ARTICLES

LIABILITY FOR MISTAKE IN CONTRACT FORMATION

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It is generally thought that few rights and duties arise out of contract negotiations. Some courts will try to enforce an agreement to negotiate in good faith. Most courts will protect against outright deception about willingness to contract with principles of fraud or estoppel. If tangible benefits are conferred on one party in contract negotiations, the benefits may sometimes be recovered under a theory of misappropriation or restitution. The law also protects a general contractor ("general") who relies on an offer from a subcontractor ("sub") and an insurance applicant who relies on an insurer for coverage pending acceptance or

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3. Farnsworth, supra note 1, at 229-33.

4. See infra notes 21-25 and accompanying text.
rejection of an application. But these doctrines are quite limited in scope. The general rule in bargaining is that anything goes.

In particular, there is no liability in contracts for a mistake made in contract negotiations, even if the mistake harms another party, unless the mistake relates to a promise. Additionally, in torts, no duty of care exists in arm's-length bargaining. Thus, there is no liability for a mistaken misrepresentation about the price at which one will deal or about one's plans to enter into a contract unless the representation is in the form of a promise. Mistake is relevant only as a potential ground mistaken parties may use to avoid their obligations under contracts. Thus, in a leading decision protecting reliance on an offer, Drennan v. Star Paving Co., the mistaken party pressed the issue of mistake as grounds for relief from its obligation as a subcontractor to stand by its offer.

However, Justice Roger Traynor also stated in Drennan that the subcontractor's "mistake, far from relieving it of its obligation, constitutes an additional reason for enforcing it, for it misled plaintiff." Traynor did not develop this point (he concluded that he did not need to decide whether the general contractor could recover on a theory of negligence), but the mistake goes to the heart of the case, for there truly was no promise made by the sub to the general in Drennan on which a contract action could be based. A better argument for the result in Drennan is that the sub should be liable for the loss sustained by the general because it was caused by the sub's mistake.

Mistake is also an important element in cases that impose liability for losses where no contract has been formed. This includes well-known cases involving mistaken delays of acceptance or denials of insurance applications when a loss is suffered while an application is pending, along with less well-known cases involving a mistaken price quote and the mistaken rejection of a home mortgage application. Although

5. See infra notes 34-36 and accompanying text.
6. RESTATEMENT (FIRST) OF TORTS § 762 (1939). "There has been little growth, if any, in the number of courts which allow recovery on a negligence theory against an 'antagonist' in a business transaction." Hill, Damages for Innocent Misrepresentation, 73 COLUM. L. REV. 679, 686 (1973) (footnote omitted).
8. Id. at 416, 333 P.2d at 761.
9. Id.
10. See infra notes 34-35 and accompanying text.
Hoffman v. Red Owl Stores,13 a case that appears in virtually every contracts textbook, allowed recovery for losses in failed negotiations on a theory of promissory estoppel, it may be better explained both as a mistake case and on a theory of negligent misrepresentation, which is based on mistake.

These cases are inconsistent with the liberal theory of contract that justifies the enforcement of contracts by people's assent to obligation as expressed by a promise, because a promise is lacking.14 Rather, these obligations are imposed by the state, and the best argument for their imposition is utilitarian in character: The rules announced in these cases minimize losses from mistakes in contract formation by allocating losses to the better cost avoider. This, of course, is a familiar goal of tort law. Some will wonder why, if such cost-shifting arrangements are desirable, people do not bargain for them privately. And some will wonder whether the rights established by these cases can affect resource allocation, since most such rights are disclaimable. I will show why problems of mistake in contract formation may not be solved in the marketplace and why they may be solved through disclaimable rights and duties. These points are important beyond this Article, for they may justify state intervention in transactions where we would expect the market to work best—transactions that affect only two fairly knowledgeable parties with roughly equal wealth—and they suggest that intervention through disclaimable rights and duties may succeed.

These cases also raise the issue of the encroachment of torts into contracts. Traditionally, bargaining was kept free from the tort duty of care by a variety of doctrinal restrictions, including a rule that no duty of care existed in bargaining. Additionally, an action for negligent misrepresentation would not lie for representations about future events15 or about the speaker's own intent to do something in the future.16 But courts have interpreted tort law more liberally in these as in other respects, and so increasingly it is becoming possible to regulate conduct in bargaining through torts. Whether this is desirable can be answered only by considering the purposes of contract and tort law. I suggest that utilitarian values underlie much of contract and tort law and that the concern with individual autonomy that predominates in contract is

13. 26 Wis. 2d 683, 133 N.W.2d 267 (1965).
16. See RESTATEMENT (SECOND) OF TORTS § 530(1) (1977); id. comment b.
strong but derivative of the concern with utility. We care about autonomy and so respect bargains because of problems of knowledge; we do not know what is in people's interests, so we generally respect their choices. Yet, while we should resist altering bargained-for terms of a contract through torts (unless we are quite sure that a term is ill-advised), we might use torts or imposed terms in contracts to create rights and duties when, as in the cases examined here, a right is not a subject of bargaining and the failure to provide for such a right seems not to be an indication of people's preferences. Generally, this is better done through contract doctrine than tort doctrine because of certain undesirable aspects of tort doctrine—specifically, the liberal damage measures in torts that make it easier to recover for pain and suffering and other consequential damages.

Part I of this Article examines Drennan and the insurance- and mortgage-application cases. It explains why these cases do not fit within traditional contract doctrine and why they are better justified on grounds of utility than fairness. The utilitarian argument takes us into issues of market failure and of the impact of disclaimable rights. Part II examines Hoffman v. Red Owl Stores, which raises the issue of liability for mistaken misrepresentations about future contracts. Because the issue in that case is not usually perceived as mistake (most scholars think the issue is good faith), the facts of the case are covered in some detail, based on the appellate record. Part II also explores the recent history of the tort of negligent misrepresentation, which has been applied in a case very similar to Hoffman. Part II explains the differences between a promise-based rule of liability and a rule of negligent misrepresentation and justifies application of a rule of negligent misrepresentation to representations in negotiations on utilitarian grounds.

I.

This part proposes a rule protecting reliance on contract preliminaries—offers, price quotes, or solicitations of offers—where trade practice or custom invites reliance and the failure to contract is because of mistake or bad faith by the other party. It begins by describing cases that

are anomalous under current doctrine and therefore suggest such a rule. It then explains why these cases do not fit within conventional contract or tort doctrine. Finally, it considers the normative arguments for such a rule, rejecting fairness but finding a basis for the rule in concerus of efficiency.

A. ANOMALOUS CASES

Section 87(2) of the second Restatement of Contracts expressly deals with the problem of precontractual obligation. It provides as follows:

An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

Section 87(2) was adopted to account for Drennan v. Star Paving Co. The facts of the case should be familiar. A subcontractor called a general contractor, who was preparing to submit a bid on a contract, to offer to do work at a low price. The general relied on that offer in preparing his bid. But before the general could accept, the sub revoked because of a mistake in calculating the offer price. Drennan held that the sub was bound to keep his offer open because of the general's reliance. The decision was innovative at the time, but it is widely followed today.

20. Restatement (Second) of Contracts § 87(2) (1979). One other provision of the second Restatement of Contracts, section 45, also deals with the problem of precontractual obligation. This section makes an offer that invites acceptance by performance binding as an option when that performance has begun.

21. 51 Cal. 2d 409, 333 P.2d 757 (1958). See Restatement (Second) of Contracts § 87(2) comment e, illustration 6 (1979); id. reporter's note. The other two cases cited as support for the section could as well have been based on section 90. They do not require a rule protecting reliance on offers where there is no promise. One case involves an option that entails a clear promise to keep an offer open. Id. comment e, illustration 4, based on Kucera v. Kavan, 165 Neb. 131, 84 N.W.2d 207 (1957). The other seems to involve a naked offer (an offer to buy whatever poultry the plaintiff raised), but the case upon which it is based makes clear that the offer was reinforced with a promise to take the poultry. Id. illustration 5, based on Abbott v. Stephany Poultry Co., 62 A.2d 243 (Del. Super. Ct. 1948). The issue in the case was one of mutuality of consideration.

22. Drennan, 51 Cal. 2d at 412, 333 P.2d at 758.

23. The Court based this holding on section 90 of the second Restatement of Contracts. 51 Cal. 2d at 414, 333 P.2d at 760. The court also relied on section 45, which makes an offer of unilateral contract binding once the offeree begins to perform the requested act. 51 Cal. 2d at 414, 333 P.2d at 759-60. However, the offer in Drennan was not for a unilateral contract. The sub sought a promise from the general rather than an act.

24. Both cases relied upon by the court in Drennan—Northwestern Eng'g Co. v. Ellerman, 69 S.D. 397, 10 N.W.2d 879 (1943) and Robert Gordon, Inc. v. Ingersoll-Rand Co., 117 F.2d 654 (7th Cir. 1941)—involved an express promise from a sub to a general and therefore did not raise the issue of reliance on an offer.

25. See, e.g., John Price Assocs. v. Warner Elec., 723 F.2d 755 (8th Cir. 1983) (Utah law); Allen M. Campbell Co. v. Virginia Metal Ind., 708 F.2d 930 (4th Cir. 1983) (North Carolina law);
Drennan and similar cases are considered anomalous, and section 87(2) is thought to have no application in other contexts. The section is a cipher, for it provides no standards to determine when offers, which generally may be revoked at will, may instead be reasonably relied upon. But a recent case that protected reliance on price information in slightly different circumstances may illuminate the factors in Drennan that give rise to an obligation to stand by an offer. The case is Twin City Fire Insurance Co. v. Philadelphia Life Insurance Co. It involved a mistaken price quote on an annuity made by an annuity agent to a broker and then communicated by the broker to an insurance agent. The insurance agent relied on the price quote in settling a claim against his company. The case held that the insurance agent had an action in contract against the broker and that the broker had an action in tort against the annuity agent.

Twin City is similar to Drennan in several important respects. Like Drennan, the case involved reliance on price information. Like Drennan, there was a mistake in communicating that information. Perhaps most important, in both Drennan and Twin City it was customary for price information to be provided and relied upon. As for Drennan, such a

custom is attested to by two studies of construction-industry practices that are roughly contemporaneous with Traynor's decision in Drennan, as well as evidence in more recent cases. As for Twin City, there was evidence that the insurance agent had used the broker's services to determine annuity prices a dozen times, and the broker had called on the annuity agent in this fashion at least six times.

The only significant difference in the two cases, albeit a difference that takes Twin City outside the literal ambit of section 87(2), is the fact that price information in Twin City was communicated through a price quote and not an offer. This is relevant, since price quotes are usually not very reliable, but in Twin City the trade practice of relying on price quotes overcame the general practice. Read together, these cases suggest a rule of liability for losses that result from mistakes in providing price information when there is a trade practice or course of dealing that supports reliance on such information.

Liability has also been imposed for mistakes in processing insurance applications. The issue arises when an applicant dies or is injured while an application is pending. The doctrine most directly concerned with mistake makes an insurer responsible for the loss if the insurer unreasonably delays in processing an application. Another doctrine makes an insurer liable for a loss if the insurer cannot establish that the application

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29. See infra note 55.
31. Twin City, 795 F.2d at 1420-21.
32. Id. at 1421.
is unsatisfactory according to the insurer's usual standards.\textsuperscript{35} This doctrine is most directly concerned with regulating bad faith (e.g., efforts by insurers to welsh on promises of binder coverage pending acceptance), but it also implicitly imposes a duty of care on an insurer in passing on an application, since there must be a good reason for rejection.

A third doctrine provides broader protection to insurance applicants. This doctrine presumes that unconditional binder coverage of interim losses is provided if a premium is paid with an application and conditions are not clearly stated in the application materials.\textsuperscript{36} Because the presumption imposes an unconditional obligation for interim losses, it obviates the need for rules that regulate bad faith or mistake in processing applications, and therefore it may in part respond to those concerns. However, the presumption may ultimately serve a different purpose. As we will see, a rule of liability for mistakes in processing applications may be justified on loss-avoidance grounds.\textsuperscript{37} The presumption of binder coverage has more to do with loss spreading: Making insurers liable for interim losses spreads the impact of such losses across all applicants and over time.\textsuperscript{38}

Similar to the insurance cases is \textit{Jacques v. First National Bank},\textsuperscript{39} where a bank was held liable for a mistake in processing a mortgage


\textsuperscript{37} Usually this is only a presumption. If an application or receipt given for a premium clearly states that binder coverage is subject to a condition such as obtaining a medical exam or approval by the company, most courts will respect that condition. See McCullers v. Auto-Owners Life Ins. Co., 771 F.2d 1491, 1493 (11th Cir. 1985); Spencer v. Phoenix Mut. Life Ins. Co., 760 F.2d 670, 673 (6th Cir. 1985); Rohde, 632 F.2d at 669; Inola Mach. & Fabricating Co. v. Farmers New World Life Ins. Co., 631 F.2d 712, 714 (10th Cir. 1980); Hildebrandt v. Washington Nat'l Ins. Co., 181 Mont. 231, 234-35, 593 P.2d 37, 39-40 (1979); Grandpre v. Northwestern Nat'l Life Ins. Co., 261 N.W.2d 804, 807 (S.D. 1977); Williams v. First Colony Life Ins. Co., 593 P.2d 534, 536-38 (Utah 1979).

\textsuperscript{38} The other two rules also serve to spread losses by limiting the period in which an applicant has only contingent coverage and by making that coverage meaningful.

\textsuperscript{39} 307 Md. 527, 515 A.2d 756 (1986). A claim for negligent processing of a mortgage application was allowed to proceed over a motion to dismiss on similar facts in High v. McLean Fin. Corp., 659 F. Supp. 1561 (D.D.C. 1987). In \textit{First Federal Savings & Loan Association v. Caudle}, 425 So. 2d 1050 (Ala. 1982), an Alabama court held that a bank had a duty to use care in processing a
application. The Jacques applied for a $100,000 mortgage from First National Bank, paid a fee of $144, and received a commitment that if the application were granted the mortgage rate would be 117/8%. Because of a mistake in assessing the Jacques's assets and liabilities, the bank approved a loan of only $41,400, which was far less than the Jacques needed to buy the house. Meanwhile, interest rates had risen to 137/8%. The Jacques took the mortgage of $41,400 offered by the bank, borrowed $50,000 more from the bank at 15%, and borrowed the balance needed to purchase the house from friends. The Jacques sued the bank for the difference in financing costs on a theory of negligence and won.

In Jacques and the insurance cases that involve mistaken denials or delays in processing applications, the applicant relies on the institution because an application is made with only one company, a practice encouraged by the charging of a fee or a premium with the application. Additionally, there are established procedures and standards for passing on applications, which also encourage reliance by the applicant and make it possible to tell if there has been a mistake or deviation from the standard by the insurance company or bank.

The problem of bad faith in these cases is closely related to that of mistake. We may expect a bank to be liable if it denies a mortgage application in bad faith in order to avoid a low interest-rate commitment in a time of rising rates, just as an insurance company is liable if it rejects a qualified applicant to avoid liability for a loss. We might also expect a sub who "lowballs" an offer to obtain work with the intent of later raising the price to be held to his offer. As we will see, bad faith is more

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40. Jacques, 307 Md. at 529, 515 A.2d at 757.
41. Id.
42. Id.
44. For a case that appears to involve such behavior, see Montgomery Indus., Int'l v. Thomas Constr. Co., 620 F.2d 91, 93 (5th Cir. 1980) (questioning the sub's allegation of mistake).
easily dealt with under traditional contract or tort doctrine than is mistake. But concerns of bad faith and mistake cannot be entirely disentangled. A rule that regulates mistake by requiring that price information be honored or by empowering courts to review the merit of the reasons for rejecting an application will also regulate bad faith. And a rule aimed only at bad faith will also expose mistakes as parties try to explain the revocation of offers or the denial of applications as results of honest mistakes.

We may account for all of these cases with the following rule: Reliance on price information or on approval of or timely action on an application or offer is protected if trade practice or course of dealing invites reliance or if price information is dishonored or approval of an application is denied or delayed because of an error or bad faith by the other party.45

B. UNHELPFUL DOCTRINE

The analysis up to this point is mostly descriptive. The more fundamental question is whether these decisions and the rule that may be drawn from them are right. The cases do not fit comfortably within conventional contract or tort doctrine. Indeed, it is not clear which of the two areas the cases belong in. Drennan is a contract decision. Jacques is a tort decision.46 Twin City is both: The claim of the insurance agent against the broker was in contract, and the claim of the broker against the annuity agent was in tort.47 This confusion is exemplified by the cases involving unreasonable delay in insurance-application processing.

45. Twin City Fire Insurance Co. v. Philadelphia Life Ins. Co., 795 F.2d 1417 (9th Cir. 1986), shows that the rule may apply to a person who communicates mistaken information from a third party. An action against a middleman failed in Atlantic Home Insulation v. James J. Reilly, Inc., 537 A.2d 126 (R.I. 1988). The case involved a claim by a contractor against a bonding agency alleging that the bonding agency was negligent in attempting to procure a performance bond from a bonding company. The contractor lost out on a large job because it could not obtain a bond in time. The court said that the bonding agency might well have been liable in tort if it had delayed in applying for the bond or in informing the contractor of the bonding company's rejection of the application. However, because the bonding agency had not acted dilatorily in transmitting the application and in informing the plaintiff of its rejection, the court held that the agency could not be held liable. Id. at 128. I think the decision is wrong. Recovery by the contractor may be justified on two grounds. First, when the contractor asked if it should seek a bond from an alternative source, the bonding agency assured the contractor there would be “no problem” in procuring the bond. Part II of this Article will show that such assurances may be a basis for a claim of negligent misrepresentation if the bonding agency did not have a reasonable basis for making the representation. Second, the bonding agency may also have been negligent if it did not communicate the need for quick action to the bonding company.

46. 307 Md. at 540-45, 515 A.2d at 762-65.
47. Twin City, 795 F.2d at 1430-31.
These cases employ a theory of waiver or estoppel, a theory that silence is an implied acceptance, a theory of negligence, and sometimes, for good measure, a combination of these theories.

Efforts to ground these cases on traditional contract doctrine are unconvincing because there is no promise. Obligation in contract is supposed to be promise based. Many of the cases find the necessary promise by implication, but not very persuasively. In Drennan, Traynor found an "implied in fact or law" promise from the sub to the general to keep the sub's offer open. An implied in law promise is, of course, a fiction, and one strangely employed in Drennan because the general has no possible restitution claim, since the general confers no benefit on the sub. Nor is there really a basis for implying a promise in fact. This requires that the sub knew or should have known that the general would think there was a tacit commitment to keep the offer open. But the general rule is that an offer is revocable at will unless it is expressly made irrevocable. One might still find an implied promise if the parties understood there was a

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52. Drennan v. Star Paving Co., 51 Cal. 2d 409, 414, 333 P.2d 757, 760 (1958). See Barnett & Becker, Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations, 15 Hofstra L. Rev. 443, 458-60 (1987). Cf. Alaska Bussell Elec. Co. v. Vern Hickel Constr. Co., 688 P.2d 576, 579-81 (Alaska 1984) (finding that the sub's promise was implied in law). The promise crucial to Drennan is a promise to keep the offer open. All offers have a promissory quality, for acceptance binds the offeror, but that promise is beside the point in Drennan because it requires or is conditional upon acceptance. This is one of Learned Hand's arguments in James Baird Co. v. Gimbel Bros., 64 F.2d 344, 346 (2d Cir. 1933). Hand also argued that only nonbilateral promises are unconditional and might support a claim of promissory estoppel. For a discussion of this issue, see Henderson, Promissory Estoppel and Traditional Contract Doctrine, 78 Yale L.J. 343, 355-57, 366-68 (1969).
53. Restatement (Second) of Contracts § 42 (1979). See Sturp, Promissory Liability, 7 U. Chi. L. Rev. 1, 10 n.26 (1939). The Uniform Commercial Code ("UCC") similarly makes binding "[a]n offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurances that it will be held open." UCC § 2-205 (1978) (emphasis added). One case holds that an offer without such assurances and therefore not binding under § 2-205 is still enforceable under a theory of promissory estoppel. Janke Constr. Co. v. Vulcan Materials Co., 386 F. Supp. 687, 691-92, 695 (W.D. Wis. 1974). The leading treatise on the UCC agrees with this result. J. White & R. Summers, Uniform Commercial Code 50 (3d ed. 1988). One might criticize the use of promissory estoppel where the lack of a promise or a commitment to keep an offer open has been found to bar recovery under section 2-205. But this might be explained by reasoning that an implied promise that did not satisfy the formal requirements of section 2-205 would suffice for promissory estoppel because of the additional element of reliance.
commitment, but Traynor said nothing about this. In addition, the evidence from the period (two studies of practices in the construction industry in Indiana and Virginia that predate and antedate Drennan by a few years) suggests that at that time people in the trade probably did not assume subs were legally bound to stand by their offers (though subs were considered morally bound to do so).

Similarly, in the insurance cases, courts imply a promise of binder coverage by reasoning that applicants expect such coverage, but usually without any empirical evidence to show that there truly is such an expectation and sometimes despite facts that make any such expectation unreasonable. And in Twin City it is difficult to say what the broker and the annuity agent should have understood their obligations to be.

54. Cf. N. Litterio & Co. v. Glassman Constr. Co., 319 F.2d 736, 740 (D.C. Cir. 1963) (remanding for evidence on whether the general's reliance on the sub's offer was reasonable in light of trade custom); Vincent DiVito, Inc. v. Volmar Clay Prods. Co., 179 Ill. App. 3d 325, 330, 534 N.E.2d 575, 577-78 (1989) (holding same). The Drennan court at one point seemed to say that the parties' expectations did not matter. In rejecting Star Paving's argument, it stated that "[e]ven had it been clearly understood that defendant's offer was revocable until accepted, it would not necessarily follow that defendant had no duty to exercise reasonable care in preparing its bid." Drennan, 51 Cal. 2d at 416, 333 P.2d at 761. This may just be careless dicta, or it may suggest that the court thought the duty to be tortlike.

55. See Schultz, The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry, 19 U. Chi. L. Rev. 237 (1953); Note, Another Look at Construction Bidding and Contracts at Formation, 53 Va. L. Rev. 1720 (1967) (authored by J.C.C., Jr.). In the Indiana study, 70 of 93 subs surveyed said they considered firm offers binding. Schultz, supra, at 268. Although 70 described this as a moral obligation, only 4 said it was also a legal obligation. Id. Thus, only 4 of 93 thought firm offers legally binding, and 23 of 93 did not even think of them as morally binding. In the Virginia study, 65 of 67 generals said that it would be "unjust" for a sub to withdraw a firm offer. Note, supra, at 1740. It is striking that few differentiated between firm and naked offers. In the Virginia study, 44 of 51 subs said there was no difference between the two, though they said this in response to a question that asked, confusingly, if the sub thought the form of the offer mattered whether both the general and the sub were bound. Id. at 1734. Similarly, only 9 of 60 generals thought that naked offers were less binding than firm. Id. at 1740. Confusion is also suggested by the Indiana study, which did not differentiate between the two types of offers, though one sub volunteered that an offer was binding only if it was firm. Schulte, supra, at 267.


57. For example, in Collister the presumption was applied even though the receipt given for the premium stated in plain English printed in boldface type at the top of the receipt that coverage was conditional upon the applicant obtaining a medical exam and approval of the company. Collister, 479 Pa. at 595, 388 A.2d at 1354. The court simply asserted that insurance contracts are not likely
The annuity agent quoted the broker what he called a "ballpark figure" with which he was "comfortable" but that was "unconfirmed." The broker relayed the price quote to the insurance agent in roughly the same terms, telling the agent that he was "comfortable" with the quote and that it could be relied on but reminding the agent that the quote was given under time pressure and perhaps saying it was an unconfirmed price. Typically, price quotes are thought to entail no obligation at all. It is not clear that saying one is "comfortable" with a price quote and that the price quote can be relied upon, as the broker did, translates into a promise. As for the broker's claim against the annuity agent, the statements that the price was "unconfirmed" and a "ballpark figure" make it even more difficult to find a promise. This may explain why the broker's claim against the annuity agent was brought in tort.

The insurance cases involving bad faith denials fit more easily within traditional contract doctrine. These cases hold that an insurer cannot welsh on a promise of binder coverage by rejecting an application that meets its normal standards when there has been a loss while the application is pending. The doctrine of good faith is often employed in this fashion to protect contract-based expectations by preventing one party from using a power under a contract to deprive the other party of something promised. In other words, a power cannot be used in good faith to evade a promise. The insurance cases fit squarely within this paradigm, for they prevent an insurer from using its power to approve or deny an application to evade its promise of binder coverage. At a more fundamental level, the bad faith cases are consistent with conventional
contract theory because they enforce a commitment made by the parties. Contract law is supposed to be a system for carrying out the will of individuals. The theory is that courts enforce contracts that people make. If an insurer promises binder coverage but conditions that promise on approval of an application, we think the insurer limits its power of disapproval in some fashion by making that commitment. In the other cases, it is harder to argue that the defendant intended to undertake the obligation the courts impose.

This is not to say that it is impossible to justify these cases within contract conventions. The conventions are too loose to justify such a categorical claim. In Drennan, for example, we might reason that a general expects a sub to be careful in communicating price information, that this expectation attests to an implied promise by a sub to use care, and that this implied promise is a basis for bringing a contract claim. This was essentially the chain of reasoning in Jacques. As Charles Fried has observed, it is always possible to turn tort into contract in this fashion by reasoning that when people interact there is an implicit agreement to be responsible for the foreseeable risks of their conduct. Moreover, now that Drennan is on the books, subs should know they undertake a commitment when they provide price information. The law can influence expectations. But if these decisions meet some minimum standard of doctrinal credibility, they are hardly compelled by the traditional norms of contract. The question arises, Why push the law in this direction?

These cases are not well grounded on conventional tort doctrine either. The closest torts are negligent misrepresentation and negligent assistance. The first lies for a negligent statement on which another relies to his or her detriment; the second lies for a negligent attempt to aid

66. Of course, there are exceptions to this. The law will not enforce bargains that are unconscionable or products of duress. Additionally, contracts are defined objectively and not subjectively, and the law stands ready to fill in terms that people did not think about or to revise a contract in light of unforeseen circumstances. But these aspects of the doctrine are consistent with the idea that courts enforce contracts that people make. The objective definition of contract may be explained as a response to evidentiary problems or, more grandly, as a system defining a language of contract that people may use. People depend upon the law to provide rules for unforeseen or unthought-of contingencies. Cf. Fuller, Consideration and Form, 41 Colum. L. Rev. 799, 806-08 (1941) (arguing that contract interpretation that is objective and in which gaps are filled and mistakes are corrected is not inconsistent with the value of individual autonomy but rather promotes autonomy by securing exchanges); C. Fried, supra note 14, at 88 ("[T]he liberal conception of contract is made to look inadequate by having foisted upon it an untenable conception of language.").


another that instead causes harm.\textsuperscript{70} Both torts can be illustrated by a case where a bus driver negligently signals to a disembarking passenger that it is safe to cross the street and so beckons the passenger to step in front of an oncoming automobile.\textsuperscript{71} Negligent misrepresentation lies because of the false signal, and negligent assistance lies because the driver causes injury to the passenger by providing aid negligently. The torts will always overlap in this fashion when assistance takes the form of a representation.

But there are doctrinal limits that make these torts difficult to apply to mistakes in bargaining. The tort of negligent misrepresentation is fairly novel. Some courts do not recognize the tort at all,\textsuperscript{72} and others apply it only to persons in the business of providing information of the sort relied upon\textsuperscript{73} or to persons in close or confidential relationships.\textsuperscript{74} Where the tort is recognized, it generally lies only for misstatements of present facts and not for misstatements about future behavior or events.\textsuperscript{75} The representations here are forward looking (e.g., statements about the price at which one will deal) and do not concern present facts. These problems are not insurmountable. Part II will show that the law in this area has become more liberal, at least in some states, to a point where the tort of negligent misrepresentation might apply where there is an affirmative misrepresentation (e.g., in the price-information cases).\textsuperscript{76} But while these decisions might plausibly be grounded on the expanded tort, this result is hardly compelled under existing law.

There are greater problems with applying the tort of negligent assistance. For it to lie, there must be an "undertaking" to assist the plaintiff,\textsuperscript{77} and so, for example, in the insurance cases we are faced with the problem of determining what an insurer "undertakes" to do by taking an application. This problem is not much different from asking what an insurer promises; indeed, the words "promise" and "undertake" are

\textsuperscript{70.} \textit{Id.} § 323 (1965).
\textsuperscript{74.} Western Energy v. Georgia-Pacific Corp., 55 Or. App. 138, 146, 637 P.2d 223, 228 (1981) (holding that, under Louisiana law, tort does not lie when people deal at arm's length).
\textsuperscript{76.} \textit{See infra} notes 165-178 and accompanying text.
\textsuperscript{77.} \textit{RESTATEMENT (SECOND) OF TORTS} § 323 (1965).
synonyms. Some cases hold that an act that benefits another is an undertaking to provide that benefit only if the act is done with that objective in mind and not for another reason.\textsuperscript{78} Some such limit on the tort is essential; otherwise every act that indirectly benefits others would give rise to a duty. By this standard, taking an application would not be an undertaking because an insurer does this for its own benefit and not for the benefit of the applicant. Moreover, it used to be thought that this tort would lie only if the defendant actually began to do what it undertook. That is, the tort would lie for misfeasance but not for nonfeasance.\textsuperscript{79} In addition, the tort is sometimes said to lie only for physical harm and not for economic harm.\textsuperscript{80} Again, it may be possible to overcome these doctrinal barriers, but this result is hardly compelled under existing law. Again the question arises, Why push the law in this direction?

C. FAIRNESS

To answer this question, we must look outside the law to consider what values may be at stake.\textsuperscript{81} There is a tendency to explain these cases according to principles of fairness. In \textit{Drennan}, Traynor said that it was only fair for a sub to honor the offer since the sub wanted and had a stake in the general's reliance.\textsuperscript{82} In the insurance cases, a rule of binder coverage has been justified on grounds of fairness,\textsuperscript{83} sometimes on the reasoning that "the public has a right to expect that they will receive something of comparable value in return for the premium paid."\textsuperscript{84} There is similar reasoning in \textit{Jacques}, for the court emphasized that the bank benefited from the application, both in receiving a fee and in securing a potential

\textsuperscript{79} \textit{RESTATEMENT (SECOND) OF TORTS} § 323, comment d, caveat 1 (1965).
\textsuperscript{80} \textit{Id.} § 323. \textit{But see Colonial Sav. Ass'n v. Taylor}, 544 S.W.2d 116, 120 (Tex. 1976).
\textsuperscript{81} This suggests a perspective on the relationship of law and moral philosophy that is the opposite of Charles Fried's picture "of philosophy proposing an elaborate structure of arguments and considerations that descend from on high but stop some twenty feet above the ground. It is the peculiar task of law to complete this structure of ideals and values, to bring it down to earth. . . ." Fried, \textit{supra} note 68, at 231. Once we reach the ground, legal doctrine sometimes proves indeterminate. Then we have little choice but to refer to economics or other aspects of moral philosophy to decide what to do.
\textsuperscript{83} Rakoff, \textit{supra} note 57, at 1269.
\textsuperscript{84} Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 594, 388 A.2d 1346, 1353 (1978), cert. denied, 439 U.S. 1089 (1979). \textit{See also id.} at 595, 388 A.2d at 1354 ("Courts must also keep in mind the obvious advantages gained by the insurer when the premium is paid at the time of application. An insurer should not be permitted to enjoy such benefits without giving comparable benefit in return to the insured.").
borrower, and the court stressed that the Jacques were "vulnerable and dependent" upon the bank.

But the fairness argument does not work well. It may be that fairness is conceived in terms of some universal principle or axiom defining a person's obligations to others (e.g., a person may not cause injury to others), but it is impossible to explain these cases in that fashion. Any principled argument we might construct for these decisions ends up turning on question-begging assumptions or is descriptively inaccurate (that is, it cannot account for some cases). For example, some of the cases suggest a principle that an individual should be responsible for injuries negligently inflicted on another when the individual benefits from his or her relation with the other. This principle is not implausible, for it draws on familiar concepts in tort and restitution. But it falls apart on closer inspection. The benefit to the defendant is often debatable. In Drennan, for example, it is not clear how a sub benefits from a general's reliance on its offer. A general is under no obligation to employ a sub, and if a sub is low bidder in a region and has a reputation for reliability, the sub should get the job regardless of which general wins the prime contract. The sub benefits from participating in the industry, but reliance on such generalized benefits as a basis for obligation makes it possible to justify any sort of obligation under the principle. Furthermore, the

86. Id. at 540, 515 A.2d at 762.
87. See Epstein, A Theory of Strict Liability, 2 J. LEGAL STUD. 151 (1973) (arguing that underlying the law of torts is the principle of strict liability for harm caused to others). A problem with this principle is that causal arguments depend on assigning to one party a right to a particular status, so we may say that by interfering with that right the other party caused him harm. For example, we cannot assign cause when industrial emissions destroy neighboring crops until we have decided whether the position of the factory or the farm is privileged. The injury results from the interaction of the two. And there is no reason, a priori, to privilege factory or farm. See Coase, The Problem of Social Cost, 3 J. L. & ECON. 1, 2 (1960). Epstein would place responsibility on the acting party who sets into motion forces causing injury. Epstein, supra, at 184-85. But this move has been questioned on moral, logical, and semantical grounds. See, e.g., Kelman, The Necessary Myth of Objective Causation Judgments in Liberal Political Theory, 63 CHI.-KENT L. REV. 579, 583-85 (1987); Kleinig, Criminal Liability for Failures to Act, 49 LAW & CONTEMP. PROBS., Summer 1986, at 161.
89. At a deeper level, this sort of argument may rest on an idea of fairness that holds that reciprocal benefits are relevant to the fairness of state-imposed obligations. For example, John Rawls postulates as the "principle of fairness" that when people engage in just, mutually advantageous, collective action, voluntarily restricting their own liberty, they may insist upon similar acquiescence from all who voluntarily accept the benefits of that action or who take advantage of the opportunities it offers. J. RAWLS, A THEORY OF JUSTICE 112 (1971). Rawls justifies promise keeping by this principle of fairness. Id. at 345-47.
principle is descriptively inaccurate. In many states, for example, accountants are not liable to third parties who detrimentally rely on their reports, even where negligence, injury, and reciprocal benefit exist. Indeed, if we extracted the background principle in torts from the cases finding no general duty of care, we would conclude that an individual is liable for injuries negligently inflicted upon another only if there is a special relationship, such as privity, with the other. This might lead us to reaffirm the traditional rule that there is no duty of care in arm’s-length bargaining.

Perhaps we might define what is fair not by some universal axiom but instead by what a community thinks is fair. These social norms might ultimately derive from people’s views on such things as negligence, causation, or reciprocity, but their views need not be consistent or even particularly coherent. That people believe something to be fair would be all that matters. Such an approach to defining fairness might explain Drennan, for there is evidence that virtually everyone in the construction industry thought that subs were under a moral obligation to stand by their offers.

But there are problems with this approach as well. First, claims about what people think is fair are often made without empirical basis.

91. The leading case is Ultramares Corp. v. Touche Ross, 255 N.Y. 170, 174 N.E. 441 (1931). It holds an accountant liable to third parties for negligence (fraud is a different matter) only if there is some connection between the accountant and the party that makes the accountant aware of the party’s specific reliance. See also Credit Alliance Corp. v. Arthur Andersen & Co., 65 N.Y.2d 536, 483 N.E.2d 110 (1985). Some states are less protective of accountants. The most liberal hold an accountant liable to anyone the accountant might have foreseen would rely on a report. H. Rosenblum Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983); Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 335 N.W.2d 361 (1983). Some make an accountant liable to any individuals the accountant knows will rely on a report. Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 451 A.2d 1308 (1982); Raritan River & Steel Co. v. Cherry, Bekaat & Holland, 322 N.C. 200, 367 S.E. 2d 609 (1988).


94. See supra note 55.
For example, the argument that it is unfair for an insurer to condition binder coverage because that violates social norms is hardly credible given that the practice is tolerated most everywhere and is fairly common in the industry. Second, even if a social norm can be established, it is not clear the norm should necessarily translate into legal obligation. It often does not. Indeed, the law imposes no duty on a general to employ a sub whose offer he uses in bidding on a contract, though most in the trade seem to think that a general is morally bound to do so. Nor would we want all moral obligations to become legal duties, for acting morally loses much of its appeal if it is mandatory. Until these problems are resolved, appeals to communal norms of fairness as bases for legal obligation can persuade only those already committed to the norm.

D. Efficiency

But it is unnecessary to base these decisions on fairness, since most can be justified on utilitarian grounds. These cases involve allocating a loss from an error. The rules announced in these cases, viewed prospectively, minimize losses from errors in contract formation by imposing the loss on the better cost avoider. This is a familiar goal of tort law. Defendants in the cases discussed in Part I, Section A know better than plaintiffs the information relevant to determining the optimal level of care—the risk of error and the potential harm from an error—and so can best protect against the loss. Defendants can best assess the risk of error because the error occurs in their operations. They can also assess the

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95. Rakoff, supra note 57, at 1269.
97. For example, though most would agree that a person by a pool should help a drowning child by tossing the child a life preserver, the law imposes no such obligation. See W. PROSSER, supra note 92, at 375-76.
98. See supra note 55.
101. Three-party cases, such as Twin City Fire Insurance Co. v. Philadelphia Life Insurance Co., 795 F.2d 1417 (9th Cir. 1986), pose a special problem. Liability of an intermediary may be justified if the intermediary commits an error. For example, in Twin City the annuity broker may have erred in not clarifying the unreliability of the price quote with the annuity agent or in not warning the insurance agent of its unreliability. Or an intermediary might be held liable so that the cost would be passed on to the party ultimately responsible for an error.
potential loss from an error as well as or better than plaintiffs. In the insurance cases, the potential loss depends on the amount of coverage and the mortality risk, things insurers know as well as or better than applicants. In the mortgage application cases, the potential loss depends partly on fluctuations in the interest rates, something lenders usually know better than borrowers, especially if the borrowers are consumers. In the price-information cases, the potential loss is the difference between the quoted price and the market price of the goods. If the defendants’ prices are competitive, this difference will approximate the amount of their error.

It is fairly easy to determine that the defendants are the better cost avoiders in these cases because the defendants have as good or better access to all the information relevant to determining the proper level of care. The problem of loss allocation is more difficult when neither party has such a decisive informational advantage. In some situations, generals may be able to spot an error in an offer more easily than subs, since generals have access to price information from several sources and can therefore spot discrepancies that suggest a mistake has been made. In the Drennan context, the law can and does account for this factor by denying recovery where the price discrepancy is so great that a general should have suspected an error.102

Plaintiffs might also be able to better protect against consequential losses. Consider a case where a general relies on a sub to provide services that are not available elsewhere and that are essential to performing a contract. If the sub revokes its offer, the loss to the general is both lost profits on the contract and damages owed because of the breach. The general knows of this risk: the sub may not. In such a case, we may want to impose the risk of loss on the general to ensure that the general communicates the gravity of any reliance to the sub.103

Concerns of utility usually do not figure significantly in the analysis of the merit of contract terms, however, because it is assumed that people will bargain for the best terms. In the Drennan situation, for example,


103. We might account for this factor by using the contract doctrine that makes a breaching party liable only for foreseeable harms. E. FARNSWORTH, supra note 102, § 12.14, at 873-81.
one might think that if a sub can best ensure the validity of price information and so diminish potential losses, a general will bargain for such assurances by obtaining a firm offer. In the insurance cases, if binder coverage is desirable, we may expect people to purchase it.

On a more general level, the Coase theorem questions the efficiency of state intervention in the market by positing that in a world without transaction costs people will arrange their affairs in the most mutually beneficial fashion, regardless of how rights are assigned by law.\textsuperscript{104} Coasean analysis questions not only whether state intervention in the market is needed but also whether intervention of the type in these cases can have any impact. Some of the rules are only interpretive presumptions. In most states an insurer may disclaim binder coverage,\textsuperscript{105} and in \textit{Drennan} Traynor said a sub could reserve the right to revoke an offer.\textsuperscript{106} The conventional wisdom is that such presumptions cannot significantly alter people's behavior because people will simply opt out rather than change their behavior.\textsuperscript{107}

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\textsuperscript{104} Coase, \textit{supra} note 87, at 8, 15. Some argue, from the precisely opposite perspective, that legal rules have no effect on people's behavior. They believe that such factors as ignorance of the law and facts, incompetence, the small size of penalties, and people's interest in behaving in risky ways often lead people to act in disregard of the law. See Sugarman, \textit{Doing Away with Tort Law}, 73 \textit{CALIF. L. REV.} 555, 564-73 (1985). Cf. Siliciano, \textit{Corporate Behavior and the Social Efficiency of Tort Law}, 85 \textit{MICH. L. REV.} 1820 (1987) (focusing on how bankruptcy law undermines the deterrent effect of rules). There is some empirical data to support this position, see G. Eads & P. Reuter, \textit{Designing Safer Products: Corporate Responses to Product Liability Law and Regulation} vii-ix (1983) (finding that manufacturers do not respond to product liability laws), although there is also empirical data to the contrary, see W. Landes & R. Posner, \textit{The Economic Structure of Tort Law} 9-14 (1987) (collecting data). The reality probably is somewhere between these two extremes; i.e., people respond to the law, but imperfectly. Some factors suggest the rules considered here will be more effective than the usual tort rule. They influence discrete groups of specialists with professional organizations and associations to disseminate information about the rule. Cf. Givelber, Bowers & Blitch, Tarasoff, \textit{Myth and Reality: An Empirical Study of Private Law in Action}, 1984 \textit{WIS. L. REV.} 443 (finding that 75% of therapists knew of the Tarasoff case, which held a therapist liable for failure to warn of a patient's dangerous propensity, though most misunderstood the case's holding). The rules are quite specific about what is demanded. One reason tort rules do not influence behavior is because of uncertainty about what the vague standard of negligence requires. G. Eads & P. Reuter, \textit{supra}, at ix.

\textsuperscript{105} See \textit{supra} note 36.


\textsuperscript{107} Thus, many think interpretive presumptions are empty gestures, hardly worth fighting for or arguing over. See, e.g., Johnson, \textit{Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Toward a Theory of Relational Leases}, 74 VA. L. REV. 751, 770 (1988) (arguing that it would be a "farce" to interpret as a mere presumption lessors' duty of good faith when the lessors review lease assignments); Suustein, \textit{Rights, Minimal Terms, and Solidarity: A Comment}, in \textit{Labor Law and the Employment Market} 97, 108-09 (1985) (arguing that a mere presumption that job termination must be for cause is unimportant).
But a case can be made for state intervention in these cases on the familiar ground of market failure. Left alone, people may not establish the optimal arrangement. The risk of market failure is clearest in the insurance- and mortgage-application cases. Ignorance is a problem. Consumers are likely to underestimate the risk that a mistake will be made in processing an application. Additionally, they may underestimate the risk that they will die or be injured while an insurance application is pending. They may not read a contract and therefore may not know of disadvantageous terms. Even if individual consumers accurately assess a risk and read a contract, bargaining for other terms is difficult because the contract is one of adhesion. Consumers may be unable to negotiate different terms because they deal with agents who cannot alter a form contract.

Market failure is not inevitable even though some consumers are ignorant of risks and contract terms are nonnegotiable. If a significant number of consumers assess a risk accurately, read a contract, and state a preference, companies may be expected to modify their form contracts to satisfy the demands of this group to the benefit of all consumers. But such foresight and diligence cannot be expected of a significant number of consumers when the risk is remote (e.g., the risk of a processing error) or when an ambiguously drafted contract makes a company’s obligations unclear.

Market failure might seem less a risk in Drennan and Twin City. The parties are fairly sophisticated, they have comparable wealth, and they can bargain. Problems of communication, externalities, collective action, and wealth effects, which are usual sources of market failure, are absent. But there are reasons to suspect private arrangements even here. Subs tend to call in offers all at once and at the last moment before a general’s bid on a contract is due. In the confusion, it may not be possible to spell out the terms of each offer. There may be more fundamental barriers to bargaining. Friends of mine in the T-shirt printing trade, who have been in the position of both sub and general in the Drennan situation, tell me that they usually do not question or stipulate as to the reliability of a bid. They are reluctant to raise the issue of legal obligation, even if it worries them, because this might be taken as an insult.


110. I am told that in the construction industry in Dallas subs deal with this problem by filing offers that spell out all the terms except price days before the bidding frenzy.
by the other party. A lackadaisical approach to ensuring offers are binding may also be encouraged by the custom of honoring offers since it makes revocation seem less likely.\textsuperscript{111}

A recent study by Professor Stewart Schwab casts empirical doubt on the reliability of market arrangements even in cases where no obvious impediments to bargaining exist. In a test involving negotiation of a labor contract by teams of students, Schwab found that changing the presumptions governing interpretation of the contract had an allocative and distributive impact on the outcome of negotiations.\textsuperscript{112} There may be real-world confirmation of this experiment in the history of Drennan. Before Drennan, generals seemed to tolerate having no legal rights against subs, for few took corrective measures.\textsuperscript{113} After Drennan, there have been few reported cases where subs have reserved the power to revoke an offer.\textsuperscript{114} The Drennan presumption has seemed to stick. Schwab suggests that a presumption sticks because it signals to people that a right is something valuable.\textsuperscript{115} Others suggest that an initial assignment of rights may have an allocative and distributive impact because people will charge more to relinquish a right than they will pay to obtain it.\textsuperscript{116} The effect may be due to this phenomenon, or it may be that people are reluctant to vary a norm or to raise issues of legal duty in bargaining out of fear of giving offense and chilling negotiations.

Whatever the explanation, the "stickiness" of presumptions is important for two reasons. First, it suggests that interpretive presumptions can have an allocative impact. They matter. Second, it raises questions about the bargaining process. Coase is theoretically correct—presumptions can stick only if there are impediments to bargaining. Otherwise, if people were omniscient and transactions costless, people

\begin{footnotes}
\item[111] See supra note 55.
\item[113] Schultz, supra note 55, at 261-62 (reporting that 48 of 80 generals never considered a device to bind subs).
\item[115] Schwab, supra note 112, at 260-61.
\item[116] Scott, supra note 112, at 351; M. KELMAN, A GUIDE TO CRITICAL LEGAL STUDIES 147-48 (1987) (discussing the offer/asking price phenomenon).
\end{footnotes}
would bargain for the optimal set of rights and obligations regardless of interpretive presumptions. But what was a critique of presumptions becomes, when the real impact of presumptions is taken into account, a potentially devastating critique of the assumptions about human behavior underlying the Coase theorem. People seem to behave irrationally, or at least they seem to be less than completely free agents who treat all matters as negotiable as they strive to maximize their welfare.

The apparent impact of the rule change in *Drennan* also belies the claim that the pre-*Drennan* rule provided the optimal level of deterrence of sub errors because of the extralegal moral or reputational sanctions that faced a reneging sub. On the surface this claim seems credible, for a pre-*Drennan* study reported that few generals had problems with subs reneging. But this claim does not square with people's behavior after *Drennan*. If the legal remedy added on top of the extralegal sanctions is excessive or unnecessary, we would expect that people would opt out of the *Drennan* rule or at least that generals would not waste resources pursuing the legal remedy. But the number of reported cases where generals have sued reneging subs, which presumably represents the tip of a much larger iceberg of unreported cases and settlements influenced by the rule, suggests that generals do resort to the legal remedy with some frequency. At the least, it is impossible to conclude that one or the other arrangement is self-evidently in people's interests because they tolerate it. Subs and generals seem willing to operate under either arrangement.

One might wonder why, if we think these rules allocating losses to subs who misquote prices or to banks or insurers who mishandle applications efficient, we permit people to opt out of the rules. Why tolerate

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117. *See R. Scott & D. Leslie, Contract Law and Theory* 222 (1988). Scott and Leslie suggest this was because generals could rely on extralegal sanctions—e.g., refusing to deal with renegers—to force subs to stand by their offers. The Virginia study suggests, however, that generals relied more on moral suasion than on such sanctions. Note, *supra* note 55, at 1734-35 (reporting that 51 of 52 subs said they would honor an offer even though it was mistaken because of moral or legal obligation, and 17 of 28 said they would honor an offer because of fear of loss of reputation). The Illinois study emphasizes the reputational sanction. Schultz, *supra* note 55, at 261-62.


119. See *supra* note 25.

120. If we rely on moral or reputational sanctions to deter sub errors, then we might agree with the *Drennan* decision because of a concern that denying the legal obligation might undercut the moral obligation. This concern is wholly instrumental. One might also argue that fairness requires us to conform the moral and legal rules. If we rely on the moral rule to regulate subs, then we might want to conform the legal rule to the moral to avoid enriching people who act immorally. If most subs honor mistaken offers out of a sense of moral duty, then we may not want to permit the Star Pavings of the world to be enriched by violating that moral rule.
MISTAKE IN CONTRACT FORMATION

what would seem to be suboptimal arrangements? Generally, disclaimers of liability for negligence are met with hostility by courts hearing tort claims, and this is applauded by some in the law-and-economics school who usually respect private bargains because they think no rational person would knowingly assent to such an arrangement. But there is an explanation for why we sometimes tolerate disclaimers in these cases (and sometimes do not), an explanation that is entirely consistent with utilitarian values. Disclaimers might be tolerated when and to the extent we are uncertain about the utility of a rule allocating a loss. Usually economic analysis is based on quite limited knowledge, and even if the analysis is generally valid, it may not apply in a particular case. Given any significant uncertainty about the desirability of a rule, we might permit people to opt out because we think they may better judge their own interests, so long as we think the alternative arrangement is intelligently chosen. Thus, our concern for autonomy is strong because of pervasive problems of knowledge, but it is ultimately derivative of utilitarian concerns. Indeed, the moral argument for disclaimable rights might be best assessed in these terms (once we realize they do more than simply save people the cost of spelling out desired terms), for disclaimable rights are attempts to modify people’s behavior that do not interfere with people’s autonomy in a significant way.

Thus, whether a disclaimer is recognized should be a function of our degree of certainty about the utility of an obligation and our assessment of whether the disclaimer was intelligently chosen. These factors are related because the more certain we are of the utility of a rule, the more we doubt the intelligence of a contrary arrangement. These two factors (especially the second, which is more easily known) explain much of the case law or at least provide a basis for assessing conflicting decisions. Courts should not respect ambiguous or inconspicuous disclaimers (and generally they do not) because such disclaimers may not be a product of an intelligent choice. In one of two cases where a sub attempted to

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123. For a more general argument along these lines, see R. Hardin, supra note 17, at 139-42.

124. See Ransom v. Penn Mut. Life Ins. Co., 43 Cal. 2d 420, 274 P.2d 633 (1954) (disregarding a disclaimer of binder coverage because it was ambiguous). A similar rule exists in torts: A disclaimer that is not per se invalid will be enforced only if the disclaimer and the risk it concerns are clearly brought to the attention of the injured party. See Gross v. Sweet, 49 N.Y.2d 102, 400 N.E.2d 306 (1979) (finding that a disclaimer of liability by a parachute-jumping school was enforceable only if the injured party was told the risks of jumping).
reserve the power to revoke an offer, the court disregarded the provision because it was hidden in a form.\textsuperscript{125} Even if a disclaimer is conspicuous and unambiguous, it should not affect liability for remote risks that a person would not realize are covered by the disclaimer. Thus, a disclaimer of binder coverage might suffice for the ordinary risk of death or injury during the normal period it takes to process an application (this is the rule in most states),\textsuperscript{126} but it might be insufficient to protect an insurer if it delays in acting upon an application. Applicants might not realize that they were undertaking the more remote risk of an extended period without coverage. This would justify the policy of some states of holding unreasonable delays tortious but otherwise permitting insurers to disclaim binder coverage.\textsuperscript{127} This also reveals the circumstances that might necessitate Pennsylvania’s additional requirement that conditions on binder coverage must be brought to the attention of applicants by insurance agents.\textsuperscript{128} The additional requirement is necessary if a significant number of people fail to read insurance contracts. There is, unfortunately (and surprisingly), little good data on this.\textsuperscript{129} If a significant number of people do not read insurance contracts, one might argue that


\textsuperscript{126} See supra note 36.

\textsuperscript{127} See De Ford v. New York Life Ins. Co., 75 Colo. 146, 224 P. 1049 (1924); Brand v. International Investors Ins. Co., 521 P.2d 423 (OkI. Ct. App. 1974); Kukuska v. Home Mut. Hail-Tornado Ins. Co., 204 Wis. 166, 235 N.W. 403 (1931). In Continental Life & Accident Co. v. Songer, 124 Ariz. 294, 603 P.2d 921 (1979), the court held that a term in the application that made coverage conditional on acceptance barred proof of contrary oral representations by the agent under the parol evidence rule. Nevertheless, the court still found the delay in processing actionable. Id. at 302, 603 P.2d at 929. Additionally, provisions in an application specifying the period of review have been enforced. Gillilan v. Federated Guar. Life Ins. Co., 447 So. 2d 668 (Ala. 1984) (holding that a 44-day delay is not unreasonable when the contract provides for action within 60 days).

\textsuperscript{128} Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 598, 388 A.2d 1346, 1355 (1978). This case involved an insurance-premium receipt that stated at its top in plain English and in boldface type that binder coverage was conditional upon the applicant having a medical exam and upon approval of the company. Id. at 598, 388 A.2d at 1356. A few other states have required such oral disclosure in similar contexts. Colorado has adopted a similar rule in a case involving a release. Sanchez v. Connecticut Gen. Life Ins. Co., 681 P.2d 974, 977 (Colo. Ct. App. 1984). An Alaska case also suggests a similar rule for binders, though it could be explained as well by the ambiguity of the disclaimer. Puritan Life Ins. Co. v. Guess, 598 P.2d 900, 906 (Alaska 1979).

\textsuperscript{129} Some studies suggest that consumers do read contracts in large or unusual transactions if the contracts are clear and readable. Brandt & Day, Information Disclosure and Consumer Behavior: An Empirical Evaluation of Truth in Lending, 7 Mich. J. L. Ref. 297 (1974) (finding mandatory disclosure laws effective). Cf. Davis, Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer Credit Contracts, 63 Va. L. Rev. 841 (1977) (finding that comprehension improves if terms are simplified and information is limited). However, these studies were conducted in artificial circumstances. People were given a contract to read, and they knew they would be asked about its terms.
Pennsylvania’s additional requirement should be adopted, since its costs are slight.\textsuperscript{130}

II.

\textit{Drennan} and the other cases covered in Part I are fairly easy to deal with because they involve regularized or systematized conduct in bargaining that makes reliance reasonable and failures to contract suspect. This also makes it possible to bound the rule of liability in fairly concrete terms by requiring that reliance be based upon trade practice or course of dealing. This part takes up the more difficult problem of reliance based on things said or unsaid in more irregular negotiations. It first explains the problems with using a promised-based rule of liability to protect reliance. Then it explores the problems with a rule of good faith. Finally it proposes a rule of negligent misrepresentation. After exploring the doctrinal problems with applying negligent misrepresentation to negotiations, it suggests that such a rule of liability strikes a plausible balance between the economic concerns that justify protecting reliance on negotiations and those that justify making people responsible for their own expenditures.

A. \textit{Hoffman v. Red Owl Stores} and Promissory Liability in Negotiations

\textit{Hoffman v. Red Owl Stores}\textsuperscript{131} is the most famous case raising the issue of how the law should protect reliance on misrepresentations about future contracts. Hoffman sought a Red Owl grocery-store franchise. Over a period of about three years (from the fall of 1959 to January 1962), at the advice of Red Owl’s agents, primarily a man named Lukowitz, Hoffman sold his bakery, bought a small grocery store in Wautoma, sold that store at the start of the peak season at considerable loss of profits, and bought and exercised an option on land for a new store in Chilton. Hoffman alleged that Lukowitz had assured him that if he did what was advised and could obtain $18,000 in capital, he would be set up in a store. But the negotiations ended in failure when Hoffman balked after Red Owl finally raised its capital demands to $34,000. Hoffman sued Red Owl to recover his expenses and losses. The court found

\begin{itemize}
\item \textsuperscript{130} The argument for such a rule is strongest when an applicant controls whether a condition is met (such as a condition that a medical exam be obtained), because applicants need to be warned of such conditions if they are to take steps to satisfy them. However, even if the cost of the rule in place is slight, we may be concerned with the transition, for insurers will initially be faced with an uncompensated cost if they did not anticipate such liability.
\item \textsuperscript{131} 26 Wis. 2d 683, 133 N.W.2d 267 (1965).
\end{itemize}
Red Owl had made and broken a promise to Hoffman to set him up in a franchise if he did what was asked. Generally, recovery in this situation depends upon establishing a broken promise.

Whether a promise was made will usually be uncertain. First, what was said will often be disputed. Since nuances are important, even completely honest parties may disagree on crucial facts. For example, Hoffman told the jury that he was assured by Lukowitz that his $18,000 capital would suffice, while Lukowitz said he told Hoffman the capital was probably adequate but Lukowitz could not be sure. Either version of events would explain Hoffman's reliance. It is conceivable that the parties construed what was said differently and later reconstructed the conversation biased by that impression. But Lukowitz's version suggests no promise was made.

Second, even if what was said in negotiations is not in dispute, it is often uncertain whether a representation about a future contract is a promise. For example, in Werner v. Xerox Corp., a Xerox agent encouraged Werner to buy expensive machinery to produce parts for Xerox. The agent told Werner that "'if they were smart they would build a machine for themselves and run off parts for Xerox'" and that "producing parts would be a 'nice little business' to get into, and one that would 'really pay.'" When Xerox failed to employ Werner after he bought the machinery, he sued for his expenses in reliance on the agent's "promise" and won. But the agent's statements seem more predictions than commitments, especially given the parties' prior dealings, which were always under formal purchase order.

Courts generally resolve such uncertainty against the party claiming a promise. They have reasoned that any representations are considered

132. Id. at 692, 133 N.W.2d at 273.
133. Werner v. Xerox Corp., 732 F.2d 580 (7th Cir. 1984), is the case most similar to Hoffman. See infra notes 136-39 and accompanying text. In Cellucci v. Sun Oil Co., 2 Mass. App. Ct. 722, 320 N.E.2d 919 (1974), aff'd, 368 Mass. 811, 331 N.E. 2d 813 (1975), the court disregarded a home acceptance clause in a lease because the lessor's agent had promised the lessee that such acceptance was perfunctory. Id. at 729-30, 320 N.E. 2d at 922-23.
134. Appellants' Brief at 114, Hoffman, 26 Wis. 2d 683, 133 N.W.2d 267 (No. 147).
135. Id. at 174. The two also disagreed about the events surrounding Hoffman's exercise of the option to purchase land in Chilton. Hoffman testified that he took this step after Lukowitz told him everything was set. Id. at 120-21. Lukowitz testified that he had told Hoffman that much was yet to be worked out on the contract, that the home office had to approve the contract, and that it was up to Hoffman to decide what to do with the option. Id. at 172.
136. 732 F.2d 580 (7th Cir. 1984).
137. Id. at 582.
138. Id.
139. Id. at 581.
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noncommittal if later execution of a formal contract is contemplated\(^{140}\) and that it is unreasonable to rely on an agent’s representations about a future contract when home-office approval is required.\(^{141}\) Courts have also found that expressions of an intent to contract in the future are simply not promises.\(^{142}\) In some states, this reluctance to find a promise in negotiations is expressed through a formal rule requiring that such promises be proved by clear and convincing, definite, or unambiguous evidence.\(^{143}\) \(A \& M\) Fix-It v. \(Schwinn\) Bicycle Co.\(^{144}\) illustrates the usual

\(^{140}\) Tull v. \(Mister\) Donut Dev. Corp., 7 Mass. App. Ct. 626, 630, 389 N.E.2d 447, 450 (1979). Tull emptied a building, which was later vandalized, in preparing to tear it down to build a new structure for \(Mister\) Donut. \(Mister\) Donut had sent Tull a letter setting forth the “rudiments of our deal... agreed upon.” \(Id.\) at 628 n.3, 389 N.E.2d at 449 n.3. Tull sued \(Mister\) Donut for lost rental income but lost. Two facts may have weighed against Tull. First, Tull’s bank had insisted upon new terms (though \(Mister\) Donut’s agent assured plaintiff this was not the case). \(Id.\) at 629, 389 N.E.2d at 449. Second, Tull was a lawyer who should have known better than to rely on the letter. \(Id.\)

\(^{141}\) Cooke v. \(Blood\) Sys., 320 N.W.2d 124 (N.D. 1982). Blood Systems backed out of lease negotiations with Cooke at the last minute. Cooke was surprised because the Blood Systems agent had been “anxious and enthusiastic about leasing the premises,” \(id.\) at 128-29, and “at no time had stated [that Blood Systems] would not occupy the premises;” \(id.\) at 128. Several facts weighed against Cooke’s claim: Cooke’s only loss in reliance was from the vacancy of his property; he was clearly told that the lease required home-office approval, \(id.\) at 127, and he was an experienced lessor and lawyer, \(id.\) Wright v. \(U.S.\) Rubber Co., 280 F. Supp. 616 (D. Or. 1967), involved a suit for breach of promise to finance a tire dealership. In reliance on receiving a U.S. Rubber franchise, Wright committed himself to a note for purchasing equipment and to a long-term lease for the dealership. \(Id.\) at 617. The court rejected Wright’s claim against U.S. Rubber because Wright knew home-office approval was required, \(id.\) at 619, and because U.S. Rubber’s agent was not informed of Wright’s actions in reliance, \(id.\) at 620.

\(^{142}\) Pacific Cascade Corp. v. Nimmer, 25 Wash. App. 552, 558, 608 P.2d 266, 270 (1980). Pacific Cascade sued Nimmer after talks over a ground lease failed. At Pacific Cascade’s request, Nimmer had executed a letter of intent stating many terms of the lease. In reliance on this letter, Nimmer did soil tests and began negotiations for a construction project. \(Id.\) at 556-57, 608 P.2d at 268-69. But the court concluded the letter of intent was not a promise that could be relied upon.


\(^{144}\) Hoffman-type claims are also sometimes barred by a rule that an agreement that is too indefinite to be enforced as a contract cannot serve as a basis for promissory estoppel. See Original Appalachian Artworks, Inc. v. \(Schlaifer\) Nance & Co., 679 F. Supp. 1564, 1581 (N.D. Ga. 1987); see also American Viking Contractors v. \(Scribner\) Equip. Co., 745 F.2d 1365, 1372 (11th Cir. 1984) (finding that reliance upon indefinite promises is not reasonable and does not give rise to estoppel). This, in
fate of *Hoffman*-type claims under such a strict standard. A & M was a longtime Schwinn dealership. In 1976, it decided to buy a larger building to move into. A & M alleged that Schwinn's agents approved of the move, even giving A & M advice on how to design its new store. Two years later Schwinn terminated the dealership, as was its right under the dealership agreement. A & M argued that Schwinn should be estopped from terminating the dealership because of its tacit approval of the costly move. The court granted Schwinn's motion for summary judgment because Schwinn had made no clear and definite promise that the dealership would not be terminated.\textsuperscript{145}

The problems of knowing what was said and meant in a transaction often make it difficult to determine if there was a promise. But they are especially troublesome in the *Hoffman* situation. A promise cannot be inferred from the fact that there is reliance, because people often invest substantial amounts in negotiations without assurances. And the significance of representations that are made is uncertain. There seems to be a tendency (at least on the part of courts) to view such representations as noncommittal, but as *Hoffman* illustrates, that view is not universal. *Hoffman* is difficult for much the same reasons cases involving claims between ex-lovers for compensation based on express or implied promises made in a nonmarital relationship are difficult. There, too, reliance is fact, was the issue Red Owl pressed on appeal. Rather than challenging the jury's finding that representations were made, Red Owl argued that to be a basis for promissory estoppel "such promise must have the same degree of definiteness and certainty as is required for ordinary bilateral contracts." Appellants' Brief at 36, *Hoffman* v. Red Owl Stores, 26 Wis. 2d 683, 133 N.W.2d 267 (1965) (No. 147). The Wisconsin Supreme Court rejected this argument, *Wheeler* v. *White*, 398 S.W.2d 93 (Tex. 1965), as have other courts, see *Barnett & Becker*, supra note 52, at 476.

\textsuperscript{144} 494 F. Supp. 175 (D. Utah 1980).

\textsuperscript{145} *Id.* at 178. A & M might have prevailed had it been able to argue equitable estoppel rather than promissory estoppel. If a landowner stands by silently watching a neighbor build a garage on the landowner's property, he will be equitably estopped from forcing removal of the garage. That the landowner promises nothing in the transaction is irrelevant to equitable estoppel. *D. Dobbs, Remedies* § 2.3, at 42-43 (1973). A & M could argue that, even if Schwinn promised nothing, Schwinn should be equitably estopped from asserting its right to terminate the dealership because it stood by watching A & M move into a new store.

In theory, claims of equitable estoppel can be used only as a shield to deflect claims and not as a sword to establish affirmative rights. *Id.* at 42. Thus, as the plaintiff, A & M could not easily argue equitable estoppel. But "defensive" claims of equitable estoppel may be used aggressively by setting up the other party as the person asserting a right. The use of estoppel to secure an easement for a garage, for example, establishes a right against the property owner. The use only seems defensive because estoppel is raised in defense to a suit to remove the garage. A & M might have styled its claim as one of equitable estoppel by arguing that Schwinn should be estopped from asserting its power to terminate the franchise. *Cf.* *Billman* v. *V.I. Equities Corp.*, 743 F.2d 1021, 1024-25 (3d Cir. 1984) (finding that a lessor waived the right to terminate a lease where the lessor tacitly acquiesced in a renewal by not objecting). On the relationship of equitable and promissory estoppel, see *Atiyah, Misrepresentation, Warranty, and Estoppel*, 9 *Alberta L. Rev.* 347, 369-73 (1971).
natural without assurances, and the social import of assurances that are made is uncertain.\footnote{146}

B. GOOD FAITH

Misgivings about whether there really was a promise in \textit{Hoffman} have led some scholars to propose a theory of good faith as an alternative basis for the decision.\footnote{147} They would compensate Hoffman for his expenses because Red Owl acted in bad faith. Although at present there is no general duty to negotiate in good faith,\footnote{148} it may just be a matter of time before one is recognized. Courts have begun to enforce express promises to bargain in good faith, and as this becomes commonplace, there will be pressure to imply such a promise when it is not express, in effect making the duty to negotiate in good faith general.\footnote{149} One might


\footnote{147. P. Atiyah, \textit{supra} note 93, at 80-92; Knapp, \textit{supra} note 18, at 686-90; Summers, \textit{supra} note 18, at 225. Nothing in the opinion suggests a theory of good faith. Indeed, the court said Red Owl had not acted in bad faith, \textit{Hoffman}, 26 Wis. 2d at 695, 133 N.W.2d at 273, though some commentators say that by this the court meant only that Red Owl had not acted fraudulently. \textit{See} Summers, \textit{supra} note 18, at 225 n.115.}

\footnote{148. See Farnsworth, \textit{supra} note 1, at 239. A few cases require that terminations of existing relations that are the subject of renegotiation be in good faith. \textit{See} Alaska State Bank v. Fairco, 674 P.2d 288 (Alaska 1983); First Nat'l Bank v. Twombly, 213 Mont. 66, 689 P.2d 1226 (1984). \textit{See also} Skeels v. Universal C.I.T. Credit Corp., 335 F.2d 846 (3d Cir. 1964) (holding that a bank cannot seize inventory when a seller breaches terms of a note where parties are negotiating additional credit).}

\footnote{149. Professor Farnsworth collects several decisions he thinks err in implying a promise to bargain in good faith. Farnsworth, \textit{supra} note 1, at 266 & n.206. But none of the cases he cites is that remarkable. One finds an implied agreement to negotiate in good faith where the parties signed a
plausibly argue that in *Hoffman* a promise to negotiate in good faith should have been implied, since Hoffman would expect at least that much of a commitment from Red Owl when he did what Lukowitz asked. And it is difficult to limit a duty to negotiate in good faith to cases where it is expressly undertaken. This implies the perverse assumption that people reserve the right to deal with each other sharply in negotiations unless they expressly say otherwise.

But even if we were to adopt a duty of good faith in negotiations, it would not reach Red Owl’s conduct in *Hoffman*. Proponents of a good faith standard are vague on what it is that Red Owl did wrong. They condemn Red Owl for breaking off negotiations for no good reason when there was reliance. But it was Hoffman who broke off negotiations when he found Red Owl’s capital requirements unacceptable. Even if we conclude that Red Owl was responsible for breaking off negotiations because it increased its capital demands, it is hard to say that its action was in bad faith. While, admittedly, it is difficult to reconstruct what happened from court records years after the event, it seems that the crucial increase in the capital demanded from Hoffman (the increase from $26,000 to $34,000) was instigated by Red Owl’s credit department, which had not reviewed the plans with the lower figure and which honestly thought that the extra capital was necessary. The negotiations

letter setting forth the major terms of a sublease agreement and stating that it was their intention to “enter into formal lease contracts embodying [these terms] within reasonable limitations” as soon as possible. Evans, Inc. v. Tiffany & Co., 416 F. Supp. 224, 239-40 (N.D. Ill. 1976). Since there was an agreement to agree—the letter—an agreement to negotiate in good faith might reasonably be implied. Cf. Vigoda v. Denver Urban Renewal Auth., 646 P.2d 900 (Colo. 1982) (en banc) (finding an implied promise to negotiate in good faith in an agreement to negotiate exclusively). Another case found an implied agreement to negotiate in good faith in a lease contract that provided for five-year renewal at a “monthly rental to be negotiated.” Family Medical Bldg. v. Dep’t of Social & Health Servs., 37 Wash. App. 662, 664, 684 P.2d 77, 79, modified, 101 Wash. 2d 105, 702 P.2d 459 (1984). Leases with renewal terms are often read to imply an agreement to renew at a reasonable rent or an agreement to negotiate rent in good faith. *See* Stancroff v. Brown, 76 Mich. App. 589, 257 N.W.2d 179 (1977).

150. Knapp, *supra* note 18, at 690; Summers, *supra* note 18, at 226 (describing bad faith as “abus[ing] the privilege to withdraw” a proposal or an offer).

151. *Hoffman*, 26 Wis. 2d at 690, 133 N.W.2d at 271.

152. Hoffman did not strongly object to the increase from $18,000 to $24,000. According to Lukowitz, this increase was a result of a misunderstanding about how $6000 to be made from the sale of certain land owned by Hoffman would be accounted for. Appellants’ Brief at 175, 177, 190, *Hoffman*, 26 Wis. 2d 683, 133 N.W.2d 267 (No. 147). Nor did Hoffman object to an increase from $24,000 to $26,000 to cover increased promotional costs. *Id.* at 131.

153. For testimony that the credit department asked for the extra capital, see *id.* at 216 (testimony of Walter Hall, credit manager) and *id.* at 225 (testimony of Frank Walker, manager of the franchise department). The representations that a lower amount would suffice were all made by Lukowitz. In their first meeting with Hoffman, Hall and Carlson indicated some discomfort with
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may also have foundered on a misunderstanding. What finally ended the talks was Hoffman’s refusal to ask his father-in-law to convert a $13,000 loan into a gift, as Red Owl demanded. Although Red Owl’s credit manager was willing to approve the original terms of a loan or equity contribution if Hoffman could obtain a letter from his father-in-law stating that his claim was subordinate to the claims of general creditors, Red Owl did not make this option clear to Hoffman.

In sum, while evidence exists that Red Owl may have been insensitive to Hoffman’s concerns, nothing suggests that it “upped the ante” in order to injure Hoffman or to drive him away. Ultimately, a theory of good faith cannot explain the decision in Hoffman, since nothing improper in Red Owl’s conduct occurred around the termination of the talks. Red Owl’s fault, if any, lay in its agent Lukowitz’s misrepresentations to Hoffman earlier in the negotiations about the amount of capital needed. Hoffman himself blamed Lukowitz for what happened. But there is no reason to think Lukowitz acted in bad faith; if anything, his sin was negligence. Indeed, Hoffman’s counsel accused Red Owl of negligence, arguing that “[w]hat is required of the Red Owl people . . . is not much. Only that they make some reasonable estimate and check it more closely when they start changing a person’s life to fit their scheme of corporate power and protection.”

the $24,000 figure. Hoffman testified that Carlson said, “‘This is a little bit tight, but I think they will put this store up for this amount of money.’” Id. at 128.

Red Owl’s witnesses testified that the extra capital was for Hoffman’s benefit. Lukowitz testified, “[T]he $13,000 gift was added . . . after the projection was made, after we had experience as to opening new stores and finding that so much money has to be poured into these stores in order to get them off the ground, especially if you are new in a location. All you are doing for is the protection of the operator.” Id. at 186. See also id. at 217 (testimony of Walter Hall, credit manager); id. at 223 (testimony of Frank Walker, manager of the franchise department). This testimony is self-serving, of course. As Hoffman’s major creditor, Red Owl would itself benefit from the increased equity, something Red Owl admitted. See id. at 217, 219 (testimony of Walter Hall, credit manager).

154. Hoffman refused to ask for a gift. Id. at 134, 228-29.
155. Id. at 216-17.
156. Id. at 183-84, 219-20.
157. Hoffman testified to the following conversation with Hall once the deal fell through:

Mr. Hall says, “I realize this thing has gotten a little goofed up”. I says, “So it is goofed up. How are you going to straighten it out?” He says, “The people from the Green Bay office has been severely reprimanded for having gotten this thing goofed up”. He also told me at that time that Green Bay, Ed Lukowitz in particular, had been taken off future development and he was going to stick to working with his men on promotion in the existing stores.

Id. at 135. Hall denied this conversation. Id. at 218.
158. Respondents’ Brief at 23, Hoffman, 26 Wis. 2d 683, 133 N.W.2d 267 (No. 147).
C. NEGLIGENT MISREPRESENTATION

This suggests that we might recast Hoffman's claim in tort, and the closest tort is negligent misrepresentation. The claim would be that Red Owl injured Hoffman by negligently misrepresenting the amount of capital needed to open a store. However, the tort does not easily extend to cover representations such as those in Hoffman. As noted in Part I, some states do not recognize the tort at all, and others limit it to people in close and confidential relationships or in the business of providing information of the sort relied upon. Traditionally, the tort lies only for false statements about present facts and not for false predictions about future events or behavior. Moreover, the tort is often held not to lie for mistaken expressions of opinion or for mistaken misrepresentations of the speaker's own intent to do something in the future if there is no fraudulent intent. All of these limitations may apply to representation about a future contract because the representation is forward looking, is likely to be an opinion, and usually concerns the speaker's intent to do an act in the future. Thus, it is not surprising that most efforts to recover on a theory of negligent misrepresentation when negotiations end unsatisfactorily on the basis of earlier representations of success have come to naught.

159. Barnett and Becker have suggested that Hoffman might have been decided on a theory of negligent promissory misrepresentation. See Barnett & Becker, supra note 52, at 492. This combination of contract and tort is peculiar. If there is a promise, Red Owl should be liable without regard to its negligence unless we treat consideration as essential to enforcing a promise in contract. Consideration is not so important in contract anymore, see Farber & Matheson, Beyond Promissory Estoppel: Contract Law and the Invisible Handshake, 52 U. Chi. L. Rev. 903, 904-05 (1985) (arguing that promises made in commercial contexts are made without consideration or reliance), and it may never have been a sine qua non of obligation, see P. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 184-89 (1979) (arguing that action for detrimental reliance on a promise has been a part of contract law from early times). If any relied-upon promise is enforceable in contract, then Red Owl's negligence is relevant only if the suit must be in tort because there is no promise.

160. See supra notes 72-74 and accompanying text.

161. See supra note 75 and accompanying text.

162. See InterPetrol Bermuda v. Kaiser Aluminum Int'l Corp., 719 F.2d 992 (9th Cir. 1983); Canfield v. Rapp & Son, 654 F.2d 459 (7th Cir. 1981); White v. Hancock Bank, 477 So. 2d 265 (Miss. 1985).

163. City of Warrensburg v. RCA Corp., 571 F. Supp. 743 (W.D. Mo. 1983) (Missouri law). The comments to the second Restatement of Torts suggest that there cannot be an action for negligent misrepresentation of intention. RESTATEMENT (SECOND) OF TORTS § 530(1) comment b (1977) (stating that an action for an honest misrepresentation must be brought in contract on a promise).

But efforts to recover losses in reliance on misrepresentations about future contracts sometimes prevail. The most striking success was in a recent Maryland case, Giant Food v. Ice King, which is similar to Hoffman. Ice King built a manufacturing plant to supply ice to Giant in reliance on representations by Giant's agents that an ice contract would be entered into. Ice King built the plant and located it where Giant wanted it, and with Giant's help Ice King secured a loan to finance the plant. Ice King's president put "everything he owned" into the plant. However, the deal fell through when Giant filled its needs from a plant it had built at the same time. Ice King had heard of Giant's plans to build a plant, but Giant's agents assured Ice King that they nevertheless had a "deal" and that "everything was 'all right.'" Ice King sued on theories of contract, promissory estoppel, fraud, and negligent

1. 390 N.W.2d 68 (Wis. Ct. App. 1986) (holding that a real estate broker's failure to "prequalify" prospective buyers was not actionable negligence).

165. In Muraoka v. Budget Rent-a-Car, 160 Cal. App. 3d 107, 206 Cal. Rptr. 476 (1984), a tort claimant who allowed the statute of limitations to pass without filing suit recovered on a theory of negligent misrepresentation because the defendant dissuaded him from suing by misrepresenting its intent to settle the claim. In Frame v. Boatmen's Bank of Concord Village, 782 S.W.2d 117 (Mo. Ct. App. 1989), a representation by a loan officer that a loan would be made if an appraisal was satisfactory was held to be a basis for a negligent misrepresentation claim. The officer had failed to warn the applicant that approval by the bank board was required. Also, in Lucini/Parish Ins. v. Lucas, 772 F.2d 317 (Nev. 1989), the court held a representation by an insurance agent that he could bind an insurer over the phone actionable on a theory of negligent misrepresentation.

Claims of negligent misrepresentation have succeeded in several wrongful termination cases. See Browne v. Maxfield, 663 F. Supp. 1193 (E.D. Pa. 1987); D'Ulisse-Cupo v. Board of Directors, 202 Conn. 206, 520 A.2d 217 (1987); McAfee v. Rockford Coca-Cola Bottling Co., 40 Ill. App. 3d 521, 352 N.E.2d 50 (1976); Eby v. York-Division, Borg-Warner, 455 N.E.2d 623 (Ind. Ct. App. 1983). See also Weisman v. Connors, 312 Md. 428, 540 A.2d 783 (1988), cert. denied, 314 Md. 497, 551 A.2d 868 (1988) (upholding claims based on misrepresentations in negotiations about position, bonus, and other terms of employment). These cases are similar to Hoffman in that the representation goes to the defendant's willingness to do business in the future, though they are different in that the representations were made in the context of an ongoing relationship. This may be relevant if the relationship is the basis for imposing a duty of care. In Eby, 455 N.E.2d 623, the court based the duty of care on the employment relationship. Id. at 630. Cf. Guerin v. Sendra Corp., 700 F. Supp. 973 (N.D. Ind. 1988) (holding that Indiana tort law did not apply in business or working relationships). This factor might be crucial in states that require a special relationship for a duty. New York, for example, requires a special relationship of trust or confidence for a duty of negligent misrepresentation. See Accusystems v. Honeywell Information Sys., 580 F. Supp. 474 (S.D.N.Y. 1984). A one-time bargain has been held not to create such a relationship, Sanitoy, Inc. v. Shapiro, 705 F. Supp. 152, 154 (S.D.N.Y. 1989), while a longstanding distributor relationship has been held to give rise to a duty, Coolite Corp. v. American Cyanamid Co., 52 A.D.2d 486, 488, 384 N.Y.S.2d 808, 811 (N.Y. App. Div. 1976).


167. Id. at 191, 536 A.2d at 1186.

168. Id.

169. Id.

170. Id. at 192, 536 A.2d at 1186.

171. Id. at 191, 536 A.2d at 1186.
misrepresentation. The contract and promissory estoppel claims were dropped at trial, and the jury found no fraud. But Ice King recovered on the negligent misrepresentation claim.

That such claims occasionally succeed is unsurprising, for the doctrinal limitations are unrealistic and manipulable. In order to overcome the most common bar, a prediction of a future event may be recharacterized as a representation about the present facts that are expected to bring that event about. For example, Professors Barnett and Becker propose that Red Owl might have been held liable on a theory of negligent promissory misrepresentation (a peculiar hybrid of tort and contract), because Lukowitz made completion of the contract seem more likely than it in fact was at the time. It is impossible to rigidly differentiate between statements of opinion and statements of fact because all statements of fact are really opinions (unless the speaker is omniscient), and all statements of opinion have some basis in fact. The real issue is whether a representation is reliable. Predictions and opinions (especially opinions about future events) are generally less reliable than statements about present facts. However, courts have recognized that the former are sometimes reliable, especially if the speakers have special expertise on the subject, if the thing predicted is in their control, or if the opinion is strongly worded.

A more compelling justification for limiting the scope of the tort of negligent misrepresentation, especially for the rule that the tort will not

172. In a phone conversation, counsel for Ice King told me there were several reasons for the tort claim. There was a potential statute of frauds problem; there was not much Maryland law on promissory estoppel, and Weisman v. Connors, 312 Md. 428, 540 A.2d 783 (1988), which suggested a liberal standard for negligent misrepresentation, was then working its way through the Maryland courts. Telephone interview with Ralph Wilson, counsel for Ice King (1989).

173. See Seavey, Reliance upon Gratuitous Promises or Other Conduct, 64 Harv. L. Rev. 913, 922-23 (1951) ("It has now become clear, however, that every statement of the future includes some statement of present facts.").


lie for nonfraudulent misrepresentations of a speaker’s intent to do something in the future, 179 is to prevent the tort from intruding into the domain of contract. This intrusion is a legitimate concern. It is troubling when claims of tortious misrepresentation are used to circumvent such barriers to contract suits as the parol evidence rule, 180 the statute of frauds, 181 warranty disclaimers, 182 or other terms in a contract contradicting an alleged promise. 183 But this concern is not all-important. It is relevant only insofar as allowing an action in tort is inconsistent with the policies served by a rule barring an action in contract.

The intrusion of torts into contracts raises several different sorts of concerns. One concern is that it will undermine important contract policies. If we consider the evidentiary or other policies underlying statutes of frauds important, for example, we ought not permit the statutes to be evaded by recasting actions in tort.

Another concern is that an action borrowed from torts brings with it other rules in torts, some of which may be undesirable. Some aspects of tort law are probably not harmful. For example, rules of contributory or comparative negligence might apply, 184 but they are likely to involve the same analysis and same result as inquiries regarding reasonableness of reliance (except in states that apportion losses, but such apportionment may be desirable). Lost profits are difficult to recover in tort, 185 but in most cases they will also be too speculative to recover in contract. Further, if the contract theory is promissory estoppel, often only reliance damages are recoverable. 186 More troubling are the liberal tort standards

179. The comments to the second Restatement of Torts explain that “[i]f the recipient wishes to have legal assurance that the intention honestly entertained will be carried out, he must see that it is expressed in the form of an enforceable contract, and his action must be on the contract.” Restatement (Second) of Torts § 530(1) comment b (1977).


181. See Levin v. Knight, 780 F.2d 786 (9th Cir. 1986).


186. See Restatement (Second) of Contracts § 90 comment d (1981).
of recovery for damages from emotional suffering and other consequential losses, which may inflate damages.\(^{187}\) Characterizing an action as tortious may also have implications for a defendant's insurance coverage, because many policies cover tort but not contract claims.\(^{188}\) Barnett and Becker suggest there may be a difference in statutes of limitations,\(^{189}\) though there is no systemic advantage to claims in tort or contract on this issue.

Probably the best solution to these sorts of problems is to characterize the action for negligent misrepresentation in negotiations as contractual in character. There is some precedence for this in the current rules on misrepresentation, which exist in both contract and tort. However, this requires some significant changes in existing contract doctrine on misrepresentation. The remedy for misrepresentation in contract is avoidance or reformation of the contract;\(^{190}\) losses from reliance on a misrepresentation are recoverable only in tort.\(^{191}\) Negligence is traditionally not an issue in contract doctrine; though contract doctrine distinguishes between fraudulent and innocent misrepresentations (the latter are a basis for voiding a contract only if they are material),\(^{192}\) it does not distinguish between negligent and innocent misrepresentations.\(^{193}\) These points are related, for the broader category of actionable

\(^{187}\) Cf. Continental Life & Accident Co. v. Songer, 124 Ariz. 294, 603 P.2d 921 (1979) (holding that insurance applicants may recover for mental anguish if the insurer negligently delayed processing the application). Treating arbitrary terminations of employment contracts as a tort has resulted in enormous awards. In California from 1979 to 1987, in actions for retaliatory discharge or breach of the covenant of good faith and fair dealing, there were at least eleven verdicts in excess of $1 million and over one-fifth of all verdicts were in excess of $500,000. Jung & Harkness, The Facts of Wrongful Discharge, 4 LAB. LAW. 259, 264 (1988). Verdicts in breach of contract actions were significantly smaller (a $60,600 median, compared with a $265,000 median for retaliatory discharge and a $142,700 median for bad faith). \(^{190}\) 263. In Montana, where wrongful discharge is also a tort, one employee recovered $1.4 million, much of the award coming from punitive damages. Flanigan v. Prudential Fed. Sav. & Loan Ass'n, 221 Mont. 419, 720 P.2d 257, appeal dismissed, 479 U.S. 980 (1986).

\(^{188}\) See First Newton Nat'l Bank v. General Casualty Co., 426 N.W.2d 618 (Iowa 1988) (holding that the insurer had a duty to defend a negligent misrepresentation claim against the bank, since the claim was in tort).

\(^{189}\) Barnett & Becker, supra note 52, at 493-94.

\(^{190}\) See RESTATEMENT (SECOND) OF CONTRACTS §§ 164, 166 (1981).

\(^{191}\) See Halpert v. Rosenthal, 107 R.I. 406, 267 A.2d 730 (1970) (holding that the remedy for misrepresentation was either to rescind the contract or to affirm it and allow losses in tort).

\(^{192}\) RESTATEMENT (SECOND) OF CONTRACTS § 159 comment a, 162 (1981).

\(^{193}\) Id. § 159 comment a.
representations in contract has been justified by the more limited remedy.\textsuperscript{194} Thus, we must create a new contract action for losses that result from reliance on negligent misrepresentations in negotiations.

However, we have yet to consider the most important concern in contract undermined by creating an action for negligent misrepresentation. This is the concern for individual autonomy that leads us to enforce contracts that people make but not otherwise to impose obligations through contract. As explained in Part I, I think this concern with individual autonomy derives from a concern for utility and problems of knowledge. We respect bargained-for terms of contracts because we think people generally are the best judges of their own interests. For this reason, we ought to resist the use of torts to alter express terms of contracts, especially terms that are the subject of bargaining. Courts that resist are to be applauded.\textsuperscript{195}

It is less troubling when the obligation sought to be imposed is not one consciously rejected by the parties. Silence should not be taken to mean rejection of an obligation, especially when, as in \textit{Hoffman}, the party who would be protected is unsophisticated\textsuperscript{196} and the other party lulls him into a false sense of security. It is even more difficult to draw

\footnotesize

\textsuperscript{194} See id. ch. 7, topic 1, introductory note ("[B]ecause tort law imposes liability in damages for misrepresentation, while contract law does not, the requirements imposed by contract law are in some instances less stringent.").

\textsuperscript{195} Call Carl, Inc. v. BP Oil Corp., 554 F.2d 623 (4th Cir.), cert. denied, 434 U.S. 923 (1977); Flow Indus. v. Fields Constr. Co., 683 F. Supp. 527 (D. Md. 1988). In Georgia an unenforceable promise cannot be a basis for a claim of misrepresentation. A promise is actionable only in contract. American Viking Contractors v. Scribner Equip. Co., 745 F.2d 1365 (11th Cir. 1984). This rule is advocated in Hill, supra note 6, at 717-18. The Georgia rule is more difficult to justify than a rule protecting the express terms of a contract because it will sometimes result in courts' not enforcing people's bargains and will therefore actually frustrate people's plans. The justification for this rule must lie in whatever policies there are for not enforcing certain promises, such as the evidentiary policies that underlie the statute of frauds and the parol evidence rule.

\textsuperscript{196} This may help explain the common belief that Hoffman's relative lack of sophistication was crucial to the outcome in his case. See Knapp, supra note 18, at 689; cf. P. Atiyah, supra note 93, at 89-90 (arguing that the decision turned on undisclosed distributional considerations). This belief seems borne out by other cases that emphasize the relative sophistication of the parties in allowing recovery, see Cellucci v. Sun Oil Co., 2 Mass. App. 722, 320 N.E.2d 919 (1974), aff'd, 368 Mass. 811, 389 N.E.2d 447 (1979) (holding an agent's misrepresentations of need for home-office approval fraudulent because of the defendant's "superior knowledge" and plaintiff's "relative ignorance"), or denying recovery of claims arising from failed negotiations, see Gruen Indus. v. Biller, 608 F.2d 274 (7th Cir. 1979); Blanton Enters. v. Burger King Corp., 680 F. Supp. 753 (D.S.C. 1988); Tull v. Mister Donut Dev. Corp., 7 Mass. App. Ct. 626, 389 N.E.2d 447 (1979). Hoffman's counsel emphasized this fact in their argument. See Respondents' Brief at 20, 26, Hoffman v. Red Owl Stores, 26 Wis. 2d 683, 133 N.W.2d 267 (1965) (No. 147). There is less reason to intervene to protect sophisticated parties, who should know better than to rely on representations in negotiations and who may be expected to bargain for formal protection if they do rely. However, as we have seen, sophisticated parties may fail to bargain for rights that are in their interest.
meaningful conclusions about what the parties intended by their failure to make formal provisions of rights in *Ice King*, since there was evidence in that case that it was common in the ice trade for deals to be made informally without a written contract. Thus, we may properly ask in these cases what arrangement is in people's interest, the question we turn to now.

D. Efficiency and Negligent Misrepresentation

Professors Scott, Goetz, and Leslie ("Scott") have argued that it is generally not in people's interest to shift responsibility for costs in negotiations. The basic point is that people best know their own reliance and can therefore best take appropriate precautions against their own losses. If individuals rely greatly on an expected contract, they can seek protection by insisting upon an agreement to bargain in good faith or upon other protection. Or they can temper their reliance if the risk is too great. Other parties can but guess at their negotiating partner's reliance costs, so they are likely to miscompensate. Though Scott does not address the issue, he presumably would oppose a rule of negligent misrepresentation, which creates the possibility of unbargained-for cost shifting in negotiations. Scott might even oppose a rule that permits a fact-finder discretion in finding a promise. Such a rule would open the door to cost shifting in cases where that is not really the parties' intent. Thus, Scott might favor a rule that enforces only a clear and definite promise.


199. R. Scott & D. Leslie, supra note 117, at 137.

200. Scott and Leslie also argue that parties balance the risk of being asked to compensate another party's losses if they make a promise with the risk of not obtaining compensation for their own losses if they do not obtain a promise. Most people, they contend, would rather bear the risk of their known losses than the other party's unknown losses and therefore prefer bargaining without obligation. *Id.* at 137 n.8. Under this view, people enter into a contract once the expected benefits from contracting outweigh the uncertain risk. *See also* Goetz & Scott, supra note 198, at 1295-96 (presenting the same argument).

201. The Scott analysis does not inevitably lead to this conclusion. There is a cost to not enforcing promises under rules requiring strong proof. Since the reason for nonenforcement is failure to satisfy minimal formal standards, the cost is generally not in the effect on future behavior. A decision not to enforce a promise can affect future behavior only if people know of the rule, but if they know of the rule, it is a fairly simple matter for them to satisfy the law's formal requirements. Viewed prospectively, the only concern posed by such a formal rule is that defendants who know of the rule will use it to take advantage of plaintiffs who do not. For example, if Red Owl's agent knew his firm had this protection and that Hoffman did not know of the rule, the agent might make wild representations that would induce Hoffman to overinvest. We may also be concerned with the effect
But the Scott analysis is flawed. The argument that people generally would prefer to be responsible for their own costs because they can best appraise those costs disregards an important factor in risk assessment. Risk is a function of the probability of success in negotiations as well as the magnitude of reliance costs. Though people may best know their own reliance (even this is not obvious, for one party may know the other's costs, as Red Owl knew of Hoffman's actions), the other party may better estimate the risk of failure. In *Hoffman*, for example, Lukowitz knew better what it took to open a Red Owl store because he had prior experience. Applying a rule of negligent misrepresentation addresses this informational imbalance. It requires that people who both possess better information about the prospects for a contract and who know that someone is relying on their expertise and advice take reasonable care in providing that advice. Under such a rule ignorance about the other party's reliance, the factor singled out by Scott, might be adequately accounted for by disallowing claims of misrepresentation when a defendant had no knowledge of a plaintiff's reliance.

Scott's analysis of the efficiency of a rule imposing precontractual obligation may also be faulted on the ground that it disregards the potential welfare gains from shifting losses from franchise applicants to large firms such as Red Owl. If a firm knows that it must compensate franchise applicants for their ordinary expenses if negotiations fail, it will pass that cost on to franchise applicants or franchisees, either by charging an application fee or by demanding a greater return on a franchise. Even if the total amount charged applicants under this legal rule exceeds the total amount applicants would lose under a rule rejecting precontractual obligation (this might result if the rule encourages applicants to invest more or if the firm overestimates its potential liability), applicants might choose a regime in which they were protected because they prefer
paying a certain but small expense to facing a small risk of ruinous expense. In other words, applicants might prefer that large firms insure them against the risk of losing their sunk costs should negotiations fail.

But this is not a strong justification for a rule of negligent misrepresentation. The rule may realize some welfare gains from loss spreading, but that is only a secondary effect and is not a primary justification for the rule. A rule of negligent misrepresentation leaves losses where they lie in cases where there is no representation about the likelihood of a successful deal or where a representation that proves to be wrong was reasonable when made. If loss spreading were our primary objective, we might make large firms that repeatedly deal with small firms liable for the smaller firm’s costs in every case or at least in every case where such liability is not disclaimed. That an argument can be made for such a broad rule of liability shows that a rule of negligent misrepresentation is only one of several possible interventions in negotiations that may be justified on utilitarian grounds, and a fairly modest intervention at that.

Some of the benefits of a negligent misrepresentation rule can be realized under a more traditional promise-based theory, at least if we do away with heightened requirements for establishing a promise, such as the rule that a promise must be proved by clear and convincing evidence. Though we may question whether a promise existed in Hoffman and Werner v. Xerox, the plaintiffs were able to prevail in those cases under a conventional theory of promissory estoppel. And one suspects that at least the appellate court was willing to find a contract in Giant Food v. Ice King. The risk that misrepresentations in negotiations will be found to be promises is some deterrent to misrepresentations.

A theory of negligent misrepresentation has two advantages over a promise-based theory. First, it more precisely describes the conduct we are trying to regulate. Second, it imposes the proper degree of obligation on the speaker.

204. See supra note 143.

205. The court found that Giant had a duty because the relationship between the parties had “ripened into a full-fledged business dealing.” Giant Food v. Ice King, 74 Md. App. 183, 190-91, 536 A.2d 1182, 1185, cert. denied, 313 Md. 7, 542 A.2d 844 (1988). It concluded that there was an “‘intimate nexus’ akin to a contractual relationship or its ‘equivalent.’” Id., 536 A.2d at 1185-86 (citing Jacques v. First Nat’l Bank, 307 Md. 527, 537-38, 515 A.2d 756, 759-60 (1986), where a duty in tort was grounded on a contractual relationship).
The first advantage results from a difference between representations and promises. A promise is a commitment, while a representation is any statement of fact. Thus, if someone states a fact without committing himself to its occurrence, he may be liable under a theory of negligent misrepresentation but not under a contract theory. Consider a case involving a claim of wrongful termination brought by a teacher. The teacher alleged that the principal had represented to her that she would be rehired the next year. The court held that this was not a promise because the principal did not guarantee the teacher employment. However, the court found that the representation could be a basis for a negligence action if the principal should have known at the time that the teacher might not be reemployed because of declining enrollment.

This difference is important because representations about future contracts are likely to be noncommittal. For example, Lukowitz testified that he told Hoffman that Hoffman's capital would suffice but that the home office had to approve the deal. If we accept Lukowitz's story, it is difficult to conclude that there was a promise because he made it clear that he could not bind Red Owl. However, he may have misrepresented Red Owl's policies or plans. In *Werner v. Xerox*, the Xerox agent's statement that it would "really pay" if Werner invested in certain equipment may not have been a promise to do business, since Werner should have known that such a promise required a formal purchase order approved by the home office. However, it does seem to be a representation about Xerox's plans.

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206. The jury in *Hoffman* was asked to find whether Red Owl made "representations," rather than promises, to Hoffman. *Hoffman v. Red Owl Stores*, 26 Wis. 2d 683, 692, 133 N.W.2d 267, 272 (1965). The significance of this is not clear. At one point in the appellate transcript, the trial judge seems to note the difference between the two. In discussing the form of the question with counsel, the judge observed, "Unless there is a promise all the representations in the world wouldn't make any difference. If they are dealing at arm's length, without any eventual promise to do anything on the part of Red Owl, it doesn't make any difference what they represented to him." *Appellants' Brief* at 231, *id*. At an earlier point the trial judge indicated there might be a cause of action on a theory of estoppel in pais, though there was no contract on the basis of representation. *Id.* at 200-01.

207. Cf. Hill, *supra* note 6, at 684 ("To say that the representation is not promissory is tantamount to saying that the parties understand that the one who utters the representation will not have to 'make it good' if it turns out to be false.").


210. *Id.* at 220-21, 520 A.2d at 233.


212. 732 F.2d 580 (7th Cir. 1984).
The second advantage of a negligent misrepresentation rule results from the fact that liability under such a rule is based on negligence while liability in contract is usually strict.213 Thus, in the case of the teacher's wrongful termination claim, the school would be liable under a theory of negligent misrepresentation only if the principal should have known at the time he assured the teacher of continued employment that there was a significant chance she would not be employed. Had the principal promised the teacher a job, the school would have been liable without regard to his fault.

A negligence rule encourages people to whom representations are made to be cautious. They cannot blindly rely on representations, because the party making the representation will be held liable for that reliance only if the representation was unreasonable. Due reliance might also be encouraged under a rule of strict liability if there is a defense of contributory negligence.214 This would be analogous to the Drennan rule, which holds subs strictly liable for their prices quoted in offers but denies recovery to generals who rely unreasonably on quotes.215

A negligence rule (which is also subject to a defense of contributory negligence216) has several advantages over a strict liability rule with a

213. Contract doctrine is tortlike in that promises are defined objectively. Thus, whether an individual makes a promise depends upon how a reasonable person would construe that individual's words or behavior. Embry v. Hargadine, McKittrick Dry Goods Co., 127 Mo. App. 383, 105 S.W. 777 (1907). This rule has been characterized as tortlike, since it may impose obligation where there is no real assent. See Whittier, The Restatement of Contracts and Mutual Assent, 17 CALIF. L. REV. 441, 442 (1929). Two aspects of this area of contract doctrine are strongly reminiscent of tort doctrine. No contract exists if people are equally responsible for a misunderstanding. RESTATMENT (SECOND) OF CONTRACTS § 20 comment d (1979); cf id. § 201 illustration 4 (showing that where there is a good faith, reasonable misunderstanding of a contract term the agreement fails). Additionally, no obligation exists unless there is a loss in reliance on a misunderstanding. Id. § 153 comment c. Thus, the rule is one of loss shifting where one person is more negligent than the other. This pattern is similar to that of tort doctrine. However, if there is a loss, expectation damages will generally be awarded.

214. The similarity of a negligence rule and a strict liability rule subject to a defense of contributory negligence is noted in W. LANDES & R. POSNER, supra note 104, at 64-65; S. SHAVELL, ECONOMIC ANALYSIS OF ACCIDENT LAW 12-14 (1987).

215. See supra notes 101-02 and accompanying text.

216. Robinson v. Poudre Valley Fed. Credit Union, 645 P.2d 861 (Colo. Ct. App. 1982); Darner Motor Sales v. Universal Underwriters Ins. Co., 140 Ariz. 383, 682 P.2d 388 (1984). Economically, there is little reason to add a defense of contributory negligence to a negligence rule, S. SHAVELL, supra note 214, at 14-15; W. LANDES & R. POSNER, supra note 104, at 75-76. But it may be justified on the normative ground that a plaintiff ought not recover when his conduct is no better than that of the defendant. Cf W. LANDES & R. POSNER, supra note 104, at 76-77 (arguing that defense of contributory negligence reduces administrative costs "by eliminating a class of cases where no allocative purpose would be served by imposing liability").
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Defense of contributory negligence. First, a negligence rule is more familiar. Having rejected promise as a basis for obligation in cases like Hoffman v. Red Owl Stores, we must appeal to theories of obligation developed in torts, where strict liability is rare. Second, neither a negligence rule nor a strict liability rule with a defense of contributory negligence provides the optimal level of deterrence. As Professor Steven Shavell has shown, a negligence rule encourages injurers to engage in excessive levels of harm-causing activities, since they will not be liable for harms that cannot be efficiently avoided given a particular level of activity; for the same reason, a strict liability rule subject to a defense of contributory negligence encourages victims to engage in excessive levels of harm-bearing activities. Shavell concludes that the choice between these two imperfect rules should be made on the basis of whether we want to provide injurers or victims an incentive to reduce their activity level. Given the traditional principle of self-reliance in bargaining, it seems better to opt for the rule that imposes greater responsibility on the victim. Third—and related to the other two points—a negligence rule is a less radical change from current law than a strict liability rule. Thus if I am wrong in concluding that it is desirable to provide greater incentives to be cautious in bargaining representations, the harm from that mistake will be minimized.

An important situation where negligence and strict liability may produce different results is when circumstances change after a representation is made. If a representation is held to be a promise and liability is strict, a defendant will not be excused, even though circumstances change, unless the promise was conditioned on the nonoccurrence of the change. This is a difficult standard to meet. A representation is negligent in such a case only if the speaker should have foreseen the change in circumstances. For example, if Red Owl increased its capital demands because its competition opened a new store, Lukowitz’s representation that less capital would suffice would not be negligent, unless he should have foreseen the new store and taken account of that in his initial assessment. The same event probably would not be sufficient to excuse Red Owl from a promise to Hoffman.

In sum, a rule of negligent misrepresentation broadens the category of statements in negotiations for which a person may be held legally

217. W. Prosser, supra note 92, at 536-37.
218. S. Shavell, supra note 214, at 27-29; Shavell, Strict Liability Versus Negligence, 9 J. Legal Stud. 1, 6-7 (1980).
220. See E. Farnsworth, supra note 102, at 677-89.
responsible (to any representation that is reasonably relied upon) while it lessens the degree of responsibility for statements that are noncommittal (to a negligence standard). Promises are, in some respects, devices for allocating risks of change. When people promise to do something, they commit to do it even if circumstances change such that keeping the promise is no longer in their interest. In negotiations a promise is made when there is this sort of general commitment to do business in most conceivable future circumstances. Representations to the effect that a contract is likely to be entered into in the future are not that sort of general commitment, but nevertheless they are relied upon and should be expected to be relied upon. Holding such representations to a negligent misrepresentation standard recognizes that they entail a duty of care but nothing more.

III. CONCLUSION

The rules proposed here, taken in conjunction with the existing principles of fraud, restitution, and (perhaps) good faith, should not be assumed to be the exclusive grounds for recovery of losses incurred when an offer or price quote is withdrawn, an application is rejected, or negotiations fail. Nor should the emphasis on concerns of utility be taken as an implicit assertion that only concerns of utility may justify imposing obligations in precontractual settings. These proposals try to account for only the most prominent cases that are not adequately accounted for under current doctrine. The focus is on utilitarian concerns and the issues of efficient loss allocation and market failure only because these concerns best explain the immediate cases. Utilitarian concerns may not best explain other aspects of the law in this area. As we have seen, the rules regulating bad faith may be justified by traditional norms of contract or fraud. The enforcement of contracts or protection against fraud may ultimately be grounded on utilitarian concerns, but these rules may as well be explained by concerns with the morality of promise keeping and lying.

OAO Corp. v. United States\textsuperscript{221} is an example of a case imposing a precontractual obligation that seems intuitively correct but that can be justified neither on traditional grounds nor under the rules proposed in this Article. It is also difficult to justify on utilitarian grounds. The case involved a claim by a defense contractor to recover its startup expenses when the Air Force rejected a contract. The Air Force had pressured the

\textsuperscript{221} 17 Cl. Ct. 91 (1989). For a similar case outside the defense context, see Brewer St. Invs. v. Barclays Woollen Co., 1 Q.B. 428 (1954).
contractor to begin performance before the contract’s approval so that a tight production schedule could be met. Recovery of the startup expenses was allowed on the theory that there was an implied promise from the government to compensate the contractor for those expenses. But the court cited no evidence suggesting that the parties actually thought there was such a commitment. Indeed, it rejected the contractor’s argument that there was an implied agreement to go through with the deal because there was no evidence that this was the government’s intent and because such commitments were usually made formally.

The court found an implied promise to pay for the startup expenses because such an agreement would have been in both parties’ interest, since the government wanted immediate production. But arguments about what the parties would have agreed tell us little about the parties’ actual intentions. The case cannot easily be accounted for under the rules proposed here. Consummation of the contract was not thought to be pro forma or a matter of satisfying certain conditions as to eligibility, and there was no hint of mistake or bad faith. There was no negligent misrepresentation. The disapproval of the contract was due to a change in defense policy that the contracting officer could not have predicted.

Nevertheless, the decision seems right. There is a utilitarian argument for a rule we might extract from the case (that parties who want performance to start before a contract is entered into must pay for startup costs if they later back out), but it proves too much. The rule cannot be justified as an inducement for contractors to undertake such efforts in the future. If contractors realize the risk that they may not be compensated for startup costs, it is a simple matter to obtain protection from the risk by an express agreement. If they do not realize the risk, they cannot be deterred. The utilitarian argument for the rule must be that the government should bear the contractor’s costs so that the government will consider those costs when it determines whether to continue with the original plans. This keeps the government from undervaluing completion of the project and from ignoring the contractor’s investment in the project. For example, it is troubling from a social perspective if the government chooses a different contractor in order to save money when the savings to the government are less than the costs already expended by the first contractor. This results in a net social loss from the shift in contractors. We might want to impose that loss on the government even though

222. OAO Corp., 17 Cl. Ct. at 103.
223. Id. at 99-100.
224. Id. at 101-02.
225. Id. at 96-97.
the parties did not bargain for such loss shifting, because the need for such a provision arises only when the government considers changing its plans.

But this analysis also proves too much. It could justify cost shifting in any case where one person has made an investment in a joint venture and the other considers backing out. And any such general rule of cost shifting conflicts with the likely reluctance of people to be responsible for costs not within their control (the point emphasized by Scott\textsuperscript{226}). This concern might be addressed by a rule restricted to the defense context, but from a utilitarian perspective, such a restriction seems arbitrary. The problem is the same whatever the subject matter of the contract and whoever the parties are.

The case might be better explained on grounds of fairness. There is something to be said for the proposition that the government ought to compensate a contractor it asks to undertake a significant expense in the public interest. In other contexts, the defense-contracting relationship has been treated as special. The government is required to disclose things in bargaining that a private party may keep secret\textsuperscript{227} and to pay for unanticipated costs when private parties might not.\textsuperscript{228} It may be significant that the issue in these cases is the allocation of a loss between the government and a private party and not the allocation of a loss between two private parties, if we find the prospect troubling that all of society might be enriched at the expense of one firm.\textsuperscript{229}

\textit{OAO Corp.} is mentioned more as a counterpoint to the main theses of this Article than as a conclusion. It seems there is a place for intuitions of fairness based on social norms. It may be that these intuitions ultimately can be justified on utilitarian grounds. We may respect social norms because practices that have evolved over time are likely to be efficient. And changes in the law that are inspired by intuitions of fairness often turn out to be efficient. The decisions justified here on utilitarian grounds are usually justified by their authors and argued for by counsel in terms of fairness. For one, like myself, who rationalizes the law in

\textsuperscript{226} See supra notes 198-200 and accompanying text.

\textsuperscript{227} Helene Curtis Indus. v. United States, 312 F.2d 774 (Ct. Cl. 1963).


\textsuperscript{229} This might be turned back into a utilitarian argument on grounds of loss-spreading. But these contractors are large publicly held firms; even if they absorb the loss, the burden on any one person will be small. Indeed, to the extent we think the executives and shareholders of these firms are likely to be relatively wealthy and the beneficiaries of alternative government expenditures relatively poor, this sort of loss spreading is perverse from a utilitarian perspective.
mostly utilitarian terms, this fact raises uncomfortable questions, for
there is something strange about the argument that a system serves pur-
poses that most people who work within the system do not vocalize.
Nevertheless, these cases, along with much of the rest of contract and
tort law, are consistent with utilitarian goals (especially once we realize
that many apparent inconsistencies between the law and utilitarianism
may be explained as compromises forced by problems of knowledge), and
at the very least we may take comfort from this. Even those who think
fairness important would not want the law to make people worse off.