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FILLING GAPS IN DELIBERATELY  
INCOMPLETE CONTRACTS**

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**“AGREEING TO DISAGREE”:  
FILLING GAPS IN DELIBERATELY INCOMPLETE CONTRACTS**

*Omri Ben-Shahar*\*

Abstract

This Article develops a new standard for gap filling in incomplete contracts. It focuses on an important class of situations in which parties leave their agreement deliberately incomplete, with the intent to further negotiate and resolve the remaining issues. In these situations, neither the traditional no-enforcement result nor the usual gap filling approaches accord with the parties’ partial consent. Instead, the Article develops the concept of *pro-defendant* gap-fillers, under which each party is granted an option to enforce the transaction supplemented with terms *most favorable* (within reason) to the other party. A deliberately incomplete contract with pro-defendant gap fillers transforms into *two* complete contracts, each favorable to a different party, with each party entitled to enforce only the contract favorable to her opponent. Under this approach, partial consent gives rise to a correspondingly intermediate burden of liability. The Article demonstrates that this regime promotes the interests of negotiating parties who enter agreements-to-agree. It also identifies various doctrinal practices that already incorporate the pro-defendant gap filling logic.

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## INTRODUCTION

Incomplete contracts have always been viewed as raising the following challenge for contract law. Does the incompleteness—or, “indefiniteness”, as it is usually called—rise to such a level that renders the agreement legally unenforceable? When the indefiniteness concerns important terms, it is presumed that the parties have not reached an agreement to which they intend to be bound. This “fundamental policy” is the upshot of the view that “contracts should be made by the parties, not by the courts.”<sup>1</sup> When, in contrast, the indefiniteness concerns less important terms, courts supplement the agreement with gap fillers and enforce the supplemented contract.

The common law has traditionally tended towards the no-contract outcome. For example, an agreement to pay an employee “a fair share” of the profits, without specifying the precise fraction, was too indefinite to be enforced.<sup>2</sup> This traditional result has been weakened under the Code’s “contract with open terms” approach, that more aggressively supplements the parties’ agreement with reasonable or average terms, including price terms.<sup>3</sup>

While many areas of contracting have witnessed significant shifts from the formalist no-contract outcome to the more liberal gap filling and enforcement approach embodied in the Code, both the traditional common law and the Code share the premise that the problem of indefiniteness is of a dichotomous nature: either a full-blown contract can be assembled with the aid of gap-fillers, or no contract exists. These are the only two choices. Regimes and jurisdictions may differ as to where the contract/no-contract boundary lies, but they all follow the all-or-nothing methodology.

This Article proposes a different methodology. It advances the idea that *partial agreements may deserve partial enforcement*. If a deal is only partially struck—if it contains pockets of indefiniteness—the law should not be limited to choosing polar solutions, full enforcement versus no enforcement, but should instead have available an intermediate solution, of holding the parties accountable only to the definite parts of the agreement. The more definite the deal is, the greater the contractual liability.

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<sup>1</sup> Restatement 2d of Contracts, § 33(2), cmt b.

<sup>2</sup> See, e.g., *Varney v. Ditmars*, 111 N.E. 822 (N.Y. 1916).

<sup>3</sup> Uniform Commercial Code 2-305.

The Article identifies an important category of situations in which parties intentionally drafted their agreement indefinite, leaving issues that were difficult to resolve for future completion. In these situations, contractual incompleteness is neither a result of haste nor of unforeseeability, but rather a deliberate choice to temporarily *disagree* over some matters, to sidestep difficult issues over which consensus could not be reached. It is here, in the presence of partial assent, that “partial enforcement” could be desirable.

The Article argues that the familiar standards of filling gaps, using either reasonable hypothetical consent (a.k.a. “mimicking”, or “majoritarian” default rules) or information-forcing one-sided provisions (a.k.a. “penalty” default rules), are not suitable for filling gaps in such deliberately incomplete contracts. They are not suitable because they provide *definitive* default terms, which prevent the parties from leaving their deal legally binding and incomplete. That is, under the familiar standard of gap filling, if parties recognize and anticipate the content of the gap filler, the set of *legal obligations* governing the transaction—whether explicit or supplemented—is no longer incomplete. Effectively, then, in the presence of definitive default terms, no additional assent is needed, and the parties are deprived of the power—which they may have sought to maintain—to affirmatively approve or veto the missing terms.

Instead, the Article proposes a new approach to gap filling: a party who seeks enforcement of a deliberately incomplete agreement would be granted an option to enforce the transaction under the agreed-upon terms supplemented with terms that are the *most favorable* (within reason) to the defendant. I will call this gap filling principle a “pro-defendant” default rule. If, say, a buyer and a seller agree on many provisions but leave others, such as payment terms, “to be agreed upon”, each party should be able to enforce a deal supplemented by payment terms that are most favorable to the other party. The buyer should be able to enforce a deal in which payment is made in cash, in full, upfront; and the seller should be able to enforce a deal in which the buyer is granted the credit terms that the buyer sought. The incomplete contract is supplemented by a “decoupled” default provision, either payment in cash or lenient credit terms, depending on the identity of the enforcing party. Effectively, a deliberately incomplete contract becomes the legal equivalent of *two* complete contracts, each favorable to a different party, with each party entitled to enforce only the contract favorable to her opponent.

To understand the novelty of this gap-filling approach, compare its prescription to those of other gap-filling approaches in a contract with

a missing price. For example, consider a landlord and a tenant who agreed on the subject matter of the lease and all other terms, but left the price term open. Imagine that the reasonable monthly rent for such property varies from \$3000 to \$5000. Under the “mimicking” approach to gap filling, the court ought to set a “fair and reasonable” price, reflecting the rent in the majority of comparable leases, that is, somewhere between \$3000 and \$5000, perhaps \$4000. Under the “penalty” default rule approach, the court might want to set the price biased against the party who drafted the agreement (contra-proferentem), to provide her incentives to draft the price term explicitly. If it were the landlord who drafted the vague contract, the supplemented price would be \$3000. Under the pro-defendant gap filling approach that is developed here, the price term would depend on the party seeking enforcement. If the tenant is the one trying to enforce the deal, she can only do so under a price of \$5000, most favorable to the landlord. And if it is the landlord who is suing for enforcement, he can only get a price of \$3000, most favorable to the tenant.

Of course, the selection of a gap-filling standard should not be arbitrary, but should depend on the reason for the incompleteness. Thus, the mimicking gap-filler should apply when the parties wanted to save the cost of explicit agreement and intended to apply an “average” or market term. The penalty gap-filler should apply when one of the parties—here, the landlord—is responsible for the vagueness and could have resolved it cheaply by making an explicit stipulation. And, along the argument that will be developed in this Article, the pro-defendant gap-filler should apply when the parties failed to reach consensus over this issue and left it deliberately indefinite. Specifically, it should apply in the common scenario in which the parties left this term “to be agreed upon”, that is, when they preserved mutual veto power.

The Article develops various justifications for the pro-defendant gap filling approach. First, it suggests that, on conceptual grounds, this outcome reflects more precisely the intent of the parties who drafted a deliberately indefinite agreement or an agreement-to-agree. These parties have reached some consensus, a partial commitment, and thus a no-contract result would frustrate their achievement. But at the same time they failed to reach consent over the missing term, rendering the presumption of “hypothetical consent”—which lies at the bottom of the mimicking default rule—false. Further, while it is reasonable for the defendant to reject a court-imposed “compromise” term, on the basis that she explicitly reserved her right to veto such compromises in

the hope of securing better-than-average terms, it would be unreasonable for the defendant to reject a deal containing her most favorable terms. Surely, when she entered the indefinite agreement, the best terms she must have intended to secure are these “most favorable” terms (although she may have soberly hoped to get terms that are less one-sided). What grounds, then, does the defendant now have to reject a deal that grants her such terms? Such one-sided deal, we can say for certain, is the one deal that does not conflict with the enforced-against party’s initial intent. Although she reserved the veto power, it is not such favorable terms that she intended to veto.

Further, the Article suggests that the pro-defendant gap-filling approach serves additional goals. First, it will be shown that this regime provides parties in negotiations with greater security against unilateral retractions by their counterparts, thus enhancing the incentives to make precontractual investments. This, in turn, also increases the overall contractual “pie”. Second, the binding nature of precontractual agreements enables parties to break down the “big” commitment into smaller, piecemeal, commitments, accumulated sequentially. These two effects increase the chances that negotiations will succeed and that full agreement will eventually be achieved.

The proposed pro-defendant gap-filling approach is not merely a theoretical possibility, but rather a viable technique recognized (and occasionally applied) by courts adjudicating incomplete agreements. Section IV of this Article will survey the variety of contexts in which courts have considered pro-defendant gap-fillers, and how courts managed to identify the content of the defendant’s most favorable term. To briefly illustrate one such context, consider the case of *Ontario Downs v. Lauppe*,<sup>4</sup> which involved an agreement for the sale of 16 acres of land for \$50,000, but left for further agreement where, within the seller’s 450-acre lot, would the 16-acre parcel lie. The negotiations were not yet resumed and the lot was never identified, when the seller retracted. In the suit by the buyer, the court rejected the no-contract outcome but also refused to designate a reasonable parcel. Instead, the court instructed that the contract can only be enforced with respect to a parcel that seller would designate. Effectively, the contract was supplemented with a term (parcel) most favorable to the seller/defendant.

Similarly, there is a substantial line of cases in which the parties left the payment terms “to be agreed upon”, where courts applied the doctrine of “cure by concession” and allowed the buyer to enforce the

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<sup>4</sup> 192 Cal.App.2d 697, 13 Cal.Rptr. 782 (1961)

deal if she agrees to make a full payment in cash and with no delay, namely, in a manner most favorable to the seller.<sup>5</sup> When the agreement is supplemented in such a pro-defendant manner, “there is no longer any way that the provision may be construed to [the defendant’s] detriment”,<sup>6</sup> and thus it is guaranteed not to violate the defendant’s original intent.

The Article develops the theory of pro-defendant gap fillers in four parts. Part I briefly reviews the law of indefiniteness and the existing theory of gap filling. Part II identifies situations in which contracts are left deliberately incomplete and demonstrates that existing standards of gap filling do not provide an adequate solution to these situations. Part III develops the concept of pro-defendant default provisions, and argues that they are uniquely suitable to fill gaps in deliberately incomplete contracts. Finally, part IV explores, as just explained, various doctrinal uses of the pro-defendant gap filling technique.

## I. INDEFINITE AGREEMENTS AND GAP FILLING

### A. The Law of Gap Filling

#### 1. *The Problem of Indefiniteness*

A contract is indefinite when it does not address a material aspect of the deal. Some seemingly unresolved aspects could be overcome by courts through liberal interpretation of meaning or by reference to context (e.g., prior oral agreements, course of performance). But other unresolved aspects cannot: the parties simply failed to reach agreement or to manifest any type of inferable assent over these matters. These are the contracts suffering from indefiniteness.

Traditionally, common law regarded indefinite contracts as lacking mutual assent and unenforceable. The justification for this policy was often stated in terms of an absence of intent-to-be-bound. Since the underlying question is always whether the parties intended to contract, the more issues left unresolved, the stronger is the inference that no such intent ripened.<sup>7</sup> Accordingly, if the missing terms were sufficiently material, the contract would have been unenforceable.

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<sup>5</sup> Restatement 2d of Contracts §33, *Ill.* 2 (“A agrees to sell and B to buy a specific tract of land for \$10,000 [...] and to lend B the amount, but the term of the loan are not stated [...]. The contract is too indefinite to [enforce] against B, but B may [enforce it] if he offer to pay the full price in cash”).

<sup>6</sup> *Busching v. Griffin*, 542 So.2d 860, 864 (Miss. 1989).

<sup>7</sup> *See, e.g., Schade v. Diethrick*, 760 P.2d 1050, 1058 (Ariz. 1988) (The requirement of definiteness is “a factor relevant to determining the ultimate element of contract formation — the question whether the parties manifested assent or intent to be bound”); Restatement 2d of

This approach, often viewed as formalistic and harsh, was reformed under the Uniform Commercial Code. Under the Code, indefiniteness—whether inadvertent or a result of inability to agree—can be cured by filling the gaps. Indeed, the Code provides gap-fillers for almost every aspect of the deal, and gives broad permission for courts to fill gaps by incorporating practices and unwritten customs.<sup>8</sup> Here, too, the underlying principle is that the parties' intent to contract should be the ultimate test. However, the Code's gap-filling jurisprudence is founded on a different empirical basis. The empirical premise is that agreements are intended by the parties to be binding even if they leave, as they often do, many terms open.

There is some debate as to whether modern courts take the doctrine of indefiniteness seriously. On the one hand, the Code's liberal gap-filling platform, imitated by the Restatement,<sup>9</sup> gives grounds for the belief that parties can nowadays enforce contracts with almost any term left open, as long as the circumstances indicate the intent to be bound. Gap fillers are available on price, duration, payment and delivery terms, and many others, effectively constituting a standardized statutory contract.<sup>10</sup> On the other hand, some evidence has recently been collected that the doctrine of indefiniteness continues to play a major role in court decisions, barring the supplementation and enforcement of gap-ridden agreements.<sup>11</sup> However, regardless of the extent to which the doctrine of indefiniteness continues to bar enforcement, it is clear that both the traditional common law and the Code regard indefinite contracts as posing a problem of binary choice: either a full-blown contract can be assembled with the aid of gap fillers, or the contract is unenforceable. All, or nothing. No other choice and no intermediate solution exist.

## 2. *Agreements to Agree*

Agreements to agree are a particular type of indefinite agreement that have received special attention and have been adjudged under a more particularized set of rules. In agreements to agree, parties affirmatively acknowledge the indefiniteness of their agreement, and state their intent—or hope—that further negotiations will ensue and

Contracts §33 cmt. c (“The more terms the parties leave open, the less likely it is they have intended to conclude a binding agreement”.)

<sup>8</sup> UCC 2-204(3).

<sup>9</sup> Restatement 2d of Contract §33.

<sup>10</sup> White and Summers, Uniform Commercial Code, Ch. 3 (4<sup>th</sup> Ed. 1995)

<sup>11</sup> Robert E. Scott, *The Theory of Self-Enforcing Indefinite Agreements*, 104 Colum. L. Rev. (forthcoming 2004) (analyzing a sample of cases with indefinite contracts, many of which were not enforced.)

enable them to reach a more complete agreement. When the “further negotiations” fail and no further agreement emerges, courts are usually unwilling to apply gap-fillers and enforce the contract.<sup>12</sup> Interestingly, the missing terms—which the parties left to be further negotiated and to agree upon—are no more material than terms that courts readily supplement into other indefinite agreements.<sup>13</sup> It is not the materiality of the terms per se that prevents gap filling, but rather the fact that the parties explicitly identified them as the subject matter for further affirmative agreement. Apparently, the inference many courts draw is that when parties agree to agree, they have not yet agreed—they do not yet intend to be bound. Such “agreements” merely mark a stage in the precontractual negotiations in which certain substance has been resolved and should be memorialized.

While agreements to agree are normally deemed unenforceable, other closely related forms of preliminary agreements are more regularly enforced. For example, “agreements in principle” or agreements “subject to a contract”, in which parties draft the outline of their agreement and acknowledge that some details need to be worked out, are held enforceable even in cases where they are quite bare.<sup>14</sup>

It might appear, then, that the jurisprudence of precontractual agreements in general, and of agreement to agree in particular, exhibits that same “all or nothing” feature that characterizes the doctrine of indefiniteness. Either the precontractual agreement manifests sufficient intent to be bound so as to be supplemented and enforced, or it does not manifest such intent and is unenforceable. In this area of precontractual liability, however, the all-or-nothing characteristic has eroded some. In practice, even when the agreement does not rise to a full-blown contract and is deemed unenforceable for the purpose of contractual remedies, the parties’ freedom to walk away from it has been somewhat limited by courts. With the emergence of the good faith jurisprudence in common law, courts have increasingly limited the privilege of parties, who made serious albeit partial precontractual manifestations of intent, to retract.<sup>15</sup> The *freedom from contract* that parties in these situations historically enjoyed was constrained.

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<sup>12</sup> 1 CORBIN ON CONTRACTS §2.8 (Rev. Ed. 1993).

<sup>13</sup> Cite an example

<sup>14</sup> *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768 (Tex. Ct. App. 1987).

<sup>15</sup> *See, e.g.*, Charles L. Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. Rev. 673, 679-81 (1969) (explaining the emergence of the obligation to negotiate in good faith as an intermediate solution between the traditional all or nothing results); Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 Colum. L. Rev. 217 (1987).

Specifically many courts have been requiring parties who entered agreements to agree to indeed make an honest effort to reach an agreement, and tailor some measure of reliance liability to a breach of this duty.<sup>16</sup> Accordingly, an arbitrary decision by a party to walk away from the negotiation could be regarded as breach of the good faith obligation.

### **B. The Theory of Gap Filling**

Filling gaps in incomplete contracts was elevated from a context-specific inquiry to a generalizable “theory” when it was noticed that while contractual gaps vary in contexts and in substance, there are unifying rationales to filling them. Although gaps concerning, say, contingent voting rights in a complex merger agreement have nothing in common with gaps concerning, say, missing payment dates in a lease contract, the formulae by which the law fills these gaps—what judges have to consider in order to generate the gap-filler—may have a lot in common.

Put differently, the reason there can be unified theories of gap-filling is the recognition that there exist systematic sources for incompleteness. Gaps in contracts are not random “holes”, but arise from identified imperfections in the negotiation process. Diagnosing these imperfections yields solutions for redressing them, namely, standards for filling the gaps.

Accordingly, it is often said that there exist two distinct efficiency-based theories for gap filling.<sup>17</sup> Each of these theories diagnoses a different reason for the contractual incompleteness, and provides gap-fillers that address the diagnosed source of incompleteness. In order to succeed in developing an additional theory of gap filling, it will be necessary to identify a different source of incompleteness, one that is not addressed by existing gap-filling formulae. Before doing that, however, let us briefly recall the existing theories.

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<sup>16</sup> See, e.g., *Teachers Insurance and Annuity Association of America v. Tribune Co.*, 670 F. Supp.491 (1987).] Some courts, while following *Tribune*, assign expectation liability for the breach of “*Tribune*-duties”. See, e.g., *Venture Assocs. v. Zenith Data Sys.*, 987 f.2d 429 (7<sup>th</sup> Cir. 1993) (unless too uncertain, expectation remedies should be awarded).

<sup>17</sup> See, e.g., Richard Craswell, *Contract Law: General Theories*, in 3 *Encyclopedia of Law and Economics* 1 (Bouckaert and De Geest eds., 2000); Ian Ayres, *Default Rules for Incomplete Contracts*, 1 *The New Palgrave Dictionary for Economics and the Law* 585 (Peter Newman, ed., 1998). For the argument that the two gap-filling theories are merely two perspectives on one unifying approach, see Bebchuk and Shavell, *Reconsidering Contractual Liability and the Incentive to Reveal Information*, 51 *Stan. L. Rev.* 1615 (1999).

### *1. Mimic the Parties' Will*

One reason for incompleteness is the cost of drafting a complete agreement. An agreement that addresses all possible contingencies involves costly negotiations and drafting. The underlying premise is that a complete contingent agreement can be reached, if only the parties invest sufficient effort and attention to the details. But the cost of attending to the fine details and to remote contingencies may exceed the benefit from doing so, making it rational to leave gaps in the agreement.<sup>18</sup>

The assumption that transactions costs are the reason for incompleteness generates a “mimicking” principle of gap filling. The law should equate the missing provisions with the hypothetical consent—the terms the parties would have agreed upon. By mimicking the parties’ hypothetical will, the law is enabling the parties to save the transactions costs of drafting these very same terms expressly. Or, put differently, by *correctly* mimicking the parties’ will, the law is enabling the parties to save the transactions costs of expressly opting out of the legal default rules.

The mimicking theory is based on a premise that there exists an underlying “will”, or hypothetical consent. Namely, there are specific definitive terms which, had the parties paid sufficient attention to the matter, they would have rationally agreed upon. The only challenge is to identify these terms. Accordingly, if the judicial task of identifying the hypothetical consent is straightforward, courts can tailor individually optimal gap fillers: ones that are rational for *these* parties. And if the judicial task of identifying the hypothetical consent is more difficult, in light of the heterogeneity of contracting parties and the uncertainty concerning the circumstances, courts could use “majoritarian” or “one-size-fits-all” default rules: ones that are rational for most similarly-situated parties.<sup>19</sup> Either way, the rationale for choosing the content of any default provision is to minimize transactions costs: the cost of opting into specific terms. Mimicking defaults appropriately addresses the drafting cost source of incompleteness.

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<sup>18</sup> EASTERBROOK & FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW*; Craswell, *supra* note 17, at 3.

<sup>19</sup> Ayres, *supra* note 17, at 586.

## 2. *Penalty Defaults*<sup>20</sup>

Another reason for incompleteness of a contract has to do with information asymmetry. When parties are differently informed about an aspect of the deal, they may either draft provisions that are sub-optimal, or neglect to address an issue that otherwise, in the presence of perfect information, would have been addressed. For example, a party may fail to alert her counterpart to the fact that she assigns idiosyncratically high value to performance, resulting in the counterpart failure to take the necessary higher precaution against breach. Since private information can be advantageous, it may not be revealed, leaving the agreement—which should optimally be tailored to the content of this information—incomplete.

If the one-sidedness of information is the cause of contractual incompleteness, gap-fillers can be designed to induce information sharing. They can do so by “punishing” the informed party. If, in the presence of contractual silence, the default provision is unfavorable to the informed party, this party will be induced to opt-out of it by drafting an express provision. In the process of reaching such an express agreement, information is shared and the information asymmetry is overcome. Thus, for example, if the default remedy for breach of contract is limited to “average” or foreseeable damages, the party who stands to suffer high idiosyncratic profit loss from breach will have the incentive to draft a higher liquidated damage provision, thereby communicating her private information about her expected profit. Such gap-fillers are often named ‘information-forcing’ default rules.

## 3. *Definitive Default Rules*

The mimic-the-parties’ will and the penalty defaults approaches share at least one important common feature: they both supplement the parties’ obligation with a definitive provision. To the extent that the parties can anticipate what the gap-filler would be—and both theories rely on the parties’ ability to anticipate the gap-fillers<sup>21</sup>—the set of *legal obligations* governing the transaction is fully determined.

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<sup>20</sup> The term “penalty defaults” was coined in Ayres and Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989). A similar information-cost theory of gap-filling was developed contemporaneously by Bebchuk and Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L., Econ. & Org. 284 (1991).

<sup>21</sup> Craswell, *supra* note 17.

Whether the obligations are based on express provisions or on legally supplied default terms, they are definitive.<sup>22</sup>

But definitive default terms are not the only conceptual way to deal with ambiguity. Consider by analogy computer software. Programs always start with preset defaults that usually represent the average user's preferences—what most people would have selected if they had the chance to try and experience different settings. These are definitive majoritarian defaults. (One can also imagine penalty defaults, utilizing settings that most users would not want, eliciting setting reversals and “preference revelation”.) But some features are set such that no prior setting is selected, requiring that the user will make an affirmative selection (e.g., click one of several buttons), or else the feature will not be activated and the process will be stalled. These are non-definitive defaults: the settings are not fully determined (although they might be “narrowed down”), but, as a result of the different selections made by different users, the program will eventually run with each user's most favorable setting. In the analysis below, I will argue that contractual ambiguity could potentially be dealt with in a similar manner, utilizing non-definitive default terms.

## II. DELIBERATE INCOMPLETENESS

### A. When Do Parties Prefer Indefiniteness?

Once it is concluded that the parties entered into a binding agreement, default rules—whether mimicking or penalty defaults—supplement any incompleteness in the agreement with *definitive* and predictable terms. This basic feature of gap-filling law has the implication that parties cannot create liability while leaving any of their *obligations* legally blank. If they want to create liability, then whatever obligation they leave unresolved, the law would eventually supply. True, it might be unclear, at the time of the agreement, how the law would supplement the missing term, but it is clear that if the agreement would be held binding, it would be supplemented. Thus, imagine a situation in which parties who negotiate over an aspect of the deal cannot reach consent. If they leave this issue open, and if the gap is not too severe to render the contract unenforceable due to indefiniteness, a gap filler will kick in, resolving the open issue. But the parties would anticipate this and realize that leaving a blank is

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<sup>22</sup> Indeed, by its legal definition a “contract” cannot be incomplete. UCC § 1-201 (11) defines “contract” as “the total obligation which results from the parties’ agreement as affected by this Act,” namely, including all the gap-fillers.

equivalent to agreeing on a definitive term that is identical to the gap filler. That is, when gaps are filled by definitive default provisions, parties are effectively precluded from leaving an issue unresolved.

This feature of contract law could, at times, conflict with the parties' interests. In the discussion to follow, I will argue that there is both a theoretical and an empirical basis for the claim that parties have an interest in unresolved agreements. In a nutshell, the parties may want to leave an issue unresolved when they want actual, rather than inferred consent to govern. That is, each party may seek to maintain a "veto power" over the specific term—to avoid having to surrender to a "compromise" which she never embraced. Parties may seek to maintain the power to *reject* any undesired term. Once this claim is established, it will provide the necessary foundation for a different approach to gap filling, one that does not utilize definitive defaults.

### 1. *Conceptual Grounds*

Can rational parties choose to leave part of their agreement deliberately incomplete? One way to think about this, which was offered in a thought-provoking and influential Article by mathematician Robert Aumann, is to characterize situations in which parties may *agree to disagree*.<sup>23</sup> Aumann showed this to be possible, by identifying the conditions for the *opposite* to be true: when is it that parties *cannot* agree to disagree. The logic of his claim is, roughly, the following. If one party knows that the other party's view is different from his own, she should revise her own view so as to take into account the fact that the other party may have some different information justifying her view.<sup>24</sup> The other party would follow the same updating process. Thus, for example, if two doctors have differing views/predictions on how a certain medical procedure would affect the patient, each basing her view on her own prior experience, each would rely on the other doctor's position as a valid reason to update her own. As long as their views are different, this convergence-by-inferences dynamic will remain in action. In equilibrium, the parties' views will converge.

The lesson from Aumann's insight is not that disagreements are impossible, but rather that: different opinions or views among rational parties can be maintained only in the presence of initial *biases* or

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<sup>23</sup> Robert J. Aumann, *Agreeing to Disagree*, 4 *Annals of Statistics* 1236 (1976)

<sup>24</sup> More precisely, a player's updating should occur only if the player shares common "priors", such that a player can attribute the opponent's differing view to "new information", rather than a "bias". It also requires that the shared priors be common knowledge. See, e.g., Fudenberg & Tirole, *Game Theory* 548-9 (1991).

*prejudices*. In the doctors example, they may remain in disagreement if, say, each considers her own training as superior (a “prejudice”), or if each is influenced by the salience of her own prior experience (a “bias”). Disagreements cannot be solely attributed to one-sided information. Information-based differences in views “wash out”.<sup>25</sup>

Aumann’s theorem, by articulating the conditions under which disagreement would be overcome tells us also the flip side, namely, when a disagreement *cannot* be overcome—when will parties agree to disagree. It suggests that even rational parties who are willing to update their own views in light of the views of others may fail to reach consensus, if they either have different priors (i.e., biases, prejudices), or if their private information is not sufficiently well communicated to trigger the inference process.

When an “agreement to disagree” results from different priors—different initial beliefs on what is going to happen—there is little reason to expect that the parties would eventually be able to resolve their differences. If parties attribute the gap in their positions, not to private information but to a preference-based divergence, they would not reach consensus. If, say, a buyer and a seller negotiating the sale of a firm have different probability assessments concerning the future profitability of the firm, such that are not based on private information but rather on psychological factors, prejudices, or tastes, agreement may permanently elude them.

On the other hand, an “agreement to disagree” may also occur even when parties are not influenced by such biases, but instead have a difficulty in credibly communicating each other’s views and information. Take the buyer of the firm who is potentially ready to infer that the firm is worth more than she thought, once she recognizes that the seller’s true valuation is high. While the seller’s information cannot be directly conveyed, his assessments can. As long as the buyer cannot reliably infer all that the seller knows, disagreement may persist.

Interestingly, if disagreement arises from the difficulty to communicate the underlying information between the parties, it may nevertheless be short lived. Over time—over several “rounds” of communicating each other’s opinions—the parties would eventually revise their views, infer each other’s information, and reach

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<sup>25</sup> See also Morris H. DeGroot, *Reaching a Consensus* 69 *The Journal of the American Statistical Association* 118 (1974).

agreement.<sup>26</sup> Thus, an “interim” negotiation stage may exhibit an agreement to disagree, only to be resolved later, as more updating will take place.

In real life negotiations, this “interim” negotiation stage might be a long one. Parties may be unable to agree on an issue, but at the same time recognize that their inability to agree could eventually be overcome, as more of their private information is credibly shared. It is this perceived “temporariness” of the disagreement that could manifest itself in a phased agreement, whereby parties postpone till a later stage the further resolution of some term of their agreement. Thus, the economic model of agreeing-to-disagree provides a rationality-based account for the negotiation practice of postponement of problematic issues. The next section discusses the prominence of this practice

### *2. Negotiation Practices*

Parties to complex negotiations may deliberately choose to leave parts of their agreement incomplete. This is done, not as an oversight, but as a calculated strategy aimed at increasing the chance for success. To begin with, in complex deals it is technically impossible to tackle all issues simultaneously. Consensus is achieved piecemeal, as different aspects of the transaction are brought up. There usually comes a point in the negotiations in which sufficient issues were resolved that some commitment between the parties becomes desirable. The arrival at partial agreement does not represent a conclusion or a negotiation peak, but rather a necessary stage toward a more complete agreement. At this stage, parties expect that the remaining issues would eventually be resolved, through a process of continued piecemeal negotiations.

Other reasons why the aspects of the transaction cannot be resolved all at once have to do with the varying degrees of difficulty in agreeing over different issues. The parties may believe that the difficulty in overcoming disagreement over these issues may subside after most of the agreement is determined, or that future negotiations may succeed where present negotiations failed (if, say, some new information comes along). They may also postpone some sticky issues in the hope that might be able to sidestep them (say, when a relevant contingency does not materialize.)

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<sup>26</sup> For a model in which agents need several rounds to revise their opinions and to reach consensus, see John D. Geanakoplos and Heraklis M. Polemarchakis, *We Can't Disagree Forever*, 28 J. Econ. Theory 192 (1982).

In any event, when parties leave their agreement deliberately incomplete, they are making a commitment to be bound to the agreed upon terms, conditional on the remaining terms being resolved in a manner satisfactory to them. While this is *not* a commitment to the full blown contract that was not yet finalized, it is a commitment to the relationship and to refraining from unilateral departure. Specifically, it is commonly recognized in negotiation manuals that contentious issues should be avoided in initial stages of the negotiation as they might “place an unbearable strain on overall settlement process”.<sup>27</sup> Parties are encouraged to tackle easier issues first, reach as much consensus as possible, thereby increasing their own motivation and incentive to find ways to resolve the contentious issues. Or, each may believe that by delaying consensus a future resolution that is more favorable to her would become more likely.<sup>28</sup> The effort already spent on achieving partial agreement, the dynamic of good will that this effort generated, as well as the shaping up of the potential surplus from a complete agreement, may accord a more amenable context for the resolution of the remaining, stalemated, issues.<sup>29</sup>

This phasing strategy, it should be noted, is different than the negotiation strategy of resorting to a third party neutral’s arbitrational authority. The latter strategy, by removing the veto power each party has, exposes them to greater risk. It is appropriate for parties who are willing to accept a compromise, but have conflicting views on what consists a fair compromise. In the situations discussed above, parties are not yet ready to commit to a compromise, and prefer to maintain their veto power over a non-consensual resolution. In these situations, a rational phasing of the agreement process is believed to increase their chances of success. Indeed, parties often elect non-binding forms of mediation, further evidence to the prevalence of the ir desire to maintain the veto power over any compromise, however reasonable.

At the interim stage, after some of the less contentious issues were resolved, do the parties regard themselves under commitment? Surely, the parties do not consider there to be a full-blown enforceable

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<sup>27</sup> David A. Lax and James K. Sebenius, *The Manager as Negotiator* 97 (1986) (parties should avoid, or altogether remove, contentious issues that “may render agreement impossible”).

<sup>28</sup> See, e.g., David A. Lax and James K. Sebenius, *The Manager as Negotiator* 96-97 (Free Press 1986) (“Negotiations often leave much ambiguity with the tacit understanding that a definite resolution of the issue perhaps strongly favoring one party will later become necessary”)

<sup>29</sup> *Id.*, at 222; Robert Mnookin, Scott R. Peppet, and Andrew STulumello, *Beyond Winning: Negotiating to Create Value in Deals and Disputes* 251 (2000).

agreement.<sup>30</sup> On the other hand, a complete freedom to walk away also conflicts with the dynamics of the negotiation. It would indicate that even the resolved issues can be reopened and would thus diminish the value of such initial agreement. Since it is this value that generates further agreement, a norm of unrestricted freedom to retract would be detrimental to the successful resolution of a negotiation that has already reached a serious stage.

[Talk here about no-retraction norms in the markets]

The recognition that parties might prefer to leave parts of their agreement deliberately incomplete due to the fear that otherwise the deal might fall through is commonly mentioned in contracts treatises.<sup>31</sup> It has also been developed independently in a recent article by Robert Scott.<sup>32</sup> According to Scott, indefiniteness is often a deliberate drafting choice of the parties, who “appear to prefer the indefinite agreement they concluded to the more explicit and verifiable alternative that they ignored”.<sup>33</sup> Scott’s particular account suggests that deliberate gaps are left in the agreement to make room for subsequent informal agreement, which in turn is driven by reciprocal fairness. That is, Scott suggests that deliberately incomplete agreements should be legally unenforceable, to enable the parties to utilize informal methods of self-enforcement, particularly voluntary performance through reciprocity.

While Scott’s explanation for the existence of indefinite agreements and of agreements-to-agree is different than the one offered in this Article, it shares the fundamental observation of the existence of deliberately incomplete agreements. Scott too observes that one of the strategies available to parties negotiating an agreement is to leave some terms unresolved, in the expectation that their resolution will become possible in the future course of their relationship, and in the expectation that the law will not fill the gaps with a mid-range compromise. But while Scott argues that there should be no legal sanction on a party who retracts from such an agreement, to leave room for informal negotiations the account developed in this Article focuses on settings in which such informal negotiations failed. Let me turn now to explain what parties might gain

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<sup>30</sup> Lax and Sebenius, *supra* note 27, at 279-280 (Emphasizing the informal sanctions of breaking contingent agreements); Roy J. Lewicki, et al., *Negotiations* 100 (2d Ed. 1994) (Advocating that negotiators strategically make only tentative commitments until an entire agreement is reached).

<sup>31</sup> E. Alan Farnsworth, *Contracts* 208 (3d Ed. 1999)

<sup>32</sup> Scott, *supra* note 11.

<sup>33</sup> *Id.*, at 19

from a regime that assigns some legal consequences to their deliberately indefinite agreement.

### *3. The Benefits of Gradual Commitment*

The argument thus far suggest that agreements to disagree are both conceptually possible and practically prevalent, but it has yet to explore the reasons why such intermediate forms of commitment should not be freely retractable. Shouldn't the parties be free to walk away anytime prior to full agreement? In thinking about what negotiating parties gain from constraining their mutual ability to walk away even before full agreement is reached, there are various sources of value that might be recognized. One type of benefit, often mentioned in the negotiation literature referenced above, has to do with "psychological" and cognitive effects that are associated with a gradual compromise. Concessions that may be hard to make if framed as a lumpy, measurable departure from the ideal terms, may be easier to digest in consecutive small portions.<sup>34</sup> Here, the value of entering into partial commitments in the intermediate stage is the fragmentation of the otherwise hard-to-swallow large commitment. Is this not the major reason why increasingly growing pre-marital commitments are a common feature preceding the full-blown marriage? And why, the more advanced the pre-marital commitment is, the more costly it is, in terms of informal sanctions, to retract? Thus, if parties were free to walk away anytime prior to a full formal agreement, the benefits of a gradual progression of the commitment would be lost.

Another benefit arising from the existence of an interim commitment at the precontractual stage has to do with the "integrity" of the negotiation process. It is increasingly recognized by legal writers that when the risk of parties walking away is diminished, the "ritual" of contract negotiation is taken more seriously. Parties are more likely to enter the bargaining only when they are ready to do business, they would refrain from making misleading gestures, and greater trust is likely to emerge.<sup>35</sup> Put differently, the signal that an entrance into negotiations transmits with respect to the propensity of a

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<sup>34</sup> See, e.g., Robert C. Cialdini, *Influence* 27 (1984) ("The trick is to bring up the extra [expenses] independently of one another so that each small price will seem petty when compared to the already-determined much larger one.")

<sup>35</sup> See, e.g., Farnsworth, *supra* note 15; Hoffman v. Red Owl Stores, 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

party to work towards a deal is more powerful the greater is the sanction for walking away.<sup>36</sup>

Why is some form of interim commitment useful for the parties? In fact, we might worry that the opposite is true, namely, that any form of costly precontractual commitment—any limitation of the *freedom from contract*—might cause parties to think twice before entering the negotiations. Such precontractual commitments, if backed up by legal liability, might “chill” the incentives to bargain, reducing the incidence of surplus creating negotiations, and thus reducing, rather than enhancing, the parties’ payoffs.<sup>37</sup>

One explanation for the value-enhancing effect of precontractual liability, which was developed in recent economic literature, focuses on the incentives to invest in the relationship.<sup>38</sup> In the same manner that contractual liability is instrumental in promoting reliance on the contractual promise, precontractual liability can be instrumental in promoting reliance on the partial, precontractual commitment. Such precontractual reliance on negotiations can take many forms. It may involve the forgoing of opportunities to negotiate with other partners;<sup>39</sup> loss of job offers and promotions;<sup>40</sup> training and investment in relationship-specific assets;<sup>41</sup> acquisition or sharing of information; investment in the real estate by a potential tenant;<sup>42</sup> and many more. These are costly activities that parties undertake in order to increase the size of the “pie” that any agreement would subsequently divide.

<sup>36</sup> This “signaling” effect is recognized in the international negotiations literature. See, e.g., Lloyd Jensen, *Soviet-American Behavior in Disarmament Negotiations*, in I.W. Zartman (ed.), *THE 50% SOLUTION* (Anchor Book 1976), at 289.

<sup>37</sup> See 1 FARNSWORTH ON CONTRACTS 361 (2d. Ed. 1998) (describing “a chilling effect” of discouraging parties from entering negotiations); Jason S. Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 Va. L. Rev. 385, 416-417, 445-446 (1999) (arguing that liability for pre-trade representations in the event of negotiation breakdown would “cause the market to shrink” and would force parties to utilize more cautious bargaining strategies, wasting opportunities for efficient trade).

<sup>38</sup> The argument that liability can enhance precontractual reliance appears in Avery W. Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 Yale L.J. 1249 (1996); Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 Stan. L. Rev. 481 (1996). A formal analysis of the particular rules of liability that can induce efficient reliance is Lucian A. Bebchuk and Omri Ben-Shahar, *Precontractual Reliance*, 30 J. Leg. Stud. 423 (2001).

<sup>39</sup> *Teachers Insurance and Annuity Association of America v. Tribune Co.*, 670 F. Supp.491 (1987).

<sup>40</sup> *Grouse v. Group Health Plan, Inc.*, 306 N.W. 2d. 114 (Minn. 1981).

<sup>41</sup> *Hoffman v. Red Owl Stores*, 133 N.W.2d 267 (Wis. 1965).

<sup>42</sup> *Hammond v. Ringstad*, 10 Alaska 543 (1945).

In the absence of some kind of commitment, parties will apply greater caution and expend less in precontractual reliance, in the fear that any such investment might be wasted if the other party walks away, or in the fear that reliance will make them vulnerable to hold-up by the other party. That is, the benefits a party can enjoy from any reliance investment are diminished by the chance that the deal will fall through or by the ability of the other party to expropriate some of the surplus created by the investment. Indeed, this is one reason why parties who enter complex and costly negotiations are careful to first agree on some precontractual arrangements for cost reimbursement in the event that negotiations fail.

According to this view, parties enter into partial agreements and agreements-to-agree in the hope that they would have some binding force (the precise magnitude of this force will be discussed below), in order to provide each other some measure of security, thereby encouraging each other to keep investing in the success of the relationship. Because it is costly for the other party remain in the negotiations and to further invest in it, each party must sacrifice some of her own freedom to walk away in order to encourage the other party to take the chance. The precontractual commitment enables a party to make a commitment to a specific *partner* without making a commitment to the full set of specific *terms* of the deal. In the presence of such a commitment, the risk each party faces, of her counterpart unilaterally abandoning the relationship, is diminished. With this added confidence greater mutual relationship-specific investment emerges. And with the greater mutual investment, a subsequent full-blown contract is both more likely and more profitable.

Another way to think about the value of a partially binding agreement to agree is to recognize the “self-fulfilling prophecy” that it embodies. When parties are faced with issues that are difficult to resolve, the memorialization of a precontractual agreement over the resolved issues and an agreement to agree over the unresolved issues—if coupled with some liability for breakdown—makes it more likely that the parties will eventually succeed to agree over the unresolved issues. The notion, prevalent among contract law scholars, that an agreement to agree is a “contradiction in terms”<sup>43</sup> and that a ‘contract to make a contract’ is conceptually impossible, overlooks this self-fulfilling effect. A contract-to-make-a-contract, if it is associated with some (albeit less than full contractual) liability, can make the subsequent contract more likely.

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<sup>43</sup> *Ridgway v. Wharton*, 6 H.L.Cas. 268; Corbin, *supra* note 12, at 134.

### **B. The Inadequacy of Standard Gap-Fillers**

Having argued that contractual gaps can arise from transactors' deliberate choice to phase the agreement process, the next step of the argument is to demonstrate that standard approaches to gap filling are ill equipped to address the needs and concerns that give rise to such deliberate gaps. Standard gap filling techniques, we saw, provide a single definitive provision, which the parties are assumed to anticipate. Thus, when the parties take into account the legally supplied default term, they cannot effectively leave portions of their deal unresolved, for future negotiation and agreement. Whether it is the express agreement or the background default rules that define the totality of obligations, they are fully determined: the set of legal obligations cannot remain both binding and obligatorily incomplete. No further stipulation of terms by the parties is required.<sup>44</sup>

For example, if, in the absence of an explicit agreement over price the law supplements the contract with a definitive term, either the "reasonable" (majoritarian) price, or a *contra proferentem* (penalty) price provision, the parties would recognize the default price provision and would consider the deal to be obligatorily complete.<sup>45</sup> Contracting in the shadow of this definitive default term is equivalent to explicitly drafting this term into the contract. Any desire that the parties might have had to reach a binding commitment and leave the price term temporarily open, for future affirmative resolution, rather than a court-imposed compromise, would be frustrated.

Put differently, once it is recognized that the gap in the agreement is due neither to drafting costs nor to one-sided superior information, there is no *prima facie* reason to expect that either a mimicking or a penalty default provision would be desirable. In fact, in many cases in which parties deliberately leave a term open, long and costly negotiations preceded. In these cases parties often search for ways to explicitly state the incompleteness of their agreement, which—from a drafting perspective—is probably more costly than drafting a definitive "reasonable" provision. That is, the saving of drafting cost—

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<sup>44</sup> The law recognizes interim forms of agreement, under which the obligations are not fully determined but the parties are required to negotiate them in good faith. *See Teachers Insurance and Annuity Association of America v. Tribune Co.*, 670 F. Supp.491 (1987). Here, however, the incomplete agreement is wholly unenforceable; A breach of the good faith duty usually does not give rise to contract damages.

<sup>45</sup> True, the parties would have to be able to anticipate what price the court would supplement, but their ability to do so is the foundation of standard default rule theories. Without it, parties cannot be assumed to opt out of non-mimicking defaults, or cannot be incentivized to reveal private information in opting out of penalty defaults.

the rationale of the mimic-the parties' will theory—cannot explain the gap. Similarly, the failure of the parties to agree on a term is not necessarily due to one party's superior information. True, non-agreement may arise as a result of, say, each party safely hiding his or her private information or reservation value, and had these values been revealed, an agreement would be easier to reach. However, this is not the type of one-sided information that the law is necessarily interested in forcing out of the parties by means of a penalty default. Thus, in these deliberate incompleteness cases, the underlying justifications for standard gap filling techniques are not valid.

### **C. The Inadequacy of the No-Enforcement Approach**

When a contract is recognized to be deliberately incomplete, it may be conjectured that the correct legal response is to refrain altogether from filling the gap, not because of indefiniteness, but due to absence of assent. After all, each party had a different term in mind, and they manifested a preference to have an incomplete set of obligations and to postpone till a later date further agreement. Since contract enforcement requires an objective manifestation of meeting-of-the-minds, here we have an indication of the opposite, of an absence of consent. If the court were to supplement the parties' agreement with a definitive term, the contract would be complete, contrary to the parties' intention.

The problem with this no-supplementation regime is that, under current contract law doctrine, it implies non-enforcement of the entire—albeit partial—agreement reached by the parties.<sup>46</sup> If the court does not supply a definitive term, it is impossible to determine the plaintiff's expectation interest, and thus the remaining solution is to deem the contract too indefinite to be enforced. To illustrate, consider again the missing price example. If the parties left the price intentionally undetermined, and if one of the parties tries to enforce the deal from which the other party is now completely backing off, the choice *not* to supply a price term leaves the court little choice but to consider the whole deal unenforceable. Since the deal cannot be carried out without setting a price, nor can damages based on lost profit be calculated to make the enforcing party whole, the contract

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<sup>46</sup> See *Drees Farming Ass'n v. Thompson*, 264 N.W. 2d 883 (N.D., 1976) (no-supplementation of an option of renewal under "terms to be negotiated" would make the option meaningless). Farnsworth, *supra* note 31, at 213-4.

fails for indefiniteness. The missing term is deemed essential, rendering the remaining terms unenforceable.<sup>47</sup>

One way to defend the no-supplementation approach is by recognizing that parties often prefer their agreement to be governed by norms other than legal sanctions.<sup>48</sup> Parties expect either their reputational concerns or norms of fairness and reciprocity to provide both the missing content of the agreement as well as the inducement to abide by it. By not supplementing these partial agreements, courts leave room for parties to invoke such informal mechanisms of consent, catering to the parties' preference for fairness-guided exchange. Supplementation, then, even if sought by one party *ex-post*, is in conflict with the parties' initial intent to rely on extra-legal sources of obligation.

While this approach recognizes and relies on the ability (and desire) of the parties to resolve the indefinite portions of their deal informally, it does not conflict with legal intervention in those cases in which the parties failed to resolve their differences. Further, the premise that the parties may want the court not to interfere with the resolution of the remaining issues does not imply that the parties also consider the formally drafted portions of the agreement non-binding. While the agreement is incomplete, it does contain some elements of consent, which the parties chose to draft into a legally binding format. Making the agreement wholly unenforceable even when the norms of reciprocity failed to provide resolution and allowing the parties to freely walk away would frustrate this accomplishment. If, instead, the court were to enforce only the memorialized parts of the agreement, and non-intervene in the unresolved parts, extra-legal relations could continue to maintain their role in providing the missing terms.

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It might seem, then, that presented with a deliberately incomplete contract, the court's adjudicative choices include either "aggressive" supplementation of terms with definitive default provision or non-enforcement of the contract entirely. That is, the court is faced with an all-or-nothing choice. Supplement the gaps and enforce the partial, incomplete, deal as if it were complete ("all"), or consider it a preliminary, non-binding deal ("nothing"). In particular, this

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<sup>47</sup> See, e.g., *Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*, 417 N.E. 2d 541 (N.Y., 1981); Corbin, *supra* note 12 § 4.1, at 532.

<sup>48</sup> See Scott, *supra* note 11.

dichotomy suggests that the court cannot apply a partial enforcement approach, and enforce only the agreed upon terms.

In the next section, I will argue that this all-or-nothing feature, although it fairly describes many areas of the law, is not optimal and not necessary. When the parties affirmatively choose to leave a matter open for further negotiation and yet manifest an intent to be bound to the resolved issues, a legal regime different than the standard gap-filling approach is called for. The choice courts face should not be restricted to no-enforcement versus aggressive gap filling. In these situations, an intermediate regime is available, which supplements and enforces such deliberately incomplete deals without writing the missing elements of the contract over for the parties.

### III. BIASED SUPPLEMENTATION

#### A. Decoupling the Default Rule

Consider a situation in which parties negotiate a contested issue (say, a contingent price), with each insisting on a term that is favorable to her. If the parties reach a deadlock over this issue, yet proceed to draft an agreement on the remaining issues, each party can be deemed to manifest consent to a complete contract which contains the agreed upon terms and the term she demanded concerning the stalemated issue. That is, assent by a party to the incomplete agreement that contains a “to-be-agreed-upon” gap eliminates any reasonable grounds she might have to reject the complete agreement when supplemented by the term she has been openly seeking all along. This manifested consent is, of course, “constructive”. There is actual assent only to the part of the deal that includes the expressly agreed upon terms; but there is constructive, or inferred, intent to be bound to the part of the deal that was contested, as long as it is resolved with the term that this party vied for.

Accordingly, in this situation where a contested issue is left deliberately open, each party can be seen as manifesting assent to a different deal. It is as if they drafted two contracts, identical in the components that contain all the agreed-upon issues, but different in the components that contain the contested issues. Each party is making a commitment to be bound to the contract that contains her favorable terms. Thus, if one of these hypothetical contracts were to be enforced against a party, it can only be the one to which she assented, the one containing her favorable terms.

This interpretation of the deliberately incomplete agreement is consistent with the parties’ choice to address their differences by

entering into a partial understanding, rather than remaining silent or walking away. If the parties recognize their deadlock and nevertheless draft a partial agreement, they are indicating that some assent has been obtained. They are also indicating, however, that each is seeking a different content to the remaining commitment. Accordingly, the only way to give efficacy to their intent is to decouple the remaining commitment.

How could that be done? Of course, neither party can enforce a contract containing her own favorable terms. To these terms, the other party never surrendered. Instead, the power that each party would have is to enforce upon her opponent a deal that, with respect to the contested issues, includes the *opponent's* favored terms. (A party can, of course, choose not exercise this option, in which case — if the other party does not exercise her own option—the “no contract” outcome remains.) If the incomplete contract is supplemented in such a manner, the enforced-against party—being granted the terms she either agreed to or unilaterally sought—cannot legitimately claim that she never intended to be bound to it. Isn't this the deal she pursued all along? Liability here is grounded, if not on what a party affirmatively assented to, then at least on a reasonable restriction over what a party may reasonable reject.<sup>49</sup> If she refuses to deal under such terms, she is effectively retracting from her previous manifestation of intent.

This gap-filling approach transforms the incomplete contract into a set of *two* complete contracts. Essentially, the gap-filler is “decoupled”: it equals the term favored by the party against whom enforcement is sought. If, say, the seller demanded a price none less than \$1000 and the buyer was willing to pay no more than \$800, and if every other term of the transaction was agreed upon, the seller can enforce a deal supplemented by the buyer's price of \$800, whereas the buyer can enforce a deal supplemented by the seller's price of \$1000. Hence, each party receives an *option* to enforce a deal containing the term the other requested. The precontractual agreement is transformed into a “double option”.<sup>50</sup>

Thus, unlike standard gap-filling approaches, which trace a single definitive term that best supplements the deal, and apply this term

<sup>49</sup> For the moral basis of this principle of obligation, resting on the non-rejectability of an individual's own representations, see Thomas Scanlon, *Contractualism and Utilitarianism*, in Amartya Sen and Bernard Williams, eds., *Utilitarianism and Beyond* (1997)

<sup>50</sup> See Daniel Friedman and Nili Cohen, 1 *Contracts* 289 (in Hebrew) (mentioning the technique of double option and arguing that “a substitute to no supplementation can be found in the willingness of the plaintiff to acquiesce to the other party's maximal demand with respect to the missing element.”)

regardless of the identity of the party seeking enforcement, this approach provides a *pair* of gap fillers. Standard gap-filling techniques, such as the majoritarian mimicking approach, would supplement the missing price term in the example above with one that is “reasonable”. Generally, this term would differ from either \$800 or \$1000, and would lie somewhere in the mid range. Such a term, however, would force on the parties a compromise to which they did not assent (and perhaps affirmatively rejected.) Under the proposed approach, the terms of the enforced contract would be such that the defendant would have no reasonable grounds to claim that an undesired contract is being imposed on her.

Note, that filling the gap in a manner favorable to the defendant does not force the plaintiff to transact under terms to which she does not assent. The pro-defendant terms are enforced only if the plaintiff so chooses, preferring such a deal to the no-contract alternative. Essentially, the question I am addressing is not whether a party will want to enforce a contract supplemented in a way so favorable to the other (she often may not), but whether the other party should be entitled to reject such self-favorable deal.

#### **B. “Most Favorable” to the Defendant**

In choosing as a default the term that is favorable to the enforced-against party, the example above identified this term by reference to the party’s express proposal. It was assumed that the parties exchanged explicit communications, each stating her favored term, and failed to strike a compromise. Consequently, to complete the deal, each party was given an option to incorporate the term proposed by the other. In that example, the content of the gap filler—the term that is known to be desired by the enforced-against party—was not hypothetical, but rather evidenced by reference to her own affirmative representations.

In general, however, parties may leave a contract deliberately incomplete without first going through the motions of making explicit proposals and without marking their respective favorable terms. For example, the parties to a lease contract may agree on a renewal period, but leave the renewal price indefinite, “to be agreed upon”, in the expectation that it might be easier for them to reach assent at a later stage. In these situations, there is no affirmative statement by any party from which an inference can be drawn as to her favorable term. How would the decoupled gap filler operate in this more general setting?

Supplementing the deal with the term the enforced-against party proposed was defended above on the grounds that it assured that this party is not being subjected to a transaction with terms she had not

intended. The existence of an affirmative proposal provided a strong basis for inferring the “constructive”, if not the actual, assent of this party. It made the task of identifying the content of the non-rejectable terms straightforward. In the absence of an express proposal, a similar principle of assent can be satisfied if the gap is supplemented by terms that fulfill the same non-rejectability standard—terms that are *most favorable* (within the set of reasonable terms) to the defendant. While this party never expressly stated what these *most favorable* terms are, the court would have to imagine what is the most that this party reasonably hoped to gain when entering into the incomplete agreement and how this party hoped, *ex ante*, to resolve the missing provisions. Instead of using a majoritarian or an “average” term, the court would apply a biased term, favorable to the defendant.

Thus, the only difference between situations in which the defendant made a proposal versus situations in which he did not is the difficulty of ascertaining what are the defendant’s most favorable terms. There are reasons to believe, however, that the judicial task of identifying these pro-defendant gap fillers is practical, and no more difficult than identifying reasonable gap fillers. For one, the nature of adversarial proceedings is already such that each party provides evidence favorable to herself. For example, in adjudicating a missing price, the defendant-seller will likely bring expert testimony supporting a price in the higher end of the reasonable spectrum. In fact, it would be easier to apply a pro-defendant gap-filler than to try and figure out from the parties’ polarized evidence the proper balance that would adequately reflect majoritarian terms. Further, courts can instruct defendants to designate the term that they favor, and induce defendants’ compliance by threatening that if the designation is unreasonable, the court would supply a term.<sup>51</sup>

To illustrate, consider the celebrated case of *Walker v. Keith*, the Kentucky decision that ruled agreements to agree unenforceable.<sup>52</sup> Parties entered into a 10-year lease of \$100 per month with an option to extend that lease for an additional 10-year term at a rental “to be agreed upon”. Holding that the parties’ minds have never met on a criterion to determine the rent, the court refused to fill the gap or to enforce the extension of the lease.<sup>53</sup> At the trial, however, each party

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<sup>51</sup> See, e.g., *Ontario Downs v. Lauppe*, 192 Cal.App.2d 697, 13 Cal.Rptr. 782 (1961).

<sup>52</sup> 382 S.W.2d 198 (Ky. 1964).

<sup>53</sup> A minority of courts have decided, in identical circumstances, to protect the lessee’s reliance and to fill in a rental term and enforce the agreement. See, e.g., *Fuller v. Michigan National Bank*, 68 N.W. 2d 771 (Mich. 1955); FARNSWORTH, *CONTRACTS* 218 (3d. Ed. 1999). The

explicitly stated what his favorable term is. The lessor demanded a price reflecting the relatively high increase in rent *locally*. The lessee sought to prove price changes *nationally*, thereby enjoy the lowest plausible rent adjustment.<sup>54</sup> Since both demands were within reason, the court could have given the lessee the option to extend the lease under the term identified to be favorable to the lessor. At least as a matter of conceptual logic, the “biased” supplementation is no less—and arguably better—reflective of the lessor’s incompletely manifested intent than the result of no renewal.

In fact, the logic underlying this decoupled supplementation approach is already recognized and applied in contract doctrine. The *Restatement*, for example, recognizes that when an agreement is indefinite, it may be possible to provide one remedy but not another.<sup>55</sup> It may also be possible to grant a remedy only to one party, not another. For example, when payment terms are not specified in the sale agreement, “the contract is too indefinite to support a decree of specific performance against [the buyer], but [the buyer] may obtain such a decree if he offers to pay the full price in cash”.<sup>56</sup> Since it is possible to identify a gap-filler that is most favorable to the seller, the contract can be enforced only against the seller.

This is not to say that the problem of identifying a party’s most favorable terms is trivial. Even if the defendant made express proposals at some point in the negotiations, these prior proposals may have become stale, no longer representing the best the defendant can hope for. New information, changed market conditions, subsequent concessions the defendant made, might all render the defendant’s earlier proposal less favorable to her. In those cases, the defendant’s most favorable terms should be inferred, not from her proposal, but from the relevant circumstances. Any factor that materialized prior to the time designated by the parties for resolution of the open issue is relevant for ascertaining the defendant’s most favorable terms, with the exclusion of the plaintiff’s reliance investment. As explained in section III.D below, the defendant must be precluded from extracting the value generated by the plaintiff’s precontractual investment.

This generous pro-defendant supplementation guarantees that the deal to be enforced is no worse than what the defendant could have

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Code also “rejects in these instances the formula that ‘an agreement to agree is unenforceable’”. See UCC 2-305 cmt. 1.

<sup>54</sup> 382 S.W.2d at 203.

<sup>55</sup> *Restatement* § 33(2), cmt b (“uncertainty may preclude one remedy without affecting another”.)

<sup>56</sup> *Id.*, III. 2.

intended when she entered the incomplete agreement. It is the only deal to which it can confidently be said that the defendant manifested her “constructive” intent to be bound. What reasonable grounds would the enforced-against party have to reject such a favorable deal? Only opportunistic motives or a retraction from previous manifested intent can underlie a refusal to transact under such favorable terms.

Surely, the notion of assent even to “most favorable” terms is a fiction. It is less of a fiction, however, than the notion of assent to mimicking defaults. Mimicking default rules—whether tailored or ‘one-size-fits-all’—are based on the premise that a mutual will of the parties exists. In incomplete contracts, particularly ones in which the parties have reached a stalemate, the premise that such mutual will exists is problematic. As the court in *Walker v. Keith* conceded, “it is pure fiction to say that the court... is enforcing something the parties agreed to.”<sup>57</sup> The same logic of loyalty to the parties’ will can nevertheless be fulfilled by gap-fillers that mimic the will of one party at a time—the terms this party favored. Indeed, it is recognized that the hypothetical consent fiction underlying the mimicking theory of default rules prescribes those obligations that are *rational* for the parties.<sup>58</sup> If rationality, not true consent, is the underlying basis for the ordinarily supplemented obligations, this basis is only reinforced by the proposed one-sided supplementation approach. Wouldn’t it be irrational for a party to reject terms most favorable to her?

Thus, in the presence of a deliberately incomplete contract, the mimic-the-parties’-will default metamorphoses into a decoupled set of mimic-one-party’s will terms, of which a single one is chosen according to the identity of the party seeking enforcement. Assent to this term is no more, and arguably less, fictitious than assent to standard gap-fillers. There surely is less reason for the enforced-against party to reject this term. Or, stated differently, there is every reason to presume that, when leaving additional terms to be agreed upon, each party truly intended—and if asked would have confirmed this intent—to grant the other party the option to enforce the a deal supplemented by her most favorable terms.

### C. Scope

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<sup>57</sup> 382 S.W.2d at 203..

<sup>58</sup> Jules L. Coleman, Douglas D. Heckathorn, and Steven M. Maser, *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 Harv. J. L. & Pub. Pol. 639, 648-9 (1989).

Pro-defendant gap fillers, whether derived from explicit proposals the defendant made or from the constructive exercise of inferring the defendant's most favorable terms, are likely to prescribe different gap-filling content than mimicking/reasonable terms. As emphasized throughout the Article, this technique is not a substitute for standard gap-filling standards, but rather should be viewed as complementary. It is an appropriate solution to indefiniteness only when the gaps are left deliberately, with the aim of resolving them within the relationship. Before turning to doctrinal illustration of the proposed technique, two additional remarks concerning the conceptual reach of pro-defendant gap fillers are in order.

The first remark concerns the "size" of the gaps that the proposed technique can fill. Normally, when using standard majoritarian defaults, courts are wary not to "write the contract over" for the parties. That is, supplementation is conducted only when the gaps in the contract are not too wide. Otherwise, the presumption of "hypothetical assent" becomes strained. The same caution should apply to the application of the pro-defendant default terms. True, when utilizing most favorable terms, the notion of hypothetical one-sided assent can plausibly be stretched. A party may be deemed to assent to terms most favorable to her even if the set of agreed upon terms is small, or even non-existent. However, absent a serious manifestation by this party that she intends to be bound to some transaction with *this* counterpart, it would be dangerous to give the other party an option to enforce a transaction, even one containing terms that are very favorable to the enforced-against party. Such an option would relinquish the freedom *from* contract and thus undermine the security of property rights and the autonomy embedded in the voluntariness of transfers. To avoid this result, gap filling under the proposed theory can be restricted, as it is under other theories, to instances in which the express assent (this time, by one party) is sufficiently substantial.

The second remark concerns the nature of assent to *most favorable* defaults. It should be pointed out that, by its definition, the concept of 'assent' in contract law already embodies a tension between the true "factual" intent of the parties and legally binding contractual terms. What constitutes the set of binding consensual terms does not always conform to what the parties truly intended, discussed, and agreed upon. Doctrines such as the parol evidence rule, the battle of the forms, and, more generally, the objective theory of assent, drive a wedge between consent in-fact and its legal "translation", mutual assent. As long as there are good conceptual and instrumental

justifications for this wedge, it serves a useful purpose.<sup>59</sup> Accordingly, the notion of assent to most favorable default rules, to the extent that it is fictional, would have to be defended on these bases. The conceptual basis—the argument that ‘most favorable’ default terms are consistent with assent in deliberately incomplete contracts—has been developed thus far. I will now turn to examine the instrumental defense.

#### **D. Increasing the Contractual Surplus**

Parties may seek to form partially binding commitments for several reasons. As argued above, such pre-contractual commitments help parties “digest” concessions gradually, protect the integrity of the negotiation arena, and promote investments in the relationship.<sup>60</sup> Does the particular form of commitment proposed here, in which a retracting party is bound to terms most favorable to her, suffice in achieving these goals?

The conceptual analysis above showed that pro-defendant supplementation of deliberately incomplete contracts is a way to create contractual liability in gradual manner. The more terms are left to be agreed upon, the more pro-defendant terms will be utilized as gap-fillers, and thus the smaller is the burden of liability to the defendant. While the complete freedom to walk away is restricted, the practical “cost” of this restriction is a function of the terms the defendant must put up with, which, in the case of pro-defendant gap filling, is somewhere between zero-burden of no-contract and the high burden of a majoritarian contract.

This intermediate form of liability fragments an otherwise hard-to-swallow full contractual commitment into sequential small steps. When a precontractual agreement is binding but can only be enforced with terms most favorable to a party, each party knows that by entering this agreement she is effectively “surrendering” only the terms that are covered by the partial agreement. While she is not guaranteed to get the most favorable terms with respect to the unresolved issues, she *is* guaranteed that nothing worse than these terms can be unilaterally enforced against her. That is, any additional compromise from this “most favorable” benchmark can only be consensual. The unresolved matters would never be the reason to exit the relationship. Thus, a party can make incremental concessions, spared from a moment in which an entire “large” concession is to be yielded.

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<sup>59</sup> See, generally, Farnsworth, *supra* note 31 at 116-118.

<sup>60</sup> See text in Section II.A.3 *supra*.

The guarantee that the other party cannot *freely* walk away is valuable in that it diminishes the ability of the other party to engage in hold-up games. If the other party is threatening to walk away unless some terms already agreed upon are changed, the threatened party has some remedy. True, this remedy is not as potent as full-blown contractual liability would provide, as it only inflicts a partial burden on the threatening party. Still, this intermediate remedy makes it less likely that retractions from the precontractual agreement would occur or that the relationship will completely unravel. And with the greater security against retraction and in the longevity of the relationship, any investment made in enhancing the value of the relationship is more likely to bear fruit. Thus, each party will have an increased incentive to invest in the relationship and rely on the precontractual understandings.<sup>61</sup>

Stated differently, we saw that under the proposed gap-filling regime the deliberately incomplete contract is decoupled in accordance with the identity of the enforced-against party. From the perspective of party A, there are two enforceable contracts, each addressing a different concern this party might have (the same applies for party B.) The first contract is the one that can be enforced against party A. The fact that this contract includes gap fillers that are so favorable to her guarantees that no additional concessions beyond those already made would be forced on her. This gives her the peace of mind to make partial concessions, one step at a time. The second contract is the one that this party can enforce against party B, if the anticipated further negotiations are abandoned. The fact that party A has this power to enforce a contract on the other party is sufficient in providing her with the needed assurance against opportunistic hold-up by Party B. While party A might prefer to negotiate the remaining terms and not yield right away to those most favorable to party B, she at least has the option to preclude party B from abandoning the relied-upon relationship.

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<sup>61</sup> See Bebchuk and Ben-Shahar, *supra* note 38, at 443-9, for a formal proof that incentives to invest under this regime will be optimal. As the formal proof shows, for the plaintiff to have optimal incentives to invest, the defendant must be precluded from extracting any value that arises from this investment. This is also why the definition of the defendant's most favorable terms must exclude value that came about as a result of the plaintiff's precontractual reliance investment.

#### IV. DOCTRINAL APPLICATIONS

The analysis thus far studied the desirable properties of a regime that supplements indefinite agreements with terms that are favorable to the defendant. Such a regime was shown to create an intermediate level of liability, deviating from the traditional all-or-nothing approach of the mutual assent doctrine, and one that reflects more accurately the intent of parties who deliberately left an agreement incomplete. This Section turns to examine with more detail whether and how the proposed regime is already part of, or can be infused into, the law of indefinite agreements. It shows, first, that the seeds of the proposed gap-filling regime are already planted in contract doctrine. That is, courts and commentators recognize both the technique of filling gaps with terms most favorable to the defendant, and the rationale underlying this technique, although they do so without embracing the full implications and the generality of this approach. Second, the analysis shows that other existing doctrines and practices, which are traditionally viewed as part of the all-or-nothing approach, can nevertheless provide the infrastructure for expanding the domain of the proposed gap-filling regime. I will argue that when contracts are left deliberately incomplete with the intent to be further negotiated, such expansion of the doctrine is desirable.

##### A. Cure By Concession

Supplementing incomplete contracts by terms most favorable to the defendant is a technique already recognized in contract law doctrine. Under the doctrine of ‘cure by concession’, when the contract is silent over a material term, the indefiniteness is overcome precisely in the manner describe above, that is, by granting the plaintiff the option to concede the missing term in accordance with in the defendant’s most favorable arrangement.<sup>62</sup> As Corbin recognizes, “[w]here the parties intend to contract but defer agreement on certain essential terms until later, the gap can be cured if one of the parties offers to accept any reasonable proposal that the other may make.”<sup>63</sup>

Cure by concession is often applied in cases in which the parties agreed on a price but left the payment terms “to be agreed upon”. In these situations, if the buyer agrees to make a full payment in cash and with no delay, namely, in a manner most favorable to the seller, the

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<sup>62</sup> See Farnsworth *supra* note 31, at 219.

<sup>63</sup> Corbin, *supra* note 12, §4.1, at 532.

indefiniteness is cured.<sup>64</sup> It is not that courts perceive the full payment in cash as the reasonable term that the parties hypothetically intended, or would have agreed upon had they continued to negotiate. In fact, oftentimes it is quite clear that the parties hoped to agree on installment or credit terms, namely, something less favorable to the defendant/seller. Rather, courts regard the buyer's willingness to make full payment in cash as a waiver that "obviates any need to come to any agreement as to the manner and form of payment".<sup>65</sup> Since "there is no longer any way that the provision may be construed to [the defendant's] detriment", any resistance to the contract on the ground that it is ambiguous should be eliminated.<sup>66</sup>

Cure by concession can also apply to issues more central to the agreement than payment terms, such as identification of the subject-matter of the contract, or the price. In *Ontario Downs v. Lauppe*,<sup>67</sup> mentioned above in the Introduction, the parties entered agreement for the sale of 16 acres of land for \$50,000, but did not specify where, within the seller's 450-acre lot, does the 16-acre tract lie. The buyer offered to accept any 16-acre tract that the seller might designate, but the seller refused. The court held that the parties viewed the agreement-to-agree as binding, and that the gap should filled in a way favorable to the seller. Not knowing which 16-acre tract would satisfy this criterion, the court instructed that if the buyer waived his right of selection and was willing to accept any parcel, the seller would be required to designate an "appropriate parcel", which the buyer would then have to accept. If the seller fails to make such a selection, the buyer would then be entitled to designate a parcel himself. Under this scheme, the buyer can in effect force the seller to supplement the contract with a term most favorable to the seller, and the information as to what term is most favorable to the seller is extracted out of the

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<sup>64</sup> Restatement §33, *ill.* 2 ("A agrees to sell and B to buy a specific tract of land for \$10,000 [...] and to lend B the amount, but the term of the loan are not stated [...]. The contract is too indefinite to [enforce] against B, but B may [enforce it] if he offer to pay the full price in cash".)

<sup>65</sup> *Shull v. Sexton*, 390 P.2d 313 (Col. 1964); *Morris v. Ballard*, 16 F.2d 175 (D.C. Cir. 1926) (if terms of payment were not agreed upon, the purchaser can enforce the deal if he is ready to pay the agreed price under such terms as the vendor might impose.); *Matlack v. Arend*, 63 A.2d 812 (N.J ) (if the buyer "waives all credit and offers to pay cash, the defense that the agreement is too indefinite is untenable".)

<sup>66</sup> *Busching v. Griffin*, 542 So.2d 860, 864 (Miss. 1989). But many courts reject this view and hold agreements that leaves the terms of payment to be agreed upon fatally defective. See *Roberts v. Adams*, 330 P.2d 900 (Cal.1958); Corbin, *supra* note 12, at 579.

<sup>67</sup> 192 Cal.App.2d 697, 13 Cal.Rptr. 782 (1961)

seller by the threat that if he fails to designate it appropriately, he will have to accept a less favorable, court-designated term.<sup>68</sup>

Another illustration of pro-defendant gap fillers in practice involves contracts that leave the duration of the renewal indefinite. For example, parties who use standard form leases that provide an extension clause “for \_\_\_\_ years” occasionally fail to fill in the blank. This might not be a deliberate case of incompleteness but rather a result of neglect or haste. Nevertheless, courts facing such indefiniteness have generally construed these terms “to be for the shortest period for which the lease could be renewed or extended”.<sup>69</sup> This, as one court explains, guarantees that the landlord will not be held to a longer period than the agreement stated.<sup>70</sup>

When parties leave the price term to be agreed upon later, the option to cure the indefiniteness by conceding the other party’s most favorable price is less commonly recognized. Usually, the court would fill in a price term only if the parties explicitly provided a “methodology” for determining it, but would hold the agreement fatally defective otherwise.<sup>71</sup> Alternatively, even in the absence of any explicit methodology, courts occasionally would fill in the blank with a fair and reasonable market term.<sup>72</sup> At time, however, a plaintiff who prefers a contract with the conceded price to the no-contract outcome would offer to make such a concession and to accept a pro-defendant gap filler. In his landmark decision in *Sun Printing*, Cardozo makes reference to such a technique:

“If price and nothing more had been left open for adjustment, there might be force in the contention that the buyer would be viewed, in the light of later provisions, as the holder of an option. ...[The buyer] would have the privilege of calling for delivery in accordance with a price established as a maximum.”<sup>73</sup>

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<sup>68</sup> *Id.*, at 787.

<sup>69</sup> 49 Am. Jur.2d *Landlord and Tenant* § 158. Similarly, a general covenant to renew without stating the number of renewals is construed to entitle the tenant one renewal.

<sup>70</sup> *Starr v. Holck*, 28 N.W.2d 289 (Mich. 1947).

<sup>71</sup> *Joseph Martin Delicatessen v. Schumacher*, 417 N.E.2d 541 (N.Y.1981) (a methodology for determining the price has to be found within the four corners of the agreement.)

<sup>72</sup> *See* *Validity and Enforceability of Provision for Renewal of Lease at Rental to Be Fixed By Subsequent Agreement of the Parties*, 58 A.L.R.3d 500 (1974)

<sup>73</sup> *Sun Printing v. Remington Article & Power*, 139 NE 470 (N.Y.1923)..

Cardozo, however, rejects the application of this approach in his decision.<sup>74</sup> But there are circumstances in which even a price term can be supplemented by picking a value most favorable to the defendant. The following section explores these circumstances.

### **B. Agreements with an Explicit Range of Terms**

Oftentimes, the parties—while failing to specify a definite term such as price—do specify a *range* from which they expect to pick out a definite term in the course of subsequent negotiations. This situation presents courts with an “intermediate” form of indefiniteness. There is no formula or methodology that can yield a certain “resolution of ambiguity”, but there is more than “an inkling that either of the parties assented” to some figure.<sup>75</sup> Since courts are reluctant to split the difference and name a price in the mid-range, the better result—more loyal to the parties’ agreement—is sometimes achieved by granting each party an option to concede the other party’s most favorable price within the range. As Corbin explains the law in this situation,

“The exact price may be left for future negotiation with a specified maximum and a specified minimum. In such a case it may be intended that the buyer shall have a binding option to buy at the maximum, or the seller shall one to sell at the stated minimum, or both may have such options.”<sup>76</sup>

Thus, when the parties explicitly state that the price to be agreed upon “shall not exceed  $p$ ”, courts have overcome the problem of indefiniteness by granting the buyer an option to buy at the stated maximum,  $p$ .<sup>77</sup> The explicit rationale for this solution is similar to the one invoked in this article. Namely, a seller’s agreement to agree on a price not exceeding  $p$  can be view as containing two separate components: (i) continue good faith negotiations over a the price; and

<sup>74</sup> Commentators raise doubts as to the validity of the outcome in *Sun Printing*, based on the same logic developed in this article. See, e.g., Farnsworth, *supra* note 31, at 220 (“On the court’s own reasoning, had the buyer offered to pay the supplier’s highest price [...] there would appear no reason to refuse to enforce the agreement.”) However, many other examples in line with *Sun Printing* can be found in adjudication of incomplete lease contracts, where parties leave the rent to be agreed upon later, and the plaintiff is seeking enforcement under the best possible terms for the defendant. For a survey of this line of cases, see Knapp, *supra* note 15, at 698-703.

<sup>75</sup> Martin Delicatessen, 417 N.E.2d, at \_\_\_.

<sup>76</sup> Arthur L. Corbin, Corbin on Contracts 138-9 (Rev. Ed. 1993).

<sup>77</sup> See, e.g., *Denny v. Jacobson*, 55 N.W.2d 568 (Ia. 1952)(Option to renew at price to be agreed upon “not less than \$47.50 or more than \$77.50” is enforceable at the maximum rent); *Westminster Transmission v. Czik*, 2003 WL 1963271 (Cal.App. 4 Dist.) (Option to renew with a landlord promise not to raise the monthly rental by more than \$350 each year is enforceable at the maximum increase). See also cases cited in Corbin, *id.*, at 578.

(ii) forgo his prerogative to demand a price greater than  $p$ . If the buyer were willing to pay  $p$ , the seller would be considered retracting from component (ii) of this agreement if he refused to accept it.<sup>78</sup> The seller's own acceptance of the *range* negates any reasonable grounds for him to reject the best term within this range.

In cases in which parties agree to agree on a term but fail to specify an explicit range, the same result of granting each party an option to concede the other parties favorable term could be obtained if courts were to supplement the agreement with an *implied range*. True, this interpretation of the agreement takes us further from the parties' actual will, to the domain of implied or hypothetical will. But as one court explained:

“A court may not close its eyes to the truism that a landlord's proper objective is to obtain the highest rent that a tenant under all the circumstances can afford to pay.... When, therefore, a tenant's option extension clause in a lease contains a ceiling (*implied or constructive in this instance*) upon the rent to be charged for the extended period and the tenant is willing to pay that ceiling price, the landlord may not be heard to challenge that option clause otherwise void for uncertainty.”<sup>79</sup> (*Emphasis added*)

Given that the parties explicitly postponed the negotiation over the renewal price, the fiction that consent to a “reasonable” price exists—even if cautiously referred to as *hypothetical* consent—is surely more ambitious than the presumption, stated by the court above, that the landlord agreed not to demand more than the maximal plausible rent. It may well be that the tenant hoped for a better outcome and would not be interested in exercising the renewal option under such terms. But if the tenant *is* interested, and is suing to renew the lease under the “ceiling” price, is there any good reason to prefer the standard non-enforcement outcome?

### **C. Options for Renewal of Lease**

One of the main areas in which the doctrine of indefiniteness has been well tested is a lease contract with a tenant option to renew at rental to be agreed upon at the time of renewal. While the majority of courts still view these contracts as indefinite and unenforceable, a growing trend is to allow the tenant to exercise the option even if the

<sup>78</sup> “When a bargained-for term of a renewal provision sets a range within which negotiations must take place, the lessor may not render the renewal provision unenforceable simply by [...] insisting on rent exceeding the maximum allowed by the contract.” See *Little Caesar Enterprises v. Bell Canyon Shopping Center*, 13 P.3d 600, 603 (Utah, 2000).

<sup>79</sup> *Huber v. Ruby*, Misc 967, 65 NYS2d 462, 465 (1946)

negotiations over the renewal price fail, by using the fair market price as gap filler.<sup>80</sup> Of course, the latter solution clearly violates the landlord's immunity, which he explicitly secured in the contract, from non-consensual designation of the rental price. Accordingly, courts have occasionally considered a policy of allowing the tenant to renew under the landlord's maximal obtainable price. In such cases, the tenant's exercise price is sometimes equated with "the highest rent which a responsible bidder is apt to offer".<sup>81</sup>

To be sure, this solution is not without difficulty. It suggests that an option to renew under a price to be agreed upon would automatically become an option to renew under the landlord's maximal price. But if the parties already thought about granting the tenant an option (to renew), doesn't their reluctance to state a renewal price indicate that they did not seek to grant the tenant a one-sided power to effectuate renewal? Indeed, the pro-defendant supplementation of the option strains the language of the explicit agreement. But it surely does less of injustice to the parties' original intent than the polar solutions usually reached of either average market price or invalidation of the option altogether. While the landlord did not grant the tenant an explicit option to renew at the maximal price, it is unreasonable for him to defend by saying that he did not intend to be bound to such interpretation.

One way the maximal price can be inferred by court is by looking at other bids the landlord received from potential tenants, and equating the renewal price to the highest rentable value.<sup>82</sup> Like a right of first refusal, the price is set at the highest value the landlord is offered elsewhere. True, the proposed gap-filling standard is more than an "implied" right of first refusal. Here, the tenant can compel the transaction and does not have to wait for the landlord to initiate one. But both an implied right of first refusal and an option to concede the maximal price address the problem of indefiniteness by reference to the "highest market value of the premises at the time of renewal".<sup>83</sup>

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<sup>80</sup> 58 A.L.R.3d 500, *supra* note 72, § 2(a).

<sup>81</sup> *See, e.g.,* Moolenaar v. Co-Build Companies, 354 F.Supp. 980 (Restricting this formula to the highest value under the original zoning restrictions.)

<sup>82</sup> *Dietrich v. Newberry Co.*, 19 P.2d 115 (Wa. 1933); *Di Maria v. Michaels*, 90 A.D.2d 676 (N.Y.1982).

<sup>83</sup> 50 Am. Jur.2d *Landlord and Tenant* §1166 (1970), citing *Arnot v. Alexander*, 44 Mo. 25 (1869) (holding that the view that a fair rentable value is "different and may be something more than its full or highest rentable market value" is erroneous.)

Another way to implement the ‘highest-value’ formula is for the court to pick the valuation assessed by the landlord’s expert witness.<sup>84</sup> In many of these suits, the tenant, while asking the court to supplement the deal with a fair or reasonable rental price, provides some testimony concerning the market price, usually on the lower end of the market distribution. The landlord, trying to show that there does not exist one “market price” and that the agreement is thus indefinite, provides testimony concerning the high end of the market distribution. The fact that both the landlord’s and the tenant’s information is valid does not necessitate an outcome of no-enforcement. Rather, and consistent with the courts’ stated purpose to protect the tenant’s bargain, the tenant should be entitled to concede the landlord’s price.

These intermediate solutions, of enforcing an agreement to agree while supplementing it with terms more favorable to the enforced-against party, are the exception. More often courts restrict their attention to “all”-or-“nothing” solutions. Even when a tenant, say, is willing to pay the maximal rent, “as much as any other responsible party would pay”, the court may refuse to enforce the renewal option.<sup>85</sup> But often the underlying reason for the rejection of this supplementation formula is not a rejection of the pro-defendant gap filling logic, but rather a recognition that the highest price alone does not exhaust the defendant’s concern. For example, a landlord may unhappy even with the highest market price in light of the conduct of the tenant. In these situations, the correct implementation of a pro-defendant gap filler would require the impractical judicial task of ascertainment of such non-price concerns, which perhaps explains some of the judicial resistance to the rule.

### CONCLUSION

Building on an assortment of existing doctrines and gap-filling practices, and seeking justification both on conceptual and economic grounds, this Article developed a “pro-defendant” standard of gap filling in incomplete contracts, potentially contributing to the general theory of default rules in contract law.

There are several ways to think about the underpinnings of the proposed approach. One way, which I explored in a previous essay, is to think of contractual liability as arising, not from consensus between the parties, but from each party’s separate and unilateral representation of

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<sup>84</sup> *Lassiter v. Kaufman*, 581 So.2d 147 (Fla. 1991).

<sup>85</sup> *Diettrich v. Newberry*, 19 P.2d 115 (Wash. 1933)

serious intent to be bound.<sup>86</sup> Under this approach, a party cannot freely retract from the terms and proposals she indicated would be acceptable to her. If the basis of liability is divorced from consensus, each party could be accountable for a different unilateral representation. And when a party's unilateral representation is incomplete, this ground of liability is consistent only with supplementation that is favorable to the liable party, since it is only to such terms that her intent to be bound can be safely presumed.

The pro-defendant gap filling approach can also be viewed as a challenge to the general idea of reasonable, or mid-range, resolutions of disputes in contract law. Much of the law of remedies, for example, is aimed at reaching reasonable, unbiased assessments of damages, often as a prerequisite to granting any remedy at all. For example, expectation damages are awarded only if sufficiently definite and certain, namely, only if the assessment of lost profits can be made reasonably accurately. Applying the logic developed in the Article, this all-or-nothing approach—either damages are proven to be fair and reasonable, or no damages will be recovered—can be questioned. In the context of damages, even if the plaintiff failed to prove the lost expectation with sufficient certainty, the default outcome should not be a complete bar against recovery of expectation damages. Instead, the plaintiff should be entitled to a recovery of such damages as prescribed by the formula most favorable to the defendant. While this remedial burden may fail to accurately reflect the plaintiff's true loss, it is more accurate than the denial of expectation damages altogether, and it guarantees that the defendant is not held accountable to more than the loss he caused.

The analysis in this paper focused on conceptual and economic justifications for the pro-defendant default rules. A more complete inquiry into the merits of this approach would have to address additional aspects. For example, it would have to explore in greater depth bargaining practices and the extent to which they are consistent with the fundamental no-going-back norm underlying the proposed regime. Additionally, the inquiry can extend to other areas of legal doctrine in which default rule theory proved useful, and explore the value of gap filling in the manner most favorable to the "liable" parties.

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<sup>86</sup> See Omri Ben-Shahar, *Contracts Without Consent: Exploring a New Basis for Contractual Liability*, *Forthcoming* 152 *U. of Pa. L. Rev.* (2004).