CONTRACTUAL FREEDOM, CONTRACTUAL JUSTICE, AND CONTRACT LAW (THEORY)

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I
INTRODUCTION

The current symposium, "The Public Dimension of Contract," has been gathered under the promising subheading of "legal theories in dialogue." It thus might be useful to begin with a few remarks about my general approach to the "theory of private law," which informs the questions and answers provided in this article. The theoretical project to which the article is committed is neither sociological, cultural, nor economic. It is philosophical. As a philosophical project, its first aim is *to understand*, in the sense of hermeneutical understanding. Generally speaking, such hermeneutical understanding has its focus on concepts with which we are dealing every day in an unproblematic way, but which become puzzling if we try to make them explicit.[1] Time is the famous example of such an apparently unproblematic concept; truth and justice are others. Contract is a concept of the same sort. One eminent task of the theory of private law is to illuminate this concept, to help us understand what a contract is and why contract law is therefore the way it is. The focus of such a project of illumination is certainly not on this or that particular contract rule or on this or that area of contracting; its focus is on the basic structure of contract.[2] In short, this article is directed at better understanding the basic structure of contract law.

Of course, there are not only other projects in private law theory—for example sociological, cultural, and economics projects—but also alternative philosophical projects, most notably projects of critique or deconstruction.[3] However, these projects presuppose an understanding of what is submitted to

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1. *See* LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS 46–47 (P.M.S. Hacker & Joachim Schulte eds. & trans., 4th ed. 2009). For the particular case of jurisprudence, see Michael Oakeshott, *The Concept of a Philosophical Jurisprudence*, 3 POLITICA 203, 346 (1938).

2. Or "form," as Ernest Weinrib says. *See* ERNEST WEINRIB, THE IDEA OF PRIVATE LAW 25 (1995).

3. For critical projects, see EVGENY B. PASHUKANIS, THE GENERAL THEORY OF LAW AND MARXISM (Barbara Einhorn trans., 2001) and MAX HORKHEIMER & THEODOR W. ADORNO, DIALECTIC OF ENLIGHTENMENT (Edmund Jephcott trans., 2007). For deconstructive projects, see Jacques Derrida, *Force de Loi: "Fondement Mystique de l'Autorité,"* 11 CARDOZO L. REV. 920 (1990).

critique or deconstruction. Any philosophical theory, including critical or deconstructivist theories, must start (and actually does, though sometimes implicitly) first and foremost with an understanding of contract law—with an idea of what a contract is and why contract law is therefore the way it is.

It might be helpful to present a contrasting example to the philosophical approach taken here. Law and economics provides such an example. Law and economics scholars usually seem to claim that they are able to explain the basic structure of private law in general and of contract law in particular.[4] One eminent puzzle for contract law theory in general is why contract law, all over the world, usually gives expectation remedies—either specific performance or expectation damages—instead of reliance damages in case of breach of contract.[5] Hence a theory which claims to illuminate basic features of contract law must solve this puzzle.

The law and economics approach is well known for its "efficient breach" of contract theory.[6] The theory says that remedies for breach of contract must be designed in a way to make sure that contracts are only breached if breach is efficient. And this is meant to explain the award of expectation damages, as reliance damages would allow for inefficient breach. Only expectation damages secure that the promisor will breach only for a better bargain, that is, to vend an item for a higher price. Only a better bargain makes the promisor still better off, even though he pays expectation damages to the promisee. The award of reliance damages, in contrast, would invite breach for bargains which are not better but worse, in particular in the case of a promise not relied upon. The problem with this account is that it is over-inclusive. The account based on "efficient breach" is over-inclusive because it explains too much. Let us take it for granted that it would explain expectation remedies. But the same argument would hold that conversion should be treated just the same way as breach of contract.[7] If the original promisor happens to find a better bargain, but after the execution of the contract including transfer of property, he may convert and keep the surplus from the better bargain, if he repays the original purchasing price. The problem is, however, that the law does not comply. In the case of breach, the breaching party is allowed to keep the gain that exceeds expectation damages; in conversion, the converting party has to confer the whole bargain to the former proprietor.

If law and economics cannot explain this difference, it has not explained expectation remedies. And given that law and economics is unable to explain expectation damages, it is doubtful that it will be able to provide insight into

4. *See, e.g.*, Richard A. Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281 (1979); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

5. L. L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 57–66 (1936).

6. For an authoritative statement, see RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 151 (8th ed. 2011).

7. *See* Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 4–6 (1989).

any other element of the basic structure of contract law. Therefore, for the purpose of a theory of private law as a hermeneutical enterprise, law and economics is not a very promising candidate.

Against this methodological background, it is the aim of this article to illuminate, in the sense just described, the relation between contractual freedom and contractual justice. The claim is, in a nutshell, that contract law requires that contractual freedom be exercised in line with the rule of contractual justice.

Conceptual restriction of contractual freedom was and still is also the aim of other approaches to contract law, which may be labelled "social" or "mixed." Section II will briefly explain why these approaches fail as hermeneutical projects. Section III, then, will show that contract law does not confer boundless freedom to enter into any contract. Instead, each and every contract is, by law, subject to the rule of contractual justice, which includes the idea of a fair price. Usually, scholars are puzzled to hear about the idea of a fair price and wonder how it can be determined. For this reason, section IV explains why the law takes the competitive market price to be fair: it is an instance of common usage that is also more generally a source to determine what is required by contractual justice.

II
LIBERAL, SOCIAL, AND MIXED UNDERSTANDINGS OF CONTRACT LAW

The social approach to understanding contract law was motivated by the ever-growing body of contract rules that placed limits on the freedom of contracting, mostly to prevent a stronger party from exploiting a weaker party.[8] From the social approach's perspective, the traditional liberal approach had proved incapable of coping conceptually with these developments. It had proven incapable of integrating them into its illumination of the basic structure of contract law. The liberal approach combines individual autonomy and corrective justice as the two general principles of contract law which illuminate its structure and its basic rules. The eminent example is still Charles Fried's *Contract as Promise* from 1981.[9] To characterize the idea in a nutshell,[10] contracting means exercising one's freedom, and the law, generally made to enable and to protect human freedom, makes such exercises effective. That is why contractual autonomy is at the core of this understanding of contract law. Moreover, if contracts are concluded, legal consequences of delayed performance, mal-performance, or nonperformance are governed by the principle of corrective justice. This means, generally speaking, a party who

8. *See* FRANZ WIEACKER, PRIVATRECHTSGESCHICHTE DER NEUZEIT UNTER BESONDERER BERÜCKSICHTIGUNG DER DEUTSCHEN ENTWICKLUNG 539–43 (2d ed. 1967). For a detailed account in German law, see Claus-Wilhelm Canaris, *Wandlungen des Schuldvertragsrechts—Tendenzen zu seiner "Materialisierung,"* 200 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 273 (2000). *See also* PATRICK S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 729–64 (1979).

9. *See* CHARLES FRIED, CONTRACT AS PROMISE (1981).

10. *See id.* at 7–13.

wrongs the other party has to compensate the loss resulting from the wrong. This general principle is, of course, elaborated in a manifold of rules for different types of contracts and different types of wrongs.

Originally, scholars attempted to articulate the counter position of the social justice approach as a full alternative. The most prominent attempt was made by Anthony Kronman in 1980.[11] He argued that contract law is one viable tool to achieve distributive justice, just as tax law is. However, Kronman's attempt failed very early in the logic of his argument, mainly because he did not manage to articulate an idea of distributive justice at all.[12] Instead, Kronman's yardstick is wealth, though not in the sense of general welfare, but in the sense of each and every individual's wealth.[13] In the upshot, Kronman's shortcomings are similar to those of law and economics.[14]

Today, the social justice approach presents itself usually not as a full alternative, but as a complementary correction of the liberal approach.[15] Although it is accepted as indispensable for some features of contract law, the liberal approach, with its two principles, is considered too narrow to cover all relevant parts of contract law. It is also criticized as too narrow from a normative point of view, as it is interested only in the formal freedom of property owners and contractors, not in the substantive freedom of human beings, which depends in large part on notions of distributive justice in judicial holdings.

The social approach today thus leads to a picture where contract law rules cannot be illuminated from a single perspective, either liberal or social. Instead, contract law rules can only be understood as emanating from a concurring influence of both approaches. It is a version of a mixed approach to contract law. Most contract law theorists today subscribe to some version of a mixed approach.[16]

Usually, mixed approaches claim that most rules of contract law are to be understood as being derived from concurring and logically independent principles. However, it seems very much unlikely that the law-generative

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11. *See* Anthony T. Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472 (1980). For a recent defense, see Daphne Lewinsohn-Zamir, *In Defense of Redistribution Through Private Law*, 91 MINN. L. REV. 326 (2006).

12. The argument is from Tugendhat and was directed to Rawls. *See* ERNST TUGENDHAT, VORLESUNGEN ÜBER ETHIK 385 (1993).

13. *See* Kronman, *supra* note 12, at 481–91.

14. For a detailed criticism, see Peter Benson, *Abstract Right and the Possibility of a Nondistributive Conception of Contract: Hegel and Contemporary Contract Theory*, 10 CARDOZO L. REV. 1077, 1119–47 (1989).

15. Thomas Wilhelmsson, *Questions for a Critical Contract Law—And a Contradictory Answer: Contract as Social Cooperation*, *in* PERSPECTIVES OF CRITICAL CONTRACT LAW 9, 30–34 (Thomas Wilhelmsson ed., 1993); BRIGITTA LURGER, GRUNDFRAGEN DER VEREINHEITLICHUNG DES VERTRAGSRECHTS IN DER EUROPÄISCHEN UNION 457–69 (2002).

16. Eminent examples are Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989); Melvin Eisenberg, *The Theory of Contracts*, *in* THE THEORY OF CONTRACT LAW 206 (Peter Benson ed., 2001); and WILLIAM LUCY, PHILOSOPHY OF PRIVATE LAW (2007).

cooperation of different principles can be depicted other than by invoking an idea of juridical balancing,[17] or, in the language of Critical Legal Studies, an idea of contestation.[18] If it is indeed true, as is supposed here, that there is functional equivalence of balancing and contestation, then a mixed approach cannot be a viable version of, but rather an alternative to, the enterprise of understanding the basic structure of contract law. It is the alternative to which we must indeed turn if—but only if—the attempt to understand the basic structure of contract law definitely fails.

As discussed above, one motive for the elaboration of the social (and mixed) approach was and still is the ever-growing body of restrictions on contractual freedom, made for the most part in order to protect a weaker party from unfair contracts. Therefore, if an attempt at understanding is to avoid the idea of balancing and contestation, it must reconcile the idea of contractual freedom and contractual justice in a way that, on the one hand, represents a coherent understanding of the basic structure of contract law and, on the other hand, illuminates contract law in its modern version.

III
CONTRACTUAL JUSTICE AND CONTRACTUAL FREEDOM

A. Three Options

There are three conceptual ways to reconcile contractual freedom and justice.[19] The first option, which has been the view of Werner Flume,[20] a German scholar of highest authority in private law, can be called the procedural understanding of contractual freedom. According to the procedural understanding, the concept of fairness does not apply to the substance of a contract. It can only apply to the procedure of contracting. Whatever the outcome of a fair procedure of contract formation, we will not be able to judge the contract upon the substantive fairness of its terms.[21] The fair procedure of contract formation is then represented as contractual freedom, that is, the freedom to choose the other party, the subject matter, the consideration due, and the other terms of a contract. As a procedural principle of justice in

17. *See, e.g.*, Eisenberg, *supra* note 16, 243–44. For the alternative attempt of a "ranking" of values, see LUCY, *supra* note 16, at 382–87, 401–03.

18. *See generally* DUNCAN KENNEDY, *A Left Phenomenological Alternative to the Hart/Kelsen Theory of Legal Interpretation*, *in* LEGAL REASONING: COLLECTED ESSAYS 153 (Gianni Vattimo & Santiago Zabala eds., 2008); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976); Roberto Mangabeira Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 625–33 (1983).

19. *See* Hugh Collins, *Distributive Justice Through Contracts*, 45 CURRENT LEGAL PROBS. 49, 58–63 (1992).

20. *See* WERNER FLUME, ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS: ZWEITER BAND: DAS RECHTSGESCHÄFT (4th ed. 1992).

21. *Id.* at 8; *see also* Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975) (taking a similar position as Flume).

contract formation, contractual freedom includes not only voluntariness of each party's consent, but also, arguably, equal bargaining power.[22]

The second option might be called the instrumental understanding of contractual freedom. According to this view, which is held by Karl Larenz, a German scholar of similar high standing as Flume, contractual freedom is an exceptionally reliable tool for reaching fair terms in contractual exchange.[23] Also in this version, contractual freedom includes the idea of equal bargaining power.[24] In contrast to the procedural understanding, the instrumental understanding does not deny the conceptual possibility that the substance of a contract can be judged with regard to its fairness. However, the law refrains from correcting the substantive unfairness of a contract if the favorable procedural conditions—that is, contractual freedom including equal bargaining power—are met.[25]

The alternative to both of these options is that contractual freedom only allows for the conclusion of fair contracts. Contractual freedom does not cover unfair contracts. There is no tension between the two concepts of contractual freedom and contractual justice because contractual freedom can only be exercised in voluntary agreements with fair terms. Unfair contracts cannot be claimed valid by appealing to contractual freedom.

This alternative has been developed by James Gordley[26] on Aristotelian grounds and by Peter Benson[27] on Hegelian grounds. However, their philosophical arguments will not be explored here. Instead this article will ask which of the three conceptual options best reflects the law of contracts. The argument presented here will be developed with reference to German jurisdiction, while complementary references to the common law will be given in the annotations.

B. Contractual Justice in Contract Law

First, the rule of contractual justice regarding auxiliary terms will be discussed, followed by its role regarding the more difficult issue of the just price. Terminologically, however, it should be noted at this point that, in what follows, "fairness" is taken to express nothing different from "justice."

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22. FLUME, *supra* note 20, at 10. Epstein, however, rejects this defense. *See* Epstein, *supra* note 21, at 297.

23. *See* KARL LARENZ, LEHRBUCH DES SCHULDRECHTS: BAND I: ALLGEMEINER TEIL 76–79 (1987). The same position is reported by Stephen A. Smith, *In Defence of Substantive Fairness*, 112 L.Q. REV. 138, 156 (1996). Though not fully explicit, Spencer Thal seems to adopt a similar view. *See* Spencer Nathan Thal, *The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness*, 8 OXFORD J. LEGAL STUD. 17 (1988).

24. LARENZ, *supra* note 23, at 78; KARL LARENZ, ALLGEMEINER TEIL DES DEUTSCHEN BÜRGERLICHEN RECHTS 46 (7th ed. 1989).

25. LARENZ, *supra* note 23, at 79; LARENZ, *supra* note 24, at 46.

26. *See* James Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587 (1981).

27. *See* Peter Benson, *The Unity of Contract Law*, *in* THE THEORY OF CONTRACT LAW 118 (Peter Benson ed., 2001).

1. Auxiliary Terms

What, then, is the conceptual relation between the fairness of auxiliary terms and contractual freedom as it is represented by the law?

Two cases must be differentiated. The first case is the filling of gaps in contracts. The aspect of gap filling refers to the situation where the parties have agreed on some issues, including the main performance, but have not dealt with problems that may occur during performance, for example, delayed performance, impossibility, or other ways of breach. As we all know, contract law provides default rules to fill in the gaps that have been left by the parties' agreement.[28] This is true no matter if the parties are of equal bargaining power. Default rules apply if the parties have not agreed on relevant rules. They are articulated by the courts or by the legislature.[29] The question with regard to contractual fairness and contractual freedom is, then, as follows: How are these default rules to be understood? More precisely, what is the normative idea that guides the articulation of default rules?

There is one old answer that tried to link the operation of setting default rules with contractual freedom. Savigny suggested that the court or the legislature try to determine a *hypothetical* agreement on the respective issues by the contracting parties.[30] The problem is that this answer does not actually help to reveal what is guiding the making of default rules because one does not know what the parties would have agreed on *ex post*, and the parties' views on the matter will diverge. Nor does it help to refer to what reasonable and honest parties would agree on if they were acting in place of the actual parties.[31] What do the rules to which reasonable and honest parties would typically agree actually look like? To get some guidance out of the formula, one has to push it further: rules to be hypothetically agreed upon by reasonable and honest parties must achieve a fair balance of the typical interests involved. This is a much better answer. A shorter version reads: default rules provide for fair terms of contract.[32] Of course, it is not wrong to suggest that reasonable and honest parties would hypothetically agree to fair terms of contract. But it is wrong to think that this additional comment would help to determine the content of the

28. *See* KARL LARENZ & MANFRED WOLF, ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS 69 (9th ed. 2004); *see also* Craswell, *supra* note 16.

29. In the terminology of the German system, legislative rules are "*dispositives Gesetzesrecht,*" and the courts' rules are generated by "*ergänzende Vertragsauslegung*." The function is the same.

30. FRIEDRICH CARL V. SAVIGNY, SYSTEM DES HEUTIGEN RÖMISCHEN RECHTS: ERSTER BAND 57–58 (1840); *see also* BERNHARD WINDSCHEID & THEODOR KIPP, LEHRBUCH DES PANDEKTENRECHTS 450 (Theodor Kipp ed., 9th ed. 1906). The *locus classicus* in common law is *Globe Ref. Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903). *See also* Todd D. Rakoff, *The Implied Terms of Contracts: Of 'Default Rules' and 'Situation Sense,' in* GOOD FAITH AND FAULT IN CONTRACT LAW 191, 192 (Jack Beatson & Daniel Friedmann eds., 1997).

31. *See* LARENZ, *supra* note 23, at 79.

32. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. d (1981) ("But where there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process.").

fair terms.[33] As a matter of fact, it does not contribute anything to the understanding of what courts or legislators try to achieve in setting default rules, besides perhaps emphasizing that the idea of fairness in question is exclusively focused on the bipolar relationship between the two parties to the contract.

It is important to repeat that default rules apply also to gaps that have been left in contracts by parties of equal bargaining power. This implies that the law presupposes and applies the idea of fairness to contracts concluded among equals. This is exactly what the procedural understanding of contractual freedom must deny as being conceptually impossible.[34] It can therefore be noted, already at this point, that the procedural understanding of contractual justice does not reflect the law regarding auxiliary terms.

The second case to be differentiated is one where no question arises between the parties due to a gap in the contract, but nevertheless a dispute arises about the contractual rights and obligations. If the instrumental understanding of contractual freedom were true and the law placed full confidence in contractual freedom to generate fair terms when that freedom is exercised between equals, then the law should enforce completed contracts among equals as they stand. But this is not the case. The law does submit the terms of contract to the standard of substantive fairness.[35] In German law, the idea of substantive fairness is represented in section 242 of the Bürgerliches Gesetzbuch (BGB).[36] The terminology is slightly different—the rule says "*Treu und Glauben*"[37] instead of substantive fairness—but this makes no difference in substance. BGB section 242 submits each and every contract to a substantive control of the fairness of its auxiliary terms. The common will of the parties, as given under the objective test, is corrected if the content is found to be unfair. This applies also to cases where the parties are of equal bargaining power.

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33. In the same vein, see LORENZ KÄHLER, BEGRIFF UND RECHTFERTIGUNG ABDINGBAREN RECHTS 116 (2012). The opposite view is held by Larenz's academic follower Claus-Wilhelm Canaris. *See* Canaris, *supra* note 8, at 285.

34. In Flume's account, default rules are a result of completive interpretation (*ergänzende Auslegung*), a way of interpretation that is, he emphasizes, "normative." *See* FLUME, *supra* note 20, at 321–23. But he does not explain the guiding idea for this normativity.

35. For an overview in English, see Reinhard Zimmermann & Simon Whittaker, *Good Faith in European Contract Law: Surveying the Legal Landscape*, *in* GOOD FAITH IN EUROPEAN CONTRACT LAW 7, 18. (Reinhard Zimmermann & Simon Whittaker eds., 2000) and Werner F. Ebke & Bettina M. Steinhauer, *The Doctrine of Good Faith in German Contract Law*, *in* GOOD FAITH AND FAULT IN CONTRACT LAW 171–90 (Jack Beatson & Daniel Friedmann eds., 1995). The concept of good faith, as expressed in RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981), seems narrower, because its focus is on performance and enforcement of a contract. However, similar results are reached by other complementary doctrines. *See* Robert S. Summers, *The Conceptualisation of Good Faith in American Contract Law: A General Account*, *in* GOOD FAITH IN EUROPEAN CONTRACT LAW 118 (Reinhard Zimmermann & Simon Whittaker eds., 2000).

36. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, BUNDESGESETZBLATT [BGBL.] 134, § 242 (Ger.).

37. "Good faith" in English.

Of course, such a statement about the functioning of BGB section 242 is only rarely found in the German literature. This literature is, instead, preoccupied with grouping apparently singular cases,[38] hardly without taking them for instantiations of the general rule of contractual justice or fairness. However, this is the idea that indeed unites the singular cases as applications of the requirement of "*Treu und Glauben.*" Why, for example, although not specified in the contract, does delivery at three o'clock in the morning not count as contractual performance? The reason is that it would not be fair.

Certainly, one could contend that this line of argument might prove that all cases subject to correction under BGB section 242 are united under the idea of contractual fairness, but that it does not prove that all cases of contractual unfairness are covered by BGB section 242. But this contention implies that it would be possible to articulate a dividing line between cases of contractual unfairness that are subject to BGB section 242 and cases that are not subject to it. This articulation would then represent the actual uniting idea of BGB section 242. But such a dividing line does not exist. In consequence, to claim that not all cases of contractual injustice are subject to BGB section 242 is unfounded. This remains true even if such a claim could be proven to reflect the practice of the courts.

As a result, it can be stated that, indeed, each and every term of contract is, via the requirement of good faith (or similar doctrines), submitted to the rule of contractual justice. This is true also among parties with equal bargaining powers. Hence, the law does not actually place full confidence in the contractual deliberations between equal partners to generate fair terms. It must be concluded, thus, that the instrumental understanding of contractual freedom does not reflect the law either, at least with regard to auxiliary terms.

The alternative, saying that contractual freedom only allows the concluding of fair contracts, is fully coherent with the law as it stands: in cases of uncompleted contracts, the law helps with providing fair terms; in the case of completed contracts regarding a certain dispute between the parties, the law corrects unfair terms.

2. Fair Price

Turning to the issue of a fair price, the question is, again, which of the three conceptual options to understand the conceptual relation of contractual freedom and contractual fairness best reflects the law as it is.

The shortcoming of the procedural understanding, which denies a conceptual applicability of fairness to the agreement on the price, is rather obvious. Contract law actually presupposes an idea of fair price. It is present not in the doctrine of consideration,[39] but in a separate doctrine in general contract

38. For representative literature, see STAUDINGER, KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH § 242, ¶¶ 211–320, 403–1187 (2009).

39. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 79 (1981).

law—the doctrine of unconscionability.[40] BGB section 138, paragraph two says that "a legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgement or considerable weakness of will of another, causes himself or a third party, in exchange for an act of performance, to be promised or granted pecuniary advantages which are clearly disproportionate to the performance."[41] Hence, for each and every contract, the provision asks whether promise and consideration are clearly disproportionate. Given that the regular form of consideration is money, a disproportionate consideration is nothing different from an unfair price. Hence, the conceptual applicability of the doctrine is not restricted to contracts concluded by unequal parties.[42] From this we must infer that the law represents the concept of a fair price as applicable to each and every contract, including contracts among equals. We must, therefore, note that the procedural understanding that denies even such conceptual application does not reflect the law, not only with regard to auxiliary terms but with regard to the price as well.

But what about the instrumental understanding of contractual freedom: does it not reflect unconscionability? As can be inferred from BGB section 138, paragraph two, an unfair price will induce correcting effects by the law only if further conditions are met (and to ease the presentation, they can be lumped together in the general concept of unequal bargaining power). According to the view committed to the instrumentalist understanding of contractual freedom, equal bargaining power is the precondition to the functioning of contractual freedom with regard to the fairness of exchange.[43] Hence, if the procedural condition is not met, fairness must be imposed on the parties. But if the procedural condition is met, then the law, although it might find a price unfair, refrains from imposing a fair price. This view seems perfectly in line with the doctrine of unconscionability as expressed in BGB section 138, paragraph two, as, under that section, the law indeed judges the fairness of the price, but refrains from correction, if bargaining power is equal.

The problem with this view is that, although it seems to reflect exactly the operation of the law, it has difficulties selling this operation as coherent. The puzzling consequence of this view is that the law enforces a contract even though it is aware that it is unfair. And it does so only because the procedural condition of equal bargaining power is met. To explain such operation, contractual freedom, if exercised among equals, has to be given additional significance. The significance must come from something other than its instrumental role in contractual fairness. General observations regarding what

40. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 208 (1981).

41. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, BUNDESGESETZBLATT [BGBL.] 134, § 138, para. 2 (Ger.).

42. For an elaboration of the argument, see Smith, *supra* note 23, at 142–44. *See also* JAMES GORDLEY, FOUNDATIONS OF PRIVATE LAW: PROPERTY, TORT, CONTRACT, UNJUST ENRICHMENT 366 (2007).

43. For a representative statement, see CLAUS-WILHELM CANARIS, DIE BEDEUTUNG DER IUSTITIA DISTRIBUTIVA IM DEUTSCHEN VERTRAGSRECHT 51 (1997).

contractual freedom amounts to—efficiency or individual autonomy (or any other policy)—will not suffice at this point because the explanatory task is exactly this: Why should the law accept an unfair price among equals? If it accepts unfair prices among equals to support efficiency or autonomy (or any other policy), then why does this (or any other) policy not also trump in the case of unequal parties? If the answer is that such is a requirement of fairness, then why does the requirement of fairness not play out among equals? In other words, to restrict the law's requirement of a fair price to the case of unequal parties makes incomprehensible the reason why contractual fairness was allowed to enter the conceptual stage at all. The instrumental understanding's answer to the problem of the fair price, which restricts the application of the concept to cases of unequal parties, undermines its own premise that there is conceptual room for the idea of fairness also regarding the price.

A similar conceptual dilemma arises in view of the different treatment of price and terms: unfair terms among equals are to be corrected, but an unfair price is not. Why should the law, among equals, accept an unfair price but not unfair terms? Whatever reason is given to support acceptance of an unfair price—efficiency, autonomy, and so on—could also apply to unfair terms. This is even truer, given that terms and price are complementary, in the sense that a price that is higher or lower than the fair price may allow for terms that are more unfavorable than fair terms.

Of course, this kind of conceptual dilemma can be solved by invoking the framework of conflicting considerations, values, or interests—efficiency and freedom on the one hand, fairness on the other—that need balancing. And this balancing might come out this or that way at this or that point in the doctrine of contract law. However, as was stated in the introduction of this article, such a solution is not valuable in a project of understanding contract law because it represents abandoning understanding.

The alternative that proposes a harmonious unity of contractual freedom and contractual fairness is in a much better position. According to the alternative, the additional condition of equal bargaining power in cases of unconscionability will help to sort out whether the relevant contract is indeed a full contract of exchange or whether it is in parts a contract of gift.[44] The gift part is the part of, for example, an amount of money given for consideration that exceeds the fair price. "Collector's price" and "special price for a friend" are the eminent examples. It is inferred from the absence of impaired bargaining power that the amount exceeding the fair price is a gift. Admittedly, German law is not fully in line with this argument. The sum that exceeds the fair price is usually not treated as a gift, as this would require further conditions to be binding before performance.[45] Instead, the exceeding sum is treated as an

44. The argument that the law's distinction between contract and gift requires the idea of equal value has been developed by Peter Benson. *See* Benson, *supra* note 27.

45. BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], Aug. 18, 1896, BUNDESGESETZBLATT [BGBL.] 740, § 518, para. 1 (Ger.).

inseparable part of the contract. But in contrast to the shortcomings of the two other conceptions discussed, this seems a misfit of only minor importance. In the upshot, it turns out to be true that the law submits each and every contract of exchange to the standard of a fair price.

As an intermediate conclusion, it can be stated that, firstly, the procedural understanding of contractual freedom is not able to reflect any relevant aspect of contract law. Secondly, the instrumentalist procedural understanding does only slightly better. It does not reflect the law regarding fair terms. It seems to fit for the fair price, but this apparent success leads it into a conceptual dilemma in that it either loses the idea of justice or results in a position of non-understanding. The alternative proposal, in contrast, best reflects contract law, and it does not raise further difficult conceptual questions. This is why the alternative version seems worthy of being explored further.

IV
CONTRACTUAL FAIRNESS, COMMON USAGE, AND MARKET PRICE

This section will shed more light on the idea of contractual fairness, including the idea of a fair price, namely, how the idea operates in contract law.

In order to articulate the requirements of contractual fairness, German law sometimes, on relevant points, refers to common usage (*Verkehrssitte*). In German contract law, this is the case in BGB sections 157 and 242.[46] To determine what is required by "*Treu und Glauben*" the law resorts to common usage. Why is this?

Common usage represents what parties typically agree on. The similarity to the standard answer to the question of how default rules are to be determined is evident. But it is an empirical standard, not a normative one. This notwithstanding, common usage serves to articulate default rules more precisely or to fill in gaps which are left by default rules; these two purposes are functionally equivalent. For a court, common usage is a way to find out what terms would be fair, instead of determining them by its own judgment. Common usage is one of the law's sources of knowledge about contractual fairness.[47] But why does the law view common usage as a reliable source?

This is the point where deliberative theory must be introduced.[48] Common usage is the result of a multiplicity of transactions. In each transaction, the parties argue about fair terms. Either they deliberate and give reasons why this or that term is fair or unfair, or they do not deliberate but decline to agree unless one party offers terms which are considered fair by the other. When will deliberation lead to fair results? Deliberative theory claims that this requires an ideal speech situation.[49] Though the argument would require further

46. *See also* RESTATEMENT (SECOND) OF CONTRACTS §§ 219–22 (1981).

47. *See* PAUL OERTMANN, RECHTSORDNUNG UND VERKEHRSSITTE 369–86 (1914).

48. For a deliberative theory of contract, see Bertram Lomfeld, *Contract as Deliberation*, 76 LAW & CONTEMP. PROBS., no. 2, 2013 at 1.

49. *See* Jürgen Habermas, *Wahrheitstheorien (1972)*, *in* VORSTUDIEN UND ERGÄNZUNGEN ZUR

elaboration, for which this paper leaves no space, it is suggested that the ideal speech situation for determining fair terms of contractual exchange is the condition where the parties have equal bargaining power, which is the case in an ordinary competitive market. So it is assumed, in the upshot, that in a competitive market parties will usually agree on fair terms. This is why the law can legitimately refer to common usage to determine what terms would be fair.

It is important to note the difference between the law's deferral to common usage and the instrumentalist procedural understanding of contractual freedom. The latter accepts each and every result agreed on by parties with equal bargaining power. In contrast to this, common usage refers not to the single case, but to the usual case. This implies that parties, in a single case, may err about the fairness of terms and will be corrected by the law, even though they were in a good position to generate fair terms due to their equal bargaining power. The usual case is the normative standard for the single case.

This understanding of common usage can also help to explain why the fair price is represented as the competitive market price.[50] It was argued above that common usage is one important source for the law's knowledge about fair terms. The next step seems evident: The market price is the usual price, the price which results from common usage, from a multiplicity of deliberations about the fair price. However, there is an explanatory gap. In the argument above, it is presupposed that judges, legislators, and even private parties can argue about the fairness of terms. One has an idea about the kind of arguments that can be given in such deliberation. What kinds of arguments can be used to discover the fair price? What argument could be made that a certain commodity should be exchanged for x euros rather than for 2x euros?

Concurring approaches have suggested either that there is actually no reasonable argument available,[51] or that the argument is eventually based on need, scarcity, and costs.[52] The alternative answer is that parties' deliberations circle around the idea of the value of the good. And the conceptual framework set up by the law presupposes that value functions as an objective standard. Value is not established, but rather it is discovered by the contracting parties. Imagine the case of a new commodity for which no market price exists yet. In this case, the parties will determine the value by inquiring into the purchasing power that it represents. The objective value of the commodity is represented by the price that will be paid for it in a different transaction involving another party (and so on). So even in the first transaction of a new commodity, the parties try to anticipate the purchasing power that the good will command in similar transactions. With this, the parties try to anticipate the market price. And a given competitive market price is just the outcome of a multiplicity of such anticipations; it is a multiplicity of judgments about the value of a

THEORIE DES KOMMUNIKATIVEN HANDELNS 127 (Jürgen Habermas ed., 1st ed. 1984).

50. For concurring approaches, see Benson, *supra* note 27, and Gordley, *supra* note 26.

51. *See* Benson, *supra* note 27, at 189.

52. *See* Gordley, *supra* note 26, at 1605.

commodity. Given that a competitive market price exists, it represents common usage. Common usage provides the relevant standard of contractual fairness also with regard to the price. The competitive market price is an instantiation of common usage.

V
CONCLUSION

The conclusion shall be restricted to three remarks on the functions served by the hermeneutical view of contract law presented in this paper. First, it helps to understand the basic structure of contract law. Second, it can help to understand where case-by-case and ex post control of contractual fairness by courts is not sufficient, and where instead general and ex ante guidance by the legislature is needed. The eminent examples are the areas of essentially distorted markets, as in the case of human labor, housing space, foodstuffs, energy, loans of money, et cetera. The markets for these "fictitious commodities"[53] are essentially distorted in the sense that even competition law cannot impose a competitive structure on them. Third, it helps us to reveal where the basic structure of contract law cannot apply at all, as in the case of surrogate parenting or organ transplantation.

A final word should be said explicitly to the "public dimension of contract," the subject of this symposium: Contract law realizes a basic structure of morality. Liberals claim that this structure reflects and enables human freedom. The argument above shows, in turn, that it reflects human equality, the equality of human beings (and yet being human certainly implies being free). This fundamental foundation in equality is the one and only "public dimension" of contract law's basic structure. At the very end, one puzzling question remains: Why has this idea been so unattractive for authors who have tried to develop an alternative to the liberal understanding of contract law?

53. The term and the theory of "fictitious commodities" were developed by Karl Polanyi in KARL POLANYI, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME (1944).