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Hoffman v. Red Owl Stores and the Limits of the Legal Method

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Hoffman v. Red Owl Stores and the Limits of the Legal Method

ROBERT E. SCOTT*

According to the overwhelming majority view, promissory estoppel is not an appropriate ground for legally enforcing statements made during preliminary negotiations unless there is a “clear and unambiguous promise” on which the counterparty reasonably and foreseeably relies. Bill Whitford and Stewart Macaulay were among the first scholars to note the apparent absence of such a promise in the case of Hoffman v. Red Owl Stores. Several years ago, after studying the trial record, I concluded that the best explanation for the breakdown in negotiations was the fundamental misunderstanding between the parties as to the amount and nature of Hoffmann’s equity contribution to the franchise. After locating and interviewing Hoffmann, Whitford and Macaulay tell a different story. They view as insignificant the misunderstanding about the nature of Hoffmann’s equity contribution. Rather, they focus attention on additional statements urging Hoffmann to sell his bakery business and store. In these later statements, ignored by the Wisconsin Supreme Court, they find the “missing promise” that they challenged all of us to look for years ago. While I credit their account, I remain as unconvinced by their story as they are of mine. Thus, the important question is how scholars could draw such different inferences from the same basic facts. In this Article, I speculate that the different stories are a product of our respective methodological commitments: their commitment to a law-and-society approach to legal issues and mine to a law-and-economics mode of analysis. Those diverse approaches illustrate the tension between “context” and “theory” and the inherent paradox of legal analysis: without context, no legal rule can be applied, but with nothing but context no legal rule can be found. For this reason, I conclude, it is important for legal academics of every stripe to appreciate the biases inherent in their methodology of choice and to work to correct for them.

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INTRODUCTION

I learned how to teach *Hoffman v. Red Owl Stores, Inc.*¹ at the hands of Stewart Macaulay and Bill Whitford. Their casebook was the first to focus on the “missing promise” as the key issue in determining whether promissory estoppel was an appropriate ground for assessing liability against Red Owl Stores for the reliance losses incurred by Joseph Hoffmann.² The question that they posed was a direct challenge to the rationale adopted by the Wisconsin Supreme Court in support of its opinion that a “promise” that supports liability under promissory estoppel—here Red Owl’s representation that \$18,000 was sufficient capital to secure a franchise—need not be as definite in its terms as a promise that is the basis of a traditional bargain contract.³ And, indeed, the court’s opinion seemed to be quite inconsistent with the now-dominant view of when courts should use the doctrine of promissory estoppel to protect precontractual reliance. The majority view is expressed in the oft-quoted opinion of the Second Circuit Court of Appeals in *R.G. Group, Inc. v. Horn & Hardart Co.*: a claim for promissory estoppel for early reliance requires a “clear and unambiguous promise; a reasonable and foreseeable reliance by the party to whom the promise is made; and an injury sustained by the party” who has relied.⁴

1. 133 N.W.2d 267 (Wis. 1965).

2. See 1 STEWART MACAULAY, JOHN KIDWELL & WILLIAM WHITFORD, *CONTRACTS: LAW IN ACTION, THE INTRODUCTORY COURSE* 398–401 (2d ed. 2003).

3. *Id.* at 275.

4. 751 F.2d 69, 78 (2d Cir. 1984) (quoting *Ripple’s of Clearview, Inc. v. Le Havre Assocs.*, 452 N.Y.S.2d 447, 449 (App. Div. 1982)). In denying liability, the court found that “the entire history of the

My preferred approach to answering Macaulay and Whitford's challenge to look for the missing promise was to focus instead on quasi-contract: here, the argument was that Mr. Hoffmann⁵ had conferred a benefit on Red Owl during the period from January through November 1961 when he opened and then sold his grocery store, and thereafter sold the bakery business and building and purchased an option on a lot in Chilton.⁶ All these actions gave Red Owl valuable and beneficial information as to the kind of franchisee that Hoffmann was likely to be and the extent of his commitment to the project. Under the prevailing view, a quasi-contract claim lies either because one party wrongfully induced the other to confer the benefit in question or had the opportunity to prevent the other from conferring the benefit by mistake.⁷ This at least put the right question to a court: was Hoffmann wrongfully induced to provide this benefit to Red Owl or was he a "mere volunteer"?⁸

Meanwhile, I had begun to research an article on precontractual agreements focusing on the sea change in the law following the landmark opinion of Judge Pierre Leval in *Teachers Insurance & Annuity Ass'n v.*

parties' negotiations made it plain that any promise or agreement at that time was conditional upon the signing of a written contract." *Id.* at 79. Plaintiff manifestly cannot make an end run around the defendant's reservations against undertaking a legal obligation absent a signed contract by recharacterizing the claim as one of promissory estoppel. *Id.* at 78–79. Other courts have adopted similarly stringent requirements for imposing liability for precontractual reliance. *See, e.g.,* Banco Espirito Santo de Investimento v. Citibank, N.A., No. 03-Civ.-1537, 2003 U.S. Dist. Lexis 23062 (S.D.N.Y. Dec. 22, 2003).

5. The reader should note that Joseph Hoffmann in fact spells his last name with two n's, and it was so spelled in the trial transcript and in Respondents' Brief to the Supreme Court of Wisconsin. *See* Transcript of Record, *Hoffmann v. Red Owl Stores, Inc.*, No. 14954 (Wis. Cir. Ct. Oct. 21, 1963); Respondents' Brief, *Hoffman*, 133 N.W.2d 267 (No. 147). The majority opinion of Justice Currie in the Supreme Court misspelled his name and the misspelling has remained ever since. *See Hoffman*, 133 N.W.2d 267.

6. *See* ROBERT E. SCOTT & JODY S. KRAUS, *CONTRACT LAW AND THEORY* 295–96 (4th ed. 2007).

7. *See* *Bailey v. West*, 249 A.2d 414, 418 (R.I. 1969). For discussion, *see* SCOTT & KRAUS, *supra* note 6, at 4–12.

8. The court in *Bailey* summarized the well-established test for determining whether the benefit that was conferred by the plaintiff on the defendant constitutes an "unjust enrichment":

There is a long line of authority which has clearly enunciated the general rule that "... if a performance is rendered by one person without any request by another, it is very unlikely that this person will be under a legal duty to pay compensation."

The Restatement of Restitution, § 2 (1937) provides: "A person who officiously confers a benefit upon another is not entitled to restitution therefor." Comment *a* in the above-mentioned section states in part as follows:

"... Policy ordinarily requires that a person who has conferred a benefit ... by way of giving another services ... should not be permitted to require the other to pay therefor, unless the one conferring the benefit had a valid reason for so doing. A person is not required to deal with another unless he so desires and, ordinarily, a person should not be required to become an obligor unless he so desires."

249 A.2d at 417–18 (alterations in original) (citation omitted) (citing 1A ARTHUR LINTON CORBIN, *CORBIN ON CONTRACTS* § 234).

*Tribune Co.*⁹ Leval held that parties will have made a “binding preliminary commitment” when they have agreed on certain terms even though other terms are left open and when the best inference from their negotiations is that they have agreed to bargain in good faith over the open terms.¹⁰ In cases following *Tribune*, a number of courts began to relax the knife-edge character of the common law by which parties are fully bound or not bound at all. Instead, a new default rule emerged holding that parties to such a preliminary understanding “accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement.”¹¹ Thereafter, if the parties could not ultimately agree on a final contract, they were free to abandon the deal.¹² In the course of analyzing this trend toward enforcing certain preliminary agreements, my coauthor Alan Schwartz and I studied a random sample of 108 cases litigated between 1999 and 2003 that directly presented the issue of recovery for precontractual reliance.¹³ Our goal was to disaggregate the precontractual-reliance cases by categorizing the various commercial patterns revealed in the cases and their legal consequences.

Thirty cases in the sample raised the issue of reliance in the context of ongoing negotiations where the theory of liability was based on promissory estoppel, thus implicitly conceding that the parties had yet to reach any agreement at all.¹⁴ The courts denied liability in eighty-seven percent of these promissory estoppel claims.¹⁵ Based on the cases in the sample, I surmised that many lawyers were bringing suits claiming reliance on preliminary negotiations based on a theory of promissory estoppel, but because they lacked evidence of a “clear and unambiguous

9. 670 F. Supp. 491, 499 (S.D.N.Y. 1987).

10. *Id.* Currently, the Leval framework has been followed in at least thirteen states, sixteen federal district courts, and seven federal circuits. See Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661, 664 n.7 (2007).

11. *Tribune*, 670 F. Supp. at 498. When the parties have agreed upon everything important—when they have made what courts call a “fully binding agreement”—the court will enforce the disappointed promisee’s expectation interest. See, e.g., *Gorodensky v. Mitsubishi Pulp Sales (MC) Inc.*, 92 F. Supp. 2d 249, 254–55 (S.D.N.Y. 2000). When the question involves ongoing negotiations, such as occurred in *Hoffman*, the focus is on so-called “binding preliminary commitments,” where the parties have left important matters for further negotiation. See *Tribune*, 670 F. Supp. at 498.

12. A federal court recently referred to this way of enforcing certain kinds of precontractual reliance as the “modern trend in contract law.” See *Beazer Homes Corp. v. VMIF/Anden Southbridge Venture*, 235 F. Supp. 2d 485, 491 (E.D. Va. 2003).

13. We began the project in the spring of 2004 by examining all public databases for preliminary negotiation and preliminary agreement cases proceeding under the following theories of liability: promissory estoppel, quantum meruit, implied contract, definiteness, and intent to be bound. This initial search returned 280 cases. We then selected every other case to produce a sample of 140 cases. In thirty-two of those cases, precontractual reliance was only peripherally relevant to the outcome. That produced the final sample of 108 cases. The sample represented twenty-nine state jurisdictions, nineteen federal district courts, and seven federal courts of appeal. We subsequently published our findings in Schwartz & Scott, *supra* note 10.

14. *Id.* at 692–93.

15. *Id.* at 671–72.

promise,” as required by cases such as *R.G. Group, Inc. v. Horn & Hardart Co.*,¹⁶ they would almost always lose. For me, the irony was that meanwhile an entire new body of law had emerged enforcing certain “preliminaries” that seemed to offer these parties a viable theory on which they might have predicated their claims. Given the earlier skepticism of Macaulay, Whitford, and others about the doctrinal integrity of the rationale of the court in *Hoffman*,¹⁷ and the fact that the case was not being followed in other jurisdictions,¹⁸ I resolved to study the trial record and the appellate briefs of the parties. In the process, I hoped to find some answers to two key questions: What explained the rather bizarre behavior of Red Owl Stores in not simply breaking off negotiations if, in fact, they were reluctant to go forward with Hoffmann as a franchisee? And, would the answer to that question provide an alternative and more defensible doctrinal basis for the opinion of the Wisconsin Supreme Court?

My efforts convinced me that the best inference to be drawn from the record was that the breakdown in the negotiations between Joseph Hoffmann and Red Owl officials was primarily attributable to a fundamental misunderstanding between the parties as to the amount and nature of Hoffmann’s capital contribution to the franchise operation. This misunderstanding cast considerable doubt on the meaning of Hoffmann’s statement to Ed Lukowitz, Red Owl’s agent, that “I got—approximately eighteen thousand dollars. Will this put me in a bigger operation or won’t it?”¹⁹ The meaning of that statement is central to the case because the Wisconsin Supreme Court held that Lukowitz’s reply—that there would be no problem with that level of investment—was the grounds for imposing promissory liability.²⁰ Thus, evidence that the parties never had a shared understanding of what that statement meant would seriously undermine the court’s rationale. The Red Owl representatives appeared to mean that Hoffmann would have to contribute equity of at least that amount, and Hoffmann, on the other hand, clearly was focusing on how much cash he would put into the

16. 751 F.2d 69 (2d Cir. 1984).

17. A number of scholars have noted the weak doctrinal basis for the *Hoffman* decision, in particular the absence of a finding that Red Owl officials made any specific promise to Hoffman. See, e.g., CHARLES FRIED, *CONTRACT AS PROMISE* 24 (1981) (stating that *Hoffman* is best explained as liability for negligent misrepresentation); Mark P. Gergen, *Liability for Mistake in Contract Formation*, 64 S. CAL. L. REV. 1, 34–36 (1990) (same); Edward Yorio & Steve Thel, *The Promissory Basis of Section 90*, 101 YALE L.J. 111, 143 (1991).

18. See E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 236–43 (1987) (reviewing the cases and noting that the *Hoffman* case was not widely cited or followed by other courts).

19. Transcript of Record, *supra* note 5, at 86.

20. See *Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267, 274 (Wis. 1965).

transaction, whether borrowed or not.²¹ Based on the facts as reported in the trial record, I reached the conclusion that Mr. Hoffmann was at least partly responsible for failing to clarify the nature of the contribution he was required to make, and that failure largely explained his frustration with the changing nature of the financial requirements that Red Owl proposed to him.²²

Bill Whitford and Stewart Macaulay (hereafter Bill and Stewart) have written an excellent article that offers an alternative view of the case.²³ As they suggest, we have different perspectives on the outcome of the litigation. They read the trial transcript as supporting a finding of promissory estoppel liability.²⁴ My reading of the same transcript convinces me that the misunderstanding over the nature of Hoffmann's capital contribution undermines any promissory estoppel claim. But although there are important differences between our stories, fundamentally we do not disagree about the "facts" of the case as revealed in the record, the briefs of the respective parties, or the opinion of the Wisconsin Supreme Court. Rather, we disagree about what legitimate inferences can be drawn from those facts.²⁵ In their view, the misunderstanding about the nature of Hoffmann's equity contribution was insignificant (perhaps even a litigation ploy advanced by Red Owl Stores).²⁶ Rather, they focus their attention on the additional statements made by Ed Lukowitz in October urging Mr. Hoffmann to sell his bakery business and store.²⁷ In these later statements, ignored by the Wisconsin Supreme Court in its opinion, Bill and Stewart now find the "missing promise" that they challenged all of us to look for years ago.²⁸

21. On cross-examination, Hoffmann was asked, "Was there any discussion . . . at any time as to how this \$18,000 was to be made up? That is, was it all to be unencumbered cash or was it partly to be borrowed cash?" *Id.* at 167. Hoffmann answered: "I don't believe there was any discussion on that." *Id.*

22. My conclusions were reported in a subsequent article, Robert E. Scott, *Hoffman v. Red Owl Stores and the Myth of Precontractual Reliance*, 68 OHIO ST. L.J. 71 (2007). The article was reprinted in *CONTRACTS STORIES* 62 (Douglas G. Baird ed., 2007).

23. William C. Whitford & Stewart Macaulay, *Hoffman v. Red Owl Stores: The Rest of the Story*, 61 HASTINGS L.J. 801 (2010).

24. *See id.* at 850.

25. To clarify this point, I begin by accepting the accuracy of the factual statements that Bill and Stewart recount in their story and that are derived from the trial record and briefs. However, also important to Bill and Stewart's story is the information gained from (and their evident confidence in) the interviews with Mr. Hoffmann as he recalled the events of fifty years ago. *See id.* at 809 n.18. Since they did not record the interviews, it is impossible for others to judge Hoffmann's answers without knowing the questions, the question sequence, and the context for answers so as to rule out response bias or other flaws in the interview methodology. And, in any event, Hoffmann recounts only one side of the story, and through the lens of time at that. Thus, we must put those conversations on the side of inference and not fact.

26. *See id.* at 838-44.

27. *See id.* at 839-40.

28. *Cf. id.* at 839-41.

So, what is a reader to make of all this? Bill and Stewart are at pains to say in their article that it would be a shame if the lesson drawn is that these exercises in legal archeology are wholly subjective, reflecting only the biases and ideologies of the legal analyst.²⁹ They state, and I certainly concur, that we agree on many points. But we do draw quite different inferences, and in this companion Article I want to use our respective attempts to understand this case as an occasion to think about why that is so. We all bring biases to our work, but I am inclined to think that my desire to vindicate an earlier expressed viewpoint and their desire to vindicate Mr. Hoffmann (whom they see as having been wronged by my account) play only limited roles in shaping our analyses. And certainly ideology in the narrow sense of political preferences offers no explanation. After many conversations with Bill and Stewart, good friends for many years, I know that we share the same set of political preferences. Rather, I will argue that our inferences are shaped much more by our methodological commitments: their commitment to a law-and-society approach to legal issues and mine to a law-and-economics mode of analysis.

The Article proceeds as follows: In Part I, I argue that these different methodologies lead the analyst to deploy, respectively, either a bottom-up (or “contextual”) approach to a legal problem or a top-down (or “theoretical”) approach to the problem, thus leading the analyst to focus on quite different sets of facts as salient in any controversy. Part II traces the two very different conceptions of “justice” that these two methodologies emphasize; differences that explain the focus on the “result” of the case on the one hand and the “rule” of the case on the other. I conclude that both approaches struggle with the inherent paradox of legal analysis: without context no legal rule can be applied, but with nothing but context no legal rule can be found. For this reason, among many others, it is important for legal academics to appreciate the biases inherent in their methodology of choice and work to correct for them.

I. SELECTING THE FACTS THAT MATTER

A. TWO QUITE DIFFERENT STORIES

Bill and Stewart tell a story in which Joseph Hoffmann is a careful and cautious young businessman,³⁰ Ed Lukowitz is an enthusiastic (perhaps overly enthusiastic) good guy who was looking out for Hoffmann’s interests,³¹ and the folks in the home office—the relatively

29. *See id.* at 849.

30. *Id.* at 837–39.

31. *Id.* at 838–41.

anonymous “corporate” types—were intent on changing the playing field owing to their decision to concentrate on placing franchises in larger markets.³² In this environment, they focus on the statements made by Lukowitz in mid-October telling Hoffmann “that the only hitch in this thing” was that he sell the bakery business and building.³³ This statement, rather than the earlier statement in May in which Lukowitz indicated that Hoffmann’s \$18,000 was a sufficient investment,³⁴ represents the missing promise—a promise that the Wisconsin Supreme Court, as well as subsequent analysts, failed to see.³⁵

In my article, I told a much different story. For me the key fact was the May exchange between Hoffmann and Lukowitz concerning the amount of money that Hoffmann had available to invest in the franchise.³⁶ Hoffmann’s statement that “I have \$18,000 to invest,” the subsequent financial plans which used that sum as their foundation, and statements by both parties concerning the nature of Hoffmann’s investment all reflect an ongoing misunderstanding between Hoffmann and the Red Owl officials as to the precise nature of his investment. As Bill and Stewart point out, from the beginning Hoffmann only intended to invest \$10,500 of his own money and to secure the balance through a loan from his father-in-law,³⁷ while Red Owl officials consistently emphasized in the various financial statements, signed by Hoffmann, that he contribute “equity” of at least \$18,000.³⁸

The record thus also appears to support a story of ships passing in the night: The parties never had a mutual understanding about the meaning of \$18,000 of capital. Red Owl officials testified under oath that

32. *Id.* at 841–45. The basis for the claim that Red Owl’s franchise policy changed is Mr. Hoffmann’s current recollection of a memorandum shown to him by Lukowitz in November 1961 that was never mentioned in any testimony in the record. *See id.* at 817–20. Bill and Stewart suggest that this omission may have been because Red Owl was unable to produce any such memorandum during discovery, *see id.*, but they fail to explain why Hoffmann’s attorney did not bother to ask Hoffmann about such a crucial piece of evidence about which he could testify firsthand. Moreover, Bill and Stewart have not explored whether any objective evidence suggests that Red Owl’s business model changed during this time.

33. Transcript of Record, *supra* note 5, at 133; *see also* Whitford & Macaulay, *supra* note 23, at 816–17, 837–40.

34. Recall that during this conversation Hoffmann said, “Fellows, you know how much money I got—approximately eighteen thousand dollars. Will this put me in a bigger operation or won’t it?” Transcript of Record, *supra* note 5, at 86. And Hoffmann “was assured at that time there would be no problems.” *Id.*

35. In my earlier article, I note this conversation and mention the “without a hitch” comment, but I did not (and still do not) attribute to it the same significance as do Bill and Stewart. *See* Scott, *supra* note 22, at 79.

36. In defense of this approach, I should note that this statement was the most salient fact in the finding of the Wisconsin Supreme Court that Red Owl had made a “promise” on which Hoffmann was justified in relying. *See Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267, 274 (Wis. 1965).

37. *See* Whitford & Macaulay, *supra* note 23, at 814–15.

38. *See* Scott, *supra* note 22, at 80–82.

they always meant that Hoffmann would have to contribute equity of at least that amount,³⁹ and Hoffmann clearly was focusing on the cash into the transaction—whether borrowed or not.⁴⁰ Framed in this way, the case turns on which party was responsible for Hoffmann’s mistaken assumption about the meaning of \$18,000 of capital. In resolving that issue, we should begin with the conclusion of the Wisconsin Supreme Court, supported by the record, that there was no evidence of any bad faith by Red Owl.⁴¹ At most, Lukowitz was careless in his initial representation that \$18,000 “would not be a problem” because he did not inquire further as to what Hoffmann meant. But Hoffmann appears to have been careless as well. Certainly, he could see by September, when he was handed a proposed financing plan,⁴² that what he was to contribute was “equity” of at least \$18,000. While the cash requirements for the franchise increased over time, the equity requirements remained largely fixed and the additional proposals for cash were loans that Hoffmann was free to repay if he did not need the funds in his grocery business.⁴³

B. THE DIVIDE BETWEEN LAW AND SOCIETY AND LAW AND ECONOMICS

These two quite different stories rest, as I have suggested, on inferences drawn from facts on which we agree. The interesting question, therefore, is not which story is “true,” nor even which set of inferences is closer to the truth. Rather, the key question for legal scholars is what explains why two sets of experienced contracts scholars—committed to the scholarly ideal of searching for the truth—would reach such different conclusions. Not only have we chosen to focus on different facts, but the authors of both stories tend to discount the inferences on which the other’s story depends. The reason that this is so, I believe, is attributable to differences between our priors; that is, the preexisting methodological commitments that separate my analysis on the one hand from Bill and Stewart’s on the other. The shorthand for those differences is expressed as the divide between “law and society” and “law and economics.” This divide results from fundamentally different conceptions about the role of law and the relative power of context versus theory as the best means of

39. Transcript of Record, *supra* note 5, at 310, 417–22.

40. *Id.* at 141–44.

41. *Hoffman*, 133 N.W.2d at 273.

42. See Transcript of Record, *supra* note 5, at 103–04 & Ex. 39.

43. Scott, *supra* note 22, at 91. The trial transcript suggests (to me) that Lukowitz was trying to mediate between Hoffmann’s meager capital assets and the home office’s capital requirements. If so, the question is whether Hoffmann should have been more cautious in nailing down exactly how much capital he would have to provide prior to buying the grocery store, selling the store, selling his bakery, buying an option on a lot, etc.

understanding the relationship between law and legal rules and the actions of contracting parties.⁴⁴

Analyzing the effects of legal rules on contracting behavior has been a fruitful source of inquiry for analysts using the techniques of law and economics.⁴⁵ By imposing sanctions or granting subsidies, the law gives contracting parties incentives for desirable behavior. Analyzing the incentive effects of legal rules thus provides a useful predictive tool both to explain the legal rules we see and to support a normative critique of those rules that have undesirable effects. Economic theory, especially the theory of rational choice, is well suited to analyzing variables—such as the legal rules governing precontractual liability—that stimulate changes in the costs of certain behaviors.⁴⁶ Thus, this analyst might treat context variables as exogenous, not because these phenomena are unimportant, but because her analytical tools do not allow her to say anything systematic about them. This “parsimonious” approach begins with the assumption that the principal way law influences the behavior of contracting parties is in how it affects the costs of that behavior, either directly through legal sanctions or indirectly by stimulating social sanctions associated with that behavior.⁴⁷

44. I have previously discussed this divide in the context of the relationship between law and social norms. See Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603 (2000). The following discussion draws on that analysis. It is important to emphasize that the methodological categories I am describing are quite broad and ill defined. Some law-and-economics scholars who begin with theory have sought to test their claims against available evidence, while some law-and-society scholars, whose views are shaped by experience and context, have sought to critique the theory on its own terms. Nevertheless, because the divide is methodological, the participants rarely join issue on particular normative claims. This debate between Bill, Stewart, and me is thus both an exception to the norm as well as an opportunity for thoughtful reflection on these broader themes.

45. See, for example, SCOTT & KRAUS, *supra* note 6, at 81–84, and sources cited therein.

46. Rational choice theory is the branch of economics that studies how an individual decisionmaker chooses between competing alternatives. Traditional rational-choice theory usually assumes that an individual's preferences are consistent over time, and even those traditional models that incorporate changing preferences do not account for strategic manipulation of one's future alternatives. Economists and other scholars have recently developed a theoretical structure to analyze individuals' attempts to control or modify their choices through precommitment or self-command. This theory describes how individuals limit or manage their future behavior to ensure that they do not compromise their commitment to a present decision. See, e.g., THOMAS C. SCHELLING, *ETHICS, LAW AND THE EXERCISE OF SELF-COMMAND*, in *CHOICE AND CONSEQUENCE* 83 (1984); Thomas C. Schelling, *Self-Command in Practice, Policy, and in a Theory of Rational Choice*, 74 AM. ECON. REV. 1 (1984); Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39 (1980); Richard H. Thaler & H. M. Shefrin, *An Economic Theory of Self-Control*, 89 J. POL. ECON. 392 (1981).

47. Social sanctions are powerful mechanisms for informal enforcement of contractual obligations. These informal enforcement mechanisms derive from one or more of three complementary sources: (1) the fear of losing expected future dealings with the counterparty, (2) the threat of loss of reputation with the resulting reduction in future business with other potential counterparties in the relevant economic and social communities, or (3) an individual taste for reciprocity. The uneasy relationship between these informal extra-legal sanctions and formal legal sanctions has been a principal focus of my scholarship for over twenty years. See, e.g., ROBERT E. SCOTT

Law-and-society scholars tend to adopt a bottom-up rather than a top-down approach to understanding contract law.⁴⁸ If the goal of the analyst is to examine the behavior of parties in particular contexts and to eschew abstraction, prediction, and generalization, then the tools of social theory and sociological description offer a rich story of the human experience. From sociology we learn about the existence of social norms: an alternative, complex regime of social control that interacts with law in many different ways. From psychology, we learn something about the relationship between external law and internal values and emotions. We know that external, material incentives are not the only force that governs behavior. Rather, behavior is stimulated by complex psychological reward mechanisms. Moreover, evolutionary psychology teaches us that there is long term advantage in moral behavior.⁴⁹ Salient emotional reactions—such as guilt, anger, or empathy—mark as a “cooperator” one who is able to make credible commitments concerning her future actions.⁵⁰

But the verdict is far less clear when it comes to using this more textured understanding of human experience to improve our ability to identify precisely when legal liability for reliance costs should be imposed

& PAUL B. STEPHAN, *THE LIMITS OF LEVIATHAN: CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW* (2006); Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009); Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641 (2003); Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005 (1987). I trace my interest in this question directly to the classic paper by Stewart Macaulay, who first studied systematically the potency of informal mechanisms for contract enforcement. See Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). For a current effort to harmonize the tension between formal and informal enforcement, see Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice and Doctrine* (Stanford Law & Econ. Olin Working Paper No. 389, 2010), available at <http://ssrn.com/abstract=1535575>.

48. STEWART MACAULAY, JOHN KIDWELL & WILLIAM WHITFORD, *CONTRACTS: LAW IN ACTION, THE CONCISE COURSE* 12 (2d ed. 2003).

49. ROBERT H. FRANK, *PASSIONS WITHIN REASON: THE STRATEGIC ROLE OF THE EMOTIONS* 5, 11–12, 37 (1988).

50. Robert Frank argues that moral behavior has its source in the emotions rather than in “rationality” and reason. *Id.* at 11–12. Beyond the strategic role of endogenous values and preferences, we have learned from cognitive and social psychology that there are systematic “errors” in human judgment and decisionmaking reflected in the deviation between empirically observed behavior and the predictions of rational-choice models of behavior under conditions of uncertainty. Best known to legal scholars is the “prospect theory” developed by Daniel Kahneman and Amos Tversky. See generally *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* (Daniel Kahneman, Paul Slovic, & Amos Tversky eds., 1982). More recently, the normative underpinnings of this research have been challenged by new studies that show that framing bias by researchers may account for many of the observed “errors” in human judgment. Thus, behavior that once might have been crudely characterized as reflecting cognitive errors or biases is better understood as human tendencies to use adaptive rules of thumb or “smart heuristics” that order human decisionmaking around frequencies rather than probabilities. See generally GERD GIGERENZER & PETER M. TODD, *SIMPLE HEURISTICS THAT MAKE US SMART* (1999).

in a failed negotiation. The danger in such an environment is that the analyst will be guided more by the strength of her a priori beliefs in the relative efficacy of judicial intervention than in the analytical tools that are deployed. In short, the dilemma remains no different than when it was first identified by Arthur Leff a generation ago. As Robert Ellickson has noted, Leff said law and economics is a “desert,” and law and society is a “swamp.”⁵¹ For more than twenty-five years legal scholars have searched for the fertile middle ground between economics and the other behavioral sciences. The search may be noble and important, but the tale of these two different stories of *Hoffman v. Red Owl Stores* demonstrates that the end of the journey is not yet in sight.

C. A CRITIQUE OF BOTH ACCOUNTS

So, we have two stories—the “found promise” story and the “missing equity” story. How would analysts from either tradition critique the other? The law-and-society analyst begins to deconstruct the “missing equity” story by first conceding the standard analysis from economic theory that a franchisor will appropriately insist that the franchisee make a substantial equity contribution to the franchise.⁵² As a matter of theory, Red Owl’s apparent insistence that Hoffmann make a substantial equity contribution to the franchise reflects perfectly appropriate business judgment.⁵³ The risk in any franchise contract is that the interests of the parties will be misaligned and, as a consequence, the franchisee may manage its operation in a manner inconsistent with the interests of the franchisor.⁵⁴ Requiring the franchisee to invest his own capital and then allowing him to retain the profits induces the franchisee to increase his efforts compared to that of an employee-manager. Franchisees are disinclined to shirk because their income is directly tied to their efforts. By requiring the franchisee to contribute a substantial sum of equity capital, the relationship mitigates agency problems and promises greater operational efficiencies.⁵⁵

51. ROBERT C. ELICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 147 & n.46 (1991) (“Stanton Wheeler reported that Leff used these metaphors in a casual conversation.”).

52. See Whitford & Macaulay, *supra* note 23, at 838–41.

53. Scott, *supra* note 22, at 91.

54. *Id.*

55. A widely recognized conflict that arises with excessive debt financing is that the agent may be motivated to increase the riskiness of his management of the franchise. By “putting all his eggs in one basket,” the agent can gamble with the borrowed funds. If the venture is successful, all the returns in excess of the fixed debt accrue to the agent. But if the venture fails, the agent shares the loss with his creditors. Scott, *supra* note 22, at 91–92. See generally Benjamin Klein, *The Economics of Franchise Contracts*, 2 J. CORP. FIN. 9 (1995); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223 (1978). These theoretical claims have been supported by empirical studies. See, e.g., Francine LaFontaine, *Agency Theory and Franchising: Some Empirical Results*, 23 RAND J. ECON. 263 (1992).

Despite the standard theory, the law-and-society critic might argue that the particular context of this case shows that it was irrelevant whether Hoffmann contributed his own equity or borrowed funds. He was personally liable on any debts he incurred, and, in any case, he was not “the type of person” who would declare bankruptcy to gain a discharge from those debts.⁵⁶ Thus, for Hoffmann, borrowed funds were the equivalent of his own equity capital.

A law-and-economics analyst might offer the following rejoinder to this more contextualized analysis. Accepting for the moment the speculation that Hoffmann was not the sort to declare bankruptcy, nevertheless the debts that he contemplated incurring in order to make up the balance of his capital contribution came from his father-in-law, Simon Vanden Heuvel.⁵⁷ Given the close personal ties that, according to Hoffmann, characterized his relationship with his father-in-law,⁵⁸ it is inconceivable, should the franchise have failed, that Simon would pursue collection of his loan—whether it was \$7500 or the later, larger sum of \$13,500. Thus, a substantial amount of Hoffmann’s equity was a loan that he felt “morally obligated” to repay should the franchise succeed and which would likely be forgiven should the franchise fail. Such an arrangement appears to push a franchisee even further toward a high-risk business plan: under such a financing arrangement, he loses less on the down side and needs to make up even more to return his own profit on the upside.

If the “missing equity” story results in a standoff, what about the “found promise” story? The law-and-society scholar might support the “found promise” story by once again providing a richer and deeper context to explain Hoffmann’s behavior. Important facts that help us understand the impact of Lukowitz’s “last hitch” comment are that Lukowitz knew at the time that he made those statements that Hoffmann was very reluctant to sell his bakery business and building, as he hoped to use that income to support his family.⁵⁹ Under those circumstances, a reasonable person in Hoffmann’s position might understand that a commitment had been made.

The context evidence is significant, and the law-and-economics analyst would do well to pause at this point. Is there any rebuttal to the conclusion that the missing promise has at last been found? One response lies in the fact that the law governing precontractual reliance places a strong thumb on the scale of finding no promise, and thus no liability, when one party relies on statements made by the other in the course of preliminary negotiations. Recall that the standard legal

56. Whitford & Macaulay, *supra* note 23, at 842.

57. Transcript of Record, *supra* note 5, at 147; *see also id.* Ex. 40.

58. *See* Scott, *supra* note 22, at 84–88; Transcript of Record, *supra* note 5, at 333.

59. Transcript of Record, *supra* note 5, at 133–34.

doctrine governing promissory estoppel states that it is not sufficient that the fact finder conclude that it is possible or even probable that the statement in question constitutes a promise.⁶⁰ Rather, the test is that there must be “a clear and unambiguous promise; a reasonable and foreseeable reliance by the party to whom the promise is made; and an injury sustained by the party” who has relied.⁶¹ Conceding the latter two elements and assuming (after giving Lukowitz’s October statements due weight) that a *clear* promise is not self-evident on these facts, what justification is there for insisting on a “clear and unambiguous promise”? Here the law-and-economics analyst would turn to the undesirable incentive effects of a rule that finds promissory liability too early in the negotiation process.

There is an economic justification for the common law preference for a clear and unambiguous promise in precontractual negotiations. An economic analysis of liability for relied-upon statements made in preliminary negotiations is premised on the goal of facilitating parties’ efforts to invest in valuable projects that create a contractual surplus that they both can share. Courts encourage efficient investment not only by enforcing contracts but also by refusing to protect the interests of parties disappointed by the failure to reach agreement. Freedom from liability for honest expressions of future intention that are later withdrawn encourages parties to negotiate freely without fear that their initial expressions of interest will be binding.⁶² Imposing liability because one party failed to correct the other’s misunderstanding that led to lost reliance has significant costs, especially if one believes that, ordinarily, precontractual statements of intention are essentially truthful.⁶³ Such statements of intention (economists call these statements “cheap talk”) should not be the basis of liability in the ordinary case.⁶⁴ Because delay in reaching a deal is costly to both parties, negotiators have strong incentives to communicate useful (and truthful) information so as to either reach a deal as expeditiously as possible or move on to other opportunities.⁶⁵

60. Here, it is important to remind ourselves of the legal definition of “promise” and its relationship to the doctrine of promissory estoppel. See RESTATEMENT (SECOND) OF CONTRACTS § 2 (1981) (defining a *promise* as a manifestation of an intention to be bound that *justifies* the promisee in believing a *commitment* has been made); *id.* § 90 (section that governs promissory estoppel, beginning, “A *promise . . .*” (emphasis added)).

61. R.G. Group, Inc. v. Horn & Hardart Co., 751 F.2d 69, 78 (2d Cir. 1984) (quoting Ripple’s of Clearview, Inc. v. Le Havre Assocs., 452 N.Y.S.2d 447, 449 (App. Div. 1982)); see *supra* note 4.

62. Jason Scott Johnston, *Communication and Courtship: Cheap Talk Economics and the Law of Contract Formation*, 85 VA. L. REV. 385, 494–99 (1999).

63. *Id.*

64. *Id.*

65. *Id.* (arguing that liability for precontractual statements should be imposed only when one party misrepresents his relative optimism about the prospects of reaching a deal).

Accepting for the moment the force of this argument, the law-and-society analyst might nevertheless respond by noting that there still may be sound reasons to accept the costs of chilling future negotiations in order to prevent exploitation of the weak by the strong in particular contexts. Perhaps a franchise negotiation between a sophisticated franchisor and a relatively unsophisticated franchisee presents just such a case.

In the end, therefore, the tension between these alternative accounts, each reflecting the tradeoff between theory and context, cannot be readily harmonized. Law incorporates both the general and the particular. One function of law is to generalize across contexts. But law is also particular and context specific. Indeed, the common law method itself illustrates the parallel processes of generalization and contextualization. Out of the particular facts and circumstances of a single dispute emerges a rule that is then generalized in its application to other, similar circumstances. In deciding whether the rule applies to another case, the common law method requires a further inquiry into the particular context and circumstances of the new dispute in order to determine whether the necessary salience exists to support generalization of the rule.

As a consequence, academic lawyers, more than any other academic discipline, need to be mindful of the paradox of context: Without context no legal rule can be applied, but with nothing but context no legal rule can be found. As legal scholars, we are in the uncomfortable middle ground between the general and the particular. Law, as applied behavioral theory, strives to generalize from real-world observations in order to implement socially desirable changes in real-world behaviors. Inevitably, this requires the legal analyst to generalize uncomfortably from the particular observations of the behavioral sciences and to particularize with equal discomfort the abstractions of economics.

II. THE JUSTICE PARADOX

A. TWO CONCEPTIONS OF JUSTICE

In the preceding Part, I focused on the methodological divide between theory and context that separates scholars working in law and economics from those in law and society. In this Part, I turn to a second area where the focus of the two disciplines diverges: the tension between the *ex ante* and the *ex post*. Law-and-society scholars of contracts generally take an *ex post* perspective in adjudication. They view adjudication, such as the litigation in *Hoffman*, as an occasion for identifying and vindicating the preexisting rights of the litigants.⁶⁶ Thus,

66. See MACAULAY, KIDWELL & WHITFORD, *supra* note 48, at 12, 20–24.

in their article, Bill and Stewart treat the litigation in *Hoffman* primarily as a mechanism for justly resolving a dispute between Joseph Hoffmann and the Red Owl Corporation. In contrast, law-and-economics analysts generally take an ex ante, and therefore consequentialist, perspective on common law adjudication.⁶⁷ Economic theorists view adjudication primarily as a mechanism for creating rules and rights that will provide incentives for individuals in the future. Judicial decisions are then evaluated according to whether these prospective effects are socially desirable.⁶⁸ In contract law, economic analysis asks, for example, how enforcement of precontractual reliance is likely to affect the behavior of promisors and promisees in the future. Thus, a key question is whether it is socially more desirable to encourage or to discourage parties to rely on statements made during preliminary negotiations.⁶⁹

This tension between the ex ante and the ex post is more sharply illustrated by what I call the “Justice Paradox.”⁷⁰ We can illustrate the paradox by starting with the exclamatory statement that Bill and Stewart make at the outset of their article in referring to the *Hoffman* case: “Justice was done!”⁷¹ By that they surely mean that the outcome of the case, in particular the affirmation of the jury verdict in favor of Mr. Hoffmann, was proper under the law. But this is only a partial conception of justice. It focuses solely on the outcome of the particular case (who won/who lost) and not on the effects of the “rule” of the case as announced by the Wisconsin Supreme Court. To understand the justice paradox, therefore, we must recognize that legal rules that determine liability have both a distributive function and a behavior modification function. Not only do they redistribute wealth and

67. SCOTT & KRAUS, *supra* note 6, at 26–27.

68. *Id.*

69. Scholars continue to debate the merits of the focus on social welfare in contract law. For a normative discussion of social welfare as the only objective of a contract law between sophisticated corporate firms, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 544 (2003). For a criticism of an economic approach and discussion of collaborative agreements among individuals as the primary purpose of contract law, see Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417 (2004). For a criticism of *Contract Theory and the Limits of Contract Law* on the ground that a contextual interpretation strategy may be preferred to a formalist interpretation of contracts between firms, see James W. Bowers, *Murphy's Law and The Elementary Theory of Contract Interpretation: A Response to Schwartz and Scott*, 57 RUTGERS L. REV. 587 (2005). Schwartz and I respond to this criticism in our article, *Contract Interpretation Redux*. See Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. (forthcoming 2010), available at <http://ssrn.com/abstract=1504223> (arguing that both the available evidence and prevailing judicial practice support the claim that sophisticated parties commonly prefer judicial interpretations to be made on a limited evidentiary basis, the most important element of which is the contract itself; but, in any case, since commercial parties' preferences are heterogeneous, any interpretation rules the state adopts should be defaults).

70. For discussion of the “justice paradox” and its implications for legal scholarship, see generally Robert E. Scott, *Chaos Theory and the Justice Paradox*, 35 WM. & MARY L. REV. 329 (1993).

71. Whitford & Macaulay, *supra* note 23, at 801 (abstract).

entitlements between the immediate parties, say, Mr. Hoffmann and the Red Owl Corporation, they also influence the behavior of future parties who may find themselves similarly situated. The justice of all legal outcomes under our common law system must therefore be evaluated from two distinct perspectives: Does the law accomplish justice between the parties to any particular dispute? We can call this “present justice.” And, does the law appropriately regulate the conduct of other parties likely to have similar disputes in the future, making it less likely that similar misfortune will befall others who can learn from the experience of these litigants? We might call this “future justice.”

The paradox arises from two propositions. First, *both* criteria must be satisfied in order to achieve a just outcome. Second, these two criteria of justice are often in opposition. Simply put, you can’t always have it both ways. We aspire to a just society that satisfies the essential conditions of both present and future justice, and yet we live in a world that often requires us to choose between one or the other. Viewed this way, the tension between the law-and-economics and law-and-society approaches is both understandable and inevitable—the two perspectives seem committed to incompatible assumptions about the nature of adjudication.

B. WAS JUSTICE REALLY DONE IN *HOFFMAN*?

This tension between the *ex ante* and the *ex post* is illustrated, but not resolved, in our current debate over the meaning of *Hoffman v. Red Owl Stores*. Accepting the facts as reported by Bill and Stewart, as well as accepting as truthful and accurate the memories of the events that Mr. Hoffmann recounts today, one is hard pressed not to agree with Bill and Stewart at least to the extent that the jury in the case “got it right.”⁷² In Peter Linzer’s words, this may be a case for “rough justice” and not for doctrinal niceties.⁷³ But as I have noted above, this conclusion ignores important conceptions of justice that deserve equal dignity. Thus, the new information that Bill and Stewart gleaned from conversations with Mr. Hoffmann does not rescue the opinion of the Wisconsin Supreme Court and the unhappy effects of the *Hoffman* “rule” as it has survived through the years.

Bill and Stewart are critical of my statement that the *Hoffman* case is an outlier.⁷⁴ They assume that I stand by that statement because I

72. *Id.* at 857. Bill and Stewart actually say at the end of their article that the court “got it right,” *see id.*, and that is a statement with which I take issue below. A more temperate analysis might support the jury’s verdict but not the court’s rationale affirming that verdict. *See infra* text accompanying note 82.

73. Peter Linzer, *Rough Justice: A Theory of Restitution and Reliance, Contracts and Torts*, 2001 WIS. L. REV. 695, 719–20.

74. *See* Whitford & Macaulay, *supra* note 23, at 850–55.

believed that there was no promise, and thus, now that they have found the missing promise, that claim must be incorrect.⁷⁵ But here they are mistaken. My statement that *Hoffman* was an outlier is not a normative claim, but rather is a descriptive statement of how the “rule” of the case has fared in other courts. As first reported by Allan Farnsworth⁷⁶ and subsequently supported by the large case sample that Alan Schwartz and I assembled, the *Hoffman* case—based on the facts as reported in the opinion and thus as it has come to be understood—has been either ignored or rejected in the overwhelming majority of jurisdictions that have grappled with the question of precontractual reliance.⁷⁷

C. WHY IS THE DOCTRINE IMPORTANT?

But what harm is there in inviting recovery for precontractual reliance when it is at another party’s “urging or was a foreseeable and desired response to a strong assurance that a deal would be reached”?⁷⁸ At one level the answer is that no harm is done, *as long as the doctrinal basis for the claim is clear*. As I suggested at the outset of this Article, my instinct in teaching the *Hoffman* case through the years (and my continuing position going forward, accepting as true everything that Bill and Stewart report) is that the *Hoffman* “facts” best support a theory of liability resting in quasi-contract for unjust enrichment. As noted above, the argument is that Hoffmann conferred a benefit on Red Owl by providing them valuable information when he purchased and then operated a grocery store, sold the bakery business and building, and acquired an option on a lot in Chilton. All these actions gave Red Owl officials some further indication of the kind of franchisee that Hoffmann was likely to be and the level of his dedication to the project. To be sure, quasi-contract claims then require proof that the defendant specifically and wrongfully induced that benefit: “it must be shown that a party was unjustly enriched in the sense that the term ‘unjustly’ could mean illegally or unlawfully.”⁷⁹ Thus, the key issue is whether Hoffmann was “wrongfully” induced to provide a benefit to Red Owl either because Red Owl officials’ inducements were opportunistic or because these same officials failed to correct Hoffmann’s evident misunderstanding.⁸⁰

But is it not just academic sophistry to insist on doctrinal integrity in judicial opinions? Here my answer is no. This is where the considerations of future justice become salient. The doctrines governing precontractual

75. *See id.*

76. *See* Farnsworth, *supra* note 18, at 236–43.

77. *See infra* text accompanying notes 81–85.

78. Whitford & Macaulay, *supra* note 23, at 855–56.

79. *First Nat’l Bank of St. Paul v. Ramier*, 311 N.W.2d 502, 504 (Minn. 1981); *see also* *Fimon v. Kenroc Drywall Supplies, Inc.*, No. C7-01-1588, 2003 Minn. App. Lexis 311 (Ct. App. Mar. 18, 2003).

80. *See supra* text accompanying notes 62–65.

liability are undergoing rapid and dynamic change. What we learn from the cases is that courts rarely impose promissory estoppel liability based on one party's reliance on the other's statements during ongoing negotiations.⁸¹ But at the same time, many state and federal courts in the United States have been developing an alternative theory of intermediate liability premised on a finding of preliminary agreement.⁸² Bill and Stewart appear somewhat dismissive of this trend as a substitute for promissory estoppel, perhaps because they see recovery on this ground as being too limited. They suggest, for example, that the key conditions for finding a binding preliminary commitment (at least as I have previously outlined them⁸³) would not apply to the *Hoffman* case.⁸⁴ But here I believe they are mistaken, perhaps because in previous work I have been insufficiently clear about the nature of this new theory of liability.⁸⁵

D. *HOFFMAN* AS A PRELIMINARY AGREEMENT CASE

To see how the facts in *Hoffman* might be framed so as to fit within this new paradigm, consider the following hypothetical: Assume a franchisor and a prospective franchisee agree to jointly pursue what they hope to be a profitable project culminating in the establishment of a new franchise store in a promising location. The parties also agree on the nature of the initial contribution that each is to make to the enterprise. The prospective franchisee agrees to search for a new location and to spend time and efforts in learning how to operate the franchise successfully, and in liquidating assets sufficient to make up his capital investment. The franchisor, through the agency of various officers, implicitly (and indeed explicitly) commits to devote a substantial amount of internal resources by diverting from other tasks valuable human capital—the time and efforts of its employees—in order to see whether a franchise is viable. At this initial stage, however, the ultimate project, and what each is to do to achieve it, cannot be precisely described. Important terms such as price and location also cannot be agreed upon. Nevertheless, the parties agree to proceed with their respective investments and also agree to negotiate the remaining terms of the contract once they can observe the fruits of those efforts.

Our two parties have now reached what the law recognizes as a preliminary agreement. They are unable to write a more complete contract at the outset because they face many complex and uncertain

81. Schwartz & Scott, *supra* note 10, at 671–73 & n.31.

82. See *supra* text accompanying notes 11–12.

83. See Schwartz & Scott, *supra* note 10, at 703–04.

84. See Whitford & Macaulay, *supra* note 23, at 853–55.

85. See generally Schwartz & Scott, *supra* note 10. The discussion in the next section draws on that analysis.

conditions. Depending on how those conditions interact, a profitable franchise operation could take a number of forms, and just which form would work, if any, is unknown at the start. Notwithstanding the continuing uncertainty, however, the parties must now make investments if a successful franchise project is to be achieved. Only by both parties investing can they determine whether a franchise operation can possibly succeed. The increased knowledge about the project revealed by their respective investments, together with increased knowledge of the state of the world in which a potential franchise must operate, will then permit the parties to determine whether to finalize the deal with a fully enforceable contract.

The question is whether and to what extent such an agreement is legally enforceable. The question is important because the parties meet as strangers with no necessary prospect of an ongoing relationship, and as yet there is no mechanism to stimulate the development of trust. Thus, the risk of opportunism is significant. This is particularly the case where the parties undertake to invest concurrently. Suppose now that the franchisor, who has agreed to invest at the same time as the prospective franchisee, thereafter elects instead to wait and see what comes of the counterparty's investment. Delaying a promised investment under these conditions offers several strategic advantages. First, the passage of time and her partner's investment is likely to reveal whether the project will be profitable. If so, the delaying party enjoys a strategic advantage in negotiating the terms of the final agreement. Second, if the project proves unsuccessful, delay permits the opportunistic party to avoid the resulting sunk costs. Those savings may well be larger than any offsetting losses from delayed returns if the project instead proves profitable.

Historically, as I suggest above, preliminary agreements such as this would be unenforceable under the indefiniteness doctrine of the common law of contracts.⁸⁶ Recently, however, a new enforcement rule is emerging that responds to the increasing importance to successful

86. See SCOTT & KRAUS, *supra* note 6, at 29-41, 299-303.

[T]wo factual patterns typify unenforceable indefinite agreements at common law. The first, illustrated . . . by *Varney v. Ditmars*, is the indefinite bonus contract. In *Varney*, the New York Court of Appeals held a bonus agreement for "a fair share of the profits" too indefinite and thus enforceable [sic]. The second archetype is a variation on the first, extending the common law rule to agreements where essential terms were explicitly left to further negotiation. For example, in *Petze v. Morse Dry Dock & Repair Co.*, the New York appellate court held that an agreement providing that "the method of accounting to determine the net distributable profits is to be agreed upon later" was unenforceable under the indefiniteness rule. Common law courts thereafter have consistently held that such "agreements to agree" are unenforceable so long as any essential term was open to negotiation.

Id. at 35 (citations omitted) (citing 111 N.E. 822 (N.Y. App. Div. 1916); 109 N.Y.S. 328 (App. Div. 1908)).

contracting of the search for new partners in an uncertain environment. The new enforcement rule holds that parties to such a preliminary understanding “accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement.”⁸⁷ Neither party, however, has a right to demand performance of the contemplated transaction.⁸⁸ If the parties cannot ultimately agree on a final contract, they may abandon the deal.⁸⁹

Returning to our hypothetical facts, the franchisor has engaged in just the strategic behavior that the new rule is designed to discourage: it delayed processing several of the franchisees’ financial statements and officials seemed to drag their feet on resolving important issues regarding the necessary financing for a franchise. A court applying the new doctrine would thus likely find the franchisor to be in breach of a preliminary agreement to bargain in good faith and would award the prospective franchisee reliance damages based on his investment expenditures in investigating locations and selling assets prematurely. And furthermore, such a decision would support the interests of future justice: it would motivate future parties to enter such relationships and make the investments necessary for innovative projects such as this to succeed. In the absence of a legal rule protecting the franchisee’s investment cost, a rational party in that position would anticipate the risk of hold-up and would decline to make the efficient investment. Finding that the parties have reached a preliminary agreement thus legally commits the franchisor to invest as promised and to reimburse the franchisee’s reliance expenditures if it did not, but it does not commit either party to negotiate an ultimate deal.

No one can say for sure that Mr. Hoffmann would win a verdict today if the facts were as we imagined in our hypothetical. But the point of the demonstration is to show that the rule of a case is as important as the result. The Wisconsin Supreme Court found a promise on facts that failed to persuade many readers thereafter that a binding commitment had, in fact, been made. One of the possible effects of such a rule could have been for courts to follow the lead of *Hoffman* and impose promissory liability for ambiguous statements made by one party during contract negotiations on which the counterparty relied to her detriment. In such a case, justice would not have been done to those who thereafter were deterred from making value enhancing contracts by the threat of liability during the negotiation process. As it happened, courts did not follow *Hoffman* and most such claims failed in other courts.⁹⁰ But this outcome, too, has generated perverse effects. Justice has not been done

87. *Teachers Ins. & Annuity Ass’n v. Tribune Co.*, 670 F. Supp. 491, 498 (S.D.N.Y. 1987).

88. *Id.*

89. *Id.*

90. Schwartz & Scott, *supra* note 10, at 671–73 & n.31.

to those parties in the intervening years who might well have been able to recover their reliance losses because their counterparty strategically breached a preliminary agreement, but who failed to recover because their case was framed solely on a legal theory that courts have generally discounted.

CONCLUSION

The two stories of *Hoffman v. Red Owl Stores* offered here can stand on their own as different views of the Cathedral.⁹¹ Readers are free to prefer one to the other or even to undertake the research that might further harmonize these two accounts. For me there are several lessons. I have learned that archeological research of this sort is difficult and that one should be both more cautious and more modest in making claims and drawing inferences from complex facts. I have also been reminded of the inherent bias in legal scholarship toward stories that support our preexisting methodological commitments. This bias does not rest upon the claim that most legal scholars have political views that lead them to prefer governmental to market-based solutions or vice versa. Rather, it is an observation based upon the political economy of the academic marketplace. Law professors enhance their importance relative to other academics in direct relation to the frequency with which the instruments they deploy can be seen as superior to alternative solutions premised on a different set of methodological tools.⁹²

Whatever the reasons, it is important for legal academics to appreciate the biases inherent in their adopted disciplines and work to correct for them. As an applied discipline, law is dependent on the tools of primary disciplines for both the positive and normative claims that it makes about real-world phenomena. And thus it is that legal analysts use either economics or the behavioral sciences to suggest solutions to legal problems. Economic theory is useful for many purposes and any legal scholar who purports to make claims about the effects of contract law rules on contracting parties should have a basic competence in deploying these techniques. Similarly, the research methodologies of psychology and sociology used by scholars in the law-and-society tradition are useful in enriching our understanding of the underlying behaviors that are regulated by those same rules. By the same token, therefore, familiarity with particular context is good medicine for any law-and-economics analyst who strives for general theory.

91. With apologies to Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

92. For a discussion of the political economy of legal academics in the context of private law reform groups, see Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).