The recording statutes constitute the primary example discussed in this book. See §18.4 and §19.7.

[3]See §§19.4 through 19.12.

[4]See §19.15.

[5]See §§19.16 through 19.23.

[6]"Assent to conduct" and "assent to terms" have assigned meanings. See §19.9.

[7]This means loss not fully reparable by money. See §19.13.

[8]This is loss quantifiable in monetary terms. See §19.13.

compensation depend on the state of the proofs,[9] but ideally should simulate the bargain the parties would have reached if they had negotiated before the injury.

4. When nonconsensual loss threatens wherever the court places the entitlement and a judicial decree is the most feasible way of assuring full compensation, the court uses declaratory, specific, and substitutionary relief in an effort to simulate the bargain the parties would have reached if they had negotiated on the matter beforehand. The third and fourth paradigmatic cases are the bargain-*simulating* paradigms.[10]

§19.4. THE PRINCIPLE OF CONSENT

To be actionable, actual or threatened loss must be consensually imposed and nonconsensually received. Actors are not liable for unavoidable accidents, and *volenti non fit injuria*.[1] Obviously, the term *consent* is central to understanding and proving or disproving the hypothesis proposed.

Consent has a practical rather than a technical meaning. In other words, it has the meaning the average person would give it. This meaning is broader than express agreement or the "consent" that meets the formal requirements of contract law. People manifest consent not only by contract but by gratuitous verbal agreement, acquiescence, and other conduct.[2]

Two elements must be present for consent to arise: *actual notice* and *assent*. A person consents to a situation if, when faced with reasonable alternatives,[3] the person *assents* to the situation

[9]See §§19.19 through 19.21.

[10]See §19.16, §19.17, and §19.22.

§19.4. [1]"No wrong happens to the volunteer."

[2]The issue of the person who first consents, then changes his mind, is considered at §19.10 and §19.11.

[3]To say that the alternatives must be reasonable is not to say they must be attractive. Thus, the alternative of bankruptcy may be unattractive, but reasonable, as it increasingly is recognized to be. An unreasonable alternative would be one imposed by a person we would say is guilty of duress: to a parent, "Do this or I take your child"; to an invalid, "Do this or I cut off your food."

while on actual notice of it. The consent process can be diagrammed as follows:

Actual Notice + Assent → Consent

§19.5. ACTUAL NOTICE AND RISK OF LOSS: IN GENERAL

A person may be on actual notice of any of a variety of facts and circumstances. Because this chapter focuses on the notion of consent to loss, the emphasis here is on actual notice of *risk of loss*. Of course, when the courts hold that a person is on actual notice of a risk of loss, they do not mean that the person must have known the precise level of risk or the exact nature of the potential loss. It is sufficient that he be on actual notice of a significant possibility that an injury of the general type could occur. (If the damage already has occurred, the risk of loss is 100 percent.) To be liable to a victim for the loss of a leg, for example, a motorist need be on actual notice only that his (aberrant) behavior imposes on others a significantly heightened risk of personal injury.

The courts use the phrase *actual notice* in several different ways;[1] the trend, however, is to hold that a person is on actual notice of a fact if most people in that person's position would have known the fact.[2] That is more or less the way the term is used in this book. Correspondingly, a person is on actual notice of a fact if most people, on fully learning of the situation, would expect that person to know it.[3]

§19.5. [1]Merrill, The Anatomy of Notice, 3 U. Chi. L. Rev. 417 (1936); 1 M. Merrill, Merrill on Notice 11-13 (1952).

[2]This definition is close to that reported by Professor Merrill's to be Mr. Wade's. Merrill, The Anatomy of Notice, 3 U. Chi. L. Rev. 417, 425 (1936). It thus includes both Merrill's "cognitive notice" and that part of his "absolute notice" that he places under the rubric of "unforgettable knowledge." See also Merrill, Unforgettable Knowledge, 34 Mich. L. Rev. 474 (1936).

[3]What most people would know and what most people would expect others to know are not necessarily identical. For the broad purposes of this chapter, however, the usual coincidence should be sufficient.

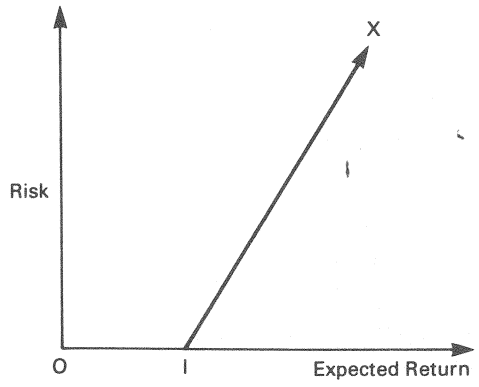
In economic terms, and from the standpoint of the person bound, actual notice is *cheap knowledge*. Thus, A is on actual notice of a fact of which A has knowledge because the further cost to A of obtaining that knowledge is zero. Even when A does not know the fact, A is on notice of it if he may so inexpensively obtain and retain knowledge of it that in the real world people would assume he knew it.[4]

In the absence of actual knowledge, the circumstances determine whether obtaining and retaining a piece of information is sufficiently cheap to infer actual notice. The "circumstances" include the cost of obtaining the information compared to the perceived risk to that person of not having it.

Another economic measure of actual notice is the measurement of risk in any markets available to the person bound. One is on actual notice of a risk if the risk is one that the market would price in advance. For example, the market for homes responds to the fact that a wood home is more vulnerable to fire than a brick home; home buyers can expect to be held on actual notice of that fact.[5]

[4]See, e.g., U.C.C. §2-201(2) (merchant presumed to read his mail).

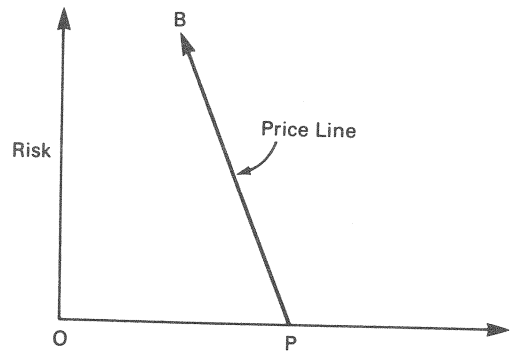
[5]A price is received for risk assumed and paid for risk shifted. In the capital markets, the investor of funds receives an expected rate of return that rises as risk increases. According to the graph,



when risk = O (e.g., for U.S. Government securities), the expected rate of return is I, the "pure interest rate." As risk rises, the expected rate of return rises along the line I-X, the *capital market line*.

Instead of stating that the defendant was on actual notice of the risk of a particular injury, a tort lawyer would say that the injury was "foreseeable" to the defendant. As Judge Posner has noted, these are different ways of labeling the same concept.[6] For this reason, saying that the defendant acted negligently is to say the defendant acted consensually — deciding to do what he did while on actual notice of the risk.[7] While public policy concerns recently have extended tort liability further,[8] the garden-variety negligence case fits well within private law principles.

In purchasing a home, the buyer pays to minimize (shift) the risk of being without housing in the future. As the inflammability of the home increases, the price (*ceteris paribus*) should decrease along line P-B:



The first graph is adapted from Sharpe, Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk, 19 J. Fin. 425-442 (1964).

Market failure can be represented by kinks in lines such as I-X and B-P. See §19.13.

[6]Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir.), cert. denied, 459 U.S. 1017 (1982) (Posner, J.).

[7]In nontort cases, the courts characterize proceeding in the fact of actual notice of the risk of harm as "negligence." See, e.g., §17.11 (negligent putative grantor estopped to deny delivery of deed).

[8]One must not exaggerate the role of public policy in the extension of strict tort liability and implied warranty. To a considerable degree, this extension is merely the result of the consent principle operating in the mass marketing context. Implied warranties and strict tort liability often are based on purchasers' reasonable expectations — that is, the scope of actual notice and effective assent.

§19.6. ACTUAL NOTICE: SOURCE AND SCOPE

One may obtain actual notice of a risk from any of a variety of circumstances, including custom and business practice.[1] Sources of notice in real property transactions include the condition of a particular subdivision,[2] conditions on a particular tract of land,[3] and the climate and topography of a particular area.[4] Of course, the parties are not automatically on notice of such circumstances; in each case, notice depends on the relative cost of acquiring the knowledge in question.[5]

In transactions involving contracts and other written instruments, the documents can be an important source of actual notice. But occasional judicial language notwithstanding, one is not on actual notice of, nor is one bound by, all of the terms of every document one signs. Once a court has determined the sources of actual notice, it must ascertain the *scope* of such notice, and written document cases are no exception. The principle that ambiguities are construed against the drafter, for example, is a statement of a conclusion that the wording of the document was not clear enough to put the other party on actual notice of a particular result, especially an unexpected or unusual result. Moreover, signatories have been held to be without actual notice of some (but not all) preprinted provisions in form contracts ("boilerplate").

Illustration 19-1. A, a seller, drafts two contracts for V's signature. Each contains three pages of preprinted matter

§19.6. [1]See, e.g., U.C.C. §§2-103(1)(b), 2-202(a); Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984), cert. denied, 471 U.S. 1005 (1985) (for a practice to constitute legally relevant custom for parties to a contract, both parties must have notice of the practice).

[2]Sanborn v. McLean, 233 Mich. 227, 206 N.W. 496 (1925).

[3]E.g., Pioneer Mining Co. v. Bannack Gold Mining Co., 60 Mont. 254, 198 P. 748 (1921); Van Sandt v. Royster, 148 Kan. 495, 83 P.2d 698 (1938) (service of area by city sewer suggested existence of easement).

[4]Baldwin v. Blue Stem Oil Co., 106 Kan. 848, 189 P. 920 (1920).

[5]Goeres v. Lindey's, Inc., 190 Mont. 172, 619 P.2d 1194 (1980) (refusing to apply notice doctrine of Sanborn v. McLean, supra note 2, in a largely undeveloped subdivision). See also Piney Woods Country Life School v. Shell Oil Co., supra note 1.

totaling 2,000 words. The first contract is to govern the sale of an office building to V at an agreed-on price of $400,000. The second is to govern the sale of a television to V at an agreed-on price of $400. V signs both contracts without reading them. A later seeks to enforce a preprinted term unfavorable to V. Other things being equal, a court is more likely to enforce the term in the office building contract than in the television contract.[6]

A law-and-economics scholar might explain this result by pointing out that in the office building context it is inefficient to allow V to shift a cost (potential unhappiness with the terms) to A if V has a lower cost of avoidance and that, because V knows his own needs better than A does, V has a lower cost of avoidance. The law-and-economics scholar might go on to defend the result in the television contract because encouraging buyers to negotiate such contracts would result in transaction costs prohibitive for such small deals. It may be true that the result in each case is efficient, although this is debatable as regards the television contract.[7] But efficiency is the symptom, not the cause, of the result. The reason for the result is that people customarily act in wealth-maximizing ways, and other people know this.

One can illustrate the point by placing oneself in the shoes of V, the buyer. Assume that V is a layperson and that, in order to fully understand the terms of each deal, V must employ a lawyer to review the contract. Assume further that the cost of attorney consultation for each contract is $200. Against this cer-

[6]Similarly, a court is likely to enforce complicated subdivision covenants against parties who purchased land while those servitudes were in effect because both the developer and other purchasers rely on those covenants. See Natelson, Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association, 51 Ohio St. L.J. 41 (1990). But if the subdivision restrictions are kept in a relatively inaccessible place or are otherwise difficult to obtain, they may not be enforced. Id. at 64.

[7]One must weigh the cost of not enforcing the contract against the costs of the occasional negotiation. If A is a dealer in televisions, presumably A relied on the preprinted terms in thousands of other deals. Failing to enforce such terms imposes significant uncertainty on the dealer in those other deals as well.

tain cost V must balance the value of the risk that a court will enforce against V a term he does not understand and whose content is therefore unknown. Because the losses that may result from a $400 deal are minimal, V is likely to evaluate the risk of ignorance in the television deal at less than $200. For that contract, he probably will not hire a lawyer.

Moreover, A probably knows that it is not cost-effective for V to employ a lawyer and that V likely does not understand all the terms of the instrument. In other words, A knows, or should know, that V has not consented to all of the terms in the television contract. As Llewellyn suggested, V has at most given a blanket consent to "not unreasonable" terms — those that do not impair the basis of V's bargain.[8] This lack of consent to unknown, damaging terms is the reason those terms are not enforced against V; and because A has actual notice of V's lack of consent, A does not suffer *nonconsensual* loss when the court refuses to enforce those terms against V.

But the office building contract is quite a different matter. Because the financial losses that may result from liability on a $400,000 deal are large, V is likely to value the risk of not understanding all the terms of the writing at more than $200. Hiring a lawyer is now cost-effective for V. The lawyer (if competent) will make sure that V's consent to all terms is informed.[9] Holding that V is on actual notice of all terms is an evidentiary conclusion about what V probably agreed to.[10]

[8] K. Llewellyn, The Common Law Tradition: Deciding Appeals 370 (1960).

[9] See, e.g., Berman v. Gurwicz, 189 N.J. Super. 49, 458 A.2d 1289, cert. denied (N.J. 1983), affg. 189 N.J. Super. 89, 458 A.2d 1311 (Ch. Div. 1981) and 178 N.J. Super. 611, 429 A.2d 1084 (Ch. Div. 1981) (most condominium unit purchasers who were not represented by legal counsel had proved fraud; those who were represented by counsel should have known the content of condominium documents). In New Jersey, there is no prevailing custom that a condominium purchaser is or is not represented by counsel.

[10] Observe the difference between the formulation in the text and that of the widely repudiated "tacit agreement" test, whereby the determinant of liability is whether the defendant states he "would have assented to such a liability, had it been called to his attention at the making of the contract." Cf. Southwestern Bell Tel. Co. v. Norwood, 212 Ark. 763, 207 S.W.2d 733 (1948). The problem with the tacit agreement test is that the defendant's post hoc assertions that he would not have assented to liability can be misleading. Insisting only that the person subject to liability must have been on actual notice of the risk identifies probable consent without the evidentiary problems. Cf. U.C.C. §2-715(2) and comment 2.

When V denies understanding a term of a written contract, a conclusion that V was on actual notice of the term embodies the conclusion that V either is lying or intended, for his own purposes, to give a limited blank check to A. See infra this section and §19.10, §19.11, and §19.25.

For the judicial tendency to hold parties to real property deeds on actual notice of their content, see §16.3.

Suppose, however, that, in seeming defiance of economic sense, V did not hire a lawyer to examine the office building contract. Instead, V merely signed it without reading it. V may do this for any number of reasons, only one of which is that he may undervalue the risk of failing to understand all terms. The risk actually may be unusually low because of V's sophistication in real estate transactions. Or, the risk to V may be outweighed by the desirability of closing the deal immediately without waiting for attorney review. Or, V may so dislike lawyers that the value to him of indulging this distaste is greater than the risk.[11]

Whatever the factors causing V's aberrant behavior, they should not prejudice the rights of A. Most people consult lawyers before buying office buildings, and A will assume that V either will do so or has good reason not to. In other words, A has no actual notice that V is not consenting to all terms. To refuse to enforce such terms would leave A with nonconsensual loss. To enforce them would impose only consensual loss on V.

[11] As the text suggests, when a person enters into a transaction in which prudence would suggest acquiring full knowledge, but the person does not do so, this usually is the result of a conscious decision. See, e.g., Dunn v. Barnum, 2 C.C.A. 265, 51 F. 355 (8th C.C.A. 1892):

> An offer to sell land worth $30,000 for $100 was enough to arouse suspicion and excite inquiry in the most lethargic mind, and if inquiry was not made and the facts not learned it was because the purchaser deliberately and purposely abstained from doing so, to avoid the actual knowledge of facts he with good reason believed to exist, and this is the legal equivalent of actual notice. 51 F. at 360.

§19.7. CONSTRUCTIVE NOTICE DISTINGUISHED FROM ACTUAL NOTICE

Actual notice differs from *constructive notice.* Constructive notice, also called formal, legal, or absolute notice,[1] means notice imposed not by reason of factual circumstances but by a positive rule of law. An example referred to in this book is the law of real estate recording. By statute in all states, a person considering an investment in real estate is said to be on notice of recorded documents, irrespective of other circumstances.

Fact patterns giving rise to constructive notice and fact patterns giving rise to actual notice are not mutually exclusive. Facts affording constructive notice may readily communicate knowledge to the recipient; an illustration is communication by letter. However, a person may be on constructive notice of recorded documents but have no actual notice of them.[2] When a statute provides that recording an instrument places the world on notice of the instrument, but the facts of the case suggest an absence of actual notice, the courts often try to evade the statute.[3]

§19.7. [1]Merrill, The Anatomy of Notice, 3 U. Chi. L. Rev. 417, 425 (1936); 1 M. Merrill, Merrill on Notice, 13-25 (1952).

[2]See, e.g., Berman v. Gurwicz, 189 N.J. Super. 49, 458 A.2d 1289, cert. denied (N.J. 1983) (condominium unit purchasers held not on notice of recorded documents in making out fraud claim). Similarly, one may have actual notice of a document not properly recorded and be bound by virtue of actual notice. See Schaumburg State Bank v. Bank of Wheaton, 197 Ill. App. 3d 713, 555 N.E.2d 48 (1990).

[3]Different scholars working in different areas of property law, including your author, have noted this response. See Natelson, Running with the Land in Montana, 51 Mont. L. Rev. 17, 72-75 (1990) (in nearly a century of precedent the Montana Supreme Court never had enforced a land covenant based on recording alone); Natelson, Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association, 51 Ohio St. L.J. 41 (1990) (similar findings in an interstate study of cases involving condominiums and other property owners associations).

See also E. Kuntz, J. Lowe, O. Anderson, and E. Smith, Cases and Materials on Oil and Gas Law 579 (1986) (scope of the covenant of general warranty often is limited by excepted interests of which the grantee has actual notice but not by excepted interests of which the grantee has merely record notice). Compare Gilbertson v. Charlson, 301 N.W.2d 144 (N.D. 1981) (actual notice) and Hartman v. Potter, 596 P.2d 653 (Utah 1979) (actual knowledge) with Sibert v. Kubas, 357 N.W.2d 495 (N.D. 1984) (record notice only).

See also 1 G. Palmer, Law of Restitution 255-256 (1978), where the author observes that when a person ignorant of a recorded second mortgage pays off a first mortgage for the benefit of the owner of the property, the payor is subrogated to the first mortgagee and takes priority over the junior lienor. Professor Palmer attempts to distinguish this case from other recording act problems because subrogation is an effort to avoid unjust enrichment, but his comment only underscores the point: Judges perceive as unjust the recording acts' system of windfalls and forfeitures, imposed without regard to actual notice.

See §18.9 for another example of avoidance of the recording acts (chain of title cases). Other examples of the preference for consent over formality in the law of conveyancing include construction of the Statute of Frauds to minimize imposition of nonconsensual loss by creating exceptions unwarranted by the text of the statute, e.g., Farash v. Sykes Datatronics, 59 N.Y.2d 500, 452 N.E.2d 1245, 465 N.Y.S.2d 917 (1983) and evasion of the Statute of Wills and legal delivery rules by enforcing deeds reflecting testamentary intent. See §17.17.

§19.8. ASSENT AS AN ELEMENT OF CONSENT

Consent to a risk of loss requires agreement to a risk of which one is on actual notice. In this book, such agreement is called *assent.*[1]

Each day people enter into transactions in which they assent to risks of which they have actual notice. Frequently assent is expressed in words, but more often it is expressed by conduct or by silence. The man who boards the bus knowing of the fare, the woman who shows up for work knowing the nature of the job, the father who permits his child to play with his shoes, the boy who kisses the girl without verbally asking permission, and the girl who lets herself be kissed — all are assenting to risk of loss, usually in hope of ultimate gain. They are acting volitionally and accepting responsibility for their own conduct and for the risks associated with it.

Judges know this. The typical judge is not a cloistered academic or a human computer, but an aging professional with years of experience in a real-world occupation. Judges (and ju-

§19.8. [1]This word has useful connotations of passive agreement. Webster's New International Dictionary of the English Language 165 (2d ed. 1955).

rors also) infer unexpressed assent from context,[2] much as other experienced people do, and like those other experienced people, their inferences usually are correct.

Some of the practical guidelines for inferring assent have become legal presumptions. Thus, in absence of unusual facts, acceptance of a beneficial gift is presumed, for if A gives V a useful gift and V does not reject it, an experienced person would presume that V had accepted it. Similarly, speeding is prima facie negligence, if not negligence per se, for if A is driving 70 miles per hour in a 45-mile-per-hour zone, A usually is assenting to a "foreseeable" risk — that is, a risk of which A has actual notice.[3] If A's excessive speed causes an accident and A suffers harm, a practical person might remark, "He asked for it." Yet the same person would express pity and concern for any victims suffering the consequences of the risk imposed by A's conduct — a risk beyond that common to driving (for few people speed so excessively) and a risk of which they had no notice and to which they did not assent.

§19.9. ASSENT TO CONDUCT AND ASSENT TO TERMS

Discussion of assent is complicated by the fact that the actor (A) and the victim (V) may assent to different risks. If A volitionally chooses to act in a manner that imposes a risk of loss on V, A *assents to conduct*. If V assents to A's actions, V *assents to terms*.

Illustration 19-2. Abigail is a rancher. When her well is shut down for repairs, Abigail approaches her neighbor, Victor, and asks him if she may use some of his water. Abigail makes her request volitionally and with notice that

[2]The reason the court must do so is evidentiary. A judge or juror cannot determine whether there was actual assent by performing a Vulcan mind meld. The judge or juror must rely on circumstantial evidence.

[3]See §19.5 for the identity of the concepts of actual notice and foreseeability.

compliance probably will inconvenience Victor. Abigail has assented to conduct. Victor refuses to permit Abigail to use his water. Victor has refused to assent to terms.

In the foregoing illustration, the courts protect Victor's rights under the doctrine of trespass, at the intersection of the law of property and the law of torts.

Illustration 19-3. The facts being otherwise the same as in Illustration 19-2, Victor, with actual notice of the probable results, agrees to allow Abigail to use his water. Victor has assented to terms. Mutual assent continues as Victor sees Abigail drive her herd over to Victor's trough.

In Illustration 19-3, if Victor later sues for the reasonable value of the water, recovery will be denied under the rules pertaining to donative transfers and restitution (Victor was a "volunteer").[1] There is no nonconsensual loss.

In Illustration 19-3, assent to conduct and assent to terms are contemporaneous, a situation typical of the donative transaction. This is not always true:

Illustration 19-4. Abigail, a rancher, *contracts* with Victor, a neighbor, to permit her to water her cattle at Victor's well for a period of one month. The parties agree on a price. Abigail has assented to conduct; Victor has assented to terms. Three days later, Victor changes his mind and, gun in hand, refuses to allow Abigail to water her cattle.

By mutual assent, the agreement between Abigail and Victor changed the rules between them. Put another way, the agreement changed the scope of their respective consents. Now it is Victor's obstruction of Abigail's access to water rather than her use of Victor's water that may impose nonconsensual loss. It is Victor who is now assenting to (his own) conduct. Because this conduct would impose loss on Abigail, she need not assent to

§19.9. [1]D. Dobbs, Handbook on the Law of Remedies 299 (1973).

terms. If she decides to enforce her rights in court, she will win under the law of contracts.

Illustrations 19-2, 19-3, and 19-4, resolved respectively by the rules of property and the rules of torts, restitution-donative transfers, and contract, demonstrate how each of these substantive areas is governed by the principles of private law. In the absence of an agreement or unusual circumstances, Abigail has no right to water her cattle at Victor's expense; property and tort rules protect Victor. But Victor may give up his water gratis. If so, restitution and donative transfer rules protect Abigail. If Abigail contracts with Victor for water, contract rules, as well as other rules,[2] protect her rights.

§19.10. DOCTRINES EFFECTUATING ASSENT TO TERMS FROM SILENT INACTION

Absent extraordinary circumstances (such as mental defect or compulsion), nonverbal assent to conduct generally can be inferred from the conduct itself. Nonverbal assent to terms, however, may be inferred from mere inaction — for example, from a failure to reject. Nonverbal assent to terms should be inferred in circumstances in which an average person similarly situated would, if he intended to reject the conduct, reject by words or conduct. A person (V) would reject by words or conduct if he were on actual notice that the other person (A) reasonably could interpret silent inaction as assent.[1]

But in order for A reasonably to interpret V's silent inaction as assent, A must have actual notice of circumstances suggesting same. In the usual case, A and V are on notice of the same circumstances, perhaps through widespread custom or a prior course of dealing.

The courts use several different legal doctrines to effectuate silent assent to terms, of which one of the better known

[2]See §19.10 and §19.11.

§19.10. [1]I.e., that the actor has actual notice of facts suggesting that silent inaction constitutes assent.

is contract implied in fact. In *Hobbs v. Massasoit Whip Co.*,[2] a fisherman (A) sent packages of eel skins on four or five separate occasions to a factory (V), which used them to manufacture whips. Each time, without express assent or rejection, the factory paid for them. When, on the next occasion, the factory retained but refused to pay for a shipment, the court held that due to the previous course of dealing silence constituted acceptance. The court observed that in these circumstances the fisherman had reason to believe that silence constituted assent, and the factory had reason to know of the fisherman's expectations in this regard.

On receipt of the fisherman's eel skins, it is possible either that the factory manager (or other responsible employee) intended to accept them or did not so intend. In *Hobbs* the conclusion was that the factory did intend to accept the eel skins and that its subsequent testimony to the contrary was perjured or mistaken.[3] In this case, the doctrine of contract implied in fact served an evidentiary purpose: as a presumption of acceptance in such circumstances. The presumption reflected probable economic reality — that the factory did not assent expressly because assent by silent inaction was more cost-effective, for the factory did not have to send a letter whenever it decided to keep a shipment. Of course, the factory would have had to send a letter and return the eel skins if it wished to reject, but the fisherman (and the court) had reason to believe that the factory had calculated the risk-adjusted cost of the process of silent acceptance-or-express rejection as less than the cost of the process of express acceptance-or-silent rejection.[4]

[2]158 Mass. 194, 33 N.E. 495 (1893) (Holmes, J.).

[3]The possibility that the factory never intended to accept is examined in the next section.

[4]Sometimes A does not have reason to believe that V has so calculated. In such cases, A has reason to believe that silent inactivity has other explanations. The retail direct marketer knows that (1) a large percentage of the addresses on most commercial mailing lists are outdated or otherwise incorrect and that (2) because of the large volume of such mailings and the prohibitive cost of expressly rejecting each, the potential consumer rejects most by

Other doctrines whereby the courts infer assent from silent inaction are waiver, abandonment, and acquiescence,[5] each of which is the preferred vehicle in a particular kind of fact pattern. The courts rely on the doctrine of waiver when there is silent consent without consideration (and often without reliance) and when the facts justifying the inference of consent occur over a short period of time. They rely on the doctrine of abandonment when dealing with facts involving longer periods of time coupled with circumstances suggesting relinquishment. Acquiescence cases tend to involve facts suggesting actual notice and inaction over time.

§19.11. DOCTRINES EITHER EFFECTUATING V'S SILENT ASSENT TO TERMS OR PROTECTING V FROM A'S SILENT ASSENT TO CONDUCT

Under the facts of *Hobbs v. Massasoit Whip Co.*,[1] discussed in the preceding section, it is possible the factory manager never intended to assent by silence. Instead he may have intended to reject, or merely disregard, the shipment while on actual notice of the misleading impression his behavior gave the fisherman.

tossing them in the trash. Thus, the direct marketer has no reason to believe that silence means anything but nonacceptance.

[5]On waiver, see Phoenix Ins. Co. v. Heath, 90 Utah 187, 61 P.2d 308, 311-312 (1936) ("A waiver is the intentional relinquishment of a known right. . . . To constitute a waiver, there must be an existing right, benefit, or advantage, a knowledge of its existence, and an intention to relinquish it. It must be distinctly made, although it may be express or implied.").

The doctrines of waiver, acquiescence, and abandonment frequently are confounded, for they really all are labels for the same conclusion — consent. Thus, in Western Land Co. v. Truskolaski, 88 Nev. 200, 495 P.2d 624 (1972) the court found that there was no abandonment or waiver of restrictive covenants, stating that the violations were "too distant and sporadic to constitute general consent by the property owners in the subdivision and they were not sufficient to constitute an abandonment or waiver." There is no evidence in the case that the court considered consent to be separate from abandonment or waiver.

§19.11. [1]158 Mass. 194, 33 N.E. 495 (1893) (Holmes, J.).

At the end of the opinion, Justice Holmes makes it clear that the result would have been the same "whatever may have been the actual state of mind of the [factory]. . . ."[2]

Had the factory so acted, its assent would not have been to terms, but to *conduct*. In other words, it would have become the actor (A) consensually attempting to impose nonconsensual loss on the fisherman (V). In those circumstances, had the court not inferred acceptance, the factory would have committed fraud — the imposition of nonconsensual loss by manipulating circumstances of which another has actual notice.[3] Thus, judges may resort to the fiction of assent to terms in order to deal with the nasty implications of assent to conduct.

Contract implied in fact is not the only legal doctrine that can either effectuate consent to terms or protect a victim from assent to conduct. Waiver, abandonment, and acquiescence, discussed in the preceding section, usually serve the former purpose, but also may serve the latter. Adverse possession and estoppel may be employed for either purpose. A title holder's failure to enforce his rights against an adverse possessor over a period of many years may suggest an intent to abandon.[4] If the title holder receives property tax bills and refuses to pay them, and in the meantime permits the adverse possessor to do so, such conduct is a strong indication of assent. But if the title holder induces an adverse possessor to believe he could stay on the property forever when the title holder actually expects to recover the land after the possessor has spent money on improvements, the title holder does not really assent to the loss of title, but creates a situation misleading to the possessor.

Similarly, estoppel may be used either to effectuate assent by the person estopped or to protect the other party from ma-

[2]33 N.E. at 495.

[3]See §16.7 and §16.10.

[4]More time must pass in the average adverse possession case than in the typical acquiescence case because of the value of the property involved and the difficulty of the procedure required for ending the adverse possession: The true owner must physically re-enter the land (which involves the potential for violence) or commence a lawsuit. 3 American Law of Property 807-809 (A. J. Casner ed. 1952).

nipulative conduct. Assume a landowner (L) permits a neighbor (N) to construct a right of way over L's land. L then stands by while N erects improvements in reliance on that permission. In a proper case, a court will decree an easement by estoppel, because L either agreed to the creation of the easement or misled N into believing he had.[5]

§19.12. ASSENT BY DURESS

Just as an actor may impose nonconsensual loss on a victim by manipulating the information readily available to the victim, so one may manipulate assent through force, threats of force, or other coercive means. The particular circumstances determine what actions are sufficiently coercive to justify a finding of duress. Generally, however, the required severity declines as the underlying dependence of the victim on the tortfeasor increases. Duress in general and undue influence (a kind of duress occurring in relations of dependence and trust) are discussed further in Chapter 16.[1]

§19.13. QUANTIFIABLE AND SPECIAL VALUE

As noted in §19.2, the overriding purpose of the private law is to protect victims from nonconsensual loss, consensually imposed. The last few sections have discussed the concept of consent. Before proceeding further, we must examine two different kinds of loss.

In the American system of private law, the salient division of loss is that between injury readily reducible to a particular

[5]For easement by estoppel, see §10.3. For estoppel as a device to prevent a victim from being misled, see Morgan v. Board of State Lands, 549 P.2d 695, 697 (Utah 1976) ("Estoppel is a doctrine of equity purposed to rescue from loss a party who has, without fault, been deluded into a course of action by the wrong or neglect of another."). See also Board of Mgrs. of Heatherton Homeowners Assn. v. First Capitol Oil Co., 798 S.W.2d 176 (Mo. Ct. App. 1990).

§19.12. [1]See §16.8 and §16.11.

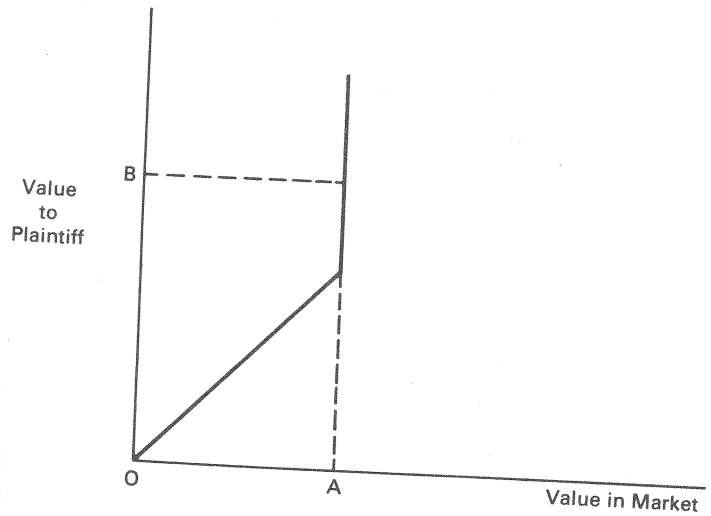
sum of money and injury not so readily reducible. The former is *quantifiable loss*, and the value it represents is *quantifiable value*. The distinguishing characteristic of quantifiable loss and quantifiable value is that there are orderly, available markets for measuring them.[1] Loss not easily calculated as a particular sum of money is *special loss*, and the value it represents is *special value*.[2] The distinguishing characteristic of special value is that the available markets do not measure it adequately.[3]

Illustration 19-5. On March 1, B, a tenant on Blackacre, has cash savings of $120,000. On that date, he enters into

§19.13. [1]On the role of markets in determining whether the appropriate remedy is specific or substitutionary, see Laycock, Death of the Irreparable Injury Rule, 103 Harv. L. Rev. 687 (1990).

[2]The latter term is taken from Bangert v. Osceola County, 456 N.W.2d 183 (Iowa 1990).

[3]The presence of special value as a market failure can be illustrated by a kink in the pricing curve. In the graph below, the market fails to reflect fully the value to the individual plaintiff. Market value remains O-A, while the value to the plaintiff is O-B.



OA = Value in Market
OB = Value to Plaintiff

a contract with S, the landlady, whereby she will sell Blackacre to B for an agreed-on price of $100,000. B gives her a $2,000 deposit and spends $1,000 searching title. Closing of title and full payment of the purchase price are to take place on May 1. On May 1, the market value of Blackacre is $107,000. On that date, S fails to show up at closing and subsequently refuses to convey title. B intended to resell the property.

Normally, in a land sale contract where no unique use is contemplated, one measures a frustrated buyer's money damages by subtracting the contract price from the fair market value and deducting costs of purchase.[4] (In the illustration, assuming no further costs of purchase and disregarding the deposit, the damages are $107,000 less $100,000 less $1,000, or $6,000.) This is *quantifiable loss*.

If, on the other hand, B did not intend to resell Blackacre but wished to keep it because it was particularly adapted to his needs, then the value to him includes a premium over market value.[5] The injury includes a *special loss*. Although special loss usually is nonfinancial, it can be financial: If B is a commercial tenant and Blackacre is peculiarly adapted to his commercial needs, then he has a *special value* in Blackacre and the contract breach has resulted in special loss.[6]

[4] Alternatively, if the property generates an income stream, one may capitalize that stream with an interest rate borrowed from the market. See O'Brien Bros. v. The Helen B. Moran, 160 F.2d 502 (2d Cir. 1947) (capitalization of earnings of barge).

[5] Thus, cost to repair is the usual measure of damages when a homeowner is suing for a defect in the home. Natelson, Mending the Social Compact: Expectancy Damages for Common Property Defects in Condominiums and Other Planned Communities, 66 Or. L. Rev. 109, 122-124 (1987).

An example of special value in another context: If two tracts of land are so located that only the removal of a pig sty on Blackacre will clear the smells from Whiteacre, the owner of Blackacre is a monopolist of clean air on Whiteacre — which is to say there is no available market for clean air on Whiteacre and its value is not readily quantifiable.

[6] The existence of commercial special value is the reason the law-and-economics term for the premium, "consumer surplus," is misleading. For an example of a government agency with special value in a building, see United States v. Ebinger, 386 F.2d 557 (2d Cir. 1967).

§19.14. PRIVATE LAW REMEDIES: DECLARATORY, SPECIFIC, AND SUBSTITUTIONARY RELIEF

In most cases, it is not sufficient for the court to declare the rights and duties of the parties (*declaratory relief*). The court must supplement declaratory relief with other remedies. The presence of both quantifiable and special losses accounts for the availability of *substitutionary* and *specific* remedies.[1] Following is a survey of those remedies and how they are combined. Historical distinctions, such as that between legal and equitable remedies, are disregarded.

Substitutionary relief is an award of money, whether to compensate for loss or purportedly to restore unjust enrichment.[2] *Specific relief* comprises all remedies that require a party to undertake or abstain from certain conduct other than the mere payment of money.[3] Thus, specific relief encompasses injunctive relief, specific performance of contracts, and restitution of identified things. An important kind of specific relief is a judicial grant of *immunity*. Immunity is a judicial determination that a defendant may proceed on a planned course without interference from the plaintiff. Thus, if V asks a court to enjoin A from polluting V's land and the court denies relief to V, the court has granted immunity to A. If necessary, a court may protect this immunity by granting A an injunction to protect him from V's self-help measures.

Immunity and other specific relief in favor of one party may or may not be coupled with an award of compensation to

§19.14. [1] Whence the adages that specific relief is available when damages are not "adequate" or when loss would be "irreparable" — meaning "irreparable by an award of damages." D. Laycock, Modern American Remedies 339-342 (1985). See also Professor Laycock's more recent discussion in Laycock, Death of the Irreparable Injury Rule, 103 Harv. L. Rev. 687 (1990).

[2] The text uses the phrase "purportedly to restore unjust enrichment" because of my thesis that restitution is merely another way of compensating for loss. See §19.19 and §19.20.

[3] Depending on the context, an award of a full contract price may be viewed as a form of specific relief or substitutionary relief; so also the award of the profit received by a disloyal fiduciary.

the other party.[4] In the most common kind of case — that resulting in an award of money only — the effect is that the court decrees immunity conditioned on compensation: The plaintiff gets money and the defendant gets immunity from direct interference if the compensation is paid. If the court awards no relief at all the defendant enjoys unconditional immunity.

A court may grant a pure specific relief[5] or it may couple specific relief with compensation to the party against whom the specific relief is to operate. For example, a judge may enjoin the defendant from continuing to operate a feedlot conditionally on the plaintiff's compensating the defendant for the costs of moving;[6] condition specific performance of the payment of damages;[7] order the removal of fixtures only on payment of reasonable rental value;[8] or condition specific relief against the defendant on the plaintiff's yielding up a particular item.[9]

§19.15. THE PRINCIPLE OF PREVENTION: THE FIRST AND SECOND PARADIGMS

The basis of the principle of prevention is that if a court can prevent nonconsensual *special loss*,[1] it will attempt to do so. A court applies the principle of prevention in the first and sec-

[4]Calabresi and Melamed generally are credited with pointing out that specific relief and substitutionary compensation often are used in combination. See Calabresi and Melamed, Property Rules, Liability Rules, and Inalienability, 85 Harv. L. Rev. 1089 (1972). Actually, however, "compensation" may be specific or substitutionary. Thus, a court may grant V an injunction unconditionally or conditioned on the payment of money to A or transfer of a specific thing to A. See infra note 9.

[5]For examples, see §19.15, note 3 and accompanying text (judicial refusal to balance the equities).

[6]E.g., Spur Indus. v. Del E. Webb Dev. Co., 108 Ariz. 178, 494 P.2d 700 (1972).

[7]Libman v. Levenson, 236 Mass. 221, 128 N.E. 13 (1920).

[8]Woodson Oil Co. v. Pruett, 298 S.W.2d 856 (Tex. Ct. App. 1957).

[9]For example, A and V enter into a land exchange contract. A anticipatorily breaches. V may obtain a decree of specific performance conditional on giving A the promised consideration — in this case, V's land.

§19.15. [1]Special loss is loss not readily quantifiable in money. See §19.13.

ond paradigms, set forth in §19.3. The first, or pure specific relief, paradigm is as follows:

> **Paradigm 1.** A, having assented to conduct, threatens to impose nonconsensual *special loss* on V. The court grants specific relief to V.

The first paradigm is familiar to all lawyers. The limitation to special loss is equity's irreparable injury rule.[2]

In many cases within the first paradigm, the defendant contests the plaintiff's request for an injunction by asking the court to "balance the equities." Where A has assented to conduct, however, courts almost uniformly refuse to do so. In other words, when A volitionally proceeds while on actual notice of the risk to V, an injunction is almost automatic.[3]

The second, or bargain-stimulating, paradigm is less familiar. It is as follows:

> **Paradigm 2.** When nonconsensual loss threatens wherever the court places the entitlement, the court grants specific relief to the party with the *smaller* potential loss from the other's conduct if a bargain among the parties seems to be the most feasible way of assuring full compensation.

An illustration of this paradigm is the following:

[2]The tendency of modern courts readily to enjoin threatened damage, see Laycock, Death of the Irreparable Injury Rule, 103 Harv. L. Rev. 687 (1990), reflects their recognition that many forms of injury are special that previously were thought quantifiable.

[3]Good illustrations of judicial refusal to "balance the equities" are found when A violates a land covenant of which he was on actual notice, resulting in nonconsensual detriment to V. See, e.g., Ariola v. Nigro, 16 Ill. 2d 46, 156 N.E.2d 536 (1959) (summarizing Illinois and Massachusetts law); Board of Mgrs. of Heatherton Homeowners Assn. v. First Capitol Oil Co., 798 S.W.2d 176 (Mo. Ct. App. 1990); Papanikolas Bros. Enters. v. Sugarhouse Shopping Center Assocs., 535 P.2d 1256 (Utah 1975). For a very rare but widely noted case in which the court effectively denied specific relief against an obnoxious land use by a party with actual notice of the potential harm, see Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 257 N.E.2d 870 (1970). (There was a strong dissent.) The court did grant the plaintiffs damages.

Illustration 19-6. Farmer and Factory are neighbors. Smoke from Factory frequently damages Farmer's crops. Farmer purchased his land after the pollution began, but Farmer claims the pollution has grown increasingly worse. In any event, neither party is able to demonstrate a clear priority of right. Farmer sues for an injunction against the pollution; Factory counterclaims for a judgment declaring that it may continue present levels of pollution.

A court that wishes to prevent nonconsensual loss in this situation may find itself in a quandary. If it enjoins Factory, then Factory suffers loss to which it did not consent. If it grants immunity to Factory, then Farmer suffers loss to which he did not consent. The court may enjoin Factory while conditioning the injunction on Farmer's paying compensatory damages, or it may grant immunity to Factory while conditioning the immunity on Factory's paying damages to Farmer. But if the court does either, it must calculate the amount of damages, which may be difficult to do. If damages are difficult to ascertain but transaction costs[4] are low, the most feasible way of preventing nonconsensual loss may be to grant specific relief protecting the less valuable use and enjoining the more valuable use. The owner of the more valuable use will then buy off the injunction, and the parties will have avoided nonconsensual loss while determining for themselves the amount of the compensation. Thus, if the court decides that the pollution causes less damage to Farmer than enjoining pollution would cause to Factory, the court should enjoin the pollution (temporarily causing the greater loss) in order to induce Factory to purchase the right to pollute, thereby compensating Farmer.

The conclusion that, in absence of agreement to the contrary,[5] specific relief is awarded to the less efficient user is, of

[4]Transaction costs are the costs involved in ordering economic activity through voluntary exchange. R. Posner, Economic Analysis of Law 367 (3d ed. 1986).

[5]This paradigm assumes no agreement to the contrary. The result is a collection of bargain-stimulating default rules — rules to induce the parties to settle their dispute out of court. The origin of the bargain-stimulating default rule seems to be an intuitive judicial recognition of the Coase theorem. On the Coase theorem see R. Posner, supra note 4, at 7, 43–45.

course, counterintuitive. If (one might ask) Factory would suffer "irreparable damage" from stopping the pollution, why deny Factory the immunity it needs while giving specific relief to Farmer, who would suffer less from closing down his operation than would Factory? The answer lies in the conjunction of three factors. First, the court does not wish to leave any nonconsensual harm both unprevented and uncompensated. Second, Farmer's harm is hard for a court to quantify, and therefore is best measured by actual negotiation.[6] Third, if the entitlement were given to Factory unconditionally, Factory would have no incentive to negotiate with Farmer, and Farmer would continue to suffer nonconsensual harm without compensation. Giving the entitlement unconditionally to Farmer encourages Factory to bargain with Farmer to purchase the right to pollute.[7] The result is to further not only the principle of prevention, but the principle of compensation also.[8]

Protecting less valuable uses in order to induce bargaining between the parties is an important way for the courts to prevent uncompensated special losses, particularly when there is a pre-existing relationship between the plaintiff and defendant but no contractual provision governs their rights inter se.[9]

[6]If the harm is quantifiable, the court applies the fourth (bargain-simulating) paradigm: specific relief and compensation.

[7]For example, if the pollution costs Farmer $10,000 per year and enjoining pollution would cost Factory $100,000 per year, Factory can afford to buy off an injunction in favor of Farmer. Farmer could not afford to buy off an injunction in favor of Factory.

[8]On compensation, see §§19.16 through 19.23.

[9]Further examples:

1. Allocation of risk of loss between real estate vendor and vendee: If S has contracted to sell land to P for $100,000, and the house on the land burns down during the executory period, forcing the vendee to take and pay for the property is likely to cause more loss to the vendee than forcing the vendor to forego the price and retain the property. Therefore, before fire insurance became common, the courts developed the rule placing the risk of loss on the vendee. This rule encourages the vendee to bargain with the vendor — the expected result being that the vendor will retain the property in exchange for a portion of the price (which may be the earnest money deposit). If the courts had placed the risk of loss on the vendor, the vendee would have had no motivation to bargain with the vendor in order to mitigate the vendor's loss.

§19.16. THE PRINCIPLE OF COMPENSATION: THE THIRD PARADIGM

The third principle of private law is the principle of compensation. We have seen that in second paradigm cases the court compensates by stimulating bargaining between the parties.[1] In third and fourth paradigms, the court actually awards a sum of money. The third paradigm, reproduced from §19.3, is as follows:

> **Paradigm 3.** A, having assented to conduct,[2] threatens to impose (or already has imposed) nonconsensual *quantifiable loss*[3] on V. The court orders A to compensate V. The amount and nature of the compensation depend on the state of the proofs,[4] but ideally they should simulate the bargain the parties would have reached if they had negotiated before the injury.

Examples of the third paradigm are typical breach of contract and negligent tort cases. Usually the damage already has occurred; since prevention no longer is possible, compensation is the only alternative. This paradigm also covers the case, increasingly rare, in which the court denies preventative relief because the threatened injury is fully reparable in money.

Because most properties are now insured against fire, insurance quantifies and pays for the seller's loss. Therefore, the traditional rule is no longer defensible, and there is a trend away from it. Most commentators, while criticizing the rule, have not identified the original reason for it. See, e.g., R. Cunningham, W. Stoebuck, and D. Whitman, The Law of Property 699 (1984). The rule remains viable in noncasualty contexts. See, e.g., DiDonato v. Reliance Standard Life Ins. Co., 433 Pa. 221, 249 A.2d 327, 39 A.L.R.3d 357 (1969) (risk of loss from zoning change on purchaser).

2. The analogous development in landlord-tenant law. See Albert M. Greenfield & Co. v. Kolea, 475 Pa. 351, 380 A.2d 758.

3. Protection of the less efficient use in land covenant cases. Cobblestone II Homeowners Assn. v. Baird, 545 N.E.2d 1126 (Ind. Ct. App. 1989); Crimmins v. Simonds, 636 P.2d 478 (Utah 1981); University Gardens Property Owners Assn. v. Marrow, 134 N.Y.S.2d 908 (Sup. Ct. Nassau Co. 1954). For other examples, see §19.24.

§19.16. [1]See §19.15.

[2]See §19.9.

[3]This is loss quantifiable in monetary terms. See §19.13.

[4]See §§19.18 through 19.21.

The measurement of compensation to approximate a hypothetical bargain is why this paradigm, together with the fourth, is a *bargain-simulating* paradigm. The manner in which compensation is measured is the subject of later sections.[5]

§19.17. THE PRINCIPLE OF COMPENSATION: THE FOURTH PARADIGM

The fourth paradigm is much less familiar than the third:

> **Paradigm 4.** When nonconsensual loss threatens wherever the court places the entitlement and a judicial decree is the most feasible way of assuring full compensation, the court uses declaratory, specific, and substitutionary relief in an effort to simulate the bargain the parties would have reached if they had negotiated on the matter beforehand.

In cases falling within the fourth paradigm the court finds itself in a dilemma. Whether it bestows the entitlement on the plaintiff or on the defendant, the other party will suffer nonconsensual loss. In this respect, the fourth paradigm is like the second. But in the fourth paradigm, unlike the second, "a judicial decree [must be] the most feasible way of assuring full compensation." This means that judicial determination of the matter is likely to be more effective in protecting the parties than private bargaining. In the usual fourth paradigm case, the injury inflicted on the holder of the less valuable right by specifically protecting the more valuable right is easily quantifiable in money. Occasionally, however, a "judicial decree is the most feasible way of assuring full compensation" because the transaction costs of negotiating an agreement are prohibitive or be-

[5]Id.

cause it is practical to compensate by the award of a thing other than money.

The paradigm further states that "the court uses declaratory, specific, and substitutionary relief." Sometimes the court merely declares the respective rights of the parties, as when it is construing an instrument to cover an unforeseeable situation, that is, a situation not the subject of bargaining and therefore outside the scope of the consent of either party. More often, the court adds to its declaration specific relief (sometimes in the form of immunity) coupled with compensation. An example of this approach may be constructed from Illustration 19-6, already considered in discussing the second paradigm:

> **Illustration 19-6.** Farmer and Factory are neighbors. Smoke from Factory frequently damages Farmer's crops. Farmer purchased his land after the pollution began, but Farmer claims the pollution has grown increasingly worse.[1] In any event, neither party is able to demonstrate a clear priority of right. Farmer sues for an injunction against the pollution; Factory counterclaims for a judgment declaring that it may continue present levels of pollution.

Assume that an entitlement to pollute would be worth $100,000 to Factory and an entitlement to be free of pollution would be worth $10,000 to Farmer. Assume further that the court easily can calculate damages. In applying the compensation principle to the fourth paradigm, a court should grant the entitlement (immunity) to Factory but require Factory to compensate Farmer in the amount of $10,000. If the values of the respective uses are reversed, the court should grant Farmer specific relief (an injunction) but order him to compensate Factory. In either event, the ideal goal of compensation is bargain simulation.

Unlike the Farmer-Factory illustration, most fourth paradigm cases, like most second paradigm cases, arise when the parties have a pre-existing legal relationship but the rights and liabilities at issue are not governed by contract.[2] Like the rules applied in the second paradigm, those in the fourth are *default rules* — those applied in absence of agreement to the contrary.

§19.17. [1]Cf. Michael v. Michael, 461 N.W.2d 335 (Iowa 1990) (nuisance found where plaintiff purchased after defendant, but defendant commenced obnoxious conduct after plaintiff's purchase).

§19.18. MEASURING COMPENSATION

In third and fourth paradigms, either A has inflicted nonconsensual loss on V or the court permits A to do so. The compensation principle mandates that the court then undertake the task of measuring the amount of compensation. Unfortunately, the doctrines of compensation are fragmented into different measures for torts, for breaches of contract, and for unjust enrichment. Moreover, there is no single measure applied in contract, in tort, or in unjust enrichment cases. In the following sections, I propose to elucidate the common principles underlying the fragmented doctrines.

A general theme runs through this material: The courts select remedies primarily for making good nonconsensual loss. That is, courts choose the device best calculated to compensate fully the loss actually proved. Traditional limitations imposed by substantive law play only a subsidiary role. In keeping with this theme, even "punitive" awards are often compensatory in nature — designed to compensate for attorneys' fees or dignitary losses. Furthermore, "restitution of unjust enrichment" is primarily a *compensation* device. In other words, there is no such thing as "restitution of unjust *enrichment*" as an independent basis of liability. Within the realms of traditional contract and tort law, restitution serves as an alternative measure of the plaintiff's *loss*, particularly (but not always) when part of the injury is special loss. Within the interstices between contract law and the traditional torts, restitution serves as a substantive justification for compensating for nonconsensual loss. Argu-

[2]For examples, see infra §19.24.

ably, substantive restitution ought to be considered a branch of tort law.

§19.19. FIRST LEVEL OF COMPENSATION: RESTORING THE PLAINTIFF TO ORIGINAL POSITION (O − A)

There are several devices by which a court measures injury when a plaintiff has suffered nonconsensual loss. The device the court selects seems to be determined more by the practical constraints of proof than by traditional substantive law analysis.

Let us return to Illustration 19-5, reprinted here for reference:

Illustration 19-5. On March 1, B, a tenant on Blackacre, has cash savings of $120,000. On that date, he enters into a contract with S, the landlady, whereby she will sell Blackacre to B for an agreed-on price of $100,000. B gives her a $2,000 deposit and spends $1,000 searching title. Closing of title and full payment of the purchase price are to take place on May 1. On May 1, the market value of Blackacre is $107,000. On that date, S fails to show up at closing and subsequently refuses to convey title.

In this case, the plaintiff has suffered out-of-pocket expenses in the amount of $3,000: a $2,000 deposit and $1,000 for searching title. One may represent these expenses by referring to them as the difference between B's Original Position (designated by "O"), that is, his position immediately before entering the contract, and B's current, or Actual, Position (A). Thus, we can describe B's out-of-pocket expenses using the formula

$$Loss = Original\ Position - Actual\ Position$$

or

$$L = O - A$$

This is a measure of loss available not only in contract cases but also in cases of tort and, as we shall see in a moment, in "restitution" cases. It has the advantage of usually being the easiest for the plaintiff to prove. If, therefore, he is unable to demonstrate his full expectancy, he nearly always can rescind the contract and recover O − A.[1] In Illustration 19-5, because B started out with $120,000, gave $2,000 to S, and spent $1,000 searching title, his measure of loss is shown by the following:

$$L = \$120{,}000 - 117{,}000$$

$$L = \$3{,}000$$

To the extent that B recovers money previously paid to S — the $2,000 deposit — courts and commentators may refer to the process as "restitution"[2] and the basis of recovery as "unjust enrichment." But the real basis of the recovery, I submit, is not unjust enrichment, but the need to compensate the plaintiff for O − A.[3]

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§19.19. [1]E. A. Farnsworth, Contracts 888 (1982). Reliance expenses paid to third parties now are routinely awarded when the plaintiff rescinds. See, e.g., Cherry v. Crispin, 346 Mass. 89, 190 N.E.2d 93 (1963); L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182 (2d Cir. 1949) (Hand, J.) (where expectancy not proved but reliance interest is, contract plaintiff may get reliance damages).

[2]E. A. Farnsworth, Contracts 908 (1982).

[3]I struggled for a long time to try to avoid this conclusion, which seems inescapable. The incoherence of orthodox restitution theory — that unjust enrichment per se justifies restitution — is such that no one has been able to elucidate a convincing definition, or even a convincing set of criteria, for determining when there has been enrichment and when it is deemed "unjust." Is it possible that the spell of the Restatement of Restitution has been such that no one has noticed the emperor has no clothes? On the multiple meanings of "benefit," see 1 G. Palmer, Law of Restitution 44-47 (1978). For an effort at explaining "unjust" in bargain terms, see Levmore, Explaining Restitution, 71 Va. L. Rev. 65, 67 (1985).

In many contract cases, the plaintiff has surrendered to the defendant a specific item rather than money. If the plaintiff was not attempting to sell that item at the time, it may have had special value to the plaintiff. Specific rescission, generally in the name of replevin or constructive trust, may be available to him if there is no other way to make him whole.[4] Alternatively, the plaintiff may sue for the reasonable value of the item given.

If, in reliance on the contract, the plaintiff has performed services for the defendant, return in specie generally is impractical. The court awards substitutionary relief. Courts and scholars frequently characterize such relief as being based on unjust enrichment rather than as loss from Original Position, but the popular characterization is almost certainly wrong. For example, it certainly does not explain the "losing contract" cases that have long perplexed scholars committed to the unjust enrichment theory of restitution. In the typical case,[5] the plaintiff contracts with the defendant to build a dam for the defendant for a price of $350,000. The plaintiff commences work, but the project proves to be a terrible deal for the plaintiff. Costs, which were expected to be only $300,000 (resulting in a $50,000 profit), have risen to $600,000 with the dam only 95 percent complete. The defendant already has paid the plaintiff 94 percent of the consideration. Then, fortunately for the plaintiff, the defendant breaches and refuses to allow him to finish. Instead of asking

When courts award premiums in restitution cases, it usually is to compensate for loss of special value; occasionally, the court uses restitution as an alternative measure of purely punitive damages.

[4]See, however, Cherry v. Crispin, supra note 1, a specific restitution case not involving either replevin or constructive trust. In *Cherry*, the plaintiffs had purchased a home infested with termites. The court allowed the plaintiffs to rescind the contract, return the house, and receive their money back. This was the correct decision, for an award based merely on cost of repairs or diminution in market value would not have fully compensated them, given the special expectations home buyers have for the property they acquire. It is not fully compensatory to force home buyers who justifiably have lost faith in a house to keep the house on payment of only market losses.

[5]The text represents a simplified version of Boomer v. Muir, 24 P.2d 570 (Cal. App. 1933).

the defendant how he can return the favor, the plaintiff sues in quasi-contract for the cost of the work performed, less amounts already paid. The court awards $600,000, less amounts already paid.[6]

Such cases are puzzling to scholars because if plaintiff had completed the project and sued for the price, he would have received only $300,000, less amounts already paid. Under the agreement between the parties that is all the plaintiff would have been entitled to. Moreover, the defendant does not seem to have been enriched by more than $300,000, the value the parties themselves put on the dam. In fact, the plaintiff is allowed to recover $600,000 (less amounts already paid) not because the defendant has been enriched in that amount, but because the court is repairing the plaintiff's *loss* — the difference between the plaintiff's Original Position and his Actual Position. The court can do so because the defendant has disavowed the contract between the parties — the only basis on which the defendant was entitled to this work from the plaintiff — and the plaintiff therefore may proceed in a noncontractual context.[7]

Once we retreat from the attempt to shoehorn losing contract cases into the theory of unjust enrichment, we can see the real problem with the holding of those cases. The real problem is that the court probably should not permit the plaintiff to rescind the contract and thereby trigger substantive restitution — really a species of tort law. Rescission is the proper remedy for *material* breach of contract. Here, the defendant has paid nearly all the consideration and the plaintiff has completed nearly all the work. The court might do better to enforce the agreement between the parties, awarding the plaintiff the portion of the $350,000 the defendant has not already remitted.

Let us now turn to the more traditional tort causes of ac-

[6]If the court awards the reasonable value of the work rather than the amount of expenses, the case may be analyzed as compensating for opportunity losses. Cf. the architect cases, discussed in §19.20.

[7]Cf. Farash v. Sykes Datatronics, 59 N.Y.2d 500, 452 N.E.2d 1245, 465 N.Y.S.2d 917 (1983) (plaintiff may obtain reliance damages when contract within statute of frauds).

tion. A successful claimant theoretically is entitled to (at least) the difference between his Original Position and his Actual Position after the tort. The claimant must prove the loss, however, and in tort cases, quantifying the difference between Original and Actual Positions often is not so easy as it is in contract. Suppose the plaintiff has lost a leg due to the defendant's negligence. The loss is unquestionable and cannot be restored in specie. On the other hand, it also is nonquantifiable, which raises doubts about the adequacy of a money award.

There are two possibilities. The court could order the defendant to perform personal services designed to compensate the plaintiff: an apology, assistance with mobility and medical care, acquisition of prosthetic devices.[8] Or, the court could close its eyes, take a leap, and choose a sum of money for the defendant to pay. Perhaps either the defendant or the market could cure the damage equally well — or equally badly — but the courts award money rather than mandating that the defendant perform services for the victim. This is the correct response. For practical and psychological reasons a tortfeasor probably will not respond as readily to his victim's needs as will the market. A person who has injured another tends to resent the one he has injured, and judicial prodding is likely to exacerbate the resentment. Therefore, even in absence of the Thirteenth Amendment's proscription of involuntary servitude, the courts probably would award damages rather than personal services.[9]

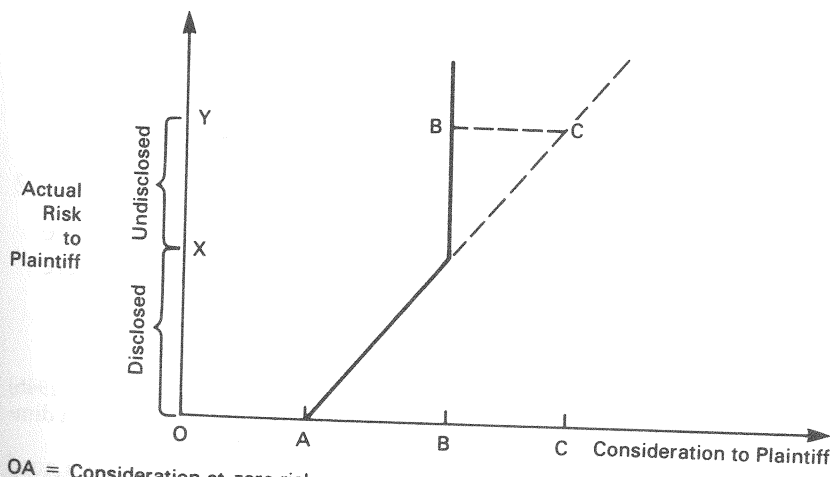
In another kind of tort case the injury not only is unquantifiable, but the fact of unquantifiable injury is hard to prove. This is especially so if the injury is a dignitary one or

[8]A desire to emphasize human "connectedness" (interdependence) has induced some academics to suggest that the tortfeasor should provide the continuing assistance rather than pay the victim a sum from which the victim can resort to the market.

[9]For a discussion of the rule, see E. A. Farnsworth, Contracts 835-836 (1982).

involves the imposition on the plaintiff of an unbargained-for risk,[10] as when the plaintiff is the victim of theft, fraud, breach of fiduciary duty, or violation of a constitutional right. The plaintiff's feelings of outrage and his decrease in security may not be subject to direct proof, but the average judge or juror can be convinced of their existence. The problem then becomes one of attempting a rough compensation for the injury to the extent it exceeds quantifiable loss. Modern courts employ substantive doctrines such as the tort of outrageous conduct to justify compensatory damages. But there are more traditional compensation devices, which are still employed freely. These devices include a constructive trust to give the plaintiff a specific item free of the claims of other creditors,[11] a constructive trust or accounting for profits to award money over

[10]The effect of contract fraud of placing on the victim an unbargained-for risk may be demonstrated by the following graph. The line B-C represents plaintiff's damages should he elect to affirm the contract.



OA = Consideration at zero risk
OB = Actual consideration
OC = Ideal consideration (full disclosure)

[11]Hicks v. Clayton, 67 Cal. App. 3d 251, 136 Cal. Rptr. 512 (1977).

and above the quantifiable loss proved,[12] a higher measure of restitution than appropriate in the absence of dignitary loss,[13] and damages purportedly punitive but actually compensatory.[14]

Thus, in each case, the remedy selected, whether reliance damages, tort damages, punitive damages, or some version of restitution, is the one designed to best bridge the gap between the plaintiff's original and actual positions. Usually, however, the plaintiff can prove some loss in addition to O − A. The second level of compensation is the subject of the next section.

§19.20. SECOND LEVEL OF COMPENSATION: OPPORTUNITY LOSSES (N − O)

The second level of compensation is N − O, the difference between the plaintiff's original position and the position he would have enjoyed but for the defendant's conduct. Return to Illustration 19-5:

Illustration 19-5. On March 1, B, a tenant on Blackacre, has cash savings of $120,000. On that date, he enters into a contract with S, the landlady, whereby S will sell Blackacre to B for an agreed-on price of $100,000. B gives S a $2,000 deposit and spends $1,000 searching title. Closing of title and full payment of the purchase price are to take place on May 1. On May 1, the market value of Blackacre is $107,000. On that date, S fails to show up at closing and subsequently refuses to convey title.

[12] E.g., Snepp v. United States, 444 U.S. 507 (1980).

[13] E.g., Olwell v. Nye & Nissen Co., 26 Wash. 2d 282, 173 P.2d 652 (1946) (restoration of pro rata profits earned by converted machine rather than diminution of value or reasonable rental value).

[14] D. Dobbs, Handbook of the Law of Remedies 205 (1973). For a good example of punitive damages being used to vindicate dignitary loss, see Goldwater v. Ginzburg, 261 F. Supp. 784 (S.D.N.Y. 1966), affd., 414 F.2d 324 (2d Cir. 1969), cert. denied, 396 U.S. 1049 (1970) (punitive damages for intentional libel of Senator Barry Goldwater during presidential campaign).

Assume that B can demonstrate that in contracting with S he turned down an opportunity to acquire another tract that's almost as good for the same price and that as of the agreed-on date of closing that tract was worth $105,000. In this case, B incurred not only out-of-pocket expenses (the $3,000 paid out) but also *opportunity losses*. A plaintiff who can prove opportunity losses as well as out-of-pocket expenses may be able to increase the amount of his recovery. In formulaic terms,

$$\begin{aligned} \textit{Loss} = {} & \textit{Position if there had been no S-B Contract}^{1} \\ & - \textit{Actual Position} \end{aligned}$$

or

$$L = N - A$$

Because B started out with $120,000, the total amount of loss may be divided into out-of-pocket and opportunity costs (adjusting for title expenses) in this way:

$$L = (N - O) + (O - A)$$

Substituting the numbers in Illustration 19-5, we arrive at

$$\begin{aligned} L = {} & [(\$120{,}000 - 100{,}000 - 1{,}000 + 105{,}000) \\ & - (\$120{,}000)] + (\$120{,}000 - 117{,}000) \end{aligned}$$

$$L = \$4{,}000 + \$3{,}000$$

$$L = \$7{,}000$$

Breaking the formula out in this way tells us that B's opportunity losses are $4,000 and his out-of-pocket losses are $3,000.

§19.20. [1] Hereinafter represented by "N."

In contracts scholarship, the total of out-of-pocket expenses and opportunity losses (that is, N − A) is called plaintiff's *reliance interest*.[2] Although this term is inappropriate to tort cases, the courts traditionally measure tort cases by a similar formula: the difference between what the plaintiff's position would have been if the tort had not occurred (N) and the plaintiff's actual position (A). As in contract cases, one may split N − A into two components — opportunity losses, such as income lost after the date of the tort by reason of the tort (N − O), and the difference between the plaintiff's original and actual positions (O − A).

I have already noted that the "losing contract" decisions seem inexplicable when one considers the basis of "restitution" to be unjust enrichment.[3] There is a series of professional service cases that presents analogous problems. The typical fact pattern is that a landowner requests an architect to design plans for a proposed building or other improvement. In anticipation of winning a contract the architect proceeds to draw the plans, but the landowner then changes his mind for reasons that have nothing to do with the architect or the quality of the architect's work. Although there is no contract for the architect to enforce, a number of courts have used a *quantum meruit* standard to permit recovery for the value of the architect's time and work.[4]

Restitution scholars have found such cases difficult because they are not contract cases, they do not fit the usual conception of tort, and because the landowner, having no use for the plans, really is not enriched by the architect's work in any

[2]Fuller and Perdue, The Reliance Interest in Contract Damages, 46 Yale L.J. 52 (1936). For cases involving recovery of contract reliance damages, see Drennan v. Star Paving Co., 51 Cal. 2d 409, 333 P.2d 757 (1958) (Traynor, J.); L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182 (2d Cir. 1949) (Hand, J.).

[3]See §19.19.

[4]See, e.g., Parrish v. Tahtaras, 7 Utah 2d 87, 318 P.2d 642 (1957); Sterling v. Marshall, 54 A.2d 353 (D.C. Mun. Ct. 1947).

but the most trifling respects. But if one applies the consent and compensation principles to certain reasonable assumptions, the problems disappear. Under prevailing custom, an owner approaches an architect to ask the latter to prepare and submit plans for the owner's approval. At this stage, there may not be a contract, but both parties understand that if the owner is dissatisfied with the plans the owner may reject them and ask the architect to draft others or the owner may turn to another architect. Further, it is understood that if the plans are satisfactory the owner will retain the architect, and the latter will supervise the construction of the project. The architect then is paid a generous percentage of the total cost of the improvement.

In these circumstances, the architect is on actual notice of certain risks that the plans will be rejected. The architect understands that rejection may occur because the plans would be too costly to execute, because someone else proposes a more satisfactory scheme, or merely because they are not to the owner's taste. But the architect does not have actual notice of an appreciable risk of highly unusual events, such as the owner's hiring him and then changing his mind for arbitrary or unforeseeable reasons. If one accepts those assumptions,[5] it follows that when the owner cancels because he has changed his mind for arbitrary or unforeseeable reasons the owner imposes nonconsensual loss on the architect[6] and owes the architect compensation.

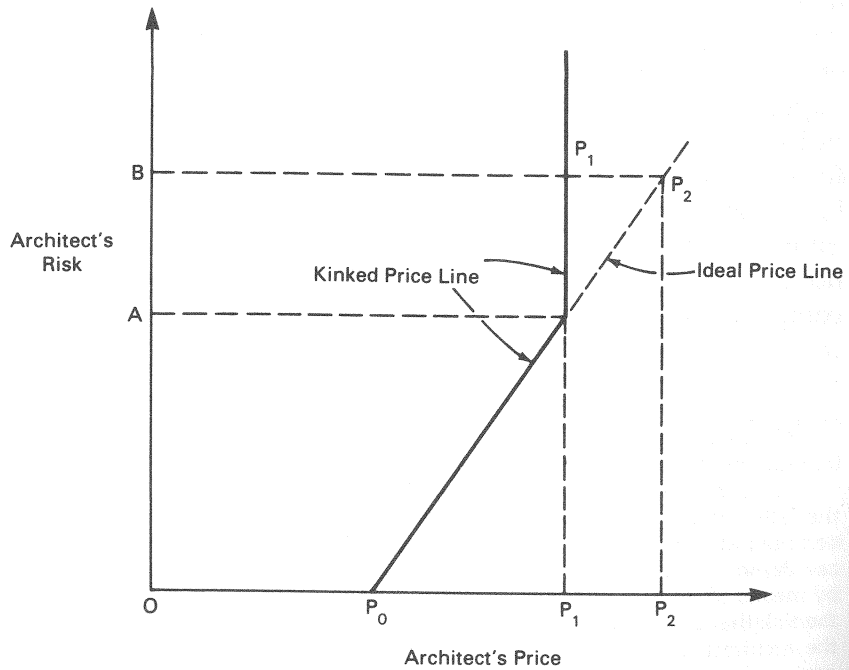
[5]The validity of the assumptions actually depends on local cultural factors not mentioned in the cases.

[6]I.e., the owner denies the architect the implicit consideration for which the latter worked: a particular level of probability that the plans would be accepted and the improvement built under the architect's supervision. One can demonstrate the unbargained-for nature of the architect's additional risk by means of a kinked price curve. On the chart, the quantity O-A represents the risk that the architect would not be employed, but only to the extent that the architect had actual notice of that risk; O-B represents the real risk of nonemployment; P_0 is the architect's received consideration ("price" — not necessarily in money) under conditions of no risk; P_1 is the actual consideration; and P_2 is the "ideal price" — the consideration for which the architect

How is such compensation to be measured? If the architect did not work on other projects because he was occupied in preparing the defendant's plans, then the architect has incurred lost profits — opportunity losses. Assuming the architect would have worked on other projects at the market rate, then the market rate, or *quantum meruit*, is the proper measure of the architect's recovery. This is the measure commonly used in the cases.[7]

Once again, we see the selection of a substantive law theory driven by the extent to which the victim has been able to prove loss. If the victim can demonstrate opportunity losses (N − O), then in contract and traditional tort cases those losses are awarded outright. When nonconsensual loss is inflicted in the interstices between contract and traditional tort causes of

would have performed if he had had notice that the owner might change his mind.



[7]If the product given is in the form of goods rather than services, the analogous measure is *quantum valebat* or *quantum valebant*.

action, the court employs some version of quasi-contract, such as *quantum meruit* or *quantum valebant*, or constructive trust, replevin, or accounting for profits.[8] The choice of remedy depends on which one the court believes is likely to compensate more fully (without, of course, overcompensating).

§19.21. THIRD LEVEL OF COMPENSATION: NET EXPECTANCY IN CONTRACT CASES (E − N)

The full amount of N − A is the cap on damages when there is no enforceable contract. As noted above,[1] however, when parties agree to change the rules between them, they alter the scope of their normal consent to loss. Recall Illustration 19-5, which is reproduced here, together with a lost opportunity.

Illustration 19-5. On March 1, B, a tenant on Blackacre, has cash savings of $120,000. On that date, he enters into a contract with S, the landlady, whereby S will sell Blackacre to B for an agreed-on price of $100,000. B gives S a $2,000 deposit and spends $1,000 searching title. Closing of title and full payment of the purchase price are to take place on May 1. On May 1, the market value of Blackacre is $107,000. On that date, S fails to show up at closing and subsequently refuses to convey title. B can demonstrate that in contracting with S he turned down an opportunity to acquire another tract for the same price and that as of the agreed-on date of closing that tract was worth $105,000.

[8]A related use of restitution theory arises in the context of what economists call "public goods" — products or services that confer benefits on nonpurchasers (free riders) in a way that imposes additional costs on the purchasers. A court may focus on the *benefit* to justify requiring the free riders to pay for the additional *costs* they impose. See, e.g., Island Improvement Assn. v. Ford, 155 N.J. Super. 571, 383 A.2d 133 (App. Div. 1978) (private roads in residential community).

§19.21. [1]See §19.9.

In this case, B agreed to surrender the sum of $100,000 in exchange for Blackacre, and S agreed to surrender Blackacre in exchange for $100,000. When S breached the contract, she, assenting to conduct, imposed nonconsensual loss on B.[2]

In order to compensate for that loss, it is necessary to raise B to the position he would have been in if the contract had been honored — his Expected Position (E). Thus, as every lawyer knows, the formula for contract damages is:

$$Loss = Expected\ Position - Actual\ Position$$

or

$$L = E - A$$

In Illustration 19-5, because E = $107,000 (value of Blackacre) + $19,000 cash and A = $117,000 cash,

$$L = (\$107{,}000 + 19{,}000) - (\$117{,}000)$$

$$L = \$126{,}000 - 117{,}000$$

$$L = \$9{,}000$$

This formula may in turn be expressed as three separate factors: out-of-pocket losses (O − A), opportunity losses (N − O), and what economists call "economic rent" and Professors Fuller and Perdue define as "net expectancy" (E − N)— the extent to which this contract was better than the one passed by:

$$L = (E - N) + (N - O) + (O - A)$$

In Illustration 19-5 as modified by the opportunity loss, net expectancy is $2,000, opportunity loss is $4,000, and out-of-pockets are $3,000. These add up to total damages of $9,000.

As the opportunities lost begin to approach the quality of the opportunity afforded by the breached contract, the net expectancy (E − N) approaches zero, and the reliance interest approaches total expectancy (E − A: gross expectation interest, in the language of Fuller and Perdue). Put another way, the contract measure of damages, E − A, approaches the measure used in noncontract cases, N − A.[3] For example, if the land the plaintiff would have purchased in absence of a contract was worth $106,000 instead of $105,000 at the time of breach, the reliance interest would be $8,000 (instead of $7,000) and the net expectancy would be only $1,000 (instead of $2,000). When opportunities passed by are comparable to those of the contract, the plaintiff's counsel usually has an easier time proving gross expectation interest.

The dependence of remedies on matters of proof may be seen by examining traditional judicial treatment of consequential damages. Consider a variant of Illustration 19-5, wherein during the executory period of his contract with S, B enters into a contract to resell the property to R for $110,000. Courts have been willing to calculate damages based on the fair market value at time of closing — such damages are the "natural consequence" of the defendant's breach[4] — but $3,000 over market value would be considered "consequential" damages, and either would be denied entirely or would require special proof. Distilled to its essence, judicial reluctance to award consequential damages amounts to an insistence that (a) those damages be proved[5] and (b) they be foreseeable to the defendant — that the defendant have actual notice of them in advance.[6] In the absence of actual notice of the results, an actor does not assent to conduct and is not liable for loss imposed.[7]

[2]Id.

[3]E. A. Farnsworth, Contracts 888 (1982).

[4]This is the first rule in Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854).

[5]If the case is one in which the plaintiff is suing for his expectancy, he must prove that he really had the expectancy. A court may elect to apply a tort rather than a contract measure when it considers the expectancy to be unproved. See, e.g., Smith v. Bolles, 132 U.S. 125 (1889) (plaintiff claimed to have expected stock worth $10 per share when his purchase price was $1.50 per share). Cf. Chatlos Systems v. National Cash Register, 670 F.2d 1304 (3d Cir. 1982) (where a majority, but not the dissent, believed that the plaintiff had the large expectancy claimed).

[6]This is the second rule in Hadley v. Baxendale, supra note 4. E. A. Farnsworth, Contracts 874 (1982).

[7]See §19.4.

§19.22. BARGAIN SIMULATION AND BARGAIN STIMULATION

In absence of an enforceable contract establishing an Expected Position, the plaintiff with adequate proof is raised to the position he would have been in if the loss had not been inflicted (N − A).[1] When a court uses money to accomplish this aim it attempts to duplicate the sort of arrangement the parties might have entered into if they had agreed on the matter in advance. A similar process of bargain simulation takes place when a court must construe a written instrument to cover a situation that the parties did not bargain over because they were not the original parties to the instrument (as, for example, a deed earlier in the chain of title) or because they did not foresee the events as they transpired.[2] In effect, the court posits a hypothetical expected position for the plaintiff and then seeks to place the plaintiff in that position. The result of this judicial bargain simulation is the *constructive agreement,* or *hypothetical bargain.*[3]

Perhaps the most explicit example of judicial bargain simulation is the doctrine of quasi-contract, whereby the plaintiff is compensated "as if" (*quasi*) there were a contract. Although the courts usually are not so explicit, one can find many other

§19.22. [1]See §19.20.

[2]Union Pacific R.R. Co. v. El Paso Natural Gas Co., 17 Utah 255, 408 P.2d 910 (1965). See also §10.11 (construction of mineral conveyances).

[3]"Constructive agreement" may be the more accurate — albeit the less colorful — term, for the courts fill in the gaps in donative transfers by a similar method. Thus, in the donative context, the courts construe uncertainties in favor of the donor. This reflects the fact that, had the parties been able to foresee unforeseeable events, the donee still would not have had any bargaining power, so most issues presumably would have been resolved in the grantor's favor.

The term "hypothetical bargain" appears in legal literature, but is of comparatively recent coinage. See, e.g., Levmore, Explaining Restitution, 71 Va. L. Rev. 65, 68-69 (1985); Easterbrook and Fischel, Close Corporations and Agency Costs, 33 Stan. L. Rev. 271, 291 (1986). Judge Easterbrook uses the term to describe arrangements that are wealth-maximizing in the aggregate. Because, however, no party would grant a benefit without receiving what he perceives to be its equal or greater in return, my use of the term is different.

instances in which the courts expressly state the nature of what they are doing.[4]

Not every award of money is a hypothetical bargain; for example, simply returning money the plaintiff paid is not a hypothetical bargain. Similarly, if the plaintiff proves opportunity losses and out-of-pocket expenses and the court awards only out-of-pocket expenses, that is not a hypothetical bargain, for the plaintiff never would have negotiated to give up opportunity costs for nothing. A court arrives at a hypothetical bargain when it fully compensates for every item of proved loss under the formula N − A.

In cases of the third paradigm — where the loss, often irreparable, already has occurred — full realization of the hypothetical bargain is not always practical. It is, however, a useful ideal in such cases. But an important distinction between cases of the second paradigm (specific protection for the less valuable use) from cases of the fourth paradigm (protection for the more efficient use conditioned on payment of compensation) is that for a dispute to be treated in the fourth paradigm, compensation must be complete. If the court cannot make it so — if it cannot realize the ideal of the hypothetical bargain — then in almost every instance the court will treat the case within the second paradigm.[5]

[4]One example is cited at §4.4.3, note 18. For examples in other contexts, see Albert M. Greenfield & Co. v. Kolea, 475 Pa. 351, 380 A.2d 758, 760 (in choosing default rule in landlord-tenant case, "the court is left with the task of determining what the parties would have done had the issue arisen in contract negotiations"); Phillips Petroleum Co. v. Cowden, 241 F.2d 586 (5th Cir. 1957) (measure of damages for wrongful geophysical exploration "should conform fairly closely to the sort of agreement that might actually have been reached by reasonable parties . . ."); Sheldon v. Metro-Goldwyn Pictures Corp., 309 U.S. 390 (1940) (accounting for profits for copyright infringement). See especially Union Pacific R.R. Co. v. El Paso Natural Gas Co., supra note 2:

> In resolving a dispute about the interpretation of provisions in a contract the objective is to determine what the parties intended at the time it was executed; and if the intent with respect to some unforeseen subsequent occurrence is not clearly articulated, what would have been their intent if their minds had adverted to such an occurrence. 408 P.2d at 913.

[5]There is the rare exception where transaction costs would make real bargaining prohibitive. See Boomer v. Atlantic Cement Co., 26 N.Y.2d 219,

§19.23. RULES AND OCCASIONS FOR CONSTRUCTING A HYPOTHETICAL BARGAIN

Each third or fourth paradigm case is a potential candidate for a hypothetical bargain. There are, however, fairly rigid criteria for structuring hypothetical bargains. After determining that such an arrangement is appropriate, a court must ascertain what kind of agreement the parties might have entered if they had dealt with the matter themselves beforehand.[1] In arriving at its determination, the court considers the same kinds of evidence it might consider if it were determining the scope of an actual agreement between the parties: their respective purposes, their actual intent at the time, and so forth. In applying this evidence, the court must abide by both of two rules. First, the court must put itself in the position of the parties *before* the issue arose. For example, if the court is considering how the parties to a contract might have dealt with an unforeseen issue, it must act as the parties would have acted without the benefit of hindsight. Second, if the relation between the parties is not donative, the court must take account of the fact that had they negotiated a resolution of the unforeseen issue, the benefits of the resolution probably would not have been entirely one-sided. Each party would have required that its concessions be matched by compensating concessions by the other side. Thus, considered from the time of contract (or, if appropriate, considered from the time immediately before the issue arose), the court's arrangement must be Pareto-superior.[2] If the damage already has occurred (the usual third paradigm case), the court does its best to achieve this ideal. If the damage has not yet occurred, inability to achieve Pareto-superiority results in the court's

257 N.E.2d 870 (1970). In *Boomer*, 15 plaintiffs owned 8 separate parcels. Yet even in *Boomer*, it appears that most of the loss was quantifiable rather than special. The use of 4 of the parcels is not stated, but all of the remaining 4 were used mainly for the production of income. See the opinions at 72 Misc. 2d 834, 340 N.Y.S.2d 97 (truck repair shop and mobile home sales lot, dairy farm and tenant house, and auto shop) and at 55 Misc. 2d 1053, 287 N.Y.S.2d 112 (unspecified business).

§19.23. [1]See §19.22.

[2]On Pareto-superiority, see §19.24.

treating the case under the second (bargain-stimulating) paradigm. This becomes apparent when one examines cases involving persons with pre-existing legal relationships, the subject of the next section.

§19.24. THE PRE-EXISTING RELATIONSHIP CASES

Many cases involve parties among whom there is some pre-existing relational structure: co-owners of real or personal property, landlord and tenant, vendor and vendee, trustee and beneficiary, members of the same organization, shareholders in the same corporation, or parties to a contract that fails to address the issue at hand. The striking fact about such cases, especially when there already is a governing mechanism that all parties had previously accepted (for example, a corporate board of directors), is judicial insistence on full compensation to V before a court will sanction an action by A. This is true even if V represents a small minority of the entire group. Thus, if the harm can continue into the future and compensation is impractical, the courts treat the matter as a second paradigm case — which is to say they protect the lesser right in the hope of stimulating bargaining. If compensation is practical, the courts treat the matter as a fourth paradigm case — protection of the greater right, conditional on full compensation for the lesser.

In economic terms, the courts do not sustain group actions *even when they are unquestionably efficient*[1] unless they are Pareto-superior.[2]

§19.24. [1]An action is *efficient* for a certain group of people if it increases net economic value. Despite the difficulty of expressing some values in economic terms, most legal writers use the word "efficient" to mean much the same as the philosophical term "utilitarian" — that is, increasing net happiness more than decreasing it.

[2] An action is Pareto-superior for a particular group if after the action at least one person is better off and no person is worse off. To illustrate, imagine a society of three people (A, V-1, and V-2) in which each person has a net worth of $100. Assume that A undertakes an action that increases his own net worth to $150 and increases the net worth of V-1 to $120 but decreases the net worth of V-2 to $90. Assuming no unexpected consequences, the action is "efficient" with respect to this society because it has increased overall net worth from $300 to $360. But it is not Pareto-superior because it re-

Many illustrations of this judicial predisposition may be drawn from the law of conveyancing, and some of these are examined in this book.[3] Following are several other examples:

1. If the trustee of a private trust manages property for a life beneficiary and a remainderman, the trustee may not invest in a way that disproportionately harms one beneficiary, even though the net result is good for the trust as a whole. If the trustee wishes to retain the investment, he must compensate the losing beneficiary from the gains of the winner. Thus, when a trustee purchases a wasting asset with a high current income and little future principal, some of the income must be "amortized," or allocated to the remainderman.[4]

2. In close corporation cases the courts authorize dissolution for "oppression" of the minority where majority conduct, even if reasonable for the entity as a whole, defeats the minority's reasonable expectations.[5] But if the minority's loss is quantifiable and those in control can compensate for it, the corporation need not be dissolved.[6]

3. In cases involving mutual benefit societies and cooperatives, the courts refuse to enforce bylaw amendments against members who joined previous to the amendments if such members would suffer disproportionate loss by reason of the change — even where the members had agreed at the time of joining that they would be bound by future changes.[7]

4. Under the "changed conditions" doctrine applied to covenants that run with the land, old servitudes survive even if it would be economically efficient to remove them. They are invalidated only if the dominant estate no longer enjoys any benefit (other than nuisance value) from them.[8]

duces V-2's wealth from $100 to $90, thereby leaving him worse off. The action can be made Pareto-superior if compensation for V-2's loss is built into it. If as part of the measure A and V-1 each give V-2 $5, A and V-1 still are better off (having $145 and $115, respectively), and V-2 is no worse off. Compensation has rendered an efficient action both efficient *and* Pareto-superior.

"Unexpected consequences" may include bitterness and demoralization of V-2 that may outweigh the monetary gains of the action unless V-2 is compensated. Professor Michelman uses the phrase "critical demoralization" to define a situation in which such demoralization exceeds the "settlement cost" (administrative cost) of compensating V-2. See Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1214 (1967).

It is clear that any truly efficient action can be rendered Pareto-superior through the compensation device, unless the costs of compensation are unusually high. Obversely, if A and V-1 do not have enough gains to be able to compensate V-2, then, although the action may have benefited A and V-1, it really wasn't efficient and never should have been undertaken. For example, if an action benefits A and V-1 $20 each but costs V-2 $50, the action is not efficient. Net losses ($50) exceed net gains ($40). "Thus, it would appear that any measure which society cannot afford or, putting it another way, is unwilling to finance under conditions of full compensation, society cannot afford at all." Michelman, supra, at 1181. Compare San Diego Gas & Elec. Co. v. City of San Diego, 450 U.S. 621, 621 n.26 (1981) (Brennan, J. dissenting).

Efficiency is sometimes called *potential Pareto-superiority*.

[3]E.g., §10.11 (construction of "other minerals").

[4]3A A. Scott, The Law of Trusts 184 (4th ed. 1988) (W. Fratcher ed.); cf. id. at 211 (allocating part of the sale price of property not producing income to life beneficiary).

[5]Matter of Kemp & Beatley, Inc., 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984); Meiselman v. Meiselman, 309 N.C. 279, 307 S.E.2d 551 (1983). Cf. the statutory right of "appraisal" in business corporations, where the dissenting shareholder has the right to be bought out if he disapproves of certain extraordinary corporate actions. H. Henn and J. Alexander, Laws of Corporations 997-1010 (1983); R. Clark, Corporate Law 443-461 (1986).

An example in a quasi-public context is the monopolist's traditional "duty to serve." When the sovereign grants to an entity the exclusive right to provide a good or service (thereby foreclosing consumer choice by government coercion), the good or service must be delivered in a fair and nondiscriminatory manner irrespective of considerations of efficiency maximization. On the duty to serve, see generally C. Haar and D. Fessler, The Wrong Side of the Tracks (1986). For a survey of the cases and literature on the subject, see C. Haar and M. Wolf, Land Use Planning 660-673 (1989).

[6]See, e.g., Maddox v. Norman, 206 Mont. 1, 669 P.2d 230 (1983), appeal after remand, 215 Mont. 458, 697 P.2d 1368 (1985) (court sought to force bargaining when lack of market for minority's shares suggested loss was not quantifiable; later, when there was a previous transaction to serve as a price "floor," court simulated bargain).

[7]See, e.g., Lambert v. Fishermen's Dock Coop., 61 N.J. 596, 297 A.2d 566 (1972); Whitney v. Farmers' Co-op. Grain Co., 110 Neb. 157, 193 N.W. 103 (1923). See also Annot., 61 A.L.R.3d 976 (1975).

[8]Riley v. Stoves, 22 Ariz. App. 223, 526 P.2d 747 (1974); Western Land Co. v. Truskolaski, 88 Nev. 200, 495 P.2d 624 (1972). See also Lakemoor Community Club v. Swanson, 24 Wash. App. 10, 600 P.2d 1022 (1979) (developer could not exercise reserved power to alter the covenants so as to impair lot purchasers' contract expectancies, even though lot owner had notice of reservation); Petersen v. Beekmere, Inc., 117 N.J. Super. 155, 283 A.2d 911 (Ch.

Mineral law provides many illustrative cases, often involving conflicts between landowners and the owners of mineral interests. The usual scenario is that a consensual agreement — such as a mineral deed or oil and gas lease — governs the broad outlines of the parties' relationship, but the parties have never agreed on important details. The judicial resolution is either to immunize the threatened party completely (when loss would be nonquantifiable, which is seldom the case in mineral disputes) or to simulate a bargain to fill the gap in the parties' real agreement. Thus:

5. The courts regulate the relationship between the owners of minerals and the holder of the executive right to ensure that the holder of the executive right makes only decisions that are Pareto-superior.[9]

6. The courts regulate the relationship between mineral lessor and lessee, to the extent not governed by actual agreement,[10] by the imposition of implied covenants.[11] These implied covenants define the duties of the lessee to explore and drill, but only in such a way that neither party suffers nonconsensual loss.[12]

7. The courts simulate bargains to deal with the uncertainty caused by "other minerals" clauses of deeds and leases. For many years the courts did this with specific relief, but more recently they have turned to monetary compensation devices to ensure Pareto-superiority. Thus, the Texas Supreme Court,

Div. 1971) (disallowing burden of assessment where it would impose a disproportionate burden on some owners in violation of contract expectancies).

[9]Thus, the right to lease the mineral interest of another cannot be exercised "so as to obtain benefits for O that would not also be shared by A." R. Hemingway, The Law of Oil and Gas 48 (1983). See also Manges v. Guerra, 673 S.W.2d 180 (Tex. 1984).

[10]Eastern Oil Co. v. Beatty, 71 Okla. 275, 177 P. 104 (1918) (no implied development covenant where parties have agreed on delay rentals as substitute).

[11]Cf. the application of implied covenants in other incomplete contracts. Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 118 N.E. 214 (1917) (Cardozo, J.) (implied promise to use best efforts).

[12]E.g., Superior Oil Co. v. Devon Corp., 604 F.2d 1023 (8th Cir. 1979) (drilling required to fulfill expectations of lessor, but only if there is a reasonable expectation of profit for lessee).

the leading tribunal in oil and gas law, now permits the mineral owner to extract most minerals under an "other minerals" clause conditioned on the payment of compensation to the affected landowner.[13]

Further illustrations of the Pareto-superiority rule arise in cases involving property owners associations — associations governing condominiums, residential subdivisions, and similar entities. For example:

8. Pursuant to the consent principle, a person buying into a land subdivision is bound by existing covenants if on actual notice of them. If, however, the content of the existing restrictions was not readily available, or if the association imposes new rules, the courts review the rules under a Pareto-superiority standard called "reasonableness." If a new or obscure regulation disadvantages any existing unit owner disproportionately, it is not enforced against that owner unless full compensation is provided.[14] If the loss to be compensated is difficult to quantify because it is of a personal nature (e.g., a rule against pets or children), the rule is not enforced against current owners but is struck down as "retroactive" or "discriminatory" as to those owners. In other words, the case is treated under the second paradigm and current owners are immune.[15]

[13]See §10.11. For other examples of imposition of a hypothetical bargain in mineral law, see R. Hemingway, The Law of Oil and Gas 186-188 (1983); Phillips Petroleum Co. v. Cowden, 241 F.2d 586 (5th Cir. 1957); Prairie Oil & Gas Co. v. Allen, 2 F.2d 566 (8th Cir. 1924) (nonconsenting co-owner of fugitive minerals cannot prevent other co-owners from developing, but must be compensated).

[14]See generally Natelson, Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association, 51 Ohio St. L.J. 41, 85-87 (1990). See also Grey v. Coastal States Holding Co., 22 Conn. App. 497, 578 A.2d 1080, cert. denied, 216 Conn. 817, 580 A.2d 57 (1990); Schaumburg State Bank v. Bank of Wheaton, 197 Ill. App. 3d 713, 555 N.E.2d 48 (1990) (pursuant to amendment in condominium declaration in *business* condominium, association granted easement to third party in return for easement over other property; plaintiff unit owner opposed grant, claiming diminution in value of unit; relief denied, since there was no diminution in fair market value of unit).

[15]See generally Natelson, Consent, Coercion, and "Reasonableness" in Private Law: The Special Case of the Property Owners Association, 51 Ohio St. L.J. 41, 85-87 (1990). See also Lyman v. Boonin, 397 Pa. Super. 542, 580

§19.25. CONCLUSION: ROLES OF EFFICIENCY AND POLICY IN PRIVATE LAW

The previous section examined the courts' treatment of disputes involving persons in pre-existing legal relationships. The conclusion was that in such disputes, as in other private law cases, the courts are true to the principles of consent, prevention, and compensation. The implication was that the courts judge cases on a standard of Pareto-superiority — refusing to impose nonconsensual loss, even to further societal goals of efficiency and public policy.

This should be a controversial conclusion, for it has long been the fashion to explain private law cases from a public policy standpoint. However, several additional facts suggest that in such cases "social welfare" takes a back seat to individual justice, and, indeed, may not be on the same bus.

First, it is difficult to find private law cases in which individual interests are, without prior consent, sacrificed for the benefit of a group or for the benefit of society at large.[1] If public policy considerations did heavily shape private law, then we should encounter many such cases.

Second, although law-and-economics scholars have observed that most legal rules are socially efficient, efficiency is not the *reason* for such rules. The rules are efficient because they are designed to enforce, stimulate, or simulate consent, and most people act in wealth-maximizing ways (at least in microcosm). In other words, an efficient legal system is the *by-product* of respect for free choice and individual autonomy.

A.2d 765 (1990) and McIntyre v. Zara, 394 S.E.2d 897 (W. Va. 1990) (phrase "subject to future restrictions" subject to reasonableness review; if V sought rescission, he was entitled to return of reliance interest in form of value of improvements).

§19.25. [1]Most involve old rules of property imposed for policy purposes, such as the rule that "heirs" be mentioned in a deed to convey a fee simple, the doctrine of destructibility of contingent remainders, and the rule against unreasonable restraints on alienation. Many of these cases are explainable on other grounds, however, and most of the old doctrines have been abandoned. See Chapter 9.

Nevertheless, as we have seen, when efficiency collides with autonomy, autonomy prevails.

Third, the thesis that justice, not policy, is what matters squares well with the experience of practitioners of private law. Although policy arguments are regular fare in law schools (often advanced by professors with little practice background themselves), such arguments are rarely invoked in the day-to-day practice of private law. Indeed, the clever litigator may detect in his opponent's policy argument the signs of a younger lawyer's inexperience or an older lawyer's desperation.[2]

Fourth, despite some well-publicized exceptions, I believe most judges believe doing justice between the parties is a hard enough job without attempting to divine the wisest course for the public weal. In *Hobbs v. Massasoit Whip Co.*,[3] discussed in §19.10 and §19.11, the court ruled for a fisherman over a whip factory. A policy scholar might argue that the decision furthered public policy by encouraging whip factories to be more careful and by protecting fishermen from economic harm. One might as well argue for the opposite result, however, on the ground that a holding for the factory would encourage fishermen to be more careful and would protect from economic harm people who work in and invest in factories. Unless the macroeconomic facts are unusually clear-cut or the court is privy to extensive empirical data, a choice between these two visions of the public good will be arbitrary. Usually the facts are not so clear-cut and the empirical data are not available. Rather than act arbitrarily, therefore, most judges limit their attention to the dispute before them.

A fifth reason for concluding that the determinative effect of policy in private law cases has been exaggerated is that even when courts, influenced by six decades of "legal realism," pur-

[2]Hence the expression, "When the facts are against you, argue the law; when the law is against you, argue the facts; when they're both against you, argue policy." A common variant of the third alternative is "abuse the witness."

[3]158 Mass. 194, 33 N.E. 495 (1893).

port to rely on public policy,[4] their policy discussion usually does not provide the rule of decision. Either the policy language is dictum, or it serves an evidentiary purpose. For example, the social importance of a fact casts light on whether the parties had an agreement and, if so, what the scope of that agreement was. Thus, a court may hold a boilerplate clause in a consumer contract to be unconscionable because it was written in tiny type or its terms are technical or unexpected; usually, however, the *determinative* fact is that the consumer did not consent to it.[5] Similarly, the warranty of habitability in apartments and new homes, sometimes said to be a creature of policy,[6] is better justified as a reflection of inferred understanding. The doctrine of adverse possession has been said to reflect society's interest in clear titles and in the full use of land,[7] but if so, that doctrine is an erratic way of furthering such policies. Actually, the doctrine of adverse possession has assumed its present form because it reflects the concepts of estoppel and consensual abandonment.[8]

Another evidentiary use of judicial "public policy" discussions is to respond to testimony that seems perjured or clearly mistaken.[9] If in *Hobbs v. Massasoit Whip Co.* the factory manager

[4]Not surprisingly, these opinions are found in law school casebooks in disproportionate numbers. For a more primitive, and more honest, view, see Bodcaw Lumber Co. v. Goode, 160 Ark. 48, 254 S.W. 345 (1923) (rejecting litigants' attempt to inject public policy in a private law dispute).

[5]See Dunham, Merger by Deed — Was It Ever Automatic?, 10 Ga. L. Rev. 419, 439 (1976): In discussing why boilerplate warranty disclaimers in contracts yield to specific stated warranties, the author states, "[T]his is not because of 'consumerism,' 'contracts of adhesion,' 'disparity of bargaining position,' 'unconscionability,' or . . . because the buyer fits the category of a 'protected party.' The problem is really one of determining what the parties were bargaining about. . . ." Id. See §19.6 for a discussion of boilerplate language in written contracts.

[6]E.g., Green v. Superior Court, 10 Cal. 3d 616, 517 P.2d 1168, 111 Cal. Rptr. 704 (1974).

[7]Cf. Ballantine, Title by Adverse Possession, 32 Harvard L. Rev. 135 (1918).

[8]See §19.10 and §19.11.

[9]Other purposes include (1) dealing with parties who attempted to mislead others, §19.11, (2) assisting in the structuring of hypothetical bargains, §19.24, and (3) justifying punitive awards not supportable on compensatory grounds. The third is the only true public policy usage.

testified that he did not assent to acceptance by silence, the testimony probably was mistaken or perjured. If the testimony was true, then allowing it to control would enable the factory to mislead the fisherman. Although the *Hobbs* court did not adopt a policy approach, it could have dealt with the factory manager's testimony without calling him a liar or a fraudfeasor by assuming him to be honest while declaring some "public policy" as decisive. Not only is this result legitimizing to the loser; it may also avoid conflict with the trial judge's findings of fact. Of course, the winner doesn't care how he won.

When consent is not present, the court must proceed in a bargain-simulating or bargain-stimulating direction.[10] The social value of a resource may cast light on the direction the court ought to take and, if it chooses to simulate a bargain, how to structure the decree. In *Humble Oil & Gas Refining Co. v. West*,[11] the court stated that it was good public policy for a gas reservoir near Houston to be used for gas storage. The practical effect of the statement, however, was to demonstrate that gas storage was the use most valuable to the parties and the use that would have been agreed to had the parties reached a successful bargain. The court simulated such a bargain by protecting this use contingent on compensation for the loser.

A futher function of judicial policy discussions is to justify a high restitutionary and punitive award not to deter or vindicate the public interest, but to assure that the total award is not undercompensatory.[12]

Another academic fashion is to assert that all law is political. However, if one uses the term "political" in its usual sense — the promotion of political aims, the control of individuals in accordance with the "common interest," and the operation of the policymaking and policy enforcement arms of the state —

[10]See §§19.15 through 19.24.

[11]508 S.W.2d 812 (Tex. 1974) (purporting to employ public policy considerations in structuring mutually beneficial hypothetical bargain).

[12]See §§19.18 through 19.20.

then American private law judging is an essentially *nonpolitical* process. Instead, it is a process in which conscientious government agents respect the private ordering of affairs: a remarkable, and ultimately heroic, feat of self-restraint.

Table of Cases

References are to sections.