The Basis for Legal Enforcement of Promises
The Role of the Bargain

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Contract law is the law of promises. From the moment of the development of language, people began to make and break promises. In most if not all cultures, a broken promise is regarded as a wrong, at least to some degree. But is a broken promise any concern of the community's government ("the law"), or is it strictly a personal matter between promisor and promisee? This question is the beginning of contract law.

A broken promise concerning a social engagement or the making of a gift might damage a friendship, but this is not likely to be a concern of the community at large. If, in such a case, the disappointed promisee were to file a breach of contract suit against the promisor, a civil law court probably would lack authority either to compel the promisor to perform the promise, or to pay compensation to the promisee for failing to perform it.

On the other hand, if two or more parties exchange promises as part of a "deal," the rules of civil law can become involved. For example, the first party might promise to sell his house to the second party on the condition that she must pay $400,000. The second party might then promise to pay this amount on the condition that the first party signs and delivers a deed, transferring ownership of the house to her. The parties could create and sign a written document, describing their exchange of promises (a "contract").

These parties have made a deal (in contract language, a *bargain)* consisting of reciprocal promises which do not involve a social engagement or the making of a gift. Their relationship in this context is economic, and they both expect to benefit when the promises are performed. The seller would rather have $400,000 than the house, and the buyer wants the house enough to part with $400,000 to get it. It is this bargaining relationship that brings the parties' promises within the concern of contract law. Each party has promised to give something of value to the other, and each promise has been made entirely on the condition that the return promise must be performed.

A different way of expressing this is that each party gives a promise *in consideration* of the fact that the other party is giving a return promise. The exact nature of these promises is defined by a deal the parties have reached by bargaining with each other. Contract law calls such promises "consideration," and if it is *mutual* and measures up to certain other requirements, it can make the parties' promises legally binding even if they are not to be performed until some future date or time.

It is important to observe here that it is not enough for each party coincidentally to have made a promise to the other. Under the "bargain theory" of consideration, each party must make his promise specifically to induce the other's return promise. For example, "A" promises to pay $500 to "B" for a certain bicycle. "A" does this because she wants the bicycle; she intends to influence "B" to promise to give it to her. In turn, "B" makes this promise because he wants the $500 and is willing to give up the bicycle to induce "A" to give him that amount. This mutual exchange of "consideration" reflects an underlying *bargain*.

The bargaining relationship was described by Oliver Wendell Holmes as "reciprocal conventional inducement." (Oliver Wendell Holmes, Jr. was a member of the United States Supreme Court from 1902 to 1932.) Thus, the reciprocal nature of "bargained-for" promises is a critical component of contract theory.

The development of modern contract law is rooted in economic policy. As rules of law evolved, some kinds of promises came to be seen as important enough to give the community an interest in enforcing them. As noted above, these consist mainly of promises made as part of a bargaining relationship (a "deal") which, by definition, is economic. In a significant twentieth century development, a binding contract also can exist in some situations where, despite the absence of any bargaining or return promise, one party's promise influences the other to change his or her actions in a way that would result in great unfairness if the promise were broken.

A modern society is interested in enforcing "deals" because when the parties to a deal keep their promises, each of them, as well as the greater community, can benefit from the resulting exchange. For example, suppose two groups of people inhabit opposite ends of a remote island. One group has an abundant supply of water, but not enough food. The other group has a plentiful supply of food, but not enough water. By agreeing to an exchange of water for food, each group benefits. An economic system is created by the deal, improving conditions for everyone.

In a slightly more complex illustration, suppose party "A" owns land, "B" manufactures steel, "C" owns construction equipment, "D" can provide labor, "E" supplies concrete, and so on. A large group of such parties, acting together, can produce an office building, a public park, a shopping center, or an apartment building. None of the parties can do this alone, and the necessary group cooperation would never happen randomly. What is needed is a *deal* (or a series of deals) in which each necessary party *promises* to contribute to the project. Each of these promises will be made in exchange for someone else's promise to provide some form of compensation. If all of the necessary promises can be assembled and organized, and if we can have a reasonable assurance that the promises will be kept, the project can be built.

If this happens, many people will benefit. In the short term, there will be jobs in construction, architecture, engineering, accounting, law, finance, and other fields that are directly or tangentially connected to the project itself. Permanent employment will be created for others at the site of the completed project. If the completed project is not publicly owned (*i.e.,* a government project), it will generate property taxes, and possibly profits for its owners.

The investors, and all of the temporary and permanent employees, will receive income which, when spent, will support other businesses and create more jobs in the community. Everyone will pay taxes on what they earn and on much of what they spend. The money collected from those taxes will help pay for streets and infrastructure for water and sewer lines, police and fire departments, parks, maintenance, and other government services. All of this will have a positive economic impact on the community. From this vantage, the community has a clear economic interest in the promises made by the participants in the original construction project.

An important characteristic of a legally binding agreement is that it creates legal obligations that did not previously exist. Therefore, a person incurs contractual obligations only by consent. This differs from many other obligations that are imposed by law. For example, in the law of torts, every person is generally obligated to exercise reasonable care in his or her conduct, and if a failure to do so results in harm to another, civil liability for negligence can result. In criminal law, every person is obligated to refrain from certain conduct and can face criminal penalties for failing to comply. Tax law obligates people to pay taxes in many situations.

Because contract obligations are based entirely on consent, the promise of consideration made by each party to a contract must be either to do something that party was not already legally obligated to do, or to refrain from doing something that party otherwise had a legal right to do. Among other things, the case of *Hamer v. Sidway* (page 170 in the assigned text) illustrates this characteristic of consideration.

In *Hamer*, an uncle promised to give his 15-year-old nephew $5,000 if the nephew would refrain from drinking, swearing, smoking, and gambling until his 21st birthday. In 1869 in the State of New York, it was legal for a 15-year-old to do all of these things. The nephew promised to conduct himself according to the uncle's terms, and followed through on the bargain.

After the uncle died, the executor of his estate resisted payment to the nephew, contending that no enforceable contract existed because the uncle did not actually gain anything in return for his promise to pay $5,000. The executor's lawyer argued that the uncle's sense of satisfaction in instilling good habits in his nephew had no *economic* value to the uncle, and therefore did not constitute *consideration* that would support the kind of bargain the law would recognize as a contract.

The court held in favor of the nephew, pointing out that the uncle's motive for seeking to influence his nephew's behavior was not the determining factor. What was important was that the uncle had *bargained* for the ability to influence his nephew's conduct, and he got what he bargained for. The nephew had a legal right to engage in certain behavior, and he gave up that right as his part of a bargain with his uncle. Accordingly, the nephew was entitled to enforce his uncle's promise and collect the $5,000.

Contrast *Hamer v. Sidway* with a hypothetical case in which a parent promises to allow a child to watch television until 10:00 PM if she finishes her homework by 7:30. Clearly, the parent's promise would not be enforceable in a court of law, even if the parent's refusal to honor the bargain was clearly unjust.

But the line between non-legal social or familial matters and legally enforceable contracts is not always clear. There are many examples of enforceable contracts among friends or family members (including *Hamer v. Sidway.*). There's no specific formula for drawing the dividing line; however, typically there will be some identifiable economic consequence or relinquishment of legal rights attached to the exchange of promises when such agreements are found to be enforceable contracts.

In modern law, those who break contractual promises are not punished as criminals or admonished for unethical conduct. They cannot be required to pay punitive damages to the aggrieved party. A breaching party is rarely even compelled to perform the broken promise if it is possible to calculate the monetary value of the resulting harm and award that sum as damages to the aggrieved party.

Indeed, one major school of American legal thought suggests that parties *should* breach contracts if they can still realize profits after paying damages to the aggrieved party. This viewpoint is based on the theory that a party might breach a contract intentionally if it is more profitable or less costly to do something other than perform as agreed. If it is possible to pay damages to the non-breaching party and deal profitably elsewhere, "efficient breach" theory would regard a breach as economically efficient, because the goods or services involved in the contract eventually would go to a buyer who valued them more highly than the original purchaser, thereby creating a greater benefit to the general economy.

Given that a society's primary interest in the keeping of promises is economic, it is not surprising that modern law favors the enforcement of promises resulting from dealmaking or "bargaining" relationships. Over the course of centuries, in addition to separating bargains having economic implications from purely social or family agreements, the law of various cultures developed different "formalities" as ways to distinguish between promises the law would or would not enforce.

"Formalities" are simply rituals, recitations, forms of writing, signatures or other processes that accompany the making of a promise to show it was intended by the promisor, and recognized by the law, to be legally binding.

Professor Lon Fuller noted that formalities generally serve three distinct functions. (Lon L. Fuller was a Professor of Law at Harvard Law School. His 1941 article, *Consideration and Form*, identified and discussed the three functions of legal formalities.)

<u>The "evidentiary" function</u>: First, a formal process serves as *evidence* the

alleged promise in fact was made. The claims of a disappointed promisee are easier to prove if he or she can produce reliable evidence of the necessary formalities. This evidence might come from a witness who had heard the parties reciting legally binding oaths, like those used in ancient Rome. It might be a document bearing the wax seal of the promisor, as formerly used in England and in the United States, or perhaps a document bearing the promisor's signature, proving that the promise really was made. Sometimes a notarized signature is used, providing further evidence that the signature is genuine.

The "cautionary" function: A second purpose for formalities is *cautionary*, to warn the parties that their promises will be legally binding and are not just hypothetical remarks. Going through a formal process, whether that be a signature, the recitation of formal oaths, or the application of sealing wax, can cause the promisor to consider more carefully whether any given promise is understood to be legally binding, or just idle talk.

The "channeling" function: A formality can serve as a "*channel*" or method by which both parties can be certain their desire to make legally binding promises is carried out effectively. In other words, those who want assurance that a promise will be legally binding can "channel" it through the established ritual or process and be sure the task has been accomplished properly.

Two separate and distinct kinds of formalities emerged in England and ultimately affected the development of American contract law. Under one approach, a promise was deemed enforceable if the promisor put it in writing, signed it, affixed his seal to the document in sealing wax, and delivered it to the promisee ("signed, sealed and delivered"). During the twentieth century, this method gradually fell out of practice and virtually has vanished in modern America. Sections 2-203 of the Uniform Commercial Code and section 1629 of the California Civil Code abolish "sealed instruments" as a basis for enforcing promises. (Used in this sense, the word "instrument," is a traditional English term, meaning "document." Much modern law still refers to a document as an "instrument.") Although the use of sealing wax has disappeared, many kinds of contracts remain unenforceable unless they are made in writing, signed by the party against whom enforcement is desired.

A second surviving kind of formality is the bargaining process that results in an agreed exchange of consideration. Over time, this has become the dominant formality which, depending on the subject matter of an agreement, might also be required to be made in writing.

The bargaining process determines not only what promises are enforceable, but also what remedy is available to the aggrieved party in the event such a promise is broken (a "breach of contract"). The promise-breaker (the breaching party) must compensate the disappointed promisee by paying an amount that will put the promisee in the same position as if the promise had been kept. This basic remedy is often said by courts to represent the "benefit of the bargain" that was lost because of the defendant's breach of contract. This remedy also is known as "expectation" damages, enforcing what the Restatement calls the plaintiff's "expectation interest." (Sometimes the word "expectancy" is used instead of "expectation.")

By enforcing promises made as part of a bargain or deal, and by eliminating the enforcement of sealed instruments, modern contract law left one significant category of promise unenforceable. Formerly, a *gratuitous* promise would have been enforceable by the promisee if made by the promisor under seal. A gratuitous promise is simply a promise to make a gift. It is not made in exchange for consideration. (*e.g.,* "I am going to give you five thousand dollars on your birthday.") Just as the presence of bargained-for consideration alerts us to the enforceability of promises, the absence of consideration tells us the promise is gratuitous, and therefore is unenforceable under the bargain theory.

People who make gratuitous promises typically aren't thinking about contract law. They often intend to keep their promises and expect them to be taken seriously. For example, a generous uncle might promise, in writing, to pay his niece's law school tuition. No bargain is made between the uncle and niece; the uncle simply promises to give the money.

Even though the uncle has asked for nothing in return, the niece still might be influenced by this promise to change her conduct in some way. For example, the niece might quit her job to devote more time to her studies. But what happens if the uncle dies before the niece is able to present the tuition bill? The executor of the uncle's estate, bound by law to pay only the legally enforceable debts and honor legally binding contracts of the deceased, might feel obligated to refuse to pay, believing the promise to be gratuitous and therefore not legally enforceable.

In earlier times, the uncle could have put a wax seal on a document stating his promise, and the law would have enforced it as a binding contract, despite its gratuitous nature. But that approach no longer is available because the seal has been abolished as a means of making a promise legally binding. Moreover, in the illustration, the uncle's written promise was not made in the form of a legal will, and it did not pretend to be one. Without some kind of rule that would allow for enforcement of a promise *not arising from a bargaining relationship*, the niece would be unable to compel payment of the promised funds, even though nobody questioned the authenticity of the uncle's promise or doubted that if the uncle had lived, he would have kept his promise voluntarily.

During the early twentieth century, numerous published appellate cases dealt with similar gratuitous promises. These earlier cases tended to involve promises between family members, but gradually, gratuitous promises made in business relationships also began to appear in the published decisions.

In all of these cases the same kind of problem arose: First, the promise was made under circumstances where it was clear or should have been foreseeable to the promisor that the promisee might be influenced to believe and rely on the promise in a way that would involve some significant detriment or unfairness in the event the promise was not kept.

Second, in many of these cases, the promisee in fact did change his or her position in reliance on the promise. (In the illustration above, the niece quit her job and lost the income she would have depended on if her uncle had never made his promise.)

Finally, in cases where the promisee's reliance actually had caused such a detriment, it seemed highly unjust for a court to turn the promisee away with nothing.

In response to such circumstances, trial judges began to make excuses to permit enforcement, despite the obviously gratuitous nature of a particular promise. Some judges would point out some incidental conduct of the promisee and identify it as "consideration," even though no bargain ever had been made concerning that conduct. Other judges would attempt to decide the case under a theory of law other than contracts (*e.g.,* trusts or torts) using vague or tortured explanations of how liability was thus created. On appeal, higher courts often chose to affirm such creative attempts by trial courts to avoid injustice, offering opinions and explanations as vague as the ones they were affirming.

Gradually, enough case law had been published that some appellate courts were emboldened to publish decisions directly holding that certain promises could be enforced completely *without* bargained-for consideration. These published opinions gradually influenced other courts to adopt the same approach until it became a clearly identifiable new rule.

The team of law professors and judges who collaborated to draft the first Restatement of Contracts for the American Law Institute ("ALI") identified this new theory as a form of "estoppel." (The ALI researched and drafted the first Restatement of Contracts during the time from 1923 to 1947.) Estoppel is a traditional equitable concept which prevents a person from unjustly enforcing legal rights after doing something to mislead another person into believing those rights would not be asserted. In this case, estoppel would be used to prevent a party from avoiding enforcement of his promise by showing it was gratuitous, with the promisee giving nothing in return.

The first Restatement also recognized that everything about the estoppel approach, including the nature of the promisee's remedy for the broken promise, must be left to the equitable discretion of the enforcing court. In other words, the Restatement rule recognized that a trial judge must be given authority to use discretion to decide, on a case-by-case basis, whether a gratuitous promise should be enforced to avoid an inequitable result. The entire object of this new approach was to avoid injustice by allowing courts to enforce certain gratuitous promises, but only under a very specific set of circumstances.

The estoppel approach is not limited to cases where, as in the above illustration, the promisor dies before carrying out the promise. Injustice also can result where, after the promisee has changed his or her position in reliance, the promisor simply changes his mind and refuses to keep the promise. In appropriate circumstances, such a promise can be enforced like any other contract, despite the absence of a bargain. A key to enforcement is in showing the promisor is responsible for the promisee's unjust situation because, at the time the promise was made, she knew or should have known it was likely to influence the promisee to make a significant change of position.

Because estoppel in this instance is based on a promise, it came to be known as “promissory estoppel.” It is now recognized in all American jurisdictions. Other common names for it are “reliance theory” or “detrimental reliance” because reliance by the promisee on the gratuitous promise is one of its essential components. As we will discuss later, comparatively few promises actually are enforceable under the doctrine of promissory estoppel, and the dominant basis for the enforcement of promises remains the law of "bargained-for" consideration.