IMMUTABLE CONTRACT RULES, THE BARGAINING PROCESS, AND INALIENABLE RIGHTS: WHY CONCERNS OVER THE BARGAINING PROCESS DO NOT JUSTIFY SUBSTANTIVE CONTRACT LIMITATIONS

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INTRODUCTION

Contract law recognizes the power of individuals to consent to legally binding transfers of entitlements.[1] No legal system, however, enforces all agreements made between individuals.[2] Determining the scope of permissible agreements is thus an important issue in contract theory. One widely agreed upon basis for limiting the freedom of contract[3] is paternalism.[4] This Note examines one form of paternalism as a basis for limiting freedom of contract and argues that it justifies procedural, rather than substantive, limitations on contract law.[5]

After demonstrating the inadequacies of this form of paternalism as a ground for substantive contract limitations, this Note explores an alternative basis for substantive contract limitations.[6] Contract theories based on individual rights generally eschew substantive limitations on the scope of permissible contracts.[7] But, a contract theory based on individual rights may imply certain

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1. Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 300 (1986).

2. *See* MAX WEBER, ECONOMY AND SOCIETY 668-71 (1968) ("[N]o legal order ... would place its guaranty of coercion at the disposal of all and every agreement.").

3. "Freedom of contract" is somewhat misleading because it is really a power to contract. Because of the adaptability of contract law to arrange social and economic relationships with a minimum of restraint on individuals, and its function in preserving freedom, the use of freedom of contract is popular. *See* Ian R. MacNeil, *Power of Contract and Agreed Remedies*, 47 CORNELL L.Q. 495, 495 (1962). *See also* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 829-59 (1992) (discussing the social functions of contract).

4. *Compare* Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983) (summarizing the principles advanced to defend paternalism) *with* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972) (analyzing legal rules and prohibitions in terms of both paternalism and externalities as well as other principles).

5. *See infra* notes 35-91 and accompanying text.

6. *See infra* notes 92-134 and accompanying text.

7. *See, e.g.*, Eric Mack, *In Defense of "Unbridled" Freedom of Contract*, 40 AM. J. ECON. & SOC. 1 (1981).

substantive restrictions on the scope of legally permissible agreements. By looking to contract theory itself for the proper limitations of contract law, one preserves the important value of autonomy embodied in freedom of contract, while capturing the moral intuitiveness of certain fundamental restrictions on the scope of contracts.

The strategy for this argument is as follows. The first section analyzes freedom of contract in terms of relationships among legal rules.[8] This conceptual analysis reveals a distinction between procedural and substantive contract restrictions and provides a framework for analyzing justifications for various contract rules. Next, one kind of paternalism is considered as a ground for limiting freedom of contract.[9] Drawing from the contract rule analysis reveals that this paternalism fails as a substantive contract limiting principle. Lastly, an alternative basis for limiting the freedom of contract is advanced.[10] This alternative basis—the concept of inalienable rights—captures the desirable limitations on contract that paternalism leaves exposed, but withstands the criticisms that undermine paternalism.

CONTRACT LAW AS DEFAULT AND IMMUTABLE RULES

To help evaluate arguments for limiting the scope of permissible contracts, this section outlines the default rule conception of contract law. This conception clarifies the role played by various contract rules and exposes the weakness of some contract limiting principles.

The Default/Immutable Rule Distinction

Contract law may be analyzed into two sets of rules:[11] "default" rules and "immutable" rules.[12] Recently a variety of contract scholarship has utilized this analysis.[13] "Default" rules are those otherwise applicable contract rules that parties may change by agreement.[14] For example, under the Uniform Commercial Code, unless otherwise agreed, "the place for delivery of goods is the seller's place of business."[15] Similarly, a written offer assuring that it will remain open, must be held open for a "reasonable time" unless the

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8. *See infra* notes 11-34 and accompanying text.
9. *See infra* notes 35-91 and accompanying text.
10. *See infra* notes 92-134 and accompanying text.
11. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87 (1989). *See also* U.C.C. §§ 1-102(3), (4) (1989) (making a distinction between default and immutable rules and stating a preference for the former).
12. Other terms used for default rules include: backstop, enabling, fallback, gap-filling, off-the-rack, opt-in, opt-out, preformulated, preset, presumptive, standby, standard-form and suppletory rules. Ayres & Gertner, *supra* note 11, at 91 & n.25.
13. *See* Barnett, *supra* note 3, at 824 & nn.10-19 (listing recent scholarship employing the default rule concept).
14. Ayres & Gertner, *supra* note 11, at 87 ("Default rules fill the gaps in incomplete contracts; they govern unless the parties contract around them.").
15. "Unless otherwise agreed: (a) the place for delivery of goods is the seller's place of business or if he has none his residence." U.C.C. § 2-308(a) (1989).

offer states a different time.[16] Default rules make entering meaningful contracts easier by eliminating the burden of detailing every term.[17] When default rules correspond to the parties' desires and expectations, they lower the transaction costs of entering into contracts and thereby increase efficiency.[18]

"Immutable" rules are those contract rules that the parties may not change by agreement.[19] For example, under the Uniform Commercial Code, an offer may not remain open for more than three months without consideration, even if agreed to explicitly in writing.[20] Similarly, one may not generally release another from potential tort liability.[21] In practice, if parties attempt to alter these compulsory terms, the terms will go unenforced and penalties may be imposed, despite the parties' actual intentions.[22]

The default rule conception raises two basic issues of contract law: (1) what should the content of these background rules be, and (2) which rules should be immutable? A complete theory of contract law would justify both the content of the rules[23] as well as the substantive limitations placed on the

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16.
> An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

U.C.C. § 2-205 (1989).

17. GORDON TULLOCK, THE LOGIC OF THE LAW 47 (1971).

18. RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 372 (3d ed. 1981) (arguing that default rules should "economize on transaction costs by supplying standard contract terms that the parties would otherwise have to adopt by express agreement"). *But cf.* Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 505-08 (1989) (raising practical objections to the possibility of determining "expectations" in a given community). Default rules may also promote a variety of ends other than efficiency. *See generally id.* at 511-28 (arguing that many contract theories tell us very little about the content of default rules and that default rules may pursue a variety of goals); Ayres & Gertner, *supra* note 11 (arguing that courts and legislatures should sometimes adopt "penalty" defaults that diverge from the parties expectations to force the more knowledgeable party to disclose information in order to alter the default rule).

19. Ayres & Gertner, *supra* note 11 at 87. Randy Barnett analogized the default/immutable rule conception with default settings in a word processor. When one writes with a word processor, the program assumes certain "defaults." For example, the margin width, line spacing, etc. These defaults may be changed. Other background rules, for example how the word processor works internally, may not be altered by the user. Barnett, *supra* note 3, at 824.

20. U.C.C. § 2-205 (1989).

21. *See generally* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 92 (5th ed. 1984).

22. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-1315(B) (1990):
> A provision prohibited by subsection A of this section included in a rental agreement is unenforceable. If a landlord deliberately uses a rental agreement containing provisions known by him to be prohibited, the tenant may recover actual damages ... and not more than two months' periodic rent.

23. For examples of theories addressing the content of default and immutable rules, see Ayres & Gertner, *supra* note 11 (arguing for "penalty defaults" that give one of the parties an incentive to contract around the default so as to disclose more information to the other party);

freedom of contract by immutable rules.[24]

In addressing this first issue, Professor Craswell argues that autonomy and consent-based contract theories cannot, in principle, provide answers to the question of content.[25] Craswell observed that freedom of contract only requires that informed consenting agents be able to arrange their relations in any way that does not violate the rights of third parties.[26] As long as parties may change the applicable background rule, *any* default rule is compatible with freedom of contract.[27] Therefore, Craswell argues that one needs some other theory to select among competing default rules.[28]

In response, Professor Randy Barnett argues that in many cases a consent theory of contract *does* offer guidance for the content of default rules.[29] Barnett argues that consent provides the normative basis for enforcing contracts.[30] Silence provides consent to a default rule only if: (1) the parties know or have reason to know about the default rule; and (2) the cost of contracting around the rule is "sufficiently low."[31] Given the important justificatory role played by consent, default rules should facilitate ensuring consent.[32] To achieve this, Barnett argues that default rules should closely map parties' expectations.[33]

Other authors offer a variety of theories designed to inform the content of these default rules.[34] The next section considers the second issue raised by the default rule conception of contract law: which rules should be immutable. One commonly advanced basis for immutable rules is paternalism. Examining the concerns underlying this principle in light of the default rule conception reveals that paternalism may only justify default, rather than immutable contract rules.

Barnett, *supra* note 3, at 875-85 (arguing that the default rules should map most people's expectations).

24. *See, e.g.*, Barnett, *supra* note 3, at 867-69 (arguing that the role of consent in contract theory explains why default rules are generally preferable to immutable rules); Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563 (1982) (arguing in favor of certain compulsory terms or immutable rules).

25. Craswell, *supra* note 18, at 511-28. Some "[value other than truth or freedom] must be introduced to explain why any one rule ought to be chosen over any other." *Id.* at 528.

26. *Id.* at 515.

27. *Id.*

28. *Id.* at 516.

29. *See* Barnett, *supra* note 3, at 874-97.

30. *Id.* at 859-64.

31. *Id.* at 866.

32. *Id.* at 875-97.

33. *Id.* at 875-85.

34. *See, e.g.*, Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992).

PATERNALISM AND CONCERNS ABOUT THE BARGAINING PROCESS AS A BASIS FOR IMMUTABLE RULES

If parties seek to alter an immutable rule, or make an agreement violating the rule, their agreement will go unenforced by the courts.[35] But, refusing to enforce a non-rights violating agreement between competent persons who freely agreed to be legally bound requires justification.[36] One widely advanced ground for immutable contract rules is paternalism.[37]

"Paternalistic" Contract Rules

Legal paternalism refers to legal rules that restrict the liberty of a person because such restrictions are in the person's own best interest.[38] Paternalistic immutable rules seek to protect individuals by prohibiting them from entering certain kinds of agreements.[39] One common basis for paternalistic immutable rules focuses on the bargaining process.[40]

Professor Anthony Kronman, for example, argues that when concerns over the bargaining process arise, economic efficiency may justify an immutable contract rule that leaves these contracts unenforced.[41] Professor Kronman uses the warranty of habitability implied in lease contracts as an example of an immutable rule based on efficiency.[42] The implied warranty of habitability provides that landlords will deliver and maintain leased premises

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35. *See supra* notes 19-22 and accompanying text.

36. Kronman, *supra* note 4, at 764. One may always object that because the public finances the court system the state may always refuse to enforce agreements simply because the public dislikes the agreements. If the parties are willing to pay the necessary enforcement costs, through arbitration, for example, other grounds for limiting the scope of permissible agreements are needed.

37. *See supra* note 4. *See also* Ayres & Gertner, *supra* note 11, at 88 ("There is surprising consensus among academics at an abstract level on two normative bases for immutability. Put most simply, immutable rules are justifiable if society wants to protect (1) parties within the contract, or (2) parties outside the contract. The former justification turns on parentalism.") (footnote omitted); David L. Shapiro, *Courts, Legislatures, and Paternalism*, 74 VA. L. REV. 519 (1988); Kennedy, *supra* note 24.

38. *See* Kronman, *supra* note 4, at 763 ("[A]ny legal rule that prohibits an action on the ground that it would be contrary to the actor's own welfare is paternalistic."); JOEL FEINBERG, RIGHTS, JUSTICE, AND THE BOUNDS OF LIBERTY 110 (1980) ("[L]egal paternalism justifies state coercion to protect individuals from self-inflicted harm....").

39. Kronman, *supra* note 4, at 763.

40. *Id.* at 766-68. Kronman couches this line of reasoning in terms of "economic efficiency." Economic efficiency provides the normative basis for the limitations, but the inefficiency arises because of problems in the bargaining process.

41. *Id.* at 766-70. *See also* Kennedy, *supra* note 24, at 596-614 (analyzing economic efficiency as a basis for immutable contract rules).

42. *See* Kronman, *supra* note 4, at 766. Kronman does not argue that the only basis for the warranty of habitability is economic efficiency. He suggests that concerns over distributive justice may justify the rule as well. *Id.* at 770. This Note, however, is only concerned with immutable contract rules justified on the basis of the efficiency principle advanced by Kronman. The warranty of habitability is used only as a possible example simply because Kronman also used it as an example. To the extent that the warranty of habitability has an independent justification, the critique forwarded against the efficiency principle is inapplicable.

that meet "minimum" conditions.[43] In many jurisdictions, a potential tenant cannot agree to alter these conditions under any circumstances.[44]

Kronman argues that concerns over judicial economy or efficiency may underlie this paternalistic immutable rule.[45] He advances the argument as follows. If the warranty were waivable, landlords would, more often than not, take advantage of tenants and force waiver through trickery or superior bargaining power.[46] Although any agreement procured through fraud or misrepresentation would give a tenant legal relief, proving fraud and misrepresentation may be difficult.[47] Moreover, it is more likely than not that any waiver of the warranty would be procured through illegitimate means.[48] Given the expected problems surrounding waiver and the difficulties of proof, enforcing waivers of the warranty would usually mean enforcing illegitimate contracts. An unwaivable warranty creates an immutable contract rule that protects weak tenants from being duped into waiving this right. This means limiting a tenant's power to waive this right. But given the conditions under which waiver occurs, Kronman argues it is more efficient overall to simply not enforce any waivers of the warranty requirement.[49] An immutable rule maximizes the enforcement of contracts that match the parties' actual agreements.

Another example of an immutable contract rule sometimes based on judicial economy is the prohibition of slavery contracts.[50] To successfully discriminate between voluntary[51] and involuntary agreements is difficult and would require extensive and costly procedures.[52] Because these costs would be paid for publicly, the state may justifiably consider all such agreements involuntary, rather than incur the expenses necessary to ensure actual con-

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43. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-1324 (1990).

44. *See, e.g., id.* § 33-1315(A) (1990) ("A rental agreement shall not provide that the tenant ... [a]grees to waive or to forego rights or remedies under this chapter."); *id.* § 33-1315(B) (1990) ("A provision prohibited by subsection A of this section included in a rental agreement is unenforceable.").

45. *See* Kronman, *supra* note 4, at 766-70. Kronman also offers other bases that may justify the warranty, but those go beyond the scope of this Note. *See id.* at 770-74.

46. *See* Kronman, *supra* note 4, at 768 ("[I]f most of the waivers that are given are procured through fraud, and if the fraud can rarely be proven, the inefficiencies of a no-waiver rule may be outweighed by the greater inefficiency of enforcing too many fraudulent bargains.").

47. *Id.* at 768.

48. *Id.*

49. *Id.*

50. Professor Feinberg advances this argument. FEINBERG, *supra* note 38, at 124-25. Just to be clear, this Note does not propose that courts ought to enforce slavery contracts.

51. Although it may be difficult to imagine one voluntarily entering a slavery contract, Feinberg himself suggests many scenarios where a reasonable person would voluntarily consent to permanent slavery. *See* FEINBERG, *supra* note 38, at 122 ("A person might agree to become a slave for a million dollars to be paid in advance to a loved one or to a worthy cause, or out of a religious conviction requiring a life of humility or penitence, or in payment for the prior enjoyment of some supreme benefit as in the *Faust* legend.").

52. *Id.* ("[T]he legal machinery for testing voluntariness would be so cumbersome and expensive as to be impractical.").

sent.[53] An immutable contract rule prohibiting slavery contracts is therefore justified.[54]

The efficiency argument may be generalized as follows:[55]

(1) Many or most apparent agreements of type X are procured through fraud or other illegitimate means.

(2) Proving that these agreements were procured illegitimately is either extremely difficult or too expensive.

(3) The cost or harm of enforcing these illegitimate agreements outweighs the cost or harm of not enforcing legitimate type X agreements.

(4) Therefore, it is more efficient to prohibit type X agreements than to enforce them.

Although the Efficiency Argument seems appealing, its appeal ultimately undermines its soundness. The Efficiency Argument seems appealing because it relies on "soft" paternalism. Often, characterizing something as "paternalistic" is done not for descriptive purposes, but as a criticism.[56] But not all paternalism is created equal. In analyzing kinds of paternalism, Professor Joel Feinberg distinguished between hard and soft paternalism.[57] Hard paternalism aims at protecting a person from herself.[58] Soft paternalism seeks to protect weak or helpless parties from external harm, including harm from other parties.[59] Soft paternalism places limits on a person's choices in order to protect that person from the danger posed by others.[60]

Because hard paternalism seeks to protect one from oneself, it raises serious moral questions.[61] Hard paternalism suggests that some people know what is better for others. By forcibly interfering with a competent person's judgment about his or her own situation one seems to deny the fundamental moral equality of persons.[62] This usurpation of autonomy and denial of

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53. *Id.*

54. This section argues that the efficiency principle fails to justify slavery contracts. The following section, however, provides an alternative justification for prohibitions against slavery contracts. *See infra* notes 92-134 and accompanying text.

55. This argument is a generalized form of Kronman's. *See* Kronman, *supra* note 4.

56. *See* JOEL FEINBERG, HARM TO SELF 4 (1986) ("[The word paternalism] is derogatory and thus tends to be tendentious and question-begging in its bare application. Paternalism is something we often *accuse* people of.").

57. *Id.* at 12-16.

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* at 23-26.

62. Professor Joel Feinberg describes the complaints of those interfered with paternalistically as follows:

> [Their complaint of interference] has the full flavor of moral indignation and outrage.... The indignant feelings, in short, are those provoked by a sense of one's rightful prerogatives having been usurped. Moreover, the paternalistic "justifications" for the invasion rub salt in the wound by denying the very existence of the privacy, independence, and prerogatives asserted in the protests, and thereby are also belittling, degrading, or demeaning.

FEINBERG, *supra* note 38, at 117.

equality requires a heightened justification and may be invoked only in extraordinary situations.[63]

By aiming at protecting individuals from external harm, soft paternalism avoids these moral problems.[64] Laws designed to prevent the overreaching of strong parties and to balance unequal bargaining power exemplify soft paternalism.[65] Soft paternalism protects individuals from harm in cases when they have *not* consented to the potential harm.[66] Indeed, it is not clear that soft paternalism is paternalism at all.[67] Because soft paternalism aims at protecting individuals when they have *not* consented to the potential harm, it does not raise the same serious moral problems raised by hard paternalism.

The Efficiency Argument relies on soft paternalism. Immutable contract rules based on this argument do not seek to usurp decision making authority from individuals, but rather seek to prevent enforcing fraudulently procured terms.[68] The proponent of this argument does not claim that people ought to be prohibited from making these agreements *for their own good*, but rather that it is difficult to distinguish legitimate from fraudulent agreements. If courts enforced these agreements, people would be taken advantage of. Efficiency comes at the price of not enforcing legitimate contracts,[69] but is justified because otherwise many illegitimate agreements would be enforced.[70]

By invoking soft paternalism, the efficiency argument avoids the moral problems associated with hard paternalism and makes it appealing. This also means, however, that the Efficiency Argument does not question the legitimacy of a contract entered into knowingly and freely. If the concerns about consent could be eliminated without an immutable rule, this alternative would be preferable.

The problem with efficiency arguments as a basis for immutable contract rules lies in its assumption that the cost of eliminating fraud always outweighs the benefits. The veracity of this premise depends on individual circumstances and the subjective value of the contract to the parties themselves, and therefore cannot be determined *a priori*. The costs associated with ensuring freely given consent may not *always* exceed the costs of foregoing the agreement. If the contracting parties were willing to bear the

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63. For an argument along these lines, see Gerald Dworkin, *Paternalism*, *in* MORALITY AND THE LAW 107 (Richard A. Wasserstrom ed., 1971).

64. FEINBERG *supra* note 38, at 117.

65. FEINBERG, *supra* note 56, at 12 (defining "soft paternalism" as state regulation to prevent substantially nonvoluntary conduct); Kronman, *supra* note 4, at 768 (discussing contract rules aimed at preventing the enforcement of nonvoluntary contracts).

66. *Id.* at 12.

67. *Id.* ("It is not as clear that 'soft paternalism' is 'paternalistic' at all, in any clear sense.").

68. The concern underlying the Efficiency Argument is the protection of the freedom from contract. Freedom of contract consists of both the liberty to avoid unwillingly entering contracts (the freedom from contract) as well as the power to enter contracts (the freedom to contract). *See* Barnett, *supra* note 3, at 869-73; Richard E. Speidel, *The New Spirit of Contract*, 2 J. LAW & COMM. 193, 198-99 (1982).

69. Kronman, *supra* note 4, at 768 ("This solution has the obvious defect of preventing the parties from modifying the [rule], even when it would be efficient for them to do so and neither has practiced fraud upon the other.").

70. *Id.*

costs required to demonstrate freely given consent,[71] the efficiency ground collapses. To deny enforcement when the parties could demonstrate actual consent would involve hard paternalism and would require additional justification. The efficiency argument may justify a prima-facie presumption against enforcement; however, it fails to justify an immutable rule.

Procedural Restrictions on Contract

Despite failing to justify immutable contract rules, the Efficiency Argument does show that not enforcing *a particular contract* may be justified when one doubts the legitimacy of the bargaining process. This becomes particularly relevant if the agreement is one that usually involves fraud, overreaching, or other procedural problems. This also means that enforcing these contracts may require some additional safeguard aimed at ensuring consent. This suggests requiring procedural safeguards as a condition of enforcement.[72] These procedural safeguards would eliminate the concerns of fraud, while simultaneously preserving freedom of contract. Granted, enforcement of some contracts may require elaborate and expensive procedures; however, as long as the contracting parties would willingly undergo and pay for such procedures, this should not be a barrier.

A variety of procedures may be used to ensure actual consent and eliminate the fraud and bargaining power concerns. For example, in some cases the concern may focus on adequate disclosure of information. In cases like these, professors Ayres & Gertner suggest using "penalty defaults."[73] Penalty defaults intentionally contravene the parties' expectations about the default rule.[74] This encourages the more knowledgeable party to change the applicable rule thereby revealing this information to the less knowledgeable party.[75]

In some cases, simply shifting or raising the burden or proof may provide adequate protection.[76] In other cases requiring a heightened formation procedure may work better. Formation procedures specify the procedures and conditions necessary for forming legally enforceable agreements. For example, to draft a legally recognizable will requires that one follow specific

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71. Feinberg assumes that the procedures necessary for demonstrating actual consent would be paid for publicly, and therefore the public may object. *See* FEINBERG, *supra* note 38, at 124. However there is no reason that these costs should be paid for publicly. Indeed, contracting parties normally pay the transaction costs.

72. The idea of using procedural safeguards to insure certain substantive laws is not new to the law. For example, under Arizona law, before a confession may be entered into evidence in a criminal prosecution, the judge must determine the voluntariness of the confession. ARIZ. REV. STAT. ANN. § 13-3988 (1991).

73. *See* Ayres & Gertner, *supra* note 11, at 91.

74. *Id.*

75. *Id.*

76. One example where the law uses burden shifting to insure meaningful consent is in the area of wills. "A presumption of undue influence arises when one who occupies a confidential relationship to the decedent is active in procuring the execution of the will and is a principal beneficiary." Evans v. Liston, 116 Ariz. 218, 220, 568 P.2d 1116, 1118 (App. 1977).

procedures.[77] Similar safeguards may be appropriate for some particularly troubling contracts.[78]

In addition to the above reasons favoring default rules, important practical reasons cut in favor of this flexibility. When a court or legislature establishes an immutable rule, it prevents some contracting. Because one cannot know *a priori* all of the consequences of an immutable rule, it is unlikely that any immutable rule will perfectly achieve the intended goal. Indeed, it is very likely that the rule will result in some serious unintended consequences.[79]

One can achieve a more refined approach by using procedural restrictions in conjunction with default rules.[80] For example, consider the effects of an immutable rule preventing all waivers of tort liability. In the United States, limiting waivers of tort liability in conjunction with strict products liability has led to the removal of some life saving drugs from the market.[81] Drug manufacturers fear exposure to tort liability, and therefore in many cases refuse to market the drugs in the United States, despite their availability in other countries.[82] One can imagine that a person threatened with a deadly disease may quite rationally waive tort liability in order to receive experimental medicine. Sadly, without an enforceable contract the person may simply go untreated. Granted, one would want a *default* rule that prevented waiver and procedural rules for changing the default designed to ensure actual consent to the waiver. But, in these serious cases, the parties would willingly undergo these procedural costs.

Two practical consequences follow from these considerations. First, parties would only undergo the costs of the procedures when the mutual benefit of contracting outweighed the costs of undergoing the procedures.[83] This would mean preventing those contracts that the Efficiency Argument

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77. *See, e.g.*, UNIF. PROB. CODE § 2-502 (1991) ("Except as provided for ... every will shall be in writing signed in the testator's presence and by his direction, shall be signed by at least two persons each of whom witnessed either the signing or the testator's acknowledgment of the signature of the will.").

78. One could imagine even more elaborate procedures for things like waivers of tort liability for experimental medicine. To ensure consent in this context may require that one go before some tribunal for a hearing or inquiry. Selecting appropriate procedural safeguards may require assessing a variety of factors, including the probability and magnitude of the harms of over enforcement and the probability and magnitude of harms of under enforcement.

79. More often than not, any immutable rule will result in unintended bad consequences as well as the intended good consequences. For an example of the problem of unintended consequences in another area, see Cass R. Sunstein, *On the Costs and Benefits of Aggressive Judicial Review of Agency Action*, 1989 DUKE L.J. 522, 532-33. When comparing an immutable rule to a default rule, it is important to include those good consequences given up by the immutable rule that could be preserved through the use of a default rule.

80. Even default rules with procedural safeguards will sometimes prevent beneficial contracts. By giving parties the option to demonstrate consent, however, one allows beneficial contracts when parties will pay the extra transaction costs. An immutable rule eliminates all of the beneficial contracts.

81. PETER W. HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES 158-9 (1988) (listing drug manufacturers that pulled beneficial drugs from the United States because of liability exposure).

82. *Id.*

83. Richard A. Epstein, *Why Restrain Alienation*, 85 COLUM. L. REV. 970, 972 (1985) ("When total transaction costs exceed the difference in values to the buyer and the seller, then the exchange cannot go forward, since both parties no longer will emerge as net winners.") (footnote omitted).

seeks to prevent. Many of the contract limitations justified in terms of this paternalism would remain in fact, because the cost of ensuring actual consent outweighs the benefits. But, the formation rules would not offend individual autonomy because individuals willing to undergo these costs could alter the default rule.[84] Second, in the cases where contracting around the default rule proved extremely important, the parties could undertake the procedures necessary to ensure consent and thereby enter into a legally binding agreement.

The Efficiency Argument for paternalistic immutable contract rules seems to fail. Rather than justifying immutable rules, this arguments shows that courts may justifiably require heightened formation procedures for the enforcement of some contracts. By allowing parties to enter legally binding agreements when they are willing to pay the transaction costs necessary to demonstrate consent, individuals may enter mutually beneficial agreements. With an immutable rule, these beneficial agreements would never occur.

Objections

One problem with this argument may be that, although many courts and commentators advance these paternalistic reasons for immutable contract rules, all of these rules have other justifications as well.[85] Therefore, although the above argument shows that the Efficiency Argument does not justify any immutable rules, every immutable rule has some other justification as well.

In response, it should be noted that *every* immutable contract rule based on paternalistic reasons probably does not have an independent justification. Moreover, even if this were true, advancing the independent justification would clarify the true justification for many rules. If a default rule with additional procedures would protect the actual consent of the parties better than an immutable rule, then let the defender of the immutable rule articulate the actual basis for the rule, rather than invoking the relatively noncontroversial Efficiency Argument.

Another objection may be that in some cases the risks associated with mistaken enforcement simply outweigh any possible benefits of allowing the agreements. For example, with respect to slavery contracts, enforcing even one of these contracts outweighs any possible benefits that could accrue by allowing people to enter into these contracts. This criticism may be correct, but it only points out that the Efficiency Argument depends on an empirical assumption regarding the possibility and cost of ensuring consent. It seems plausible that even in the riskiest cases, one could imagine procedures elabo-

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84. Professor Barnett argues that because consent plays a normative role in contracts, transacting around default rules should be relatively inexpensive. Barnett, *supra* note 3, at 866-67. Although this seems generally correct, in cases like these, additional transaction costs are necessary to *ensure* consent. As a general principle then, it seems that transaction costs ought to be designed to maximally ensure consent. Normally, when parties are relatively equally informed and of relatively equal bargaining power, changing the default rule should be relatively inexpensive and generally map the parties' expectations. When, however, one would normally be suspicious about the voluntariness of any changes to the default rule, higher transaction costs may be justified in order to ensure consent.

85. For example, professor Kronman argues that distributive justice also justifies the warranty of habitability. Kronman, *supra* note 4, at 770-74.

rate enough to demonstrate actual consent.[86] Finally, this objection does not address the many cases of immutable rules where the risks are not that grave.

A final objection may be that the only time a default rule with procedures differs from an immutable rule is in the extreme case.[87] Why not then simply make an exception for the few extreme cases and forget the default rules? This objection, however, ignores the same problems as did the Efficiency Argument. One cannot know *a priori* all of the cases where it would be preferable to have a default rule.[88] Indeed, it is through contracting that much of this information is revealed.[89] A system of default rules provides the flexibility necessary for individuals to act on the basis of knowledge that may be available only to them.[90] A system of immutable rules chokes these possibilities and offers no corresponding benefit.[91]

AN ALTERNATIVE BASIS FOR "PATERNALISTIC" IMMUTABLE RULES: INALIENABLE RIGHTS

The previous section critically examined one kind of paternalism as a principle for limiting the freedom of contract.[92] This section explores an alternative theory for understanding the most essential limits on the freedom of contract. The first part of this section sketches professor Randy Barnett's consent theory of contract.[93] The second part uses the consent theory in conjunction with an analysis of rights to determine whether contract theory has inherent immutable rules.[94] Understanding contracts as transfers of alienable rights places natural limits on the scope of freedom of contract.

A Consent Theory of Contract

According to the consent theory of contract, contract law can best be understood as part of a larger theory of entitlements.[95] An entitlement theory specifies the sphere within which people may live their lives free from interference from others.[96] Property rights define a person's entitlements to resources.[97] A person's right to property may be transferred either uncondi-

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86. Suppose, for example, that before entering into a slavery contract one had to undergo psychological testing, demonstrate that entering the contract was objectively reasonable, pass a lie detector test, wait for six months, go through a hearing where all interested parties could question the potential contractor, etc.. *See supra* note 51 for an example of conditions that might make entering a slavery contract reasonable.

87. For example, in the experimental life saving drug case illustrated above. *See supra* notes 81-82 and accompanying text.

88. For an excellent discussion of this complicated and often overlooked point about the social functions of contract, see Barnett, *supra* note 3, at 829-59.

89. *Id.* at 844-48.

90. *Id.*

91. The only possible benefit may be the prevention of enforcing contracts that may have problems with the underlying consent. However, by hypothesis, the procedures for altering the applicable default rule ensure this does not happen.

92. *See supra* notes 35-91 and accompanying text.

93. *See infra* notes 95-102 and accompanying text.

94. *See infra* notes 103-134 and accompanying text.

95. *See* Barnett, *supra* note 1, at 293-94.

96. *See id.* at 291.

97. *See id.* at 294.

tionally by gift or through an exchange for another's rights.[98] On the consent theory, contract law consists of the rules and principles which specify the rights of individuals engaged in transferring entitlements.[99] A contract arises when individuals manifest an objective consent to the use of legal force to fulfill an agreement to transfer rights.[100]

Contracts require the use of legal coercion for enforcement. Any adequate contract theory must justify the use of this force.[101] Under the consent theory, contracts may be enforced because individuals bring rights to the transaction and *consent* to the transfer of these rights.[102] An individual's consent to the use of legal coercion justifies the use of force in case of a breach.

Understanding a contract as a manifestation of an objective consent to coercive enforcement of a covenant to transfer rights helps explain the law's reluctance to enforce certain agreements. The following section explores the concept of rights, and uses rights theory to explain the clearest limitations on the freedom of contract.

Paternalism and Inalienable Rights

Even strong supporters of the freedom of contract recognize some limits. John Stuart Mill, an impassioned defender of the freedom of contract, argued against enforcing slavery contracts.[103] Mill believed that freedom of contract was necessary in order to respect individual liberty, but that prohibiting some contracts was necessary to protect an individual's liberty.[104] It seems that even Mill retreated to paternalism as a liberty limiting principle in the extreme case. There may, however, be another alternative.

According to the consent theory, a contract is an agreement to be legally bound to a transfer of rights.[105] An enforceable contract requires that the rights transferred be transferable, both in theory and in fact. If a right is inherently incapable of transfer, then actual consent to a transfer is insufficient to extinguish the right. These rights, called inalienable rights, provide a basis for immutable contract rules independent of paternalism.[106]

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98. *See id.* at 292.

99. *See id.* at 295.

100. *See id.* Thus, when one offers cash to purchase another's automobile and the car owner accepts, each party has agreed to transfer their rights to the money and car respectively.

101. *See id.* at 269.

102. *See id.* at 319.

103. *See* John Stuart Mill, *On Liberty*, *in* PHILOSOPHY AND LAW 127, 130 (Joel Feinberg ed., 1984):

> [B]y selling himself for a slave, he abdicates his liberty; he forgoes any future use of it beyond that single act. He therefore defeats, in his own case, the very purpose which is the justification of allowing him to dispose of himself.... The principle of freedom cannot require that he should be free not to be free.

104. *Id.*

105. *See supra* notes 95-102 and accompanying text.

106. The Efficiency Argument sought to limit the scope of permissible contracts by arguing that, in some contexts, we are skeptical about consent and that it is better, therefore, to leave the contracts enforced. The inalienable rights theory argues that, in some contexts, one *cannot* consent.

When a right is inalienable, one cannot voluntarily extinguish or transfer the right.[107] This contrasts with alienable rights[108] which may be waived or transferred by the possessor *simply by consent.*[109] If one waives a right, others may behave in a way that would be unacceptable, but for the consent of the original right holder.[110] For example, normally if one enters onto another's land, it is trespassing. Consenting to the entry, however, makes it acceptable. Some rights may, however, be incapable of transfer.

Justifications for Inalienable Rights

To understand the justification for inalienable rights it is important to clarify the concept of rights.[111] The term "legal right" ambiguously describes a variety of legal relations,[112] including what might properly be called a liberty, power, or immunity.[113] A "claim right" specifically refers to a right that corresponds to another's duty.[114] To say that one has a claim right, entails that another has a duty.[115] A liberty right, or privilege, refers to one's own lack of duty.[116] If one is at liberty to do X, one lacks a duty to refrain from doing X.[117]

These concepts help clarify the justification for inalienable rights. Since claim rights correlate with duties, if everyone has some claim right, then everyone has some duties.[118] Everyone has some claim rights. One example is the right to be free from unprovoked violence. As everyone is under a duty to respect the claim rights of others, a person is unable to alienate the means necessary for fulfilling those duties.

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107. Randy E. Barnett, *Contract Remedies and Inalienable Rights*, 4 SOC. PHIL. & PUB. AFF'S 179, 185 (1986); Terrance McConnell, *The Nature and Basis of Inalienable Rights*, 3 LAW & PHIL. 25, 25 (1984).

108. "To say that something is alienable, according to Webster, is to say that it is 'transferable to the ownership of another.'" McConnell, *supra* note 107, at 27.

109. Contract law, however, normally requires something in addition to mere consent (e.g., consideration) to effect the legal enforcement of a rights transfer.

110. McConnell, *supra* note 107, at 28.

111. Since an inalienable right is simply a right that cannot be alienated, some inalienable right theories are based on considerations such as distributive justice, skepticism, and externalities. *See, e.g.,* McConnell, *supra* note 107. However, this section is concerned only with inalienable rights based on the nature of rights.

112. WESLEY NEWCOMB HOHFELD, FUNDAMENTAL LEGAL CONCEPTION 35 (1919).

113. *Id.*

114. *Id.*

115. Thus, to say that X has a right against Y for trespassing is the equivalent of saying that Y is under a duty to stay off of X's land. Similarly, when one contracts to purchase a car, the buyer has a claim right to the car, and the seller has a duty to deliver the car or the benefit of the bargain in money damages. For an argument that specific performance should be granted for the car case, see Barnett, *supra* note 107, at 195-201 (arguing that inalienable rights explains courts' reluctance to enforce personal service contracts and explains why specific performance should normally be available for contracts dealing with external resources).

116. Barnett, *supra* note 107, at 36.

117. *Id.*

118. See, e.g., *id.* at 179. The following section of this Note (*infra* notes 119-25 and accompanying text) summarizes Professor Barnett's argument for inalienable rights. *See* Barnett, *supra* note 107, at 185-94. *See also* H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 179 (1955), for arguments for natural inalienable rights.

Suppose X enters into a slavery contract with Y by agreeing to always follow Y's commands. If the contract is morally and legally binding, then X's refusal to follow Y's commands would be a violation of Y's claim right. Further suppose that Y commands X to violate Z's rights.[119] Either X can respect Z's rights, and thereby violate Y's, or X can respect Y's rights, and thereby violate Z's. If Y commands X to violate Z's rights, then X must violate either Y's rights, by respecting Z's, or Z's rights by respecting Y's. A coherent theory of rights cannot logically or functionally validate two conflicting rights claims.[120] Any coherent rights theory must either deny that Z has no right against X, or that Y has no right against X. To deny Z's right is absurd, thus Y has no right against X, which means that X cannot transfer control over herself to Y. Thus X has an inalienable right to control herself.

If X could transfer her right to liberty, two consequences follow. First, X would lose the liberty to assess the rightfulness of a situation and act on that assessment. Therefore, X would lose the liberty to respect other people's rights. But, if one has a duty to respect another's rights, then one must also have the liberty to do so. Second, a conflict of rights could exist if transfer is permissible, because X could simultaneously be under two conflicting duties.

The above considerations show the plausibility of inalienable rights based on the nature of rights; however, one may resolve the problems created above without postulating inalienable rights. A second justification for inalienable rights depends on facts concerning the content of rights.[121] A contract is an enforceable agreement to transfer control over resources.[122] In addition to having the right to transfer control over the resource, control must be in fact transferable. To illustrate this constraint, consider the transfer of a factually transferable resource. If a person consents to transfer control over her automobile, the receiver may in fact control the car in the same manner and to the same extent as the previous owner. In contrast, suppose that same person attempted to transfer control over her person. The person could willfully conform to the other persons commands; however, she would still in fact retain control over her person.[123] Regardless of any agreement, one cannot actually transfer control over one's person.

The nature of rights themselves place some limits on their transfer. These limits include the inalienable right to use and control one's person.[124] This does not mean that one may not waive one's inalienable right for the

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119. For example, by commanding X to punch Z in the nose without justification, Y commands X to violate Z's rights.

120. *See* Barnett, *supra* note 107, at 187. *See also* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 199 (1974); Hillel Steiner, *The Structure of a Set of Compossible Rights*, 74 J. PHIL. 767 (1977).

121. *See* Barnett, *supra* note 107, at 188.

122. *See* Barnett, *supra* note 1, at 291-300

123. The new "controller" could get the desired result through force or threats of force. Nevertheless, control remains with the person.

124. One might object to this by claiming that one could still transfer the right to order another person to do anything and back that up with force. This, however, runs into the problems of conflicting rights and coherence as discussed earlier. *See supra* notes 92-134 and accompanying text.

benefit of others; but rather that the rights-holder retains his or her power to withdraw consent at any time.[125]

Inalienable Rights and Contract Theory

Distinguishing between alienable and inalienable rights and understanding contracts as transfers of rights over resources helps to explain why some contract rules are immutable. Paternalistic theories ground this prohibition in terms of protecting the individual from herself;[126] however, there are circumstances when one would benefit from such an agreement.[127] According to the inalienable rights theory, slavery contracts are unenforceable because the underlying rights transfers involved lead to contradictory results.[128] Therefore, the limitation on contract is not an *ad hoc* addition to the theory, but a consequence of the theory. Rather than prohibiting slavery contracts because they are, on balance, a bad idea, the right of self ownership prohibits transfer. If the right cannot be transferred, then any attempt to transfer that right by selling oneself into slavery is futile.

In addition to explaining the immutable rule against slavery contracts, inalienable rights theory explains the prohibition of specific performance in personal service contracts.[129] Courts have been reluctant to award specific performance as a remedy in personal service contracts.[130] The courts reason that specific performance in personal service contracts crosses the line of acceptable interferences with freedom.[131] This "line" is unclear and unprincipled. But, if one has an inalienable right to possess, use, and control one's person, then specific performance for personal services would be unjustified. When one enters into a contract for personal services, the contract is best understood as an agreement to do the services or pay money damages.[132]

Immutable rules aimed at protecting personal integrity may be explained in terms of contract theory itself. This has two implications. First, not all immutable rules are paternalistic.[133] Second, since the justification is in terms

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125. Barnett, *supra* note 107, at 192 ("the most salient characteristic of inalienable rights may be that, while rights-holders may *exercise* their inalienable rights for the benefit of others, a rights-holder may never surrender *the right to change her mind* about whether to exercise such rights or not").

126. Kronman, *supra* note 4, at 775 ("A person who would give away too much of his own liberty must be protected from himself, no matter how rational his decision or compelling the circumstances.").

127. *See supra* note 51.

128. X may have a duty to Y, which if exercised violates Z's rights; and, X may have a duty to Z, which if exercised violates Y's rights. *See supra* notes 92-134 and accompanying text.

129. *See* Barnett, *supra* note 107, at 197-201.

130. *Id.* at 180-81. *See* RESTATEMENT (SECOND) OF CONTRACTS § 359(1) (1979); Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 272 ("[s]pecific performance is deemed an extraordinary remedy"); Wurtzel v. Richmond, 717 F. Supp 1 (D.D.C. 1989) (specific performance only available after plaintiff shows the existence of a contract, breach, and lack of an adequate remedy at law).

131. Barnett, *supra* note 107, at 181. *See also* Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 372; Schwartz, *supra* note 130, at 296-98.

132. Barnett, *supra* note 107, at 198-99.

133. *See supra* notes 92-134 and accompanying text.

of contract theory itself, it does not follow that any other alternative that achieved the same end would be a comparable substitute.

Immutable contract rules aimed at protecting personal integrity are best understood in terms of a consent theory of contract and the nature of inalienable rights. Although this theory prohibits enforcement of some contract terms, the theory is not paternalistic. A paternalistic theory limits contracts so as to protect the individual's own welfare. The theory outlined above limits contracts based on the nature of rights themselves.[134]

CONCLUSION

Contracts provide individuals with a means for creating their own law. However, there are limits on the kinds of agreements individuals may enter into. One common basis for limiting the scope of permissible agreements focuses on the bargaining process. These paternalistic immutable rules are often justified in terms of economic efficiency. Because these immutable rules aim at protecting individuals from harm from others, any alternative that offered the same protection but did not limit the freedom of contract would be preferable. At most, paternalism establishes a presumption against enforcement; however, this presumption may be overridden by eliminating the doubts surrounding the actual consent of the parties. One could achieve the same degree of protection against the freedom from contract, through a system of default rules in conjunction with procedural safeguards aimed at ensuring consent.

Despite the problems with basing immutable rules on this kind of paternalism, some limits are justified in terms of contract theory itself. A better way to understand the absolute prohibitions against certain contracts, traditionally based on paternalism, is in terms of inalienable rights and a consent theory of contract.

134. *See id.*