ADEQUATE ASSURANCE OF PERFORMANCE: OF RISK, DURESS, AND COGNITION

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Suppose that a plastics manufacturer has been selling to a small firm under a requirements contract with unsecured trade credit. The buyer has paid promptly in the past, but of late has started to stretch out its account. The manufacturer's credit manager has also just heard that the buyer lost a large customer. What options does the manufacturer have?

Until quite recently in the history of commercial law, very few. The buyer, if timely in its payments, would not have breached. Neither would the intimations of imminent insolvency amount to a repudiation. Were the manufacturer to make any demands of the buyer, their relation might be imperiled, and were the manufacturer to suspend its own performance until the demands were met, the manufacturer, not the buyer, would be in breach. A difficult position where the insecurity falls short of actual breach.[1]

This gloomy scenario changed with the Uniform Commercial Code ("U.C.C."). One of Karl Llewellyn's innovations was the notion of adequate assurance of performance, found in section 2-609.[2] Under this doctrine, an insecure party, whether seller or

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1. And not an infrequent one, since over a fifth of trade credit is not paid on time. *See* Finlay Waugh & Ronald K. Chung, *Communicating Value: Credit Deserves Credit*, BUS. CREDIT, May 1994, at 39, 40.

2. § 2-609. Right to Adequate Assurance of Performance.

> (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.
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> (2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

buyer, can make a reasonable demand for adequate assurance from the other party to the contract.[3] Until the demand is answered, the insecure party may suspend its own performance; if the demand is answered unsatisfactorily, the insecure party may hold the other in breach.[4] Entering commercial law with hardly an adverse comment, this section proved very successful—so much so, in fact, that with very few changes the American Law Institute added it to the Restatement (Second) of Contracts.[5] Though not every jurisdiction has yet embraced the common-law version of adequate assurance, a good many have, and only one so far has rejected it.[6] Even Louisiana's Civil Code contains adequate assurance,[7] and international contract law treats adequate assurance very much in the manner of the U.C.C.[8] The

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(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

U.C.C. § 2-609 (1995).

3. *See infra* notes 177-81 and accompanying text.

4. *See* U.C.C. § 2-609(2), (4); *see also infra* notes 184-88 and accompanying text.

5. RESTATEMENT (SECOND) OF CONTRACTS § 251 (1979); *see also* UNIF. LAND TRANSACTIONS ACT § 2-403 (1986) (adequate assurance provision, modeled on U.C.C. § 2-609).

6. *See infra* note 149 and accompanying text.

7. Louisiana, which has not adopted Article 2 of the U.C.C., recently revised its civil code to include a right of adequate assurance. This provision was based in part on the U.C.C. and is consistent with the Italian civil code. *See* LA. CIV. CODE ANN. art. 2023 & cmts. (West 1987); *see also* Shael Herman & Nancy Rix, *General and Particular: Tangents Between the Revised Law of Obligations and the Unrevised Special Contracts*, 30 LOY. L. REV. 833, 855-56 (1984).

8. The United Nations Convention on Contracts for the International Sale of Goods ("CISG"), to which the United States has acceded, gives an insecure party the right to suspend its performance until the other has provided adequate assurance of performance. Convention on Contracts for the International Sale of Goods, *ratified by U.S.*, Dec. 11, 1986, art. 71, 52 Fed. Reg. 6262. In addition, it allows a party clearly faced with fundamental breach to avoid the contract, as long as it gives the other party a chance to provide assurances when time permits. *See id.* art. 72. Outside the CISG's scope, the International Institute for the Unification of Private Law ("UNIDROIT"), an independent intergovernmental organization that includes the United States, has set forth its Principles of International Commercial Contracts. Article 7.3.4 provides a right to adequate assurance. *See* MICHAEL JOACHIM BONELL, AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW: THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 176 (1994); *see also* J.W. Carter, *Adequate Assurance of Due Performance*, 10 J. CONT. L. 1 (1996) (analyzing UNIDROIT treatment).

current revisers of Article 2, perfectly willing to refurbish many other sections of the Code, so far are leaving this one essentially alone.[9]

So here we seem to have a triumph of commercial law, an innovation so obviously overdue that even the most stodgy commercial lawyer, the most hidebound commercial judge has seen its great wisdom at once and bowed down in obeisance. And as with commercial lawyers and judges, so too with commentators. The most thorough survey of comment on section 2-609 garners little but praise, whether from the doctrinalist or the theoretician, the liberal or the conservative.[10] Indeed, a recent writer used section 2-609 as a case study for common-law efficiency; as he put it, "[o]ne would think that if ever a doctrine had the favorable characteristics necessary to justify its widespread adoption as a means of promoting economic efficiency, adequate assurances would be that doctrine."[11] This array of support is formidable indeed, and would seem an impregnable fortress. By all appearances, one would be injudicious, if not impudent, to challenge it.

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9. U.C.C. § 2-711 (Draft July 25, 1997) (unchanged); *see also* PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP, UNIFORM COMMERCIAL CODE ARTICLE 2: PRELIMINARY REPORT 172 (1990) (suggesting no changes: "[T]here is no evidence that § 2-609 has failed its intended objectives"). The A.B.A. Task Force on Article 2 did, however, suggest two relatively minor revisions in section 2-609. Task Force of the A.B.A. Subcommittee on General Provisions, Sales, Bulk Transfers, and Documents of Title, Committee on the Uniform Commercial Code, *An Appraisal of the March 1, 1990, Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981, 1170-71 (1991).

10. *See, e.g.*, R.J. Robertson, Jr., *The Right to Demand Adequate Assurance of Due Performance: Uniform Commercial Code Section 2-609 and Restatement (Second) of Contracts Section 251*, 38 DRAKE L. REV. 305 (1988-89); George I. Wallach, *Anticipatory Repudiation and the UCC*, 13 UCC L.J. 48, 55-57 (1980); James J. White, *Eight Cases and Section 251*, 67 CORNELL L. REV. 841 (1982); Thomas M. Campbell, Note, *The Right to Assurance of Performance Under U.C.C. § 2-609 and Restatement (Second) of Contracts § 251: Toward a Uniform Rule of Common Law*, 50 FORDHAM L. REV. 1292 (1982); Alan G. Dowling, Note, *A Right to Adequate Assurance of Performance in All Transactions: U.C.C. § 2-609 Beyond Sales of Goods*, 48 S. CAL. L. REV. 1358 (1975); Marc W. Sargis, Comment, *The Uniform Commercial Code Section 2-609: A Return to Certainty*, 14 J. MARSHALL L. REV. 113 (1980). *But see* W.F. Young, *Half Measures*, 81 COLUM. L. REV. 19, 27 (1981) (describing adequate assurance as "controversial"); *cf. infra notes* 150, 177-81, 188-90 and accompanying text (listing uncertainties of adequate assurance).

11. Gregory S. Crespi, *The Adequate Assurances Doctrine After U.C.C. § 2-609: A Test of the Efficiency of the Common Law*, 38 VILL. L. REV. 179, 189 (1993).

Perhaps so. But the support for adequate assurance seems to me less a fortress than a Maginot Line—impenetrable, to be sure, but not necessarily effective, and too easy to evade with an indirect assault. Without picking away much at the arguments offered in adequate assurance's behalf—though some are less impressive than they might seem—one can point out counter-arguments that carry some force. In particular, one may ask whether adequate assurance is really a sort of forced modification, compelling the recipient of the demand to grant ex post rights which the bargain ex ante had not provided. This re-allocation of risk is facially dubious, and could provide the insecure party with a windfall.

But this point awaits development. This article begins by tracing the development of adequate assurance—first through its pre-U.C.C. roots in anticipatory repudiation, and then through the drafting of the U.C.C. and of the Restatement (Second) of Contracts. Part II describes the current state of the case law, both under Article 2 of the U.C.C. and under common law. Part III then provides a conspectus of the arguments made on behalf of adequate assurance. Adequate assurance, it is said, encourages reliance, gives effect to the expectations of the parties, especially those entwined in relational contracts, promotes good faith in contracting, cuts down on moral hazard, and reduces liability by allowing for earlier mitigation. The last of these effects is potentially worthwhile, but, as is developed further in Part III, the others are either spurious or much overrated.

Part IV develops the modification argument mentioned above. If the parties to the agreement have allowed for the risk of the promisor's non-performance—routine business practice with, for instance, bad debt allowances—then the promisee has already been paid for its risk. It can insure against the risk, whether by purchasing insurance or by self-insuring. Whichever it chooses, it has been paid for the risk; accordingly, it should not be allowed to demand a modification when the risk comes about. Indeed, this sort of forced modification verges on duress, given that the alternative to modification is breach and legal liability.

Does this argument mean that adequate assurance is, or should be, a gone goose? No. For behind all of these arguments, pro and contra, are great and unfounded assumptions about risk. Standard economic analysis tends to assume that parties deal with risk assessment fairly well. They do not. If parties in fact

cannot deal well with risk ex ante, then a greater case can be made for adjustments to risk ex post. Hence Part V of this article, which discusses recent developments in cognitive psychology. Over the past couple of decades, psychologists and experimental economists have learned a great deal about how people evaluate risk. The fruits of this research have started to infiltrate the legal and economic literature. Indeed, cognitive psychology has become vital to legal analysis, applied in such diverse areas as tax[12] and environmental law,[13] torts[14] and estates,[15] contracts[16] and civil procedure,[17] securities law[18] and administrative law.[19] Still other fields could be identified.[20] And general-purpose jurisprudes have opined on the proper role of cognitive psychology in matters legal and economic.[21]

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12. *See, e.g.*, Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1994).

13. *See, e.g.*, Donald T. Hornstein, *Reclaiming Environmental Law: A Normative Critique of Comparative Risk Analysis*, 92 COLUM. L. REV. 562 (1992).

14. *See, e.g.*, Steven P. Croley, *Vicarious Liability in Tort: On the Sources and Limits of Employee Reasonableness*, 69 S. CAL. L. REV. 1705 (1996); Howard Latin, *"Good" Warnings, Bad Products, and Cognitive Limitations*, 41 UCLA L. REV. 1193 (1994); Edward J. McCaffery et al., *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards*, 81 VA. L. REV. 1341 (1995).

15. *See, e.g.*, Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1 (1995).

16. *See, e.g.*, Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995); Clayton P. Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521 (1985).

17. *See, e.g.*, Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107 (1994).

18. *See, e.g.*, John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986); Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CAL. L. REV. 627 (1996); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 861 (1992).

19. *See, e.g.*, Clayton P. Gillette & James E. Krier, *Risk, Courts, and Agencies*, 138 U. PA. L. REV. 1027 (1990).

20. *See, e.g.*, Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985) (bankruptcy); Elizabeth S. Scott, *Rational Decisionmaking About Marriage and Divorce*, 76 VA. L. REV. 9 (1990) (family law); Jeff Sovern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists Under One Roof*, 1993 WIS. L. REV. 13 (real property).

21. *See, e.g.*, CASS R. SUNSTEIN, BEHAVIORAL ANALYSIS OF LAW (University of Chicago Law School, John M. Olin Program in Law and Economics Working Paper No. 46 (2d Ser.), 1997); Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23 (1989); Donald C. Langevoort, *Ego, Human Behavior and Law*, 81 VA. L. REV. 853

Cognitive psychology may yet be a bit unfamiliar, so Part V begins with an overview of the leading concepts germane to this problem of risk, realized and unrealized: availability, over-optimism, prospect theory, and framing. Though these concepts do not all point in the same direction, collectively they show that promisees are unlikely to attach enough weight to the risk of default, and thus are likely to charge too low a risk premium. Nor should the criticisms of these experimental results be given too much weight; the results are perfectly consistent with legal doctrine, and their effects, though potentially subject to mitigation, are robust.

The final part of this article draws these ideas together, applying them to a few illustrative cases and discussing how the law of adequate assurance might properly take into account the refinements to risk analysis vouchsafed by cognitive psychology. In particular, the courts have not always shown care when deciding whether a promisee had reasonable grounds for its insecurity or demanded reasonable assurances. Both of these can be guided by cognitive lessons. But first the history.

I. THE ROOTS OF ADEQUATE ASSURANCE

A. The Common-Law Origins of Adequate Assurance

Adequate assurance of performance in its modern form is, as other writers have suggested, rather a recent arrival to commercial law.[22] Recent, yes, but hardly unprecedented. Adequate assurance may be one of Llewellyn's creations, but it was rooted in firmly established common-law principles. These underlying principles and doctrines merit some attention, for they help

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(1995); Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. LEGAL STUD. 747 (1990); Thomas S. Ulen, *Cognitive Imperfections and the Economic Analysis of Law*, 12 HAMLINE L. REV. 385 (1989); Symposium, *Legal Implications of Human Error*, 59 S. CAL. L. REV. 225 (1986); Richard L. Hasen, Comment, *Efficiency Under Informational Asymmetry: The Effect of Framing on Legal Rules*, 38 UCLA L. REV. 391 (1990). For a recent popular account, see Jonathan Fuerbringer, *Why Both Bulls and Bears Can Act So Bird-Brained*, N.Y. TIMES, Mar. 30, 1997, § 3, at 3.

22. *See, e.g.*, Arthur Anderson, *Repudiation of a Contract Under the Uniform Commercial Code*, 14 DEPAUL L. REV. 1, 2 (1964); Richard Cosway, *Sales—A Comparison of the Law in Washington and the Uniform Commercial Code*, 36 WASH. L. REV. 50, 83 (1961); Crespi, *supra* note 11, at 184.

explain both why adequate assurance has so happily conformed to commercial intuition and why, just possibly, it should not.

1. Anticipatory Repudiation

Adequate assurance is logically an outgrowth of anticipatory repudiation; if a promisee cannot sue on a contract renounced by the promisor before the promisor's time for performance, then, *a fortiori*, it cannot sue when the promisor has left its performance only in question. Until the middle of the nineteenth century, the common law took rather a formal, not to say inflexibly logical, view of executory contracts. With few exceptions,[23] executory contracts were held unbreachable until the time set for performance had come. However clear the promisor's intent not to comply, however unambiguous and explicit its messages, the promisee could not bring an action in assumpsit solely on the basis of the promisor's assertions or actions. After all, reasoned the courts, the promisor could always recant and carry out the agreement.[24] And if the duties under the contract had not yet arisen, how could the promisor breach them? Hence cases like *Philpotts v. Evans*,[25] in which the Court of Exchequer held that the appropriate time to measure damages for breach of a contract to sell wheat was at the contractual time for performance, rather than the time when the buyer told the seller that he would not accept the wheat. As Baron Parke observed, "[h]is contract was not broken by his previous declaration that he would not accept [the goods]; it was a mere nullity, and it was perfectly in his power to accept them nevertheless . . . ."[26]

To be sure, English law had edged toward accepting anticipatory repudiation by the middle of the nineteenth century. For

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23. One being contracts to wed. *See, e.g.*, Short v. Stone, 115 Eng. Rep. 911, 915 (Q.B. 1846).

24. As in the leading American case. *See* Roehm v. Horst, 178 U.S. 1, 19 (1900).

25. 151 Eng. Rep. 200 (Ex. 1839).

26. *Id.* at 202; *see also, e.g.*, Ripley v. M'Clure, 154 Eng. Rep. 1245, 1251 (Ex. 1849); Startup v. Cortazzi, 150 Eng. Rep. 71, 72 (Ex. 1835); Leigh v. Paterson, 129 Eng. Rep. 493, 494 (C.P. 1818). *See generally* 2 CHARLES G. ADDISON, A TREATISE ON THE LAW OF CONTRACTS 1065-66 (3d ed. 1853).

Baron Parke, it may be noted, was one of the judges in that casebook classic to end all casebook classics, *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. 1854). If only he had anticipated *Hochster v. De La Tour*, 118 Eng. Rep. 922 (K.B. 1853), he might well have the first-year-law-student fame of, say, Cardozo or Holmes—or, in any event, of Rose the Second of Aberlone or Mrs. Palsgraf.

example, one threshold problem—the old notion of the independence of mutual promises[27]—had been effaced by Lord Mansfield's introduction of the constructive condition concurrent.[28] Even the old notion of no breach until tender had been chipped away a bit. In *Jones v. Barkley*,[29] for example, Lord Mansfield held that it was unnecessary for the promisee to make a full tender of performance at the time set to be able to recover for breach of contract; rather, an incomplete tender (there, a draft of a release, rather than the fully executed release called for in the contract) would suffice.[30] More importantly, common-law courts came to recognize that repudiation by the promisor could serve as a defense for the promisee, allowing the promisee to suspend its own performance without itself breaching the contract.[31] Nevertheless, true anticipatory repudiation was still unrecognized.[32]

Then came that casebook classic, *Hochster v. De La Tour*.[33] There Lord Campbell, distinguishing away inconvenient precedent with insouciant virtuosity, proclaimed:

> [I]t is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it.[34]

Hochster was soon embraced by American courts, and, one state aside, is the law of the land.[35]

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27. *See* Nichols v. Raynbred, 80 Eng. Rep. 238 (K.B. 1615).

28. *See* Kingston v. Preston, 98 Eng. Rep. 606 (K.B. 1773).

29. 99 Eng. Rep. 434 (K.B. 1781).

30. *Id.* at 440.

31. *See Ripley*, 154 Eng. Rep. at 1251.

32. *See generally* Samuel Stoljar, *Some Problems of Anticipatory Breach*, 9 MELB. U. L. REV. 355, 356-60 (1974) (tracing history of anticipatory repudiation).

33. 118 Eng. Rep. 922 (K.B. 1853). The casebooks notwithstanding, there is an older contender as the *fons et origo* of anticipatory repudiation; in 1845, the New York Court for the Correction of Errors—or, at least, one of the judges delivering seriatim opinions—held that the plaintiffs need not wait until the time of performance, but, rather, could treat the contract as broken when the defendants refused to accept the plaintiffs' shipments of marble. Masterton & Smith v. Mayor of Brooklyn, 7 Hill 61, 75 (N.Y. 1845) (opinion of Beardsley, J.).

34. *Hochster*, 118 Eng. Rep. at 926.

35. *See, e.g.*, 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 8.20 (1990). The Supreme Court, after some tentative forays toward the *Hochster* rule

So far, anticipatory repudiation would seem to solve the problems that adequate assurance ultimately addressed—problems stemming from uncertain, but still possible, performance. Almost immediately after *Hochster*, however, English and American courts limited anticipatory repudiation greatly. One limit to *Hochster*'s reach was the requirement that a purported repudiation be done with utmost clarity. Starting in the latter half of the nineteenth century, courts used a good many phrasings. To illustrate, a leading U.S. Supreme Court decision required a "positive, unconditional, and unequivocal declaration of fixed purpose not to perform the contract in any event or at any time."[36] Additionally, an assertion by the promisor that it would not perform—usually called a mere assertion by the courts—would not suffice to repudiate.[37] Nor, for that matter, would a party's failure to prepare for performance, even if that failure to prepare would make timely performance all but impossible.[38]

Importantly, insolvency—again, usually called mere insolvency—would not amount to a repudiation.[39] As Justice

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in the late nineteenth century, finally affirmed it unequivocally just as the century ended. *See* Roehm v. Horst, 178 U.S. 1, 20 (1900); Dingley v. Oler, 117 U.S. 490, 502 (1886); Smoot's Case, 82 U.S. (15 Wall.) 36, 48 (1872). By the time of *Roehm*, most states had already adopted the *Hochster* approach. *See Roehm*, 178 U.S. at 16-20.

For whatever reason, Massachusetts insists on the now-archaic rule that a contract may not be breached by repudiation before the time of performance. *See* Daniels v. Newton, 114 Mass. 530 (1874); *see also* Norman R. Prance, *Anticipatory Repudiation of Contracts: A Massachusetts Anomaly*, 67 MASS. L. REV. 30 (1982).

36. *Dingley*, 117 U.S. at 502; *see also, e.g.*, Smoot's Case, 82 U.S. (15 Wall.) at 48; Kimel v. Missouri State Life Ins. Co., 71 F.2d 921, 923 (10th Cir. 1934); *In re* Spittler, 151 F. 942, 944 (D. Conn. 1907); Wells v. Hartford Manilla Co., 55 A. 599, 601 (Conn. 1903); Slaughter v. Barnett, 154 So. 134, 138 (Fla. 1934); Vittum v. Estey, 31 A. 144, 145 (Vt. 1894).

37. *See, e.g.*, *Dingley*, 117 U.S. at 503; Oliver v. Loydon, 124 P. 731, 732 (Cal. 1912); *Wells*, 55 A. at 601; Keller v. Strasburger, 90 N.Y. 381, 381 (1882). This aspect of anticipatory repudiation doctrine was attacked by some commentators as unduly restrictive. *See, e.g.*, Henry Winthrop Ballantine, *Anticipatory Breach and the Enforcement of Contractual Duties*, 22 MICH. L. REV. 329, 343-44 (1924); Lawrence B. Wardrop, Jr., *Prospective Inability in the Law of Contracts*, 20 MINN. L. REV. 380, 385-86 (1936). Ballantine's attack fell well short of modern adequate assurance doctrine, however. Ballantine, *supra*, at 343 ("It is obvious that the courts should not encourage an attempt to transform mere suspicion, fear, negotiation or request for modification into a cause of action.").

38. *See, e.g.*, Brady v. Oliver, 147 S.W. 1135, 1139-40 (Tenn. 1911). This rule would not, however, apply if time was of the essence. *See, e.g.*, Sutton v. Meyering Land Co., 227 N.W. 783, 784 (Mich. 1929).

39. *See, e.g.*, Florence Mining Co. v. Brown, 124 U.S. 385, 389 (1888); Roberts

Holmes observed, "the degree of [the promisor's] ability at any moment before he was called on to pay was no concern of the [promisee]."[40] Indeed, even a promisor's breach on one contract with a promisee would not constitute a repudiation of other contracts with that promisee.[41] So, *a fortiori*, a promisee's suspicion, however well-founded, that the promisor would not come through would not amount to repudiation.[42]

These limits yielded some peculiar results—peculiar, that is, to modern contract lawyers. For example, in *Wells v. Hartford Manilla Co.*,[43] the buyer had fallen into arrears on its payments under a supply contract. The buyer then directed the seller to slow down, and then stop, its shipments. Shortly after, the buyer was placed into receivership. Repudiation? No. True, the seller may have had "a suspicion amounting to a firm belief on its part" that the buyer would not meet its obligations; nevertheless, "suspicion and belief are not substitutes for certainties," and so the inference that a probable future breach would amount to a present renunciation was "plainly without justification."[44]

Indeed, erring in this sense could even place one in breach. In one such case, the promisee, a seller of sugar, learned that the buyer's credit was uncertain.[45] The seller therefore demanded from the buyer a guaranty of payment. When it did not arrive, the seller refused to ship. When the buyer sued for breach of contract, it won; the court held that the promisee was not contractually entitled to the assurances of payment, and so

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Cotton Oil Co. v. F.E. Morse & Co., 135 S.W. 334, 338 (Ark. 1911); Keppelon v. W.M. Ritter Flooring Corp., 116 A. 491, 492 (N.J. 1922); New England Iron Co. v. Gilbert Elevated R.R. Co., 91 N.Y. 157, 169 (1883).

40. Lowe v. Harwood, 29 N.E. 538, 539 (Mass. 1885).

41. *See, e.g.*, Hal Roach Studios, Inc. v. Film Classics, Inc., 156 F.2d 596, 599 (2d Cir. 1946); Ebling v. Ebling, 142 N.W. 1066, 1066 (Mich. 1913).

42. *See, e.g.*, Wonalancet Co. v. Banfield, 165 A. 785, 787 (Conn. 1933); Rome Hotel Co. v. Warlick, 13 S.E. 116, 119 (Ga. 1891); F.W. Kavanaugh Mfg. Co. v. Rosen, 92 N.W. 788, 790 (Mich. 1902); Coonan v. City of Cape Girardeau, 129 S.W. 745, 748 (Mo. Ct. App. 1910); Brown v. Manufacturers Trust Co., 16 N.E.2d 350, 352 (N.Y. 1938); Plummer v. Kelly, 73 N.W. 70, 72 (N.D. 1897). *But see* Mihills Mfg. Co. v. Day Bros., 50 Iowa 250, 253 (1878) (good faith belief with reasonable basis that other party in failing circumstances warrants demand for cash or security before delivery).

43. 55 A. 599 (Conn. 1903).

44. *Id.* at 602-03; *see also, e.g., Wonalancet*, 165 A. at 787 (winding up of a company is not a repudiation); Slaughter v. Barnett, 154 So. 134, 138-39 (Fla. 1934) (promisor's statement that he would not buy land not a repudiation).

45. John Dimon Corp. v. Federal Sugar Ref. Co., 213 N.Y.S. 106 (App. Div. 1925).

refusing to perform without them was itself a repudiation.[46] The stringency of pre-U.C.C. repudiation law thus tended to place severe burdens on insecure parties who sought either to end a contract before its time for performance or to demand greater certainty from the other party.

2. Stoppage *in Transitu*

The next antecedent of adequate assurance comes from the now-archaic notion of the seller's lien in goods. Until the modern age of commercial law, the focus of the law of sales was the passage of title.[47] When the property in the goods passed to the buyer, the seller's rights largely ceased. If an executory contract for the sale of goods provided for payment in cash, then the seller's rights persisted until payment.[48] If, however, the contract called for a sale on credit, then the time-hallowed rule passed the ownership to the buyer, even when the goods remained in the seller's hands.[49] As commonly put, the seller retained a lien in the goods, a lien that was variously waived or satisfied by the granting of credit.[50]

But what if the seller shipped the goods and then learned of the buyer's insolvency? Here the right of stoppage *in transitu*,[51] a time-hallowed part of commercial law, had its effect.[52] The seller had the right to stop the goods in their tracks and reclaim

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46. *See John Dimon Corp.*, 213 N.Y.S. at 108; *accord, e.g.*, Stephenson v. Cady, 117 Mass. 6, 9 (1875); Keppelon v. W.M. Ritter Flooring Corp., 116 A. 491, 493 (N.J. 1922); Hardeman-King Lumber Co. v. Hampton Bros., 142 S.W. 867, 868 (Tex. 1912); Wausau Canning Co. v. Woodruff, 207 N.W. 421, 424-25 (Wis. 1926).

47. For a memorable attack on its prominence, see K.N. Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U. L.Q. REV. 159 (1938).

48. *See, e.g.*, 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW 492 (New York, O. Halsted 1827).

49. For an early statement of the rule, see WILLIAM SHEPPARD, THE TOUCH-STONE OF COMMON ASSURANCES 224-25 (London, M.F. 1648); *see also, e.g.*, Miles v. Gorton, 149 Eng. Rep. 860, 863 (Ex. 1834).

50. *See, e.g.*, Crummey v. Raudenbush, 56 N.W. 1113, 1113 (Minn. 1893).

51. Meaning stoppage in transit. Ah, legal Latin.

52. The right can be traced back at least to 1690. *See* COLIN BLACKBURN, A TREATISE ON THE EFFECT OF THE CONTRACT FOR SALE **204-09 (Philadelphia, T. & J.W. Johnson 1847); *see also, e.g.*, Lickbarrow v. Mason, 100 Eng. Rep. 35, 39 (K.B. 1787). The right persists under the Uniform Commercial Code. U.C.C. §§ 2-702(1), 2-705(1) (1995); *see also, e.g.*, Petroleum Prods., Inc. v. Mid-America Pipeline Co., 815 F. Supp. 1421, 1423 (D. Kan. 1993).

them, regaining possession and reinstating its lien.[53] The contract of sale did not end, so the buyer could still demand performance if the contract was not otherwise in breach.[54] The credit term was, however, deemed ineffective; the buyer would thus have to pay cash for the goods, lest it breach the reformed contract.[55]

Stoppage *in transitu* thus afforded the seller on credit some rights when its likelihood of payment was severely impaired. These rights extended well beyond the ordinary rights granted under anticipatory repudiation, because here insolvency was itself a triggering event. But this right was temporally limited, starting only when the goods were shipped. It also extended only to the seller of goods on credit, and then only when the buyer's performance was rendered uncertain by insolvency. Other sources of uncertainty were not included.

3. The Implied Condition of Solvency

Stoppage *in transitu* carried with it a modification of the contract; the payment term switched from credit to cash. Why? The usual reason given fits into the third doctrine underlying adequate assurance: the implied condition of solvency. Implied conditions have long been part of contract law, whether in the roots of warranty or the duty of good faith. An early instance of implied contractual conditions came soon after executory contracts became the stuff of actions in assumpsit. The problem that courts often faced was that of the insolvent buyer. Seldom, if ever, did contracts state expressly that the buyer was to remain solvent, lest it breach.[56] Accordingly, if the seller simply declined to tender its performance to the insolvent buyer, it would be liable for breach of contract, even under the law of anticipatory repudiation. On the other hand, preparation would generally be pointless and wasteful.

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53. *See, e.g.*, Arnold v. Delano, 58 Mass. (4 Cush.) 33, 39 (1849) (Shaw, C.J.); JOSEPH CHITTY, JR., A PRACTICAL TREATISE ON THE LAW OF CONTRACTS **124-25 (London, Sweet & Maxwell 1968) (1834).

54. *See, e.g.*, Sheppard v. Newhall, 54 F. 306, 309 (9th Cir. 1893); Pennsylvania R.R. Co. v. American Oil-Works, Ltd., 17 A. 671, 672 (Pa. 1889).

55. *See, e.g.*, Diem v. Koblitz, 29 N.E. 1124, 1127 (Ohio 1892); McGill v. Chilhowee Lumber Co., 82 S.W. 210, 211-12 (Tenn. 1904).

56. Though modern contracts often do define default, and not infrequently list insolvency as something that leads either to breach or to acceleration.

The common-law courts devised rather an ingenious solution: they found an implied condition in credit contracts that the debtor would remain solvent.[57] The debtor's insolvency thus relieved the seller of the duty to grant credit. The balance of the agreement was, however, unaffected, so the seller could demand cash payment, and the buyer could be held in breach if it failed to pay at the time set for performance. More importantly, this condition had effect both with stoppage *in transitu* and before; a credit seller could thus demand cash payment before the goods left its hands.[58]

The implied condition of solvency came closer than anything else to the modern law of adequate assurance. A buyer's insolvency allowed the seller to demand adequate assurance—here, cash payment as part of the contract price—and to hold the buyer in breach if it failed to make the payment. But even this inventive doctrine had its limits. The seller was still obliged to tender the goods, for the contract was still very much in effect.[59] As a result, the seller was unable to mitigate early, whether by selling the goods elsewhere or by curtailing its own preparation or performance.[60] This condition also was limited to insolvency; though insolvency is perhaps the most important cause of insecurity, it is hardly the sole potential cause. In addition, the condition is by definition unavailable to a buyer, though buyers may well be uncertain about the likelihood that their sellers will deliver as promised.

4. The Enforceability of Insecurity Clauses

The common-law picture was thus grim for one contemplating the uncertainties that might arise in the course of a contract's life. The law of contract gave few opportunities for the insecure party to require any adjustments post hoc, and attempts to

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57. *See, e.g.*, BLACKBURN, *supra* note 52, at **320-22; Florence Mining Co. v. Brown, 124 U.S. 385, 389 (1888); *Arnold*, 58 Mass. (4 Cush.) at 39.

58. *See, e.g.*, *Arnold*, 58 Mass. (4 Cush.) at 39; Robinson v. Morgan, 25 A. 899, 899-900 (Vt. 1892); FRANCIS B. TIFFANY, HANDBOOK OF THE LAW OF SALES 315 (2d ed. 1908).

59. *See, e.g.*, *Florence Mining*, 124 U.S. at 389.

60. Though a few courts did allow the promisee to suspend its own performance pending the promisor's response. *See, e.g.*, Hanna v. Florence Iron Co., 118 N.E. 629, 630 (N.Y. 1918).

require these assurances outside their very limited scope often risked an action for breach of contract. Small wonder, then, that promisees sought by agreement to define breach and default in ways that might loose the bonds of contract law.[61]

These clauses were as multifarious as the types of contracts that embodied them.[62] At their most basic, they declared the contract in total breach if the promisor failed to make a payment or meet an installment.[63] The most sweeping of these clauses, however, allowed the promisee—typically the seller—to hold the contract breached if the promisor's credit was, in the opinion of the promisee, impaired. This sort of clause goes even further than the implied condition of solvency, for it extends to suspicion as well as certainty. An insecurity clause thus can mitigate the legal rigors of anticipatory repudiation better than could any of the doctrine's limits or exceptions.

The broader clauses were challenged from time to time by those who felt their lash, generally on the grounds that the wide discretion they gave the creditor deprived the contract of mutuality.[64] These challenges consistently failed.[65] The courts held that as long as the creditor's satisfaction with the credit was established objectively, rather than subjectively, mutuality

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61. A problem that persists. Article 9 of the U.C.C. does not define default, so parties to security agreements must do so contractually. *See* U.C.C. § 9-501 (1995).

62. For what remains the leading treatment of these clauses, see Harold C. Havighurst, *Clauses in Sales Contracts Protecting the Seller Against Impairment of the Buyer's Credit*, 20 MINN. L. REV. 367 (1936); *see also* Philip T. Carter, *Seller Control of Unsecured Trade Credit*, 32 OHIO ST. L.J. 553, 560-65 (1971).

63. While the contract would naturally have been breached, the breach might not have gone to the root of the contract, thus affording the recipient of the breach an action only for the portion not properly performed. This distinction is vital for installment contracts, which are, even under the U.C.C., subject to a substantial performance rule for breach. *See* U.C.C. § 2-612 (1995).

64. Those were the days when mutuality of obligation was still a respectable doctrine. *See* RESTATEMENT (SECOND) OF CONTRACTS § 79(c) cmt. f (1979) ("The word 'mutuality,' though often used in connection with the law of Contracts, has no definite meaning.").

65. *See, e.g.*, James B. Berry's Sons Co. v. Monark Gasoline & Oil Co., 32 F.2d 74, 76 (8th Cir. 1929); Peck v. Stafford Flour Mills Co., 289 F. 43, 44-45 (8th Cir. 1923); Midland Linseed Prods. Co. v. Charles R. Sargent Co., 281 F. 704, 708-09 (6th Cir. 1922); Trainor v. Buchanan Coal Co., 191 N.W. 431, 431-32 (Minn. 1923); Casinghead Gas Co. v. Osborn, 112 A. 469, 470 (Pa. 1921). These clauses were also validated, at least by inference, in the Uniform Sales Act. UNIF. SALES ACT § 61(1) (1906).

existed.[66] Knowledgeable creditors could thus protect themselves against financial uncertainty.[67]

So the orthodox common law at the time of the U.C.C. gave little comfort to an insecure promisee. There were, to be sure, occasional decisions that might give solace, and certain aspects of the common law, most notably the implied condition of solvency, that might afford a modicum of relief. But the rights of a promisee were almost wholly delimited contractually, and a worried promisee would have little chance for relief before the time set for performance.

B. The Uniform Sales Act and the Restatement of Contracts

By the turn of the century, then, adequate assurance of performance was at best dimly detectable in the common law. Its antecedent doctrines were firmly in place, though still perhaps under attack in scholarly quarters and the occasional courtroom. The early attempts to codify contract and sales law did much to make solid the antecedents to adequate assurance, but, as we shall see, did nothing at all to make adequate assurance itself a real doctrine.

First comes the Uniform Sales Act ("U.S.A."), issued in 1906 by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"). This was issued in a series of uniform statutes intended to bring consistency to American commercial law.[68] Modeled on the English Sale of Goods Act, 1893,[69] the U.S.A. rested on what might be termed property ideas, rather than contract ideas. Most notably, the core of the U.S.A. was title—who had it, how it might be transferred, when liens arose

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66. *See, e.g., Midland Linseed Prods.*, 281 F. at 709; Robie v. Wheeler Shipyard, Inc., 3 N.Y.S.2d 813, 815 (Sup. Ct. 1938), *aff'd*, 12 N.Y.S.2d 764 (App. Div. 1939). *But see* Corn Prods. Ref. Co. v. Fasola, 109 A. 505, 505-06 (N.J. 1920) (subjective test). The *Corn Products* approach was ultimately rejected in the U.C.C. *See* U.C.C. § 2-609 cmt. 4 (1995).

67. As some did. *See* Havighurst, *supra* note 62.

68. *See* WALTER P. ARMSTRONG, JR., A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 165-68 (1991).

69. Sale of Goods Act, 1893, 56 & 57 Vict., ch. 71 (Eng.). On the question of modeling, see 1 SAMUEL WILLISTON, THE LAW GOVERNING SALES OF GOODS 2-3 (rev. ed. 1948).

and fell, and so on.[70] As under the common law, the credit seller under the U.S.A. lost its lien if it sold on credit, but this lien revived on the buyer's insolvency.[71] The unpaid seller on credit also held the right of stoppage *in transitu* if the buyer was or became insolvent.[72] These sections changed the common law little, if at all.

Furthermore, anticipatory repudiation, albeit grudgingly, was recognized indirectly in the U.S.A.[73] Indeed, one aspect of anticipatory repudiation met with the approval of Samuel Williston, the drafter, and even found its way into the U.S.A. itself. Though Williston was reluctant to allow the recipient of an anticipatory repudiation to sue at once, he did think it appropriate for the recipient to cease its own performance.[74] The U.S.A. thus provided that a seller could not recover damages after repudiation where it failed to mitigate by ceasing performance.[75] By implication, then, a seller faced with a repudiation would be justified in this cessation. The U.S.A. thus relaxed one common-law burden, which required that the seller complete its tender, including preparatory acts, in order to be able to sue for breach.[76] By way of symmetry, the U.S.A. also excused a buyer from making prepayment when the seller had manifested its inability or unwillingness to perform.[77] Generally, then, anticipatory

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70. *See, e.g.*, William C. Jones, *Back to Contract?*, 1964 WASH. U. L.Q. 143. An index of this is the detailed attention given to the seller's lien. Fully eleven of the U.S.A.'s seventy-nine sections addressed the rights of an unpaid seller against the goods. UNIF. SALES ACT §§ 52-62 (1906). Another twenty-four dealt with the transfer of title—thus occupying about half the statute, once technical sections are left aside. UNIF. SALES ACT §§ 17-40 (1906). Another illustration comes from legal education; one of the leading casebooks on sales under the U.S.A. spends just over half of its pages on questions of title, property rights, and property-related remedies. *See* GEORGE GLEASON BOGERT & WILLIAM EVERETT BRITTON, CASES ON THE LAW OF SALES 120-621, 974-1040 (1936). The shift from title fueled Williston's objections to the U.C.C. *See* Samuel Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561 (1950).

71. *See* UNIF. SALES ACT § 54(1)(b), (c) (1906).

72. *See* UNIF. SALES ACT §§ 57-59, 61-62 (1906).

73. *See* UNIF. SALES ACT § 64(4) (1906); *see also, e.g.*, H. Muehlstein & Co. v. Hickman (*In re* Hannibal Rubber Co.), 26 F.2d 40, 43-44 (8th Cir. 1928); Home Pattern Co. v. W.W. Mertz Co., 86 A. 19, 21-22 (Conn. 1913).

74. *See, e.g.*, 3 WILLISTON, *supra* note 69, § 586.

75. *See* UNIF. SALES ACT § 64(4) (1906); *see also, e.g.*, Snelling v. Dine, 170 N.E. 403, 405 (Mass. 1930).

76. *See supra* note 59 and accompanying text.

77. UNIF. SALES ACT § 63(2) (1906); *see also, e.g.*, McDorman v. Moody, 122 P.2d 639, 642 (Cal. Dist. Ct. App. 1942); 3 WILLISTON, *supra* note 69, § 576. Indeed,

repudiation and the other doctrines that were harbingers of adequate assurance were incorporated, explicitly or implicitly, into the U.S.A.

The other great force of codification was the Restatement of Contracts ("Restatement"), issued in 1932. This Restatement was among the first offshoots of the American Law Institute's ("ALI") attempt to give greater certainty to the common law, riven with conflicting and often irreconcilable precedents.[78] Anticipatory repudiation was addressed mainly in section 318 of the Restatement, which provided that a bilateral contract would be repudiated by (a) the promisor's statement to the promisee that it would not or substantially could not perform its duties; (b) the promisor's transfer of any specific assets essential to its performance; or (c) any voluntary affirmative act by the promisor which rendered performance of its contractual duties impossible or apparently impossible.[79] The comments did observe that a breach of this sort justified immediate action, though they quickly pointed out that this was not an ordinary sort of breach (in that, for example, the breach could be retracted by the breaching party).[80] But, as before, the doctrine was rather limited. For instance, failure to prepare for performance was not an anticipatory breach.[81] Nor was insolvency of itself an anticipatory repudiation.[82] Here, then, the Restatement differed little from the orthodox common law.

Llewellyn observed that this protection for the buyer "for once exceeded that afforded the seller," which, he thought, resulted in the use by sellers of contractual security clauses. Introductory Comment on Section 98 (S 7-10) through 101 (S 7-9), Insecurity, Repudiation and Installments: Anticipatory Breach 1 (1946), *microformed on* THE KARL LLEWELLYN PAPERS, J.VIII.2.b (William S. Hein & Co.) [hereinafter LLEWELLYN PAPERS].

78. RESTATEMENT OF CONTRACTS at viii (1932). There may, of course, have been other motives, and the process of restating is subject to a wide range of pressures. *See, e.g.*, Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909 (1995); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

79. RESTATEMENT OF CONTRACTS § 318 (1932 & Supp. 1948). This section was revised in 1947 to exclude most unilateral contracts from the doctrine, but was otherwise left untouched. *See* Restatement of the Law at 251-52 (Supp. 1948).

80. *See* RESTATEMENT OF CONTRACTS § 318 cmt. d (1932).

81. *See* RESTATEMENT OF CONTRACTS § 318 cmt. i, illus. 11 (1932).

82. *See* RESTATEMENT OF CONTRACTS § 318 cmt. h, illus. 8, § 324 (1932).

But other areas of the Restatement show some willingness to push the bounds of breach a bit.[83] Consider, for example, section 323, which dealt with unwillingness or inability to perform that falls short of repudiation. Though these manifestations might not suffice to repudiate—they might, for instance, be too vague, or they might go to the promisor's solvency—they could trigger breach if the promisee materially changed its own position in reasonable reliance on the manifestations.[84] Thus, an expression of doubt, ordinarily inadequate to repudiate, would constitute breach if the promisee, relying on the doubt, arranged for cover.[85] The Restatement's use of reliance here, as elsewhere,[86] showed something of a shift from classical notions of contract and reflected a loosening of formal categories that came to fruition in, for example, the Restatement (Second) of Contracts and the Uniform Commercial Code.[87]

The Restatement also relaxed somewhat the most stringent aspects of formal contract doctrine in its treatment of uncertainty by providing that when the promisor has manifested doubt to the promisee, the promisee should be able to change its position, and, upon doing so, should be discharged from its duty to perform its promise.[88] Among the classes of prospective inability listed in the Restatement was insolvency. Though, as noted above, insolvency would not work a repudiation, it would give rise to discharge, unless the insolvent promisor performed or provided security—and even then, the promisee would be discharged if too long a period passed, or if the promisor reasonably changed position as a result.[89]

This restates the implied condition of solvency, by then a familiar part of the common law of contracting. But the Restatement goes further. Though the common-law doctrine deleted the credit term, it did not allow the promisee to get free of its duty to

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83. Or perhaps Arthur Corbin's willingness; though Williston was the reporter for the Restatement, Corbin was one of his advisors (and the primary drafter of the remedies section). *See* RESTATEMENT OF CONTRACTS at ix-x (1932).

84. *See* RESTATEMENT OF CONTRACTS § 323 cmts. a, b (1932).

85. *See* RESTATEMENT OF CONTRACTS § 323 cmt. b, illus. 1 (1932).

86. *See, e.g.*, RESTATEMENT OF CONTRACTS § 90 (1932).

87. Though Grant Gilmore might have quarreled with the word fruition, preferring instead a term more redolent of decay or dissolution. *See* GRANT GILMORE, THE DEATH OF CONTRACT 69-72, 87-90 (1974).

88. RESTATEMENT OF CONTRACTS § 280 (1932).

89. RESTATEMENT OF CONTRACTS § 287 (1932).

perform until the time for performance arose. (Hence the contractual default clauses that grew commonplace.) Under the Restatement, the insolvency can, given reliance or excessive time, ripen into discharge. Insolvency does not ripen into breach; the promisee need not tender or perform, but it cannot sue on the contract until or unless the promisor actually breaches. The defense of prospective inability was thus cabined away from anticipatory repudiation. Still, the extension added modestly to the flexibility of contract law.

C. The Uniform Commercial Code

The first attempt to recodify sales law, the Federal Sales Bill of 1937,[90] was, for the most part, merely a revision of the Uniform Sales Act, and like the U.S.A. left adequate assurance uncovered. So too did the 1940 draft of the Uniform Sales Act, NCCUSL's first attempt at recodification.[91] Not until 1941 did adequate assurance make an appearance in the draft, and then not in a form readily recognizable today. The 1941 draft, Llewellyn's first real rewriting of the U.S.A., provided that a buyer on credit warrants to its seller that it "will give the seller no reasonable grounds for insecurity in regard to his continuing ability and willingness to perform."[92] Llewellyn provided no explanation for this shift from the U.S.A. in the comments that followed.[93] While

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90. H.R. 1619, 75th Cong. (1937).

91. NATIONAL CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, DRAFT FOR A "UNIFORM SALES ACT, 1940," *reprinted in* 1 UNIFORM COMMERCIAL CODE DRAFTS 171 (Elizabeth Slusser Kelly ed., 1984) [hereinafter DRAFTS]. NCCUSL's entry was part of an attempt to head off federal legislation in commercial law. *See, e.g., Consideration in Committee of the Whole of the Revised Uniform Sales Act, in* HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 148 (1942).

92. AN ACT RELATING TO SALES OF PERSONAL PROPERTY AND TO CONTRACTS FOR THE SALE THEREOF, AND TO RIGHTS, OBLIGATIONS, AND REMEDIES ARISING OUT OF SUCH SALES OR CONTRACTS AND IN CONNECTION WITH FINANCING OR OTHER TRANSACTIONS COMMONLY ASSOCIATED THEREWITH, AND TO MAKE UNIFORM THE LAW OF SUCH MATTERS § 16-C (1941[?]), *reprinted in* 1 UNIFORM COMMERCIAL CODE CONFIDENTIAL DRAFTS 3, 73 (Elizabeth Slusser Kelly & Ann Puckett eds., 1995) [hereinafter CONFIDENTIAL DRAFTS]. The draft itself lacks a date, but the editors have, based on the context, placed it in 1941. *See id.* at 1.

93. These comments dealt instead with another part of the section, creating a warranty of solvency. This warranty later became U.C.C. section 2-702, the credit seller's right of reclamation. *See* Larry T. Garvin, *Credit, Information, and Trust in the Law of Sales: The Credit Seller's Right of Reclamation,* 44 UCLA L. REV. 247, 266-73 (1996). They also reflect pre-Code law's narrow extension of anticipatory

this draft acknowledged the potential relevance of insecurity by making its absence an implicit contractual term (and hence its presence a breach of that term), it did not create a mechanism for enforcement, beyond that present for all breaches of contract. Nor did it allow the insecure party to do anything other than declare the contract in breach. Finally, this warranty applied only to the insecure seller; though the problem of the insolvent buyer was the main motive for introducing the notion of insecurity, it was hardly the sole one.[94]

The next draft, prepared for NCCUSL's 1941 annual meeting, resolved some of its predecessor's uncertainties by providing an enforcement mechanism: an insecure seller could act as though the buyer had materially defaulted in a payment, as governed by section 45 of the Revised U.S.A.[95] Section 45, which governed installment contracts, allowed the aggrieved party to demand assurance that the other party's material default would no longer occur.[96] The party not in default would be justified in refusing to proceed.[97] Were the assurance not "prompt," the aggrieved party would have the right to cancel the balance of the contract and seek its remedy for breach of the whole.[98] By this cross-reference, Llewellyn thus created much of what section 2-609 of the U.C.C. now affords the party invoking its protections. In doing so, he acknowledged that this notion of adequate assurance "may seem to a lawyer at first sight a strange and unworkable standard of fact."[99] Llewellyn added, however, that parties often created similar standards in their contracts, particularly in clauses governing revocation and reestablishment of credit.[100] By resting this section on mercantile practice, Llewellyn thought that it "fixes a solid basis of respective rights, prevents acceptance from

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repudiation to the buyer's insolvency. *See supra* notes 56-60 and accompanying text.

94. *See supra* notes 56-60 and accompanying text.

95. "A buyer by buying or contracting to buy goods on credit . . . agrees that if he gives the seller reasonable grounds for insecurity in regard to his continuing ability and willingness to perform, the seller may proceed in like manner as in case of material default in a payment, under Section 45." REPORT AND SECOND DRAFT, THE REVISED UNIF. SALES ACT §16-C (1941), *reprinted in* 1 DRAFTS, *supra* note 91, at 407-08.

96. *See id.* § 45(2), *reprinted in* 1 DRAFTS, *supra* note 91, at 470.

97. *See id.* § 45(1).

98. *See id.* § 45(2).

99. *See id.* § 45 cmt., *reprinted in* 1 DRAFTS, *supra* note 91, at 472.

100. *See id.*

prejudicing the acceptor's position, and drives toward a mercantilely feasible solution."[101] Though the section still protected only sellers and failed to provide the time for assurance (beyond that it be "prompt"), it had moved much toward modern law.

The next version of the sales article to address adequate assurance did away with the cross-reference to installment contracts, leaving the section on adequate assurance as a freestanding entity.[102] The version discussed by NCCUSL at its 1943 meeting, set out below,[103] was substantially the same as the final product. Both the buyer and the seller were now included as potentially insecure parties, and they had a clearer right to suspend performance pending receipt of assurance than the earlier draft had given them.[104] The section also defined insecurity and adequate assurance for contracts between merchants in terms of commercial standards (implicit in Llewellyn's rationale),[105] and fixed an outer limit of thirty days on the reasonable time allowed to provide assurances in response to a justified demand.[106] The discussion, turning mainly on fine

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101. *Id.*

102. Partial drafts covering other parts of sales law were issued before this draft. At least one of these partial drafts refers to adequate assurance as in section 73. THE AMERICAN LAW INST., CODE OF COMMERCIAL LAW—SALES ACT, PRELIMINARY DRAFT NO. 7—PROPOSED SECTIONS §§ 74, 94 (1943), *reprinted in* 1 CONFIDENTIAL DRAFTS, *supra* note 92, at 181, 186, 191. No available draft contains this section 73, however.

103. § 99. Right to Adequate Assurance of Performance.

(1) There is implied in a contract for sale an obligation on each party not to impair the other's expectation that the promised performance will occur as and when due. When either party gives the other reasonable grounds for insecurity in this respect the other may demand adequate assurance of due performance and until he receives it may suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance as to the future.

(4) Failure to provide adequate assurance within a reasonable time not exceeding thirty days after receipt of a justified demand therefor is a repudiation of the contract.

NATIONAL CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, TRANSCRIPT OF DISCUSSIONS, FIFTY-THIRD ANNUAL CONFERENCE 158-59 (Aug. 17-21, 1943), *microformed on* LLEWELLYN PAPERS, *supra* note 77, at J.V.2.h.

104. *See id.* § 99(1).

105. *See id.* § 99(2).

106. *See id.* § 99(4).

points of drafting, was characteristically unilluminating.[107] For the most part, adequate assurance remained intact from 1943 to the end of drafting.[108]

In spite of this textual quiescence, and in spite of the apparent receptivity of NCCUSL and the ALI, Llewellyn seemingly felt impelled to defend adequate assurance often, as though to preempt absent critics. His first extended defense came as early as 1941.[109] But 1944 was his *annus mirabilis* for defenses of adequate assurance. First came the extended comment to the ALI drafts of 1944.[110] Llewellyn began by taking issue, at least

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107. NATIONAL CONFERENCE ON COMM'RS ON UNIF. STATE LAWS, *supra* note 103, at 159-61, *microformed on* LLEWELLYN PAPERS, *supra* note 77, at J.V.2.h.

108. A few relatively minor changes might be noted. The thirty-day outer limit in the 1943 draft changed to ten days in May of 1944, and then back to thirty in the 1950 draft. *See* THE AMERICAN LAW INST., UNIFORM REVISED SALES ACT § 99(4) (Proposed Final Draft No. 1, 1944) [hereinafter UNIFORM REVISED SALES ACT], *reprinted in* 2 DRAFTS, *supra* note 91, at 1, 64; THE AMERICAN LAW INST., UNIFORM COMMERCIAL CODE § 2-609(4) (Proposed Final Draft, 1950)[hereinafter U.C.C. PROPOSED FINAL DRAFT], *reprinted in* 9 DRAFTS, *supra* note 91, at 185, 267. The change went unexplained. A possible reason may be gleaned from the draft comments. The comment to the February 1944 draft, in which the time period was still thirty days, stated that the limit was intended "to make possible a handling of the situation which will completely free the question of reasonable time from any uncertainty in later litigation." THE AMERICAN LAW INST., SALES SECTIONS (SALES ACT) § 99 cmt. (Council Draft No. 1, 1944) [hereinafter SALES SECTIONS (SALES ACT)], *reprinted in* 1 CONFIDENTIAL DRAFTS, *supra* note 92, at 255, 441. Llewellyn added, however, that "[c]ommonly, the time involved should by commercial standards be much less, and obviously so in the light of the facts." *Id.* The draft of April 1944, in which the time period was changed to ten days, omits this last sentence. UNIFORM REVISED SALES ACT, *supra*, § 99 cmt., *reprinted in* 2 DRAFTS, *supra* note 91, at 1, 257. One might conclude that Llewellyn thought on reflection that ten days was more in keeping with commercial standards, and so limited the time in the rule. Llewellyn did note at the 1944 ALI meeting that this change was "suggested to us at the Council [of ALI] meeting and followed up in the meeting of the Committee," but that it made the section, in Llewellyn's opinion, "too tight and too short." Karl N. Llewellyn, *Proposed Final Draft of the Uniform Revised Sales Act*, 21 A.L.I. PROC. 63, 195 (1944).

The 1950 draft also required that the aggrieved party had to request adequate assurance in writing. U.C.C. PROPOSED FINAL DRAFT, *supra*, § 2-609(1), *reprinted in* 9 DRAFTS, *supra* note 91, at 185, 267. Again, this went unexplained. It has proved oddly troublesome in practice. *See infra* note 155 and accompanying text.

109. *See supra* notes 99-101 and accompanying text.

110. SALES SECTIONS (SALES ACT), *supra* note 108, § 99 cmt., *reprinted in* 1 CONFIDENTIAL DRAFTS, *supra* note 92, at 333, 439-50. This is essentially the same as a comment set forth in April of that year. *See* UNIFORM REVISED SALES ACT, *supra* note 108, § 99 cmt., *reprinted in* 2 DRAFTS, *supra* note 91, at 1, 255-66. *But see supra* note 108 (explaining difference between thirty day limit and ten day limit). This comment was incorporated, with some abridgement and editing, into the final Official Comment. *See* U.C.C. § 2-609 cmt. (1995).

implicitly, with Holmes: in commerce, said Llewellyn, one does not bargain for a promise plus a right to win a lawsuit; rather, "[t]he essential purpose of the bargain lies in the performance itself."[111] Furthermore, the point of a forward contract is the "continued sense of reliance and security" it gives the promisee.[112] Loss of security thus deprives the promisee of much of the benefit of its bargain. It also imposes burdens on either an insecure seller or an insecure buyer; the former faces hardship by continuing its performance, perhaps losing the opportunity to serve other customers, and the latter cannot be certain that it will have the supplied goods for its own manufacturing or inventory.[113]

Llewellyn pointed to three aspects of commercial law that had helped meet the needs of businesses faced with this problem. These, perhaps unsurprisingly, were the rights of stoppage *in transitu* and the seller's lien, the use of clauses permitting the seller to curtail deliveries if the buyer's credit became impaired, and the right to declare the other party to have repudiated anticipatorily.[114] For each of these, Llewellyn identified a corresponding aspect of the law of adequate assurance. The seller's lien and the right of stoppage *in transitu* were akin to the new right of the aggrieved party to suspend its own performance without liability for delay.[115] The right to require adequate assurance corresponded to the ability to provide for curtailment of deliveries in the contract.[116] Finally, the right of the aggrieved party to treat the contract as broken corresponded to the law of anticipatory repudiation.[117] Llewellyn thus tied his rather substantial change in the law of sales to time-honored parts of commercial law, lessening somewhat the apparent magnitude of the shift. Indeed, Llewellyn made this new section seem less, rather than more, radical, by pointing to it as an intermediate

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111. UNIFORM REVISED SALES ACT, *supra* note 108, § 99 cmt., *reprinted in* 2 DRAFTS, *supra* note 91, at 255; *cf.* Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it—and nothing else.").

112. UNIFORM REVISED SALES ACT, *supra* note 108, § 99 cmt., *reprinted in* 2 DRAFTS, *supra* note 91, at 1, 255.

113. *See id.*

114. *See id.* at 256.

115. *See id.*

116. *See id.*

117. *See id.*

position less severe than the "'breach or no breach'" system of then-current law.[118]

Llewellyn's next defense of his creation came during the ALI meeting in May of 1944, when he reviewed the then-current draft, section by section. He prefaced his comments on adequate assurance by calling for "really careful attention" to this "effort to clarify the very puzzling and troubling law surrounding anticipatory breach and surrounding failure of conditions."[119] Llewellyn's major complaint was that breach, the result of invoking anticipatory repudiation, is not what the promisee wants; rather, the promisee wants to be able to suspend its own performance and to have its security repaired.[120] This, he thought, was hardly unprecedented, given the substantial use of security clauses in business.[121] After this careful preparation, both in his lengthy comment and in his oral introduction, doubtless Llewellyn braced himself for sharply critical retort. If so, he braced in vain; apart from some inconsequential questions, nothing was said about the provision.[122]

Llewellyn's last fresh comments on adequate assurance came in the 1946 draft.[123] He pointed again to the problems created by a breach or no breach dichotomy: "[T]he courts, reasonably and soundly, have been slow to find a 'breach' in such cases," which meant that "the contract-keeping party has been forced to go on with his own performance on pain of breach at a time when he knew that his reasonable certainty of proper counter-

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118. *See id.* He added that courts were loath to find anticipatory breach, perhaps intimating that adequate assurance, a less radical remedy, would be used more often. *See id.*

This moderating strategy—making a substantial change seem insubstantial—is traditional in uniform-law drafting, as a means to ensure that the statute ultimately will be adopted. *See, e.g.*, Adam J. Hirsch, *Inheritance and Inconsistency*, 57 OHIO ST. L.J. 1057, 1157, nn.292-93 (1996).

119. Karl N. Llewellyn, *Proposed Final Draft of the Uniform Revised Sales Act*, 21 A.L.I. PROC. 63, 194 (1944).

120. *See id.* at 194-95.

121. *See id.* at 195.

122. *See id.* at 195-97.

123. Though there are other draft comments for what became section 2-609 in the Llewellyn Papers, they are just edited versions of the 1944 comments, with no major substantive changes. *See* Karl N. Llewellyn, Drafts—Period Preceding November Meeting, Comment on Section 98 (7-10) Right to Adequate Assurance of Performance (1947), *microformed on* LLEWELLYN PAPERS, *supra* note 77, at J.IX.2.b; Karl N. Llewellyn, Uniform Revised Sales Act Comments, Comment on Section 98 Right to Adequate Assurance of Performance (1948), *microformed on* LLEWELLYN PAPERS, *supra* note 77, at J.X.2.f.

performance had been impaired."[124] Hence the merit of separating questions of security from those of breach, which, Llewellyn thought, "affords a vitally needed mercantile protection and also carries forward the basic policy of this entire Act as well as of the sounder case law in recognizing the desirability of working out a going adjustment rather than forcing a law suit."[125]

D. Interregnum

In the end, the U.C.C. thus conflicted with most of the common law of anticipatory repudiation, which almost invariably found promisees themselves to be in breach when they demanded assurance from their wobbly promisors.[126] The general acceptance of the U.C.C.'s changes within commercial law did not, perhaps predictably, carry far into the common law of contract.[127] One appellate court remarked, rather surprisingly, that section 2-609 "reflects the general rule of law" as to demands for assurance.[128] A couple of others applied section 2-609 by analogy, though recognizing that doing so worked a change in the common law.[129] Much more common, though, were courts that pointed out that the contracts in question were not governed by Article 2 of the U.C.C., and, therefore, did not apply section 2-609, or that specifically rejected the analogical use of section 2-609.[130]

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124. Karl N. Llewellyn, Sales Act Comments, Introductory Comment on Section 98 (S 7-10) through 101 (S 7-9) Insecurity, Repudiation and Installments: Anticipatory Breach (1946), *microformed on* LLEWELLYN PAPERS, *supra* note 77.

125. *Id.*

126. *See supra* note 46 and accompanying text.

127. Though courts have applied some Article 2 provisions by analogy to problems outside of the sale of goods. *See, e.g.*, United Van Lines v. Hertz Penske Truck Leasing, Inc., 710 F. Supp. 283 (W.D. Wash. 1989) (applying Article 2 to lease agreement); Wille v. Southwestern Bell Tel. Co., 549 P.2d 903 (Kan. 1976) (applying § 2-302 to advertising contract).

128. Markowitz & Co. v. Toledo Metro. Hous. Auth., 608 F.2d 699, 705 (6th Cir. 1979).

129. *See, e.g,* Romig v. deVallance, 637 P.2d 1147, 1152-53 (Haw. Ct. App. 1981).

130. *See, e.g.*, Althoff Indus., Inc. v. Elgin Med. Ctr., Inc., 420 N.E.2d 800, 804-05 (Ill. App. Ct. 1981); Cook Plumbing Co. v. Martin Bloom Assocs., Inc., 573 S.W.2d 947, 958 (Mo. Ct. App. 1978); Schenectady Steel Co. v. Bruno Trimpoli Gen. Constr. Co., 350 N.Y.S.2d 920, 922-23 (App. Div.), *aff'd mem.*, 316 N.E.2d 875 (N.Y. 1974); *cf.* Ringel & Meyer, Inc. v. Falstaff Brewing Corp., 511 F.2d 659, 660 n.1 (5th Cir. 1975) (applying Louisiana law; no right like § 2-609 in civil law of obligation).

Furthermore, the old common-law doctrines still largely held sway, with much the same results as before the U.C.C. A statement still had to be clear, unequivocal, and unconditional before it could amount to an anticipatory repudiation;[131] a declaration not to be bound still did not of itself yield a breach;[132] the promisor's insolvency was not an anticipatory repudiation.[133] The Restatement rules did mitigate somewhat these difficulties, as did the older notions of stoppage *in transitu* and the implied condition of solvency. But even after the U.C.C., one still found cases like *McCloskey & Co. v. Minweld Steel Co.*,[134] in which a general contractor, concerned about its subcontractor's inability to secure a source for its raw materials, demanded assurances from the subcontractor that it had found a source. When the subcontractor failed to provide them, the general contractor hired another subcontractor and sued for damages. The court held that the general contractor was not contractually entitled to assurances, so the subcontractor had no obligation to supply them; as a result, the subcontractor was not in breach.[135] One can imagine a subsequent suit by the subcontractor seeking its lost profits.[136]

E. The Restatement (Second) of Contracts

A few enterprising courts aside, adequate assurance had made only slight inroads in the common law by the mid-1970s. Then, however, came the Restatement (Second) of Contracts ("Restatement (Second)"). Professor E. Allan Farnsworth of Columbia, the reporter, first addressed the problem in section

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131. *See, e.g.*, City of Fairfax v. Washington Metro. Area Transit Auth., 582 F.2d 1321, 1326 (4th Cir. 1978); Pacific Coast Eng'g Co. v. Merritt-Chapman & Scott Corp., 411 F.2d 889, 894 (9th Cir. 1969); Early v. Santa Clara Broad. Co., 27 Cal. Rptr. 212, 214 (Dist. Ct. App. 1962); STC, Inc. v. City of Billings, 543 P.2d 374, 379 (Mont. 1975).

132. *See, e.g.*, Campos v. Olson, 241 F.2d 661, 662 (9th Cir. 1957); Salot v. Wershow, 320 P.2d 926, 930 (Cal. Dist. Ct. App. 1958); *STC, Inc.*, 543 P.2d at 379.

133. *See, e.g.*, Martin v. Maldonado, 572 P.2d 763, 770 n.22 (Alaska 1977); Arizona Title Ins. & Trust Co. v. O'Malley Lumber Co., 484 P.2d 639, 647 (Ariz. Ct. App. 1971).

134. 220 F.2d 101 (3d Cir. 1955).

135. *See id.* at 104-05; *see also, e.g.*, Clark v. Ingle, 266 P.2d 672, 673 (N.M. 1954).

136. As continued to happen elsewhere. *See, e.g.*, Oppenheimer Bros. v. Joyce & Co., 154 N.E.2d 856, 861 (Ill. App. Ct. 1958); String v. Steven Dev. Corp., 307 A.2d 713, 718-20 (Md. 1973); Stefanowicz Corp. v. Harris, 373 A.2d 54, 61 (Md. Ct. Spec. App. 1977).

275 of Tentative Draft No. 8, dated March of 1973. There he elected to follow the general path of U.C.C. section 2-609. Recognizing that section 2-609 was an "innovation," he nonetheless adhered to it because the Restatement and common law in the area were "not . . . very consistent," and the rule in the U.C.C. seemed "the best solution to a problem on which there was at least no compelling precedent in any other direction."[137] Accordingly, as Professor Farnsworth observed, "we have stuck our necks out, or I guess the Advisers have stuck my neck out."[138] The detail differed; the Restatement (Second), for example, did away with the U.C.C.'s strict time limit for assurance.[139] Nor did this draft allow the obligee to suspend its performance until the obligor responded to the request for adequate assurance.[140] Still, the draft did move toward the U.C.C. approach to insecurity.

Draft section 275 was not acted on in 1973, but this section, along with the other draft sections on prospective nonperformance, were dealt with at the next meeting. Tentative Draft No. 9, prepared for the 1974 meeting, revised draft section 275 substantially, giving it essentially its final form.[141] In the meantime, the case of *Schenectady Steel Co. v. Bruno Trimpoli Gen. Constr. Co.* was decided, in which the court declined to apply section 2-609 by analogy, instead using the orthodox

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137. E. Allan Farnsworth, *Continuation of Discussion of Restatement of the Law, Second, Contracts*, 50 A.L.I. PROC. 209, 232 (1973) [hereinafter Farnsworth, *Continuation*].

138. *Id.*

139. The provision reads:

> § 275. WHEN A FAILURE TO GIVE ASSURANCES IS A REPUDIATION.
>
> When reasonable grounds for insecurity arise with respect to an obligor's future performance as a result of
>
> (a) his manifestation by words or other conduct that he doubts that he will be willing to perform, or
>
> (b) his apparent inability to perform
>
> without a breach by non-performance that would of itself give the obligee a claim for damages for total breach under § 268, his failure upon a reasonable demand by the obligee to give within a reasonable time such assurance of due performance as it is reasonable to require is a repudiation.

RESTATEMENT (SECOND) OF CONTRACTS § 275 (Tentative Draft No. 8, 1973).

140. *Id.*

141. RESTATEMENT (SECOND) OF CONTRACTS § 275 (Tentative Draft No. 9, 1974). The only difference is in the sentence structure of section 275(2); there is no substantive change. *See Discussion of Restatement of the Law, Second, Contracts, Tentative Draft No. 9*, 51 A.L.I. PROC. 344, 347 (1974) (suggesting change for clarity).

common-law rule and declaring that the insecure party had no right to demand assurances.[142]

What, then, ensued when this substantial change in the common law came up for discussion, this attempt to deal with a "troublesome" problem?[143] Nothing. Nothing at all. Professor Farnsworth stated his aversion to *Schenectady Steel*, noted the analogy to section 2-609, and summed up what he had done.[144] After asking for questions, and getting none, he quietly went on to the next section.[145] So much for storming the battlements.

Nor has the section stormed the heavens.[146] Adequate assurance made greater headway at common law after the ALI gave the idea its imprimatur. The first decisions embracing the notion came down while the Restatement (Second) was still in draft.[147] Since then, a number of courts, though not as yet most, have found the idea to their liking.[148] So far, only a single jurisdiction has expressly rejected the doctrine, and that one did

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142. 350 N.Y.S.2d 920, 922-23 (App. Div.), *aff'd mem.*, 316 N.E.2d 875 (N.Y. 1974). It should be noted, though, that the court came up with essentially the result that would have obtained under section 2-609, by finding breach of an implicit time-of-the-essence clause. *See id.* at 923.

143. Farnsworth, *Continuation*, *supra* note 137, at 231.

144. *See Discussion of Restatement of the Law, Second, Contracts, Tentative Draft No. 9*, 51 A.L.I. PROC. 344, 345-46 (1974).

145. *Id.* at 349.

146. After renumbering, it became section 251. RESTATEMENT (SECOND) OF CONTRACTS § 251 (1979).

147. *See, e.g.*, David Nassif Assocs. v. United States, 644 F.2d 4, 12 (Ct. Cl. 1981); L.E. Spitzer Co. v. Barron, 581 P.2d 213, 216-17 (Alaska 1978); Carfield & Sons, Inc. v. Cowling, 616 P.2d 1008, 1010 (Colo. Ct. App. 1980).

148. *See* Nashville Lodging Co. v. Resolution Trust Corp., 59 F.3d 236, 241-42 (D.C. Cir. 1995) (Tennessee law); C.L. Maddox, Inc. v. Coalfield Servs., Inc., 51 F.3d 76, 80-81 (7th Cir. 1995) (Posner, C.J.) (Illinois law); First Nat'l Bank v. Small Bus. Admin., 868 F.2d 340, 347 n.10 (9th Cir. 1989) (federal common law); Marvel Entertainment Group, Inc. v. ARP Films, Inc., 684 F. Supp. 818, 820-21 (S.D.N.Y. 1988); United Corp. v. Reed, Wible & Brown, Inc., 626 F. Supp. 1255, 1258 (D.V.I. 1986) (per curiam); G.W. Andersen Constr. Co. v. Mars Sales, 210 Cal. Rptr. 409, 415 (Ct. App. 1985); Conference Ctr. Ltd. v. TRC-The Research Corp., 455 A.2d 857, 864 (Conn. 1983); Weisfeld v. Peterseil Sch. Corp., 623 So. 2d 515, 519 n.3 (Fla. Dist. Ct. App. 1993); Inamco, Inc. v. Celsius Servs. Corp., 526 So. 2d 334, 336 (La. Ct. App. 1988); Drinkwater v. Patten Realty Corp., 563 A.2d 772, 776 (Me. 1989); Julian v. Montana State Univ., 747 P.2d 196, 199 (Mont. 1987); Lo Re v. Tel-Air Communications, Inc., 490 A.2d 344, 350 (N.J. Super. Ct. App. Div. 1985); Burke v. Athens, C.A. No. 2620-M, 1997 Ohio App. LEXIS 4285, at *9 (Ohio Ct. App. Sept. 27, 1997); Jonnet Dev. Corp. v. Dietrich Indus., Inc., 463 A.2d 1026, 1032 (Pa. Super. Ct. 1983); Harlan v. Hardaway, 796 S.W.2d 953, 958 (Tenn. Ct. App. 1990); Juarez v. Hamner, 674 S.W.2d 856, 861 (Tex. App. 1984); Bitzes v. Sunset Oaks, Inc., 649 P.2d 66, 70 (Utah 1982).

so before the final draft had issued (and, indeed, before any other Restatement (Second) case on adequate assurance had been decided).[149]

II. THE MODERN LAW OF ADEQUATE ASSURANCE

In theory, seeking adequate assurance under either U.C.C. section 2-609 or Restatement (Second) section 251 may not seem too difficult. In practice, though, as Robert Braucher observed, it "bristles with terms of uncertain scope."[150] It may thus be worthwhile to sum up the main trends in the law of adequate assurance.[151]

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149. *See* Mollohan v. Black Rock Contracting, Inc., 235 S.E.2d 813, 816 n.1 (W. Va. 1977); *see also* Sterling Power Partners, L.P. v. Niagara Mohawk Power Corp., 657 N.Y.S. 2d 407, 407 (App. Div. 1997) (following *Schenectady Steel*). A few federal courts sitting in diversity and state courts applying the law of another state have chosen not to adopt section 251, absent a home state court decision doing so, because they did not think it appropriate to change a state's common law. These courts did not, however, reject section 251 on the merits. *See* O'Shanter Resources, Inc. v. Niagara Mohawk Power Corp., 915 F. Supp. 560, 567 (W.D.N.Y. 1996); Innovest Group, Ltd. v. Columbus-Cuneo-Cabrini Med. Ctr., No. 91-2142-DES, 1993 U.S. Dist. LEXIS 10941, at **8-9 (D. Kan. July 2, 1993); Elliott Assocs. v. Bio-Response Corp., No. 10,624, 1989 Del. Ch. LEXIS 73 (Del. Ch. June 7, 1989) (New York law); *cf. Nashville Lodging*, 59 F.3d at 242 (diversity court adopting § 251 before state courts); *C.L. Maddox*, 51 F.3d at 81 (same). *But see* Norocon Power Partners, L.P. v. Niagara Mohawk Power Corp., 110 F.3d 6, 8-11 (2d Cir. 1997) (mem.) (certifying question to New York Court of Appeals on whether New York recognizes a common-law right to adequate assurance). And one federal court has declined to apply U.C.C. section 2-609 by analogy, even though Restatement (Second) of Contracts section 251 had long since emerged (though it may not have been raised). Tapat v. Sandwich Islands Constr., Ltd., Nos. 90-15193 & 90-15239, 1991 U.S. App. LEXIS 21122, at *2 (9th Cir. Aug. 14, 1991) (mem. op.).

150. Robert Braucher, *Sale of Goods in the Uniform Commercial Code*, 26 LA. L. REV. 192, 210 (1966); *see also, e.g.*, WILLIAM H. HENNING & GEORGE I. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE ¶ 6.02, at 6-9 (1992) ("Section 2-609 is hardly a panacea. Indeed, it raises almost as many issues as it resolves.").

151. The balance of this section will commingle the U.C.C. and Restatement versions of adequate assurance. To be sure, there are two technical distinctions. The U.C.C. requires that the demand for assurance be in writing, which the Restatement does not. Under the U.C.C., the response must be within a reasonable time, not exceeding thirty days; the Restatement places no outside limit. Though these could change the outcomes in rare cases, they are unlikely to. *See infra* note 155 and accompanying text (writing requirement under § 2-609). There is a larger difference as well, as Professor White has pointed out; section 251 applies only to threatened breaches sufficiently material to constitute total breach, while section 2-609 covers any insecurity with respect to performance. *See* White, *supra* note 10, at 841-42 n.4. Even here, though, virtually all breaches that would satisfy section 2-609 would also satisfy section 251. I have found no cases that would in this respect

First, the mechanics. One of the parties to a contract must find itself reasonably uncertain that the other will perform.[152] The cause of the insecurity need not be tied to the contract; an exogenous cause will suffice.[153] The insecure party must then demand assurances from the other party that it will perform.[154] Under the U.C.C., the demand must, at least according to the letter of the statute, be written;[155] at common law, though, it can

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be decided differently under one than under the other. Accordingly, I shall intermingle both sorts of adequate assurance cases unless the context requires otherwise; because section 2-609 cases are far more common than section 251 cases, I shall designate only the latter parenthetically.

152. *See* U.C.C. § 2-609(1) & cmt. 1 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(1) & cmt. c (1979). The contract must thus be executory; if one side has performed fully, then the other cannot be insecure as to that contract (though it could be insecure as to another contract with that party). *See, e.g.*, Gutor Int'l AG v. Raymond Packer Co., 493 F.2d 938, 943 (1st Cir. 1974); *Marvel Entertainment Group*, 684 F. Supp. at 821 (§ 251); CT Chems. (U.S.A.), Inc. v. Vinmar Impex, Inc., 613 N.E.2d 159, 163 (N.Y. 1993). Furthermore, the contract must as yet be unbreached; if the promisor is already in breach, the promisee need not invoke the apparatus of assurance, for to hold otherwise would afford a breaching party an opportunity to extract a waiver of damages in return for continued performance. *See, e.g.*, Chronister Oil Co. v. Unocal Ref. & Mktg., 34 F.3d 462, 464 (7th Cir. 1994) (Posner, C.J.); Hope's Architectural Prods., Inc. v. Lundy's Constr., Inc., 781 F. Supp. 711, 715-16 (D. Kan. 1991); Sumner v. Fel-Air, Inc., 680 P.2d 1109, 1115-16 (Alaska 1984).

153. *See* U.C.C. § 2-609 cmt. 3 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(1) & cmt. c (1979); *see also, e.g.*, Clem Perrin Marine Towing, Inc. v. Panama Canal Co., 730 F.2d 186, 189 (5th Cir. 1984); Waldorf Steel Fabricators, Inc. v. Consolidated Sys., Inc., No. 92 Civ. 7808 (SAS), 1996 U.S. Dist. LEXIS 12340, at **13-14 (S.D.N.Y. Aug. 20, 1996); Smyers v. Quartz Works Corp., 880 F. Supp. 1425, 1433 & n.7 (D. Kan. 1995). Some courts do miss this point, though. *See, e.g.*, Design for Bus. Interiors, Inc. v. Herson's, Inc., 659 F. Supp. 1103, 1112 (D.D.C. 1986) (explaining that insecurity is not reasonable as a matter of law because the promisor's nonpayment was under a separate contract).

154. *See* U.C.C. § 2-609(1) & cmt. 2 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(1) & cmt. d (1979).

155. *See* U.C.C. § 2-609(1) (1995). There has been some dispute here. Some courts read the statute—well, creatively, finding an oral demand sufficient. These cases typically display doubtful behavior over a substantial period, with a good many requests for adjustment; consequently, the final, oral demand would hardly be a surprise. *See, e.g.*, AMF, Inc. v. McDonald's Corp., 536 F.2d 1167, 1170-71 (7th Cir. 1976); Kunian v. Development Corp. of Am., 334 A.2d 427, 433 (Conn. 1973); Toppert v. Bunge Corp., 377 N.E.2d 324, 328 (Ill. App. Ct. 1978); *cf.* Diskmakers, Inc. v. DeWitt Equip. Corp., 555 F.2d 1177, 1180 (3d Cir. 1977) (dictum; actual notice plus promise to correct deficiency may excuse writing requirement); Scott v. Crown, 765 P.2d 1043, 1046 (Colo. Ct. App. 1988) (makes distinction; requires writing); S & S, Inc. v. Meyer, 478 N.W.2d 857, 863 (Iowa Ct. App. 1991) (dictum; sufficiently egregious behavior may excuse writing requirement). Most adhere more strictly to the language. *See, e.g., Chronister Oil*, 34 F.3d at 464; Automated Energy Sys., Inc. v. Fibers & Fabrics, 298 S.E.2d 328, 330 (Ga. Ct. App. 1982); Bodine Sewer, Inc. v.

be oral.[156] In any event, the demand must be clear; just as under anticipatory repudiation, an ambiguous or vague demand for assurances will likely prove ineffective.[157] Should the promisee's demand be reasonable, the promisee may suspend its own performance or preparation for performance while it awaits the promisor's answer, as long as the suspension is commercially reasonable.[158] The promisee need not wait long—a reasonable time is all that is required, and reason is capped at thirty days under the U.C.C.[159] Should the promisor fail to respond, or should it respond with inadequate assurances, then the promisee may treat the contract as repudiated and act accordingly, perhaps with an immediate action for breach.[160]

Eastern Ill. Precast, Inc., 493 N.E.2d 705, 712 (Ill. App. Ct. 1986); Teeman v. Jurek, 251 N.W.2d 698, 701 (Minn. 1977); USX Corp. v. Union Pac. Resources Co., 753 S.W.2d 845, 852 (Tex. App. 1988).

156. *See* RESTATEMENT (SECOND) OF CONTRACTS § 251(1) & cmt. d (1979); *see also, e.g.*, United Corp. v. Reed, Wible & Brown, Inc., 626 F. Supp. 1255, 1258 (D.V.I. 1986) (per curiam) (§ 251).

157. *See, e.g.*, MG Ref. & Mktg., Inc. v. Knight Enters., Inc., 28 U.C.C. Rep. Serv. 2d (CBC) 1239, 1240-41 (S.D.N.Y. 1996); *In re* Beeche Sys. Corp., 164 B.R. 12, 17 (N.D.N.Y. 1994); *Scott*, 765 P.2d at 1046-47; SPS Indus., Inc. v. Atlantic Steel Co., 366 S.E.2d 410, 414 (Ga. Ct. App. 1988); Nasco, Inc. v. Dahltron Corp., 392 N.E.2d 1110, 1116 (Ill. App. Ct. 1979); Alaska Pac. Trading Co. v. Eagon Forest Prods., Inc., 933 P.2d 417, 421-22 (Wash. Ct. App. 1997). Some courts, however, have proved willing to construe demands liberally, just as with the writing requirement. *See, e.g.*, Smyers v. Quartz Works Corp., 880 F. Supp. 1425, 1433 (D. Kan. 1995); Ward Transformer Co. v. Distrigas of Mass. Corp., 18 U.C.C. Rep. Sev. 2d (CBC) 29, 37 n.7 (E.D.N.C. 1992).

158. *See* U.C.C. § 2-609(1) & cmt. 2 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(1) (1979); *see also, e.g.*, Hyosung Am., Inc. v. Sumagh Textile Co., No. 94 Civ. 0568 (SAS), 1996 U.S. Dist. LEXIS 12829, at *27 (S.D.N.Y. Aug. 30, 1996). The insecure party may not, however, suspend its performance until it has made its demand for assurances. *See, e.g.*, Cosden Oil & Chem. Co. v. Karl O. Helm Aktiengesellschaft, 736 F.2d 1064, 1074 (5th Cir. 1984); *USX Corp.*, 753 S.W.2d at 852.

159. *See* U.C.C. § 2-609(4) & cmt. 5 (1995) (reasonable time, capped at 30 days); RESTATEMENT (SECOND) OF CONTRACTS § 251(2) & cmt. e (1979) (reasonable time); *see also, e.g.*, Hitachi Zosen Clearing, Inc. v. Liberty Mut. Ins. Co., No. 92 C 5363, 1996 U.S. Dist. LEXIS 9562, at *20 (N.D. Ill. July 2, 1996) (30 days a maximum; reasonable time could be shorter).

160. *See* U.C.C. § 2-609(4) & cmt. 5 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(2) (1979); *see also, e.g.*, Central Oil Co. v. M/V Lamma-Forest, 821 F.2d 48, 51 (1st Cir. 1987); Penberthy Electromelt Int'l Inc. v. United States Gypsum Co., 686 P.2d 1138, 1141 (Wash. Ct. App. 1984). The promisor's failure to provide assurances also gives the promisee a defense, should the promisee decline to perform and the promisor sue for breach. *See, e.g.*, Turntables, Inc. v. Gestetner, 382 N.Y.S.2d 798, 799 (App. Div. 1976).

A good many ill-defined terms and uneasy prospects nestle in this apparently simple procedure. The first problem is the requirement of a need for assurance. When is the promisee's uncertainty sufficiently reasonable to warrant a demand? And, by extension, what if the promisee's demand lacks warrant? This problem is innately fact-driven, and thus passes to the fact-finder.[161] The Official Comments do, however, give some guidance. For example, a buyer that falls behind in its other accounts, or a seller whose shipments to others have of late been defective, can render the other party reasonably insecure, as the basis for the insecurity need not arise from the contract at issue.[162] So too might a sudden increase in credit use or a sudden end to taking advantage of a discount for early payment.[163] And a delegation of duties foments insecurity.[164] In any event, the finder of fact is to apply commercial standards of reasonableness to the case at hand.[165]

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161. As, indeed, do all the questions of reasonableness and adequacy. *See, e.g.*, Kaiser-Francis Oil Co. v. Producer's Gas Co., 870 F.2d 563, 568 (10th Cir. 1989); Colorado Interstate Gas Co. v. Chemco, Inc., 854 P.2d 1232, 1239 (Colo. 1993); Universal Builders Corp. v. United Methodist Convalescent Homes, 508 A.2d 819, 822 (Conn. App. Ct. 1986); S & S, Inc. v. Meyer, 478 N.W.2d 857, 863 (Iowa Ct. App. 1991); Drinkwater v. Patten Realty Corp., 563 A.2d 772, 776 (Me. 1989) (§ 251). *But see, e.g.*, BAII Banking Corp. v. UPG, Inc., 985 F.2d 685, 702-03 (2d Cir. 1993) (stating that while the question of reasonableness is usually a question of fact, it may at times be resolved as a matter of law). However, a high standard of proof is required of promisees seeking to establish insecurity as a matter of law. *See, e.g.*, *In re* Lone Star Indus., Inc., 776 F. Supp. 206, 228 (D. Md. 1991); Phibro Energy, Inc. v. Empresa de Polimeros de Sines Sarl, 720 F. Supp. 312, 322 (S.D.N.Y. 1989).

162. *See* U.C.C. § 2-609 cmt. 3 (1995); *see also, e.g.*, Clem Perrin Marine Towing, Inc. v. Panama Canal Co., 730 F.2d 186, 191 (5th Cir. 1984) (failure to pay others); Creusot-Loire Int'l, Inc. v. Coppus Eng'g Corp., 585 F. Supp. 45, 49-50 (S.D.N.Y. 1983) (defective parts to other customers); Toppert v. Bunge Corp., 377 N.E.2d 324, 328 (Ill. App. Ct. 1978) (failure to pay under prior contracts).

163. *See* U.C.C. § 2-609 cmt. 3 (1995); *see also, e.g.*, Erwin Weller Co. v. Talon Inc., 295 N.W.2d 172, 174 (S.D. 1980).

164. *See* U.C.C. § 2-210(5) & cmt. 6 (1995); *see also, e.g.*, Aslakson v. Home Sav. Ass'n, 416 N.W.2d 786, 790 (Minn. Ct. App. 1987); Consolidated Edison Co. v. Charles F. Guyon, Inc., 471 N.Y.S.2d 269, 270 (App. Div. 1984). *But see* Field v. Golden Triangle Broad., Inc., 305 A.2d 689, 696-97 (Pa. 1973) (holding that when a future assignment is known to the parties at the time of contracting, the fact of assignment is not a basis for insecurity).

165. *See* U.C.C. § 2-609(2) & cmt. 3 (1995); *see also, e.g.*, ARB, Inc. v. E-Sys., Inc., 663 F.2d 189, 196 & n.10 (D.C. Cir. 1980); Diskmakers, Inc. v. DeWitt Equip. Corp., 555 F.2d 1177, 1179 (3d Cir. 1977); Hope's Architectural Prods., Inc. v. Lundy's Constr., Inc., 781 F. Supp. 711, 715 (D. Kan. 1991); Dumesnil, Inc. v. Republic Nat'l Mortgage Co., No. L-83-218 (Ohio Ct. App. Dec. 30, 1983) (§ 251). But perhaps not for non-commercial disputes. Though demands for assurance very

Beyond the examples in the comments, the cases yield a plethora of reasonable grounds, some contrasting greatly with the common law of anticipatory repudiation. For instance, a threat not to perform, though not itself a breach, can produce insecurity.[166] So too could suspected insolvency, even if the suspicion ultimately proves false.[167] A partial want of performance, even if not sufficient to constitute total breach, could reasonably engender insecurity.[168] Other examples are legion.[169] The level of proof is very far from that required for anticipatory repudiation; as one court put it, "[t]he standard is one of reasonable insecurity, not absolute certainty."[170]

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seldom arise when the parties are not merchants, one assumes that something less than commercial standards might apply. *See, e.g.*, 3 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-609:02, at 207-08 (1996).

166. *See, e.g.*, Copylease Corp. of Am. v. Memorex Corp., 403 F. Supp. 625, 631 (S.D.N.Y. 1975). This is especially easy when a threat not to perform is coupled with a demand for modification. *See, e.g.*, Kaiser-Francis Oil Co. v. Producer's Gas Co., 870 F.2d 563, 568-69 (10th Cir. 1989).

167. Of course, actual insolvency warrants a demand for assurances, as, indeed, it would an action for breach. *See* RESTATEMENT (SECOND) OF CONTRACTS § 252 (1979); *see also, e.g., In re* JW Aluminum Co., 200 B.R. 64, 65-67 (Bankr. M.D. Fla. 1996).

168. *See, e.g.*, T & S Brass & Bronze Works, Inc. v. Pic-Air, Inc., 790 F.2d 1098, 1105 (4th Cir. 1986); AMF, Inc. v. McDonald's Corp., 536 F.2d 1167, 1170 (7th Cir. 1976); Green Constr. Co. v. First Indem. of Am. Ins. Co., 735 F. Supp. 1254, 1263 (D.N.J. 1990); Carfield & Sons, Inc. v. Cowling, 616 P.2d 1008, 1010 (Colo. Ct. App. 1980) (§ 251); Kunian v. Development Corp. of Am., 334 A.2d 427, 433 (Conn. 1973). *But see* Northwest Lumber Sales, Inc. v. Continental Forest Prods., Inc., 495 P.2d 744, 750 (Or. 1972) (explaining that a late payment is not necessarily a reasonable ground for insecurity when due to a desire to cover possible losses for order replacement and when promisor is known to be financially sound).

169. *See, e.g.*, Jewish Employment & Vocational Serv., Inc. v. Pleasantville Educ. Supply Corp., 220 U.S.P.Q. (BNA) 613, 620 (E.D. Pa. 1982) (hostility after termination clause) (§ 251); Mitchell-Huntley Cotton Co. v. Waldrep, 377 F. Supp. 1215, 1221 (N.D. Ala. 1974) (dictum; misrepresentations made in inducement); L.E. Spitzer Co. v. Barron, 581 P.2d 213, 217 (Alaska 1978) (§ 251; alteration in written contract of terms of oral contract); Ford Motor Credit Co. v. Alachua Trading Co., 531 So. 2d 982, 984 (Fla. Dist. Ct. App. 1988) (property potentially subject to forfeiture due to illegal drug transaction); Smith-Scharff Paper Co. v. P.N. Hirsch & Co. Stores, 754 S.W.2d 928, 931 (Mo. Ct. App. 1988) (buyer of specially imprinted bags going out of business); Dumesnil, Inc., v. Republic Nat'l Mortgage Co., No. L-83-218 (Ohio Ct. App. Dec. 30, 1983) (§ 251; purported agent of lender convicted of loan fraud); Juarez v. Hamner, 674 S.W.2d 856, 861 (Tex. App. 1984) (§ 251; refusal of title holder to convey her half-interest).

170. Clem Perrin Marine Towing, Inc. v. Panama Canal Co., 730 F.2d 186, 191 (5th Cir. 1984). The U.C.C. has, at least in principle, loosened somewhat the standard for anticipatory repudiation. *See* U.C.C. § 2-610 cmt. 2 (1995) ("It is not necessary for repudiation that performance be made literally and utterly impossible."). But U.C.C. courts have tended toward traditional repudiation

But what if the promisee could not reasonably have thought itself insecure when it made its demand? This does happen from time to time, though the cases are relatively infrequent.[171] One instance comes if the insecurity is rooted in events preceding the contract's formation; only events (or the failure of expected events to occur) after the contract was formed may constitute a basis for this mechanism.[172] Nor, of course, can the insecurity have arisen because of the promisee's acts.[173] The usual result when the promisee lacks a reasonable basis for insecurity is to find the demand unwarranted, and thus to excuse any non-compliance by the promisor.[174] This in itself has no real consequences; if the promisee relents, then neither party would be in breach.[175] If, however, the promisee acts on its perceived insecurity, the consequences may be dire.[176]

The second problem is the nature of the assurance sought. What may the promisee demand? Section 2-609 provides that the assurances demanded must accord with commercial standards, which gives little guidance.[177] Again, the rather lengthy

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doctrine, Llewellyn's hint notwithstanding. *See, e.g.*, 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 6-2, at 291-92 (4th ed. 1995).

171. *See, e.g.*, Universal Resources Corp. v. Panhandle E. Pipe Line Co., 813 F.2d 77, 79-80 (5th Cir. 1987); Design for Bus. Interiors, Inc. v. Herson's, Inc., 659 F. Supp. 1103, 1112 (D.D.C. 1986); SPS Indus., Inc. v. Atlantic Steel Co., 366 S.E.2d 410, 413 (Ga. Ct. App. 1988); Ellis Mfg. Co. v. Brant, 480 S.W.2d 301, 303-04 (Tex. Civ. App. 1972; *cf.* Palmco Corp. v. American Airlines, Inc., 983 F.2d 681, 686 (5th Cir. 1993) (holding that notice of offset under U.C.C. § 2-717 is not a reasonable ground for insecurity). Possibly they are rare because promisees do not use this procedure routinely. If this is, as has been suggested, a lawyer's provision rather than a merchant's provision, then the underlying problem would have to be severe enough that the merchant has thought counsel desirable—and merchants seldom run to lawyers as a first resort.

172. *See* RESTATEMENT (SECOND) OF CONTRACTS § 251 cmt. c (1981); *see also, e.g., Universal Resources*, 813 F.2d at 79; Nasco, Inc. v. Dahltron Corp., 392 N.E.2d 1110, 1116 (Ill. App. Ct. 1979); Inamco, Inc. v. Celsius Servs. Corp., 526 So. 2d 334, 336 (La. Ct. App. 1988); Jonnet Dev. Corp. v. Dietrich Indus., Inc., 463 A.2d 1026, 1032-33 (Pa. Super. Ct. 1983) (§ 251).

173. *See, e.g.*, BAII Banking Corp. v. UPG, Inc., 985 F.2d 685, 703 (2d Cir. 1993).

174. *See, e.g.*, National Farmers Org. v. Coast Trading Co., 488 F. Supp. 944, 951 (D. Or. 1977); Cole v. Melvin, 441 F. Supp. 193, 203 (D.S.D. 1977).

175. Because the demand for assurance lacks the certainty and firmness required of an anticipatory repudiation.

176. *See infra* note 188 and accompanying text.

177. *See* U.C.C. § 2-609(2) & cmt. 4 (1995). Courts have from time to time observed that the party seeking assurances may not ask for more than that to which it was entitled. *See, e.g.*, Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572, 581 (7th Cir. 1976). This cannot be correct; if the contract

comments help. A "mere promise" might well suffice; if it came from "a known corner-cutter," though, a reasonable demand might extend to a guaranty.[178] In practice, most demands prove reasonable.[179] There are isolated instances of unreasonable demands, though, and promisees should bear in mind that they ought not ask for more than will make them as secure as the original bargain contemplated.[180] And the demand, if under the U.C.C., must be in writing.[181]

What of the promisor, faced with a demand for adequate assurances? The promisor may, of course, accede. It may also decline to reassure the promisee, and take its chances on the promisor's response. It might, however, try a third possibility—offer assurances, but not the ones sought by the promisee. This occasionally happens, though seldom successfully; the courts generally find the promisor's variant assurances inadequate, and hence treat them as though they were never made.[182] In the face of an excessive demand, the promisor might plausibly respond with reasonable, though lesser, assurances, a set of facts for which casebook authors wait eagerly.[183]

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already calls for some action which the promisor has not performed, then the promisor is in at least partial breach, and so a demand for assurances would not be necessary. Of necessity, then, the demand for assurances asks for something that the promisor would not otherwise be obliged to provide. *See also, e.g.*, 1 WHITE & SUMMERS, *supra* note 170, § 6-2.

178. U.C.C. § 2-609 cmt. 4 (1995); *see also, e.g.*, Louisiana Power & Light Co. v. Alleghany Ludlum Indus., Inc., 517 F. Supp. 1319, 1322-23 (E.D. La. 1981) (written assurance that promisor would perform reasonable).

179. *See, e.g.*, International Therapeutics, Inc. v. McGraw-Edison Co., 721 F.2d 488, 492 (5th Cir. 1983) (request for financial records reasonable); Creusot-Loire Int'l, Inc. v. Coppus Eng'g Corp., 585 F. Supp. 45, 50 (S.D.N.Y. 1983) (request for extension of contractual guarantee and letter of credit reasonable).

180. As, for example, in *United States v. Great Plains Gasification Associates*, 819 F.2d 831 (8th Cir. 1987), in which the party demanding assurance apparently did so in order to escape its obligations under a burdensome contract. *See also, e.g.*, *Pittsburgh-Des Moines*, 532 F.2d at 583-84 (Cummings, J., concurring). Indeed, an excessive demand, if insisted upon, may make the demanding party a repudiator. *See, e.g.*, Hope's Architectural Prods., Inc. v. Lundy's Constr., Inc., 781 F. Supp.711, 716 (D. Kan. 1991).

181. *See supra* note 155 and accompanying text.

182. *See, e.g., Creusot-Loire*, 585 F. Supp. at 50 (mere promise that goods would work insufficient); *Louisiana Power & Light*, 517 F. Supp. at 1323 (promise to perform for additional compensation insufficient).

183. Though treatise authors have opined freely (and, be it said, sensibly) without the benefit of judicial utterances. *See, e.g.*, 3 HAWKLAND, *supra* note 165, § 2-609:03.

While the promisee awaits the promisor's response, it has probably chosen to suspend its own performance, as is its right.[184] The promisee need wait for only a reasonable time (under the U.C.C., not more than thirty days).[185] Then, if the promisor has not provided adequate assurances, the promisee may treat the contract as though the promisor repudiated it.[186] Like other repudiations, the promisor may retract it, provided its retraction occurs before the promisee has materially changed its position, cancelled the contract, or otherwise made clear that it considers the repudiation final.[187]

Herein lies peril. The promisee may have erred. It may have lacked reasonable grounds for insecurity; it may have made an improper demand; it may have asked for more than it was entitled to. The promisor's recalcitrance would thus not be unwarranted. If the promisee then declared the contract in breach and halted its own performance, would it be in breach? So the courts hold.[188] This is quite close to the old anticipatory

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184. If the suspension would be commercially reasonable. *See, e.g.*, Ward Transformer Co. v. Distrigas of Mass. Corp., 18 U.C.C. Rep. Serv. 2d (CBC) 29, 40-42 (E.D.N.C. 1992); Julian v. Montana State Univ., 747 P.2d 196, 200 (Mont. 1987) (§ 251).

185. *See supra* note 159 and accompanying text; *cf.* U.C.C. § 1-204(2) (1995) (defining reasonable time contextually).

186. *See* U.C.C. § 2-609(4) (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251(2) (1979). If the promisee does receive its requested assurances, then it must resume its suspended performance or itself be in breach. *See, e.g.*, American Bronze Corp. v. Streamway Prods., 456 N.E.2d 1295, 1303-04 (Ohio Ct. App. 1982). And accepting one set of assurances does not waive a future claim of insecurity based on new grounds. *See, e.g.*, ARB, Inc. v. E-Sys., Inc., 663 F.2d 189, 196 (D.C. Cir. 1980).

187. *See* U.C.C. § 2-611 (1995); Record Club of Am. v. United Artists Records, Inc., 643 F. Supp. 925, 939-40 (S.D.N.Y. 1986), *vacated and remanded on other grounds*, 890 F.2d 1264 (2d Cir. 1989); Wahnschaff Corp. v. O.E. Clark Paper Box Co., 304 S.E.2d 91, 93 (Ga. Ct. App. 1983). But the retraction must be clear, and must contain any justifiable assurances sought. *See, e.g.*, Uarco Inc. v. Zig-Zag Fanfolding Corp., No. 80 C 526, 1981 U.S. Dist. LEXIS 13587 (N.D. Ill. June 22, 1981).

188. *See, e.g.*, Continental Grain Co. v. McFarland, 29 U.C.C. Rep. Serv. (CBC) 512, 513 (4th Cir. 1980); National Farmers Org. v. Coast Trading Co., 488 F. Supp. 944, 950-51 (D. Or. 1977); John J. Kirlin, Inc. v. Gaco Sys., Inc., 565 A.2d 114, 117-18 (Md. Ct. Spec. App. 1989). An unjustified demand for assurances with no accompanying suspension generally is not itself an anticipatory repudiation, any more than a request for modification was, and is, at common law. *See* U.C.C. § 2-610 cmt. 2 (1995); Unique Sys., Inc. v. Zotos Int'l, Inc., 622 F.2d 373, 377 (8th Cir. 1980); Neal-Cooper Grain Co. v. Texas Gulf Sulphur Co., 508 F.2d 283, 290 (7th Cir. 1974); *In re* Chateaugay Corp., 104 B.R. 637, 644-45 (S.D.N.Y. 1989). However, an unjustified demand could constitute a breach where the parties have contracted around section 2-609. *See, e.g.*, United States v. Great Plains Gasification Assocs.,

repudiation problem that arose when a promisee declared a contract in breach because of insecurity short of repudiation.[189] Hence the comment that "section 2-609 sometimes does little more than extend the minuet between the weaseling party and the contractual counterpart and add a couple of new moves."[190]

Finally, whether adequate assurance is a minuet or a breakdance, one may choose to be a wallflower. One may contract around adequate assurance, like most other concepts in contracts or provisions of the U.C.C.[191] One method is to provide distinct procedures for default. Thus, for instance, the parties could provide that the failure by one of them to comply with the terms of the contract would yield termination, if the non-compliance was not cured within thirty days of notice.[192] Another method is to insert an acceleration clause into the agreement, which makes one party's performance due should some insecurity or default arise.[193] In any event, an insecure party need not invoke section 2-609 or a common-law equivalent.[194]

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819 F.2d 831, 834-35 (8th Cir. 1987). It might also constitute breach when the demand for assurances is coupled with a statement that the promisee will refuse performance except on the new terms. *See, e.g.*, Design for Bus. Interiors, Inc. v. Herson's, Inc., 659 F. Supp. 1103, 1111 (D.D.C. 1986).

189. *See supra* notes 45-46, 134-36 and accompanying text.

190. 1 WHITE & SUMMERS, *supra* note 170, § 6.2.

191. *See* U.C.C. §§ 1-102(3), 2-609 cmt. 6 (1995); *see also, e.g., In re* Beverage Enters., Inc., Bankr. No. 97-13534 DAS, 1997 Bankr. LEXIS 431, at *5 n.1 (Bankr. E.D. Pa. Apr. 7, 1997). This preserves the default clauses that had become increasingly common before the U.C.C. *See supra* notes 61-67 and accompanying text.

192. *See* Canteen Corp. v. Former Foods, Inc., 606 N.E.2d 174, 183-84 (Ill. App. Ct. 1992); *see also, e.g.*, Bausch & Lomb Inc. v. Bressler, 977 F.2d 720, 727-28 (2d Cir. 1992); *Great Plains*, 819 F.2d at 835; Kupka v. Morey, 541 P.2d 740, 746-47 (Alaska 1975).

193. *See* U.C.C. § 1-208 (1995); *see also, e.g.*, Chrysler Credit Corp. v. Barnes, 191 S.E.2d 121, 123 (Ga. Ct. App. 1972); H.C. Clark Implement Co. v. Wiedmer, 389 N.W.2d 816, 816-817 & n.* (S.D. 1986).

194. *See, e.g.*, Copylease Corp. of Am. v. Memorex Corp., 403 F. Supp. 625, 631 (S.D.N.Y. 1975); Indussa Corp. v. Reliable Stainless Steel Supply Co., 369 F. Supp. 976, 979 (E.D. Pa. 1974); T. Ferguson Constr., Inc. v. Sealaska Corp., 820 P.2d 1058, 1061-62 & n. 10 (Alaska 1991) (citing Restatement (Second) of Contracts § 251 cmt. b (1979)); Cherwell-Ralli, Inc. v. Rytman Grain Co., 433 A.2d 984, 986-87 (Conn. 1980). *But see* Northwest Lumber Sales, Inc. v. Continental Forest Prods., Inc., 495 P.2d 744, 749-50 (Or. 1972) (enforcing contractual term, instead of seeking assurances, arbitrary and unjustifiable); Wrightstone, Inc. v. Motter, 1 U.C.C. Rep. Serv. (CBC) 170 (Pa. C.P. Cumberland Co. Apr. 12, 1961) (holding that failure of plaintiff to seek assurances, and instead repossessing, gives defendant a defense; plaintiff obliged to seek assurances before repossessing); *cf.* National Farmers Org. v. Bartlett & Co., Grain, 560 F.2d 1350, 1358 (8th Cir. 1977) (drawing a negative

III. THE VIRTUES OF ADEQUATE ASSURANCE

The virtues claimed for adequate assurance are many: it promotes reliance, it cements relations between contracting parties, it furthers good faith, it reduces moral hazard, and it efficiently deals with contractual risk. Each will be discussed below. Before that, though, we should consider the extent to which these might be relevant, should they be valid.

These virtues fall generally into two categories. All but the last deal primarily with conduct before insecurity—with contract formation or with extra-contractual relations. The last deals primarily with conduct after insecurity—whether the promisee would do better to demand assurances and run the risk of forcing breach when the contract would ultimately be performed, or to go ahead and hope for the best, relying on the contract all the while. These are not hermetically sealed compartments, as will be discussed later.[195] Still, this dichotomy, though false to a degree, seems largely true. And if it is true, then we must ask whether adequate assurance would have any effect on how contracting parties behave before one imports uncertainty into the relation. If, after all, adequate assurance is purely a lawyer's game, then the reasons that follow from its effects on contracting parties should be discounted heavily.

This analysis may seem irregular; we naturally assume that those subject to the law will act in accordance with it.[196] But, as relational contractarians have pointed out, businesspeople frequently—even generally—ignore the law of contract, or even do not realize how it might regulate various aspects of their agreements. For instance, Stewart Macaulay's germinal study of Wisconsin manufacturers showed their substantial disregard of

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inference from failure to invoke § 2-609); Harlow & Jones, Inc. v. Advance Steel Co., 424 F. Supp. 770, 777-78 (E.D. Mich. 1976) (same); Drake v. Wickwire, 795 P.2d 195, 198 (Alaska 1990) (holding that failure to recommend seeking adequate assurance rather than anticipatory repudiation is malpractice).

The decision in *Wrightstone* has been termed "a flight of fancy unauthorized by anything in the Code." 1 WHITE & SUMMERS, *supra* note 170, § 6.2 n. 27. On the other hand, Professors Burton and Andersen have defended *Wrightstone* as an attempt to require good faith in contract enforcement, a concept allied to mitigation. STEVEN J. BURTON & ERIC G. ANDERSEN, CONTRACTUAL GOOD FAITH § 7.2.3.4 (1995); *see infra* Part III.A.3 (discussing good faith).

195. *See infra* Part III.A.1-4.

196. Hence, for example, the maxim that ignorance of the law is no excuse. Or, if you want to impress friends and family, *ignorantia legis neminem excusat.*

such mainstays of contract as the battle of the forms[197] and the law of requirement contracts.[198] Likewise, Russell Weintraub recently surveyed a range of businesses, finding, among other things, that they favor price adjustment after frustration[199] and that they do not favor expectation damages for the breach of unique bargains.[200]

So one might expect those who make contracts not to realize that they might have a right to adequate assurance; after all, they often seem to disregard doctrine more central to business function. And there is good reason to suspect ignorance. Even relatively well-read businesspeople probably would not have met adequate assurance. It seldom appears in the trade press, and then it is often discussed as a novelty.[201] Nor would a conscientious student of business law be likely to retain any knowledge of it. First, a good many undergraduate business law texts do not even mention adequate assurance.[202] Of those that do, many

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197. *See* U.C.C. § 2-207 (1995). For another expression of amazement at the battle of the forms, see Letter from Grant Gilmore to Robert S. Summers (Sept. 10, 1980), *in* RICHARD E. SPEIDEL ET AL., SALES AND SECURED TRANSACTIONS: TEACHING MATERIALS 513, 515 (5th ed. 1993) (noting that corporate counsel "appalled" by § 2-207).

198. *See* U.C.C. § 2-306 (1995); Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

199. Rather than the current practice, which is rescission and restitution. *See, e.g.*, 2 FARNSWORTH, *supra* note 35, § 9.9.

200. *See* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 36, 41. Other empirical studies of contracting practice, generally showing differences between contract law and contract-in-action, include Stewart Macaulay, *Private Legislation and the Duty to Read—Business Run by IBM Machine, the Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966); Franklin M. Schultz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. CHI. L. REV. 237 (1952); James J. White, *Contract Law in Modern Commercial Transactions, An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1 (1982).

201. *See, e.g.*, John E. Murray, Jr., *Feeling Insecure?*, PURCHASING, June 6, 1996, at 29; Rene Sacasas, *A Manager's Guide to Quieting the Fears of Commercial Uncertainty*, BUS. FORUM, Winter/Spring 1996, at 32. These are the only articles I found in general business periodicals after a number of searches of various computer databases.

202. *See, e.g.*, ROBERT N. CORLEY ET AL., PRINCIPLES OF BUSINESS LAW (13th ed. 1986); TOWNES LORING DAWSON & EARL WINFIELD MOUNCE, BUSINESS LAW: TEXT AND CASES (4th ed. 1979); MICHAEL B. METZGER ET AL., BUSINESS LAW AND THE REGULATORY ENVIRONMENT: CONCEPTS AND CASES (6th ed. 1986); ROGER LEROY MILLER & GAYLORD A. JENTZ, BUSINESS LAW TODAY (2d ed. 1991). A standard manual for purchasing managers also omits adequate assurance. ALJIAN'S PURCHASING HANDBOOK 4-23 (Paul V. Farrell ed., 4th ed. 1982) (discussing anticipatory repudiation without adequate assurance).

either brush it off with one or two sentences[203] or get it fundamentally wrong.[204] To be sure, some do give it the dignity of a whole paragraph, or even two, and some of those give a fairly sound treatment of the right.[205] But none gives it featured billing, and even two paragraphs in a text of one thousand pages can easily evade one's memory.[206] Thus, as a number of commentators have observed, adequate assurance is mainly a lawyer's provision, of which contracting parties become aware only after they have gone to their lawyers, and thus only after the contract has been made and the risk has loomed.[207]

This is not to say that legal rules unfamiliar to businesses are irrelevant. Naturally, they guide dispute resolution after

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203. *See, e.g.*, JORDAN L. PAUST ET AL., BUSINESS LAW 160 (4th ed. 1984) (one sentence); LEN YOUNG SMITH ET AL., BUSINESS LAW AND THE REGULATION OF BUSINESS 420 (4th ed. 1993) (one sentence).

204. *See, e.g.*, PAUST, *supra* note 203 (noting that adequate assurance available after retraction of repudiation; main thrust of adequate assurance unmentioned); J. DAVID REITZEL ET AL., CONTEMPORARY BUSINESS LAW: PRINCIPLES AND CASES 392-93 (4th ed. 1990) (same; mentioned only under sales of goods).

205. *See, e.g.*, A. JAMES BARNES ET AL., LAW FOR BUSINESS 312-13 (4th ed. 1991) (two paragraphs); DANIEL V. DAVIDSON ET AL., BUSINESS LAW: PRINCIPLES AND CASES 216-17 (1984) (one paragraph and one case illustration); RICHARD A. MANN & BARRY S. ROBERTS, SMITH & ROBERSON'S BUSINESS LAW 510 (9th ed. 1994) (one paragraph). Interestingly, one book for businesspeople that does discuss the concept at relative length suggests it be used cautiously, indicates that the promisee should not suspend its own performance for fear of ultimate breach if wrong, and states that U.C.C. § 2-609 may precipitate disputes because of its ambiguous and uncertain language. *See* E.C. LASHBROOKE, JR. & MICHAEL I. SWYGERT, THE LEGAL HANDBOOK OF BUSINESS TRANSACTIONS 188, 246-47 (1987).

206. And one might ask just how much of any undergraduate course lingers after the final examination.

207. *See, e.g.*, Wallach, *supra* note 10; Ralph D. Smith, Comment, *Commercial Law—Uniform Commercial Code Section 2-609: Right to Adequate Assurance of Performance*, 7 NAT. RESOURCES J. 397, 403-04 (1967). Professor White goes one step further, stating that it is a judge's provision; judges use § 2-609 and § 251 to reach equitable results. *See* White, *supra* note 10, at 844.

To be sure, a business that has faced adequate assurance might be expected to remember it, invoking it more readily afterward (or expecting it to be invoked, if on the other end). Even here, though, one must remember (1) that a good many businesses will never face adequate assurance law, though they may well face situations in which it could be employed; (2) of those that do, many will not think it worth using later, whether because they faced unfortunate results when it was used or because of the costs of using it; (3) depending on the size of the earlier transaction and the business, even an earlier use may not come to the attention of those who might otherwise use it later; and (4) the lawyer who introduces adequate assurance may not explain it fully to the client, so the client may not realize that it can be used elsewhere. Put together, these suggest that even those businesses that use adequate assurance may give it little heed for business planning. *See also infra* Part III.A.2. (discussing the effects of relational contract on contracting norms).

problems arise, particularly once the parties have been unable to resolve their disputes informally and thus have gone to their lawyers. Furthermore, though an unfamiliar rule may seldom guide a businessperson about to enter into a transaction,[208] the general legal treatment of business may have some effect. If, for instance, a potential promisor has the impression that the law cares nothing for good faith, it may be tempted to act in less than good faith where its increasingly malodorous reputation will not hurt it unduly.[209] Relational contracts will be impaired by the bad repute of a potential party, but the constraints of relation may not apply when the relation is externally imperiled—say, by the threatened bankruptcy of a promisor; then the promisor will be awfully tempted to risk sundering the relationship itself (which, after all, is already in danger) for the possibility of saving it.[210]

More generally, the gestalt of a legal system may affect the various relations that touch on it. If, for example, breaches of contract were punishable by hanging, then relational dealings would probably arise to avoid invoking this penalty, perhaps by abandoning contract in favor of some less formal relation.[211] A little closer to reality, a legal world that systematically undervalues good faith and contract compliance, perhaps by undercompensating those breached against, will probably see less of each than it would were they valued more fully. Then, too, the way in which the law allocates rights can matter to bargaining and to distribution. The former, because, in a sort of corollary to

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208. Save when the business is represented by counsel, of course.

209. Bearing in mind that reputation is often a more potent constraint than law in controlling bad behavior. *See, e.g.*, David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373, 392-93 (1990); E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 604-05 (1969); Jeffrey L. Harrison, *Egoism, Altruism, and Market Illusions: The Limits of Law and Economics*, 33 UCLA L. REV. 1309, 1313 (1986); Karl N. Llewellyn, *What Price Contract? An Essay in Perspective*, 40 YALE L.J. 704, 720 (1931).

210. And a contractor in a world of relation and trust may seek to take advantage of that trust without reciprocating, thus making legal sanctions all the more important. *See, e.g.*, Albert O. Hirschman, *Against Parsimony: Three Easy Ways of Complicating Some Categories of Economic Discourse*, 74 AM. ECON. REV. 89, 93 (1984). *See generally* Garvin, *supra* note 93, at 341-44 (discussing trust as a part of relation).

211. *Cf.* Fred Korn & Shulamit R. Decktor Korn, *Where People Don't Promise*, 93 ETHICS 445 (1983) (study of Tonga, which lacks institution of promising).

the Coase Theorem,[212] the costs of bargaining can leave contracting parties with the default rule.[213] The latter, because the parties will bargain from a different starting point; should they value rights differently, or incur any costs in bargaining, they may not move as far from their beginning points as might happen in a frictionless, Coasean world.[214]

There is thus some reason to consider the effect adequate assurance might have on the world of a contract before insecurity. But the effect of adequate assurance before insecurity seems overshadowed by the world after. This is odd, in a way. Llewellyn's main arguments for adequate assurance rested on its effects on reliance and on good faith, both emphatically precontractual.[215] Most of the writings since Llewellyn have followed much the same course. We shall thus begin with the effects of adequate assurance before insecurity, though the discussion that follows on its effects after insecurity may prove more significant.

A. Pre-Insecurity Effects

There are a good many effects that adequate assurance could have on what the parties to an agreement do before one makes the other insecure. For ease in discussion, they are grouped below as reliance and precaution, relation, good faith, and moral hazard. One could arrange these in other ways, and they shade

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212. That, in the absence of transaction costs, contracting parties will always reach an efficient outcome. *See* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960).

213. Hence the problem-solving theory of default rules, which states that a default rule should mirror the bargain that parties would typically reach if they could bargain costlessly. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983); *see also supra* notes 191-94 and accompanying text; *infra* notes 280-83 and accompanying text.

Even if the costs of bargaining are minimal, the parties may have other reasons not to bargain around the rule. For instance, the fact of bargaining may send a signal. If a promisor were to tell a promisee that it did not want to be subject to any right of adequate assurance, the promisee would rightly suspect that the promisor was a shady customer, barring a good explanation to the contrary. (One can imagine a few—for example, that the promisor, though fundamentally sound, would be strapped financially or otherwise for a certain period, and so any demands for assurance could not be met.)

214. *See, e.g.*, Stewart Schwab, *A Coasean Experiment on Contract Presumptions*, 17 J. LEGAL STUD. 237, 261 (1988).

215. *See supra* notes 110-25 and accompanying text.

into each other at the edges. Each, however, has its own theoretical core, so each merits distinct analysis.

1. Reliance and Precaution

The most obvious effect that adequate assurance could have is on wasted reliance and precaution. Without adequate assurance, a promisee suspecting that the promisor would not perform could not declare the contract breached by dint of its expectations; it either had to continue its preparations or plan for the eventual breach of the promisor, perhaps by arranging for other sources of supply or customers. If the promisor did not perform, then the promisee's reliance expenditures might be wasted; if the promisor did, then the promisee's alternative contracts might be. One virtue of adequate assurance could then be reducing the wasted reliance, by allowing the promisee to end the contract earlier or continue its preparation in relative safety.

Some of this reliance occurs after the insecurity arises, and will be dealt with below.[216] But much, probably most, reliance occurs before the insecurity. In principle, the promisee may be more reluctant to rely on the contract without the possibility of assurance than with. Without assurance doctrine, the promisee has fewer chances to get out after insecurity arises, and thus may be left at the end with relatively large losses. With it, on the other hand, the promisee can very possibly get the assurance it seeks, thus vindicating the reliance. The greater degree of security justifies greater reliance, and thus permits the savings that result from greater and perhaps earlier reliance.[217]

Allied to reliance is precaution. Some of the events that could give rise to insecurity are outside the control of the parties to the agreement—natural disasters, war, plant closings by suppliers or customers. But many can be controlled, or at least

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216. *See infra* Part III.B.

217. Such as discounts for early purchase, greater opportunities to take advantage of discounts and market shifts, avoidance of the spot market, and the like. *See, e.g.*, Robert Cooter & Melvin Aron Eisenberg, *Damages for Breach of Contract*, 73 CAL. L. REV. 1432, 1465 (1985).

This sense of security has been pointed to as one of the bases for adequate assurance. *See, e.g.*, U.C.C. § 2-609 cmt. 1 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 251 cmt. a (1979); *see also, e.g.*, United Corp. v. Reed, Wible & Brown, Inc., 626 F. Supp. 1255, 1258 (D.V.I. 1986) (per curiam).

influenced significantly, by one or another party.[218] The degree of precaution that the parties undertake is thus relevant. Ideally, a legal rule will induce parties to take an optimal level of precaution; anything else will prove inefficient, whether because of cheaply avoidable injury or because of wasted spending on safety.[219] The rules of breach can affect the level of precaution; if, for example, the promisor had the sole right to terminate the agreement, then the promisor would have too low an incentive to take precautions, and thus would take an inefficiently low level of care.[220] In fact, before assurance doctrine came into being, the promisor had the sole right to end its obligations until repudiation, suggesting that the old law of repudiation yielded too little care.[221]

So far, so good; adequate assurance seems to increase reliance and precaution. But how much? In practice, reliance will probably be affected little by the presence or absence of adequate assurance. Most contracts, after all, are performed fully, as contracting parties know. They will thus tend to act as though their agreements will be carried out, absent information to the contrary. To the extent that they have some basis for worry at the start of an agreement, they will probably take contractual precautions against default.[222] This leaves risks arising after contracting—more precisely, the effect that a prospective risk can have on reliance. This effect depends on the promisee's familiarity with its rights under section 2-609; if it does not know of these rights, it can hardly alter its behavior. As

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218. Even the sorts of events normally seen in *force majeure* clauses can be guarded against to some extent—for example, one might be able to stockpile raw materials in anticipation of an impending strike.

219. *See, e.g.*, Cooter & Eisenberg, *supra* note 217, at 1464. This field has also provoked a great deal of literature in tort. *See, e.g.*, GUIDO CALABRESI, THE COSTS OF ACCIDENTS (1970); Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 3-5 (1980).

220. Inefficient because of the costs imposed on the promisee. *See* Richard Craswell, *Insecurity, Repudiation, and Cure*, 19 J. LEGAL STUD. 399, 410 (1990) [hereinafter Craswell, *Insecurity*]; Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 646-61 (1988) [hereinafter Craswell, *Remedies*].

221. A point more fully developed in Craswell, *Insecurity*, *supra* note 220, at 410-13.

222. Examples of such precautions are security interests, down payments, and guarantors or sureties. *See generally* Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519 (1983) (discussing means of preventing opportunistic behavior through hostage-taking).

noted, this knowledge often seems doubtful. And even if the contracting parties know of adequate assurance, this knowledge may give them little solace. Section 2-609's generality might permit a party seeking to get out of an agreement to make unfounded or barely founded claims of insecurity. As the New York Law Revision Commission noted as far back as 1955, this possibility could "weaken the security of contractual undertakings."[223] Though this threat would affect the promisee little, it might worry the promisor enough to have it rely less. The net inefficiency might thus be unchanged.

Precaution seems simpler. As Professor Craswell has shown, giving the promisee control over termination generally is efficient.[224] This arrangement aligns the parties' incentives to take precautions more closely with the optimal level of precaution, because the costs of failing to take precautions will be borne by the promisor. If the cost of assurances exceeds that of precautions, the promisor will take the precautions. Again, true—but how relevant? For adequate assurance to have this effect, the parties must have it very near the front of their minds, along with a good many delicate measures of the cost of precautions and the likelihood of risk. This is quite a lot to suppose of most parties to most contracts. The effect of precaution is there, but one may question its strength.

2. Relation

Here we consider how adequate assurance might affect the relations of the parties to a contract, for the most part by using the tools of relational contract. It is hard, if not impossible, to talk about *the* theory of relational contract, for relational contract is fundamentally contextual. Its theorists, most notably Stewart Macaulay and Ian Macneil, argue that many types of contracts connect the parties repeatedly over time.[225] True, a good many

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223. 1 STATE OF NEW YORK, REPORT OF THE LAW REVISION COMMISSION FOR 1955: STUDY OF THE UNIFORM COMMERCIAL CODE 537 (1955).

224. Except when the promisor can compensate the promisee fully for any unsuccessful attempt to perform, when the promisee's motives for termination are impure, or when the promisee bases its termination on information it had at the time of contracting. *See* Craswell, *Insecurity*, *supra* note 220, at 417-23.

225. For a classification of contract types and their relations, see Ian R. Macneil, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus,"* 75 NW. U. L. REV. 1018, 1025-26 (1981).

contracts entail only a transient connection, never to be repeated. But many are performed over substantial periods, and others take place in a milieu of frequent transactions among a small group of people and firms. Even a single cash transaction—the purchase of a meal in a restaurant, or an auto repair—can engender connections outside the single transaction. Frequent patrons in restaurants expect special service; satisfied auto repair customers will come back. These continuing or repeated deals will over time develop their own rules, which may diverge greatly from the legal rules that ordinarily would seem to govern.[226] These rules may not differ starkly from one contracting community to the next, but they will probably differ materially.[227]

One consequence of relational contract is incompleteness. If the parties contract against a backdrop of relational norms, they may well feel that they need not state those norms expressly in the agreement. Hence the often fragmentary contracting that bedevils lawyers when relations break down and contracting parties fight.[228] Of course, a good many contracts are drafted by lawyers, in whole or in part, and these will—had better—be very complete, often to the point of numbing detail. But hand-crafted, thoroughly dickered contracts are exceptional, rather than ordinary; if the normal transaction is, for instance, the purchase of a toaster at Wal-Mart, then the only lawyer likely to be in the deal is the lawyer as buyer.[229]

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226. Though legal rules themselves recognize external norms, as, for instance, in the commercial recognition of trade usage, course of dealing, and course of performance. *See* U.C.C. §§ 1-205, 2-208 (1995). And contracting parties will seldom, if ever, ignore entirely legal rules, whether because they are aware that relations may break down or because those not part of the relation may insist upon more complete contracting—for example, bank lending officers.

227. Hence the relational interest in industry studies, which are likely to pick up special industry norms. *See, e.g.*, STEWART MACAULAY, LAW AND THE BALANCE OF POWER: THE AUTOMOBILE MANUFACTURERS AND THEIR DEALERS (1966); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992); John Stephen Harbison, *Hard Times in the Softwoods: Contract Terms, Performance, and Relational Interests in National Forest Timber Sales*, 21 ENVTL. L. 863 (1991); Macaulay, *supra* note 198; William C. Whitford & Harold Laufer, *The Impact of Denying Self-Help Repossession of Automobiles: A Case Study of the Wisconsin Consumer Act*, 1975 WIS. L. REV. 607.

228. To some extent, the U.C.C. has taken relation into account through its gap-filler clauses, which supply missing terms in otherwise valid contracts. *See* U.C.C. §§ 2-305 to -312, 2-314 to -315 (1995).

229. Form contracts are generally drafted by lawyers, and these, as Professor Hillman has observed, make up most contracts. *See* ROBERT A. HILLMAN, THE

Relational contract is pertinent because the sort of contract under which adequate assurance is invoked almost always is relational. By definition, neither party has performed in full, which removes at a stroke almost all cash sales or ordinary credit sales where the goods are picked up on the spot. Rather, the usual sort of deal in these cases is a construction contract, or a long-term supply agreement, or a contract to manufacture specially-designed goods for some extended period—all potentially relational. In addition, adequate assurance normally comes about in part because the parties failed to define default in detail or otherwise provide expressly for allocating risks of the type that came about. In other words, the contracts are incomplete. We might thus expect the parties to have developed at least a partial set of relational norms, and so we should consider what effect adequate assurance might have on these.

At first blush, one might think that adequate assurance advances relational contract. As Professor Weintraub has found, parties are often inclined to adjust contracts that pinch the other parties excessively.[230] If the parties ordinarily reach this result on their own, then perhaps the legal rule should mirror the informal rule.[231] Adequate assurance might thus aid relational contract by giving legal effect to its norms. This is correct, but it is not as correct as it seems. Relational parties do tend to cooperate and reciprocate.[232] But adequate assurance comes

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RICHNESS OF CONTRACT LAW 247-48 (1997). From this, though, one should not conclude that relational contract is marginal. Form contracts do not govern the whole of the relations in which they are used. Suppliers and their customers, for example, may develop relational norms, even as they continue to exchange differing forms in the grand manner of U.C.C. § 2-207. The forms themselves become important only when the relation has broken. The use of forms is therefore not inconsistent with relational contract.

230. *See* Weintraub, *supra* note 200, at 18-23.

231. This could also decrease transaction costs, by removing the obligation of contracting around the rule from more parties. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions between Express and Implied Terms*, 73 CAL. L. REV. 261 (1985).

232. Two of the categories in Professor Feinman's relational typology. Jay M. Feinman, *Relational Contract and Default Rules*, 3 S. CAL. INTERDISC. L.J. 43, 56 (1993); *see also, e.g.*, IAN R. MACNEIL, THE NEW SOCIAL CONTRACT 39-59 (1980) (classifying relational standards); Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691, 738-40 (1974) (same).

Cooperation has been pointed to as one of the virtues protected by adequate assurance. *See, e.g.*, U.C.C. § 2-609 cmt. 1 (1995); Holt v. Seversky Electronatom Corp., 452 F.2d 31, 36 (2d Cir. 1971).

about only after the parties have failed to make mutually agreeable adjustments to their relations. After all, any sensible promisee would prefer voluntary modification to forced modification, given the untoward effects on the relation that a brusque demand for changes would likely have. As a result, adequate assurance comes only when the relation is at best troubled, diminishing the many virtues of relation.

Indeed, adequate assurance may actually encourage the dissolution of marginal relations. Without assurance doctrine, the promisee would have to wait longer before safely declaring the contract at an end. In the meantime, the relation would continue, though perhaps shakily. If the promisor did perform as promised, the relation, along with its norms, could survive, though perhaps it might need to recuperate. Adequate assurance, in contrast, effectively ends the relation. It may well yield reliance savings, but at the cost of longer-term benefits.[233] Therefore, because of adequate assurance, promisees will be more likely to abridge relations when they can do so with relatively little risk of immediate loss.

In addition, relation flows both ways. The promisor may be in difficult circumstances, but it may have gotten there because it counted on relational norms to tide it over—for example, a practice of ignoring credit terms when the promisor's cash flow was weak may have led it to take on more obligations than it ordinarily would assume. If the promisee invokes adequate assurance and makes legally justifiable demands in excess of the contract's requirements, the promisee, not the promisor, may be breaking the relation and contravening the relational norms. Yet adequate assurance doctrine does not ask whether any non-contractual norms have been transgressed; if the promisee has reasonable grounds for insecurity, however arrived at, it may demand assurance. Adequate assurance may thus encourage promisees to violate relational norms, rather than advance them.

Finally, Professor Weintraub's observation that contracting parties tend to give each other some leeway in performance may affect adequate assurance. In particular, it may show that

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233. One can thus see why promisees tend to be reluctant to use adequate assurance, even when the promisor's risk of non-performance has risen substantially. The benefits of future dealings, even discounted, will figure in the promisee's decision, and probably will weigh against the demand for assurance.

relational parties have implicitly agreed to adjustments that are tantamount to adequate assurance, at least within the scope permitted by the relation. If this is so, then perhaps the parties *have*, in effect, figured adequate assurance into their contracts, which would suggest that pre-contractual effects on relation could be significant.

This argument is not implausible, but it is rather limited. Though relational parties typically do put some play in the joints of their contracts, this play exists only to the extent that it furthers a continued relation. If the relation is failing, it is more likely going to resemble a stricter, less relational contract. Thus, the degree of adjustment contemplated even in relational contracting is likely to figure minimally in the contract price; it stems more from ordinary accommodation, when the relation is basically healthy, than adjustment when the relation is not.

Relational contract may well derive some general, amorphous benefit from this reification of its norms, and promisees may well gain immediately by using adequate assurance. But actual relations—the stuff of relational contract will more often be impaired than aided by adequate assurance. This apparent strength of adequate assurance thus ultimately proves a weakness.

3. Good Faith

Perhaps the most common argument on behalf of adequate assurance is that it will promote good faith in contract performance. Llewellyn himself referred to good faith when drafting section 2-609 and explaining it to NCCUSL, and other commentators have echoed him.[234] So a few paragraphs seem appropriate.

First, though, what *is* good faith? There seems general agreement that it is, and should be, integral to contract.[235]

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234. *See supra* notes 110-25 and accompanying text; *see also, e.g.*, Lo Re v. Tel-Air Communications, Inc., 490 A.2d 344, 350 (N.J. Sup. Ct. App. Div. 1985) (explaining § 2-609 in terms of good faith); Lane Enters., Inc. v. L.B. Foster Co., No. 00035 Pittsburgh 1997, 1997 Pa. Super. LEXIS 2632, at *21 (Pa. Super. Ct. Aug. 7, 1997) (same); Eric G. Andersen, *Good Faith in the Enforcement of Contracts*, 73 IOWA L. REV. 299, 335-338 (1988); Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 203 & n.42 (1968); Dowling, *supra* note 10, at 1378-80.

235. *See, e.g.*, ROSCOE POUND, AN INTRODUCTION TO THE PHILOSOPHY OF LAW

Certainly the U.C.C. and the Restatement (Second) say so.[236] But they leave the words rather loosely defined. Various commentators have stepped in, most significantly Steven Burton and Robert Summers.[237] Professor Burton has advanced a definition driven by discretion. In sum, bad faith "is a use of contractual discretion to recapture opportunities forgone when contracting."[238] The use of discretion itself is not the problem; contracts routinely afford the participants flexibility. But contracting also restrains; if I agree to paint your house next Wednesday at 9:00 A.M., I cannot paint anyone else's house then. This creates the possibility for opportunism, in which one party seeks to use the other's restraint to its advantage. In contrast, Professor Summers sees no real meaning in good faith as such. Rather, he sees the concept as something of a safety-valve, allowing the courts to police agreements and performance for fairness.[239] Good faith, he contends, is far too context-bound to admit of any useful generalization. Courts instead should develop specific definitions of bad faith for different types of contracts.[240]

So there is some dispute. At a minimum, though, all concerned agree that, however context-dependent, there are acts which constitute bad faith (and those that constitute good, whether by subtraction or addition). But why is good faith good? This seems almost axiomatic, but we need to outline some of the reasons before we can evaluate adequate assurance.

One set of reasons is purely economic. A world saturated in bad faith is very costly. To be sure, a degree of mistrust is useful; the purely trusting will too often be hoodwinked by the less scrupulous. But mistrust comes at a price, as we monitor the

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188, 237 (1922); Nathan Isaacs, *Business Postulates and the Law*, 41 HARV. L. REV. 1014, 1017 (1928). As Karl Llewellyn pointed out to the New York Law Revision Commission, "good faith has been a part of mercantile obligation since American law began." Karl N. Llewellyn, *Memorandum*, *in* 1 STATE OF N.Y., LAW REVISION COMMISSION REPORT: HEARINGS ON THE UNIFORM COMMERCIAL CODE 106, 115 (1954).

236. U.C.C. § 1-203 (1995); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

237. But not exclusively. *See, e.g.*, E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963).

238. BURTON & ANDERSEN, *supra* note 194, § 2.3.2; *see also, e.g.*, Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 387 (1980); Steven J. Burton, *Good Faith in Articles 1 and 2 of the U.C.C.: The Practice View*, 35 WM. & MARY L. REV. 1533, 1545 (1994).

239. Robert S. Summers, *The General Duty of Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 811-12 (1982).

240. *See id.* at 813; Summers, *supra* note 234, at 203.

acts of those with whom we deal and institute checks on their behavior.[241] Beyond the cost of monitoring, there is also the cost of underreliance. If we cannot assume that our partners will perform, we may not commit ourselves fully to our own part of the performance. Though this may prove costly, we may do better to pay a slightly higher price now than pay much more later, should the other party breach.[242] And overcoming mistrust through contract is costly, typically requiring a more tailored contract. Finally, we may wish to guard ourselves against bad faith by insuring against its effects—but, much as they would like us to believe otherwise, insurers are seldom selfless, and will exact their fees for shouldering the risk. Bad faith, by sowing mistrust, reaps inefficiency.[243]

Beyond promoting efficiency between the contracting parties, good faith has value for the contracting world generally. One can build trust from the ground up for each set of contracting parties, but that would be costly. Rather, because our world allows us to assume a fairly high level of trust and good faith, we can presume that those with whom we deal will deal fairly (or, at the least, we can make the assumption with only a modest amount of evidence). Good faith is thus, in a sense, collectively rational behavior.[244] This general good faith is, however, subject to chiseling, as some in the community seek to ride freely on the good faith of others.[245] Isolated instances of bad faith may prove unproblematic, but as they accumulate they can impair the general level of trust in a contracting community. So policing against bad faith can have general value, by lubricating the wheels of commerce for all.[246]

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241. And monitoring can itself engender mistrust, which yields more monitoring. *See, e.g.*, Carol M. Rose, *Trust in the Mirror of Betrayal*, 75 B.U. L. REV. 531, 539-41 (1995).

242. *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 228-31 (2d ed. 1997).

243. *See, e.g.*, Roland N. McKean, *Economics of Trust, Altruism, and Corporate Responsibility*, *in* ALTRUISM, MORALITY, AND ECONOMIC THEORY 29, 31 (Edmund S. Phelps ed., 1975).

244. *See, e.g.*, JON ELSTER, THE CEMENT OF SOCIETY 137 (1989); Russell Hardin, *Trusting Persons, Trusting Institutions*, *in* STRATEGY AND CHOICE 185, 205-06 (Richard J. Zeckhauser ed., 1991); Russell Hardin, *The Street-Level Epistemology of Trust*, 21 POL. & SOC'Y 505, 514-15 (1993).

245. On the free rider problem generally, see MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965).

246. *See, e.g.*, BERNARD BARBER, THE LOGIC AND LIMITS OF TRUST 127-30 (1983).

And good faith is intertwined with adequate assurance's doting parent, anticipatory repudiation. As Professor Vold long ago noted, anticipatory repudiation was itself allied with tort; anticipatory repudiation resembles closely the tort of wrongful interference with contractual relations (in this case, one's own).[247] When a promisor repudiates an agreement, it does damage, not only to the agreement itself, but also to the web of relations surrounding the agreement.[248] Furthermore, though it has long been common to divorce contract from fault, there remain, in the evocative phrase of one commentator, "fault lines" in contract.[249] A good many of the U.C.C.'s loss allocation rules can be explained using notions of comparative fault.[250] The same applies to the general law of contract damages.[251] Though one can press the relation too hard, fault has never really been divorced from contract; perhaps, then, adequate assurance lets us assign fault better than even Vold's vaunted anticipatory repudiation, by affording the betrayed party greater legal rights than it had under the contract.

Adequate assurance's role in this vast enterprise is not great, but even a walk-on part gets listed in the program. One would expect promisees to use adequate assurance to police against coercive behavior by promisors that falls short of duress. If, for example, a promisor makes disgruntled sounds about the possibility that it will not be able to perform when the time comes unless it is paid more, the promisee could reasonably claim insecurity and demand assurances. The promisor would not have breached merely by its murmurs about possible future problems, and broaching possibilities of breach seems less than an overwhelming predicate for duress.[252] Still, the promisor may still be acting in bad faith, whether by seeking to recapture opportunities or by evading the spirit of the deal.[253] Adequate assurance

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247. *See* L. Vold, *The Tort Aspect of Anticipatory Repudiation of Contracts*, 41 HARV. L. REV. 340, 354-63 (1928).

248. *See id.* at 352-54.

249. *See* George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225 (1994).

250. *See* David Morris Phillips, *The Commercial Culpability Scale*, 92 YALE L.J. 228 (1982).

251. *See* Cohen, *supra* note 249.

252. *See infra* Part IV (discussing duress).

253. Another of Professor Summers' criteria. *See* Summers, *supra* note 239, at 813.

dissuades the potentially sleazy by obliging them to pay a penalty for their sleaziness; not only do they fail to gain what they sought, but they have to give assurances that they would not have had to give if they had acted in good faith throughout.

Adequate assurance, however, does not always advance good faith. One problem, pointed out in the early days of the U.C.C., is the bad faith use of adequate assurance itself—to threaten, rather than to parry. If the promisee is unscrupulous, then it might use demands for assurance to harass the promisor or divert it from the promisee's own difficulties with performance. The promisor would either have to comply or run the risk that it would be found to have breached; given the uncertainty inherent in the rather general statutory language, it might well prefer to accede to the demands.[254] The innocent promisor could refuse to comply and then assert a bad faith defense in any subsequent litigation, but the costs of doing so would be formidable, and very likely out of keeping with the costs of assurance.[255]

In addition, the penalty paid by the promisor may overdeter bad faith. As others have noted, supracompensatory damages generally yield inefficiency.[256] One might be able to defend them on extracontractual grounds, such as deterrence or retribution, more commonly used in tort. And, of course, bad faith breach does at least verge on the tortious.[257] We do not want to encourage bad faith, and most of us would probably be willing to punish those who trade on the goodwill of others. But the uncertainty of the legal standards applied in adequate assurance makes a facile assumption of bad faith dangerous. There is a wide range of behavior that falls short of bad faith that can still give rise to the proper invocation of adequate assurance. Indeed, adequate

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254. *See, e.g.*, Anderson, *supra* note 22, at 6; Summers, *supra* note 234, at 248-49.

255. There is no independent cause of action under the U.C.C. for breach of the duty of good faith and fair dealing. *See* U.C.C. § 1-203 cmt. (1995); *see also* AMERICAN LAW INSTITUTE, PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, COMMENTARY NO. 10 (1994) (no cause of action).

256. *See, e.g.*, Alan Schwartz, *The Myth that Promisees Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369 (1990). *But see* Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443 (1980) (advocating punitive damages for bad-faith breach).

257. As in denials of insurance claims. *See, e.g.*, BURTON & ANDERSEN, *supra* note 194, § 9.2.

assurance can be, and usually is, used to combat good faith insecurity—that due to extrinsic causes or to honest errors in judgment.[258] The use of adequate assurance, with the resulting demands, could overdeter potentially risky behavior and cause those not in bad faith to pull too far short of the edge. Pulling short may be morally unobjectionable; overdeterrence is at least expensive. And pulling short may also prove more costly than we wish.[259]

As a result, adequate assurance, though it promotes good faith, may do so to excess. Certainly it is not cost-free, and at the margins might well deter acceptable conduct. It also creates the possibility of new vistas of bad faith for the determinedly opportunistic. The balance is hard to strike, and it may well be that it comes out in adequate assurance's favor. But that is hardly a certain result.

4. Moral Hazard

The final argument that can be made on behalf of adequate assurance is its probable effect on moral hazard. Briefly, moral hazard occurs when one of the parties to a contract takes advantage of its risk allocation by engaging in riskier projects. Insurance is the classic example, as it is purely risk-driven. Once a risk is insured for, the insured party has sold the risk to the insurer. The insured party may, however, be able to control the level of risk or the extent to which it protects against the risk. It may thus be inclined to trade a small possible increase in its wealth for a large increase in risk; though the insured party would not do so if it had to bear the risk itself, it might if the insurer were to bear the risk.[260] So, for instance, a manufacturer

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258. *See supra* notes 162-64, 169 and accompanying text.

259. It seems a bit odd to argue that there is an optimal level of bad faith, but the oddity is more apparent than actual. We are by now used to cost-benefit analyses which purport to state the optimal level of pollution, accidents, or other unequivocal harms, in light of the efficient allocation of resources. So too here; though costless good faith would be ideal, we in fact must buy good faith through our remedial system, and good faith deters some types of behavior that may be wealth-creating. This is not to say that the moral claim for good faith must be subsumed in a parodic utilitarianism; only that, as we advance our moral arguments, we need to bear in mind their costs.

260. A classic treatment of moral hazard is KENNETH J. ARROW, ESSAYS IN THE THEORY OF RISK-BEARING (1974). *See also, e.g.*, COOTER & ULEN, *supra* note 242, at 49-50; Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AM. ECON. REV.

might store inflammable solvents in cheaper, less fire-resistant containers, if it has fire insurance, or the owner of an auto might be careless about locking up if it has theft insurance. These activities lower the wealth of society, but they increase the wealth of the actor. Hence their undesirability.

In the context of adequate assurance, the promisor might overextend its credit, or put off arranging for a supply of raw materials, if the promisee were to bear the risk of default. In those cases, the promisor is gambling on the existence of the contract. If the promisee cannot get out of the agreement—for example, under the old law of anticipatory repudiation—then the promisor can gamble safely. With adequate assurance, however, the promisor cannot gamble as safely. If the promisee becomes insecure, the promisee can demand assurances, thus forcing the promisor to internalize the costs of its risky behavior. The promisor would have less incentive to behave riskily, and so moral hazard would decrease.

But is this a realistic picture? The moral hazard problem may not be very serious. Insurers get around moral hazard by obliging the insureds to carry some of the risk, through such tools as deductibles and partial payments. They may also have covenants that require certain acts on the part of the insureds (for example, wearing seat belts).[261] In business, lenders use covenants, such as those controlling the debt to equity ratio, to rein in borrowers. Indeed, monitoring generally can reduce, if not eliminate, moral hazard problems.[262] If the parties do business with each other frequently, they may have built-in monitoring. A seller knows how rapidly a buyer pays off its account, and whether the buyer has tended to stretch out its receivables. It can also monitor the patterns of orders for unexplained shifts.[263] A buyer may be able to monitor progress, as at a construction site, and can ensure performance through periodic payments. In sum, though moral hazard is a worry,

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531 (1968).

261. *See, e.g.*, MARK SEIDENFELD, MICROECONOMIC PREDICATES TO LAW AND ECONOMICS 75-76 (1996).

262. Though, of course, the monitoring must be paid for, which adds to the costs of doing business.

263. But monitoring is far from perfect; even relatively sophisticated monitors of solvency, for example, err with dismaying frequency. *See, e.g.*, Garvin, *supra* note 93, at 325-32 (summing up literature).

especially when risky behavior is easy to hide or when financial weakness encourages one to take chances, it may not be overwhelmingly worrisome.[264]

There is another, greater problem with moral hazard: Does it occur where adequate assurance is potentially relevant? The most common fact pattern for adequate assurance—a seller uncertain whether it will be paid by a buyer—seems not to include moral hazard. The risk of non-payment would not be assigned to the seller; rather, the usual contract would contain the constructive condition concurrent under which the seller's obligation to supply goods is extinguished by the buyer's refusal to pay.[265] Though the buyer might choose to take risks after the goods have been delivered, particularly if its own survival is at issue, adequate assurance would not apply; the seller would have performed, so the contract would no longer be executory.[266]

Indeed, if we look at moral hazard's origins—insurance—adequate assurance would be germane mainly when the *insured* is insecure about the future performance of the *insurer* (if, for instance, the insurer's reserve funds were perilously low), rather than the reverse. To be sure, there might be some cases in which moral hazard could induce a promisee to seek adequate assurance. Surety or guaranty contracts are examples. But the range for moral hazard reduction is low, and the alternative means of controlling it many—and, it should be recalled, the whole range of pre-insecurity effects is rather limited. Moral hazard should thus figure little in the adequate assurance calculus.

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264. *See, e.g.*, Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 304 n.17 (1978); Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 528 (1981). This hypothesized increase in risky and dubious behavior has been demonstrated empirically. *See, e.g.*, Edward H. Bowman, *Risk Seeking by Troubled Firms*, SLOAN MGMT. REV., Summer 1982, at 33; Philip Bromiley, *Testing A Causal Model of Corporate Risk Taking and Performance*, 34 ACAD. MGMT. J. 37 (1991); Avi Figenbaum & Howard Thomas, *Dynamic and Risk Measurement Perspectives on Bowman's Risk-Return Paradox for Strategic Management: An Empirical Study*, 7 STRATEGIC MGMT. J. 395 (1986). On moral hazard in finance, see, for example, Hideki Kanda & Saul Levmore, *Explaining Creditor Priorities*, 80 VA. L. REV. 2103, 2108-11 (1994).

265. *See* U.C.C. § 2-106(3)-(4) (1995); RESTATEMENT (SECOND) OF CONTRACTS § 238 (1979).

266. *See supra* note 152.

B. Post-Insecurity Effects

At last, a group of hypothesized effects that may materially improve the contracting world—the effects that follow the promisee's insecurity. These effects stem from mitigation. The parties to the contract would, one assumes, like to mitigate their losses as soon as they can.[267] If the promisor signals clearly to the promisee that it will not perform, the promisee can make alternative arrangements, perhaps arranging for new sources of supply or new customers. It can also reduce its wasted reliance, to the extent that its reliance expenditures are transaction-specific.

This is easy enough to do when the breach is unequivocal, as in the normal law of anticipatory repudiation. If, however, the promisor acts forebodingly but equivocally, the promisee faces a difficulty. With no doctrine of adequate assurance, the promisee would have to await performance or unequivocal breach. Should the promisee itself have to perform, it would fail to do so at its peril. For that matter, it might be held to have breached by failing to prepare adequately. In any event, if its failure to prepare would render its performance impossible, then it would be in breach.

Adequate assurance law changes the landscape. After the promisee has been made insecure, it must choose whether to go ahead. This choice can be framed as cost-benefit analysis.[268] The promisee must decide whether the adequate assurance mechanism is worth invoking. From a global vantage, one might say that adequate assurance is supposed to ensure that the cost-benefit analysis comes out in favor of performance. The insecure party has to decide whether to terminate the contract if it fails to get the assurance it requires. Its decision should compare the effect of early termination (relatively low damages) to the effect of continuation (either performance, with no damages, or breach, with relatively high damages).[269]

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267. Indeed, the breached-against party has a duty to mitigate its damages; should the breaching party establish that the mitigation was inadequate, then the damages that could have been mitigated cannot be recovered. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 350 (1979).

268. As Professor Craswell has done. *See* Craswell, *Insecurity*, *supra* note 220, at 404-07.

269. *See id.* at 405. Craswell properly points out that mitigation in this context should refer to the total savings from early termination, rather than just the

Once the promisee has become insecure, then, the virtue of adequate assurance is its potential reduction in the amount of wasted precontractual expenditure and foregone opportunities. With only anticipatory repudiation available, the prudent promisee is faced with a regrettable set of choices. If it assumes that the promisor will not perform, then it can make alternative arrangements. But if the promisor performs, then the alternative contract is wasted.[270] If, on the other hand, the promisee hopefully awaits performance and has its hopes dashed, then it has to scramble for an alternative with little notice, thus hazarding the spot market and running the risk that its own contracts may be breached if its operations depended on the breached contract. These decisions are pushed earlier by adequate assurance. At the first signs of insecurity, the promisee can, if it likes, demand assurances, suspending its performance (and thus diminishing its wasted reliance) until the goods arrive and terminating the agreement if they do not.

There are some countervailing costs. The decision, because earlier, becomes less certain. The likelihood of a false positive—of demanding assurances unnecessarily—rises. A false demand would probably be taken badly by the promisor, suggesting as it does a certain lack of trust. The future gains from the relationship, including gains on agreements not yet extant, might thus be jeopardized. Worse, if the demand is wrong then the promisee may itself be in breach.[271] And the promisor may be unable to comply with the demand when it is made, even though it would be able to perform the contract at the time provided. A justifiable, but imprudent, demand might thus yield an unnecessary breach of both a contract and a relationship, and may even render the promisor insolvent or bankrupt.[272]

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promisee's, because the issue here is the overall change in social welfare. *See id.* at 406.

The amount of assurance that the promisee could demand would be the amount needed to make the agreement worth continuing with, if one views adequate assurance as designed primarily to tip the cost-benefit analysis toward performance. *See id.* at 407; Goetz & Scott, *supra* note 213, at 991 & n.54.

270. Though there may well be substantial salvage value, especially if the contract in question is for non-perishable goods.

271. *See supra* notes 45-46, 134-36 and accompanying text.

272. A possible result if, for example, the promisee was the promisor's main customer, or its banker, or a critical supplier. *Cf.* Chris Kjelgaard, *GPA Not Yet Out of the Woods*, AIRFINANCE J., Nov. 1993, at 4 (explaining that failure to provide adequate assurance could shut down an aircraft manufacturer).

Most of these ill effects, though possible, are far less certain than the gains that adequate assurance would yield. In some cases, of course, the losses would be formidable and the gains slight. If the gains went to the promisee, but the losses to the promisor, then the promisee might demand assurances anyway—a classic externalities problem. Thus Craswell's hypothesized cost-benefit calculus for section 2-609. As Craswell points out, though, such a calculation would be very difficult for a court to carry out case by case.[273] The uncertainty that this process would require might affect the behavior of the contracting parties, depending on their responses to risk.[274]

But the operational problems of a cost-benefit method need not concern us at present, for we are considering the overall merit of adequate assurance. If the rule is efficient overall, whatever its depredations in particular cases, then we can go on to the rule's defects. Though formal cost-benefit analysis for adequate assurance requires data that do not exist, we can, I think, safely conclude that the net effect is positive, given the assumptions made. Earlier resolution will yield gains, and ordinary monitoring should shield the promisee from the sillier errors that can yield large losses.

To sum up, then, the best reasons for adequate assurance, or at least the most powerful, are tied to its effect on the parties' behavior after the promisee has become insecure. The effects before, though interesting, are less significant because adequate assurance is unlikely to have much effect on contracting parties until insecurity. From here, we must turn to the problems with adequate assurance. Some have already been outlined, but they do not seem sufficiently weighty to render the doctrine undesirable. The problems raised in the next section, however, are weightier.

IV. MODIFICATION AS DURESS: THE PROBLEMS OF ADEQUATE ASSURANCE

So some of the arguments for adequate assurance are somewhat unimposing. But what of the main points about

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273. *See* Craswell, *Insecurity*, *supra* note 220, at 407.

274. *See, e.g.*, Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279 (1986).

enhancing reliance, ensuring relation, promoting good faith, lowering moral hazard, and diminishing risk? These virtues, one would think, would be justification enough for adequate assurance. Perhaps they would if they were wholly valid. But, as the section above suggests, they are not. Indeed, some—for example, relation—may even point away from adequate assurance. The clearest argument, though one not without its gaps, is the effect of assurance after uncertainty.

There is, however, a basic argument against adequate assurance, one built on classic economic analysis. Put simply, if the parties have priced the risk at the time of contracting, adequate assurance gives a windfall to the party invoking it, by allowing the party to collect a full risk premium and yet avoid the risk when it occurs. This argument is best discussed first as it relates to contract modification (which is what adequate assurance essentially yields). From this comes an unflattering, though not inaccurate, analogy to duress; indeed, if, as this argument indicates, the effect of adequate assurance doctrine is the forced modification of contracts, then duress may be more than an analogy.

A. Adequate Assurance, Modification, and the Pricing of Risk

Adequate assurance is a first cousin to contract modification. If the party demanding assurances actually gets them, it has in essence secured a change in the express terms. Even the promisor's unsupported promise that it will in fact perform goes beyond the bargain, in that the parties could have, but did not, arrange for periodic reassurance.[275] Any greater assurance—paying in advance, or granting a security interest, or giving progress payments—gives the promisee more than it had when the contract was made. In essence, then, the promisee uses the mechanism of adequate assurance to secure a new contract, one that it had not bargained for and that, almost by definition, it could not get voluntarily from the promisor.[276]

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275. They might choose to. For example, the seller's right of reclamation is longer if the buyer has misrepresented its solvency in writing within the prior three months. *See* U.C.C. § 2-702(2) (1995). Therefore, a cautious seller might have the buyer reaffirm its solvency every quarter, in order to prolong its reclamation right.

276. If it could, then it would not risk destroying the relation by demanding

If the parties have allocated the full risk of non-performance in the contract, then this sort of modification seems dubious. The promisee could, by hypothesis, estimate the likelihood that the promisor would default, and charge an appropriate premium. If the promisor performed, so much the better; if not, the accumulated premiums would cover the loss. The promisee could either buy insurance or self-insure, in each case using the risk premium to cover the costs.[277] To allow the promisee a chance at compelled modification would, if one accepts the analogy, be like an insurance company taking a premium and then declining to pay a claim. If the bargain allocates the risk of non-performance, then, one would think, the bargain should be adhered to if the risk comes about. After all, the counterpart seems not to occur. If the risk does not come about, should the promisor be able to recover its risk premium? Presumably not, just as a healthy person should not have a right to a refund of her insurance premiums. So why the apparent asymmetry?

This argument is easy enough to deal with when the parties have allocated risk expressly, as in an insurance policy or a contract with a hold harmless clause. If the parties allocated risk clearly, then, bad faith aside, they will be held to that bargain, as even the advocates of judicial refashioning of contracts would generally agree.[278] But what about those contracts that do not allocate risk expressly—the pool from which adequate assurance cases are drawn? After all, adequate assurance doctrine is a default rule; the parties need not advert to it to be able to invoke it.[279] The case may be harder, but it is not overwhelmingly hard. Contracts do allocate risk; indeed, executory contracts exist in large part to allocate and reduce risk.

But only some of these risks are dealt with expressly. Parties to agreements may choose not to allocate risk expressly, perhaps because they prefer the default rules of contract.[280] If the default

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assurance.

277. There are robust insurance markets for the several types of risk at issue. General liability insurance, the most obvious type, is ubiquitous. Credit insurance might also be germane; though less common, it is still around and purchasable.

278. *See* U.C.C. § 2-609(4) & cmt. 6 (1995); *see also, e.g.*, Gillette, *supra* note 16, at 532.

279. *See supra* notes 191-94 and accompanying text.

280. Indeed, that is much of the point of default rules—to mirror the bargains that the parties would have reached, had they actually negotiated. *See, e.g.*, Goetz & Scott, *supra* note 213. It should be noted that these default rules can be extra-

rules mirror the ideal positions of the contracting parties, then their silence as to the default risk allocation is in fact assent.[281] Dealing with risks can be costly, and those who enter into agreements may decide that the modest gains that would come from allocating remote risks differently than would the default rules are outweighed by the costs of doing so.[282] These lower transaction costs both show some of the advantages of default rules and some of the reasons why one should not disturb default allocations too blithely. A lack of express risk allocation in a contract thus does not mean that the risk went unallocated, or that the parties should not be taken to have done so. As long as the basic risk assessment is sound, the contract's silence as to risk may in fact speak loudly.[283]

A counterargument focuses on the assumption that the risk is in fact priced in the basic contract. Why wouldn't the promisee, aware of the wonders of adequate assurance, choose *not* to factor the risk into the agreement, expressly or implicitly? The promisee could exercise its rights to seek assurances if the risk became choate; otherwise, it would collect the risk-free rate and perform. Were this true, the promisee would not be overcompensated for the risk it bore. If this is in fact the standard method of dealing with the risk of non-performance, then adequate assurance is not only sensible, but, from the vantage of transaction costs, highly desirable.[284]

There are at least two problems with this counterargument. First, it assumes that promisees take the possibility of adequate assurance into account when they enter into contracts. This

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legal as well as legal, given the force of extra-legal enforcement of community norms (for example, refusals to deal).

281. Default rules can, of course, have other functions, most notably to reduce information asymmetries. *See, e.g.*, Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989). *See generally* Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. CAL. INTERDISC. L.J. 389, 390-91 (1993) (taxonomy of default rules).

282. As Steven Shavell has noted, low-frequency events should not generally be addressed expressly in contracts, given the costs of negotiation. Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 468 (1980).

283. For a variant of this argument applied to other types of risk allocation, see Gillette, *supra* note 16, at 534-40.

284. Waiting until the risk matures might even reduce moral hazard problems; if the promisor knows that its increases in risk will be countered by demands for assurances, then it may be less inclined to take on unbargained-for risks. *But see infra* Part IV.B. (moral hazard present, but insignificant).

seems improbable. As discussed earlier, adequate assurance is probably foreign to most of those who enter into contracts.[285] Furthermore, the great majority of contracts are performed, leaving the plausible scope of adequate assurance relatively low. The costs of adjusting prices for particular risks may be sufficiently high, and the risks of default sufficiently low, that the efficient result would be to ignore the risks altogether.[286] And if the risks themselves were slighted, the possibility of taking legal action to reduce them—legal action that itself can be quite costly—would come at still higher a discount. So adequate assurance is likely not to prove significant. Leaving aside the minority of contracts negotiated by attorneys, who themselves may be hazy on adequate assurance, it is hard to see how adequate assurance would figure into contract pricing.

Second, the price system, the argument assumes, is theoretically and practically peculiar. Promisees do, after all, factor into the price some types of risk, most importantly the risk of bad debt. Though promisees do attempt to collect overdue accounts, sometimes at substantial cost, they also recognize that they cannot collect on everything—hence, a bad debt allowance is part of the cost of goods.[287] Nor should they defer this determination. Not infrequently, the promisee will not be able to demand compensation for a shift in risk, even where the law allows for it. If, for example, the risk explodes on the promisor, the promisee may not have a chance to demand assurance before breach. A suit for breach may also avail the promisee little, if anything, should the promisor prove insolvent. With no risk premium, the promisee would be left uncompensated when the promisor proved unable to pay damages.[288]

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285. *See supra* notes 196-207 and accompanying text.

286. An example of satisficing. *See infra* Part V.

287. More precisely, the promisee must take into account the added collection cost for the accounts ultimately paid (including the lost time value of money) and the cost of debt ultimately written off. The latter is buffered in part by a federal tax allowance for bad debt. *See* 26 U.S.C. § 166(a) (1994). Even if the promisee factors its accounts receivable—that is, sells them to a firm that specializes in debt collection—it will not receive the full amount of the debt, so that discount must also be provided for.

288. And, of course, even ordinary expectation damages are undercompensatory, given the lack of fee-shifting and other problems of proof. *See, e.g.*, 1 JAMES C. BONBRIGHT, THE VALUATION OF PROPERTY 278-91 (1937); John A. Sebert, Jr., *Punitive and Nonpecuniary Damages in Actions Based upon Contract: Toward Achieving the Objective of Full Compensation*, 33 UCLA L. REV. 1565 (1986).

Furthermore, the costs of a world with routine ex post adjustment for risk would be high. With no risk premium as buffer, the promisee would be more inclined to demand assurances as risks increased. The very act of demanding assurances is costly, even if it does not yield litigation; not only does it occupy time, that of the promisee, the promisor, and, in all likelihood, their lawyers, but also it bruises the relationship, perhaps launching a cycle of increasing mistrust. The heightened tendency to demand assurances might also cause some mispricing or risk. Insecure promisees would tend to make their demands when risks are relatively high. If the risk abates, then whatever guarantee has been secured would prove excessive, even if one assumes that ex post adjustment should be acceptable. For a basically sound promisee, these assurances may be irksome, but not very costly. For a shakier promisee, though, the demand for assurances may be very costly, if, for example, the demand obliged it to commit scarce working capital or other resources that it had intended using elsewhere. Since demands logically would be made more often on relatively weak promisees than on relatively strong, the costs of excessive demands may be very significant.

The best argument for adequate assurance—its frequent superiority to anticipatory repudiation as a means of reducing post-insecurity losses—is thus undercut. Ex post reallocation of risk can indeed reduce wasted reliance and opportunity costs, but at the price of some losses in transaction costs and uncertainty. When all these are bundled together, it is hard to say that overall the balance is positive. Then add the general problem of risk reallocation. If the parties to the agreement will normally allocate risk, then allowing adequate assurance gives the promisee something amounting to unjust enrichment—the sort of thing that the constructive conditions of exchange long ago were designed to prevent.[289] In sum, then, the case against adequate assurance, given some assumptions about the parties' ability to evaluate risks accurately, seems relatively strong.

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289. *See, e.g.*, Kingston v. Preston, 99 Eng. Rep. 437 (K.B. 1773) (Mansfield, L.C.J.).

B. Adequate Assurance as Duress

If one accepts this conclusion, then adequate assurance is in essence a means for a promisee to require the promisor to modify the contract, lest it be held in breach. This sort of modification is rather peculiar, though. Ordinarily modification, however characterized,[290] is voluntary; a promisor could respond to the promisee's suggested modification with a polite demurral, or even something less polite, with no legal consequence. Indeed, a request for modification is not itself a breach.[291] But the promisee's request for adequate assurance is hardly an ordinary request; in the somewhat hokey parlance of the screen gangster, it is an offer that the promisor can't refuse. Like an offer made by a gangster, there is an implicit, or even explicit, threat—here, the threat that the promisor will be held to have breached the contract if it declines. This sort of threat makes the demand for adequate assurance look uncomfortably like duress. Duress is, after all, the evil cousin of modification. Though duress does not require a pre-existing contractual relationship, a very common type of duress is the compelled modification.[292] The intersection is sufficiently germane that Contracts casebooks often teach duress and modification together, in whole or in part.[293]

So is a demand for assurance duress? In some senses, it certainly looks like it. One party to an agreement is placed in an awkward position; either it consents to an unwanted[294] modification, or it is held in breach and forced to pay damages. Though

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290. For instance, as modification, accord, novation, substituted contract, or the like. For a compendium of ways to alter an agreement, see 1 HOWARD O. HUNTER, MODERN LAW OF CONTRACTS ¶ 12.05[1] (rev. ed. 1993).

291. Unless coupled with threatened non-performance sufficiently grave to amount to total breach. *See* RESTATEMENT (SECOND) OF CONTRACTS § 250(a) & cmt. d (1979).

292. *See, e.g.*, Roger Halson, *Opportunism, Economic Duress and Contractual Modifications*, 107 LAW Q. REV. 649 (1991); Robert A. Hillman, *Policing Contract Modifications Under the U.C.C.: Good Faith and the Doctrine of Economic Duress*, 64 IOWA L. REV. 849 (1979); Henry Mather, *Contract Modification Under Duress*, 33 S.C. L. REV. 615 (1982); Thornton E. Robison, *Enforcing Extorted Contract Modifications*, 68 IOWA L. REV. 699 (1983).

293. *See, e.g.*, JOHN P. DAWSON ET AL., CASES AND COMMENT ON CONTRACTS 569-603 (6th ed. 1993); E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, CASES AND MATERIALS ON CONTRACTS 352-71 (5th ed. 1995); CHARLES L. KNAPP & NATHAN M. CRYSTAL, PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS 786-807 (3d ed. 1993).

294. Presumably if the promisor had been willing to agree to the modification, it would not be in the realm of adequate assurance.

there is a choice here, it is most unpalatable, for the promisor cannot choose simply to go ahead with the contract originally agreed upon. Either way, the promisor will incur new liabilities, whether under the modified contract or under the breached contract. As Justice Holmes long ago observed, "[i]t always is for the interest of a party under duress to choose the lesser of two evils. But the fact that a choice was made according to interest does not exclude duress. It is the characteristic of duress properly so called."[295] That there is a choice does not eliminate duress; whether the choice was coerced is the real question.[296]

But, of course, there is coercion and there is *coercion*. When the gangster suggests a contract modification, he has power behind him, but not legal power; though it may be no less effective for that, it is nevertheless unsanctioned by the law. Similarly, the opportunistic merchant who maneuvers his trading partner into a precarious position and then blandly suggests a renegotiation has done something extralegal. This form of duress—economic duress—has, to be sure, proved somewhat problematic. In the early days of duress, economic duress was unheard of; duress required physical imprisonment or threats of bodily harm.[297] Even once established, economic duress made little headway until the twentieth century.[298] The contours of economic duress may remain ill-defined, but they are out there somewhere, and society has, for one reason or another, decided that some types of economic pressure cannot be tolerated.[299] In contrast to the promisee exerting economic duress, the promisee seeking adequate assurance does so under a statute or under the beneficent aegis of the common law. As she exercises her rights, one can imagine a spectral Karl Llewellyn beaming down[300] at her, cheering her use of one of his pet creations. More to the point, one can imagine the legislature and judiciary nodding

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295. Union Pac. R.R. v. Public Serv. Comm'n, 248 U.S. 67, 70 (1918).

296. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 175, 176 (1979).

297. *See, e.g.*, John P. Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 254 (1947).

298. As one classic case had it, "this would be a most dangerous, as well as a most unequal doctrine; and if accepted, no one could well know when he would be safe in dealing on the ordinary terms of negotiation with a party who professed to be in great need." Hackley v. Headley, 8 N.W. 511, 514 (Mich. 1881) (Cooley, J.).

299. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 175-76 (1979); *see also, e.g.*, Juliet P. Kostritsky, *Stepping Out of the Morass of Duress Cases: A Suggested Policy Guide*, 53 ALB. L. REV. 581, 606-08 (1989) (critique).

300. Or maybe up, as my U.C.C. students would have it.

approvingly at this wholesome invocation of a legal right. All the difference in the world.

The distinction between public pressure (acceptable) and private pressure (unacceptable) seems obvious enough across a range of contexts. Private citizens may not kill others; police officers and soldiers may, under the right circumstances. Private citizens may not assess taxes on the incomes of others; the Internal Revenue Service may. But should this distinction be made here? More particularly, do we need to—can we—justify the use of state power to make possible contract modification procured through adequate assurance? This question can in part be answered by examining critiques of the distinction between the public and private realms, and of the relation between coercion and state action.

The more familiar modern critique comes from Critical Legal Studies.[301] One of the key attacks made by its adherents is against the notion of private autonomy and freedom of contract as controlling principles of contract law. The law of contract may well have been rooted, at least since the Civil War and its aftermath, in individualism and consent.[302] Part of this was the older notion of the overborne will as the key to duress.[303] This idea depends on the assumption that ordinarily parties are free to contract or not, so that the role for law is to ensure the freedom that attends autonomy.[304] The court is therefore to police contracts to make certain that the parties did, in fact, assent freely—nothing more.

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301. The partial discussion below verges on the parodic. For proper explications of Critical Legal Studies, see, for example, THE POLITICS OF LAW: A PROGRESSIVE CRITIQUE (David Kairys ed., rev. ed. 1990); ROBERTO UNGER, KNOWLEDGE AND POLITICS (1975); J.M. Balkin, *Deconstructive Practice and Legal Theory*, 96 YALE L.J. 743 (1987); Symposium, *Critical Legal Studies*, 36 STAN. L. REV. 1 (1984); Roberto Mangabeira Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561 (1983). Representative liberal critiques include ANDREW ALTMAN, CRITICAL LEGAL STUDIES: A LIBERAL CRITIQUE (1990); William Ewald, *Unger's Philosophy: A Critical Legal Study*, 97 YALE L.J. 665 (1988).

302. At least according to Morton Horwitz. MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW (1977); *see also, e.g.*, Jay M. Feinman, *Critical Approaches to Contract Law*, 30 UCLA L. REV. 829, 831-33 (1983). It is fair to say that others have disagreed. *See, e.g.*, A.W.B. Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533 (1979) (book review).

303. *See, e.g.*, Dawson, *supra* note 297, at 256.

304. *See, e.g.*, Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1713-22 (1976).

But is consent truly volitional? The Critical answer is no. Choices may be more or less coerced, but disparities in power and wealth render freedom to contract illusory.[305] Absolute freedom of contract, given full sway, reinforces these disparities, as did the earlier freedom of contract decisions that typified turn-of-the-century jurisprudence.[306] So duress law has come to abandon the notion of will and adopt some concepts of substantive and procedural fairness, thus ameliorating the difficulties created by the obnoxious exercise of power.[307] Once law moves toward policing for fairness, though, it has injected public standards into the private realm. Here, then, is the tension between autonomy and community that figures so prominently in Critical work.[308] The principles pull in different directions, yielding the sort of indeterminacy that eases, say Critical adherents, the political use of legal doctrine.[309]

Adequate assurance doctrine might be looked at as an example of duress. Though it exists by statute, the source of legal authority is less important than its effect. That effect is to police bargains by decreeing their remodeling, on pain of committing a civil wrong. If, as hypothesized, the contract seeks to allocate risk through a price adjustment, then adequate assurance doctrine remakes the parties' deal. Unlike those older decisions that sought to allow freedom of contract, here we have a statute that restricts that freedom, allowing a party to do that which it could not otherwise do. Hence duress.

This critique is relatively new, but its roots go to the Realist and post-Realist literature. The most pointed rejection of will theory as a predicate of the duress defense came from Robert

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305. *See, e.g.*, Elizabeth Mensch, *The History of Mainstream Legal Thought*, *in* THE POLITICS OF LAW, *supra* note 301.

306. *See, e.g.*, Coppage v. Kansas, 236 U.S. 1 (1915) (statute outlawing "yellow-dog" contracts unconstitutional); *see also, e.g.*, Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1027-29 (1985); Feinman, *supra* note 302, at 850-51.

307. *See, e.g.*, Dalton, *supra* note 306, at 1029-31.

308. *See, e.g.*, Dalton, *supra* note 306, at 1024-27; Feinman, *supra* note 302, at 847; Morton J. Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423, 1427-28 (1982); Kennedy, *supra* note 304, at 1713-24; Karl E. Klare, *The Public/Private Distinction in Labor Law*, 130 U. PA. L. REV. 1358, 1360-61 (1982); Unger, *supra* note 301, at 618-25.

309. *See, e.g.*, Dalton, *supra* note 306, at 1113; Klare, *supra* note 308. Critical scholars might also applaud the advent of fairness rules as a step toward redistributive norms in law. *See, e.g.*, HUGH COLLINS, THE LAW OF CONTRACT 70 (1986).

Hale.[310] Hale pointed out that coercion inheres in every assertion of a legal right.[311] Thus, for example, the law of property coerces those without to work for a wage, lest they starve, because the law does not oblige those with property to feed those without—and, in fact, allows those with property to exclude others, even invoking the power of the state to do so.[312] Each right to have carries with it a right to exclude; each power a liability.[313] Indeed, Hale goes further: "[T]he income of each person in the community depends on the relative strength of his power of coercion, offensive and defensive."[314] Coercion permeates the economic system; "there is compulsion in all contracts," and so the legal decision is merely what sorts of compulsion are to be proscribed.[315]

Coercion is thus the result of law, and duress is merely the term we apply to coercion that we find somehow repellent. And this coercion can come about because of lawful acts—for example, threats of civil suits.[316] Adequate assurance could thus be termed duress if there are no good reasons for it—if, that is, its enshrinement in the statute books and the reporters is the sole reason it is not duress.[317] Hale suggested that one might find coercion by

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310. Though other Realist and proto-Realist writers raised similar critiques. *See, e.g.*, John Dalzell, *Duress by Economic Pressure I*, 20 N.C. L. REV. 237, 238-40 (1942); Dawson, *supra* note 297, at 262-67, 287-89; *see also, e.g.*, Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 575-78 (1933) (criticizing will theory).

311. It should be said that Hale used coercion neutrally, with no plan to evoke the stigma customarily given it. *See* Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470, 476 (1923); Warren J. Samuels, *The Economy as a System of Power and Its Legal Bases: The Legal Economics of Robert Lee Hale*, 27 U. MIAMI L. REV. 261, 280-81 (1973).

312. *See* Hale, *supra* note 311, at 471-74.

313. This notion derives from Hohfeldian jurisprudence. *See* WESLEY N. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS (Walter W. Cook ed., 1964). Hale was, as Professors Kennedy and Samuels have pointed out, influenced by Hohfeld, and used his jural correlatives implicitly and explicitly. *See* Duncan Kennedy, *The Stakes of Law, or Hale and Foucault!*, 15 LEGAL STUD. F. 327, 333-34 (1991); Samuels, *supra* note 311, at 274-76.

314. Hale, *supra* note 311, at 477; *see also* Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 612 (1943).

315. ROBERT L. HALE, FREEDOM THROUGH LAW 124 (1952).

316. *See, e.g.*, John P. Dawson, *Duress Through Civil Litigation*, 45 MICH. L. REV. 571, 679 (pts. 1 & 2) (1947).

317. A point made more fully by Alan Wertheimer, in his attempt to give moral force to the theory of coercion. ALAN WERTHEIMER, COERCION (1987).

Compare taxation. This is rather clearly coercion; if you don't think so, try evading your taxes. Yet most of us are willing at some level to accept taxation as a good thing, even as we grumble about the level. *Cf.* Compañía General de Tabacos

looking at the difference between a standard result—perhaps the market price—and the result exacted, or by searching for the difference between the use of a privilege and the purpose for which the privilege was accorded.[318]

The first of these differences may well speak against adequate assurance. If the assumption above is correct, then the effect of adequate assurance is to grant the promisee more than its bargain, through the coerced modification that adequate assurance gives troubled promisees. So too the second difference. Certainly the opportunistic use of adequate assurance would qualify, and the courts generally have recognized that it cannot be used, for instance, to avoid the consequences of one's own breach, or get out of a burdensome contract on spurious grounds.[319] Beyond those limited instances, though, it would seem that by definition the purpose of adequate assurance is met by its proper exercise. But this is not so if the purposes of adequate assurance are unsound, or if the purposes are undermined by adequate assurance itself.[320] The critique of adequate assurance above may thus, if valid, lead us to view adequate assurance as an almost oxymoronic lawful duress—coercion unrooted in overall liberty or fairness.[321]

V. THE COGNITIVE SOLUTION TO ALLOCATED RISK

The risk-based critique of adequate assurance discussed earlier is itself subject to criticism. The earlier analysis assumes

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de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting) ("Taxes are what we pay for civilized society."). And when taxation loses these outward supports, we find tax rebels, as today, or rather substantial revolutions—consider, for example, a certain British tea tax a little over two centuries ago.

318. *See* Hale, *supra* note 314, at 619, 624.

319. *See supra* notes 171-73 and accompanying text.

320. Indeed, even if adequate assurance can be supported somehow, other doctrines may do the work as well with less offense to volition. For instance, contractual default clauses could allow for assurances; though the enforcement of contracts is itself coercive, at least the parties more or less voluntarily created this right to coercion. And the typical adequate assurance case involves businesses with relative equality of bargaining power at the time of contracting.

321. And it should be recalled that a promisee invokes adequate assurance precisely when the promisor is weakest—when there is some reason for insecurity. But for adequate assurance, a promisee seeking to compel a promisor to modify the contract on pain of breach would be subject to charges of duress or, in the right circumstances, extortion.

that contracting parties will analyze risk fairly well when they enter into contracts, and that they prefer to adjust risk ex post rather than to do so ex ante, at least for the type of risk that falls under section 2-609.[322] It assumes as well that contracting parties will tend not to make deals as though section 2-609 is to be taken into account. Is this a realistic picture of contracting? Only in part. It probably is true that parties enter into agreements with nary a thought to adequate assurance.[323] But what of their risk analysis? After all, the parties do not live in an ideal world, free of transaction costs and blessed with a superabundance of perfect and costlessly processed information. Instead, they live here, contracting with decidedly imperfect and costly facts at hand.

Imperfect information itself is not problematic. Indeed, it is inevitable; neither information nor its assimilation is free, and at some point the marginal costs of each will exceed the marginal gains. Hence Herbert Simon's concept of bounded rationality.[324] We have basic limits on our capacity for information, whether innate or not, and so we cannot give unbridled scope to our desire for perfect knowledge and perfect understanding. We therefore develop means by which we can arrive at decisions that seem satisfactory, though not, perhaps, ideal, given the information (and the means of processing it) that we have. In Simon's term, we "satisfice."[325] Satisficing does not reject rationality; rather, it embraces it, albeit somewhat chastely. Put otherwise, we are "*intendedly* rational, but only *limitedly* so."[326]

Is this a problem? Not necessarily. Satisficing creates some chance that the omitted facts will affect the outcome materially.

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322. If the parties expressly provide that one or the other should bear the risk of default, then § 2-609 would not apply.

323. *See supra* notes 197-210 and accompanying text.

324. *See, e.g.*, 1 HERBERT A. SIMON, MODELS OF BOUNDED RATIONALITY (1982); Herbert A. Simon, *Rationality in Psychology and Economics*, *in* RATIONAL CHOICE: THE CONTRAST BETWEEN PSYCHOLOGY AND ECONOMICS 25 (Robin M. Hogarth & Melvin W. Reder eds., 1987) [hereinafter RATIONAL CHOICE]; Herbert A. Simon, *Rationality as Process and as Product of Thought*, 68 AM. ECON. REV.: PAPERS & PROC. 1 (1978) [hereinafter Simon, *Rationality*]; *see also, e.g.*, John Conlisk, *Optimization Cost*, 9 J. ECON. BEHAV. & ORG. 213 (1988); Sidney G. Winter, *Satisficing, Selection, and the Innovating Remnant*, 85 Q.J. ECON. 237 (1971).

325. *See, e.g.*, JAMES G. MARCH & HERBERT A. SIMON, ORGANIZATIONS 140-41 (1958); Simon, *Rationality*, *supra* note 324.

326. HERBERT SIMON, ADMINISTRATIVE BEHAVIOR xxiv (2d ed. 1957) (emphasis in original).

Our limitedly rational decisions are potentially wrong.[327] If they are randomly wrong, though, they may, over time, yield a balanced result, one that looks as though it came about through the usual skilled prestidigitation of the Smithian invisible hand. An error toward risk-aversion will be balanced by one toward risk-seeking, and so we will in essence diversify our own little risk portfolios.[328] If, however, a contracting party errs on one side when estimating risk or responding to information (or its absence), then expected utility theory may predict outcomes poorly.

If underestimation is balanced with overestimation, netting out might yield rough compensation.[329] But this is more likely true for markets than for individuals. Markets should even out over time, insolvency problems aside.[330] Individuals may consistently err, though, and by erring may incur substantial losses (whether by buying too much or too little protection against risk). If we do not see balancing, then we might have a case for legal intervention—a sort of corrective lens for behavioral myopia, if you will, which would allow the market to function as though no error were being made.

But is this sort of error made? By whom? And, if so, what should correct it, and can we justify fussing with the market in this manner and for this reason? Hence this part.

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327. Though they may be the best decisions possible given the available data and the limits on processing. *See* David M. Grether et al., *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277, 287 (1986). On the other hand, they may not; satisfaction with one's choice may mean only that one is making a good enough decision, rather than the best available.

328. A familiar result in expected utility analysis. *See, e.g.*, Milton Friedman, *The Methodology of Positive Economics*, *in* ESSAYS IN POSITIVE ECONOMICS 3, 22 (1953); FRANK H. KNIGHT, RISK, UNCERTAINTY & PROFIT 67 n.1 (1921).

329. Or perhaps not. A party that overvalues risk may demand too high a price, or be willing to pay too little, perhaps causing its prospective partner to make other arrangements. Both parties would make their next-best deals, and thus would not put their goods or services to their best use. Only if the deals go through anyway could overestimation and underestimation balance out. In addition, the costs associated with random error may yield market fluctuations. *See* John Conlisk, *Bounded Rationality and Market Fluctuations*, 29 J. ECON. BEHAV. & ORG. 233 (1996).

330. *See, e.g.*, Dhananjay K. Gode & Shyam Sunder, *Allocative Efficiency of Markets with Zero-Intelligence Traders: Market as a Partial Substitute for Individual Rationality*, 101 J. POL. ECON. 119, 135-36 (1993). Insolvency should tend to select against risk-takers by culling those whose risks do not pay off. Accordingly, firms should become less risk-taking over time. *See* Douglas W. Diamond, *Reputation Acquisition in Debt Markets*, 97 J. POL. ECON. 828, 841-45 (1989).

A. *Expected Utility Theory and its Critics*

The basic model underlying the conventional economic model of risk assumes that economic actors behave rationally. Our old friend *homo economicus*, first cousin to that bane of the common lawyer,[331] the reasonable person,[332] seeks unceasingly in her self-interest to maximize her expected utility.[333] Rational choice theory[334] posits two types of ability—one based on information, and the other based on process.[335] The first assumes that a rational person faced with a decision knows all the choices available to her, along with their prices, and knows as well what she wants or needs.[336] The essence of rational choice theory is thus omniscience, both about one's self and about the world.[337] Hardly a world consistent with bounded rationality.[338]

The second—ideal process—entails a good many assumptions about behavior. The economic actor must be able to compute the probability of future events, assess accurately the various outcomes, and correctly perceive her own attitude to risk—be it

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331. Or at least the common law student.

332. Rather a depressing sort, isn't he? Probably useful enough as a bank manager or actuary, but not much fun at parties. *Cf.* A.P. HERBERT, Fardell v. Potts: *The Reasonable Man*, *in* THE UNCOMMON LAW 1, 4 (rev. ed. 1969) ("[T]his excellent but odious character stands like a monument in our Courts of Justice, vainly appealing to his fellow-citizens to order their lives after his own example.").

333. Or, more precisely, her *subjective* expected utility; idiosyncratic preferences fall within rational choice theory. *See* PAUL ANAND, FOUNDATIONS OF RATIONAL CHOICE UNDER RISK 6-7 (1993).

334. Also known as expected utility theory. The terms will be used interchangeably.

335. *See, e.g.*, Jules L. Coleman, *Rational Choice and Rational Cognition*, 3 LEGAL THEORY 183, 183 (1997).

336. *See, e.g.*, Eisenberg, *supra* note 16, at 213; Ulen, *supra* note 21, at 386.

337. *See, e.g.*, LEONARD J. SAVAGE, THE FOUNDATIONS OF STATISTICS 16 (2d ed. 1972). In fairness to rational choice theorists, who, though hardly omniscient, are also hardly obtuse, their theory does not actually require that a rational actor, faced with a complex decision—say, deciding which flavor of ice cream to buy at a Baskin-Robbins—knows everything about everything. Rather, they require only knowledge about all potentially relevant preferences and states of the world. Further, some degree of economizing on reality seems not inconsistent with rational choice theory, at least in principle; one can use exemplary methods to reason from woefully incomplete data. These economies on information also can and do produce a good deal of inconsistency and error.

338. Indeed, it can be shown that the standard assumptions of rational choice theory are inconsistent with bounded rationality. *See, e.g.*, Joshua S. Gans, *On the Impossibility of Rational Choice under Incomplete Information*, 29 J. ECON. BEHAV. & ORG. 287 (1996).

aversion, attraction, or neutrality. In addition, this marvel of rationality must analyze the information like a good Bayesian,[339] calculating the expected values of the range of events and deciding accordingly which will maximize her expected utility. To do that, expected utility theory assumes that its economic agents will display at least two traits—dominance and invariance.[340] Dominance requires that if one prefers A to B under one set of circumstances and thinks A at least as good in all others, then one should prefer A to B.[341] Invariance holds that any statement of a choice problem should yield the same result.[342]

These assumptions are formidable, and have hardly escaped censure. As Kenneth Arrow observed, "[h]ypotheses of rationality have been under attack for empirical falsity almost as long as they have been employed in economics."[343] If these hypotheses are untrue, then what? Expected utility theory may still be useful as an ideal construction,[344] and some argue that the ideal

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339. That is, she must calculate the probability of a future event, given the likelihood of the event and the probabilities of false negatives and false positives. *See, e.g.*, JONATHAN BARON, THINKING AND DECIDING 203-15 (2d ed. 1994); J. FRANK YATES, JUDGMENT AND DECISION MAKING 134-36 (1990).

340. *See* Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, *in* DECISION MAKING: DESCRIPTIVE, NORMATIVE, AND PRESCRIPTIVE INTERACTIONS 167, 168-69 (David E. Bell et al. eds., 1988) [hereinafter DECISION MAKING]. Expected utility theorists sometimes assign different names to their axioms, but these concepts seem central to the enterprise. *See, e.g.*, ANAND, *supra* note 333, at 12-15; Colin Camerer, *Individual Decision Making*, *in* HANDBOOK OF EXPERIMENTAL ECONOMICS 587, 618-19 (John H. Kagel & Alvin E. Roth eds., 1995).

341. *See, e.g.*, ANAND, *supra* note 333, at 13-14, 74-86. This resembles Pareto-superiority, the economist's favored means of determining preference. *See, e.g.*, COOTER & ULEN, *supra* note 242, at 12.

342. Arrow refers to this as extensionality. Kenneth J. Arrow, *Risk Perception in Psychology and Economics*, 20 ECON. INQUIRY 1, 6 (1982).

More precisely, expected utility theorists often add to these cancellation and transitivity. The first of these eliminates any states of the world that produce common results, regardless of one's choice. If, for example, one prefers bungee-jumping to croquet, then one prefers the prospect of bungee-jumping next Tuesday if one's mother-in-law does not visit (in which case one does not jump—at least, not while attached to a bungee cord) to the prospect of playing croquet if one's mother-in-law does not visit. Transitivity assumes that if A is preferred to B and B to C, then A will be preferred to C. Though expected choice theorists tend to assume both of these, many have rejected cancellation and some transitivity. *See, e.g.*, Tversky & Kahneman, DECISION MAKING, *supra* note 340, at 169. These castings-off were inspired in large part by the conflicting empirical evidence discussed below. However, expected utility theorists cling to dominance and invariance, both essential parts of a theory of rational decision. *See id.*

343. Arrow, *supra* note 342, at 1.

344. *See, e.g.*, ANAND, *supra* note 333, at 43-54.

should underpin legal rules.[345] But if legal rules should reflect how those subject to them actually behave—a long-dominant argument in commercial law[346]—then legal rules, or critiques of legal rules, bottomed on perfect rationality must be called into question. Of course, here is an *attack* based on rationality—that adequate assurance is dubious because the parties should be expected to have allocated risk contractually through charging a risk premium. If, however, the promisors err systematically by undervaluing risk, then the premium will prove inadequate and some sort of case can be made for adequate assurance.[347] A close look at the empirical validity of expected utility theory thus seems in order.[348]

Cognitive psychology and experimental economics have found a smorgasbord of cognitive errors, which collectively falsify most of the axioms of rational choice theory.[349] This, however, is not the place for a taxonomy of cognitive psychology.[350] Instead, this article will discuss those aspects of modern behavioral decision theory that seem most germane to the adequate assurance problem. These are availability, over-optimism, prospect theory, and framing. Following that discussion, this article considers whether these cognitive failings should affect legal rules in

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345. *See infra* Part V.F.1.

346. *See, e.g.*, Kerry Lynn Macintosh, *Liberty, Trade, and the Uniform Commercial Code: When Should Default Rules Be Based on Business Practices?*, 38 WM. & MARY L. REV. 1465 (1997); Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465 (1987).

347. Overestimating risk is less worrisome. The risk premium would then be too high. However, the market may well correct for some of that; promisors would over time select against excessive prices. Even if not, the excessive risk premium would merely compensate for such things as the transaction costs associated with insecurity and breach and the costs of third-party insurance (for which one has to pay extra). Thus, overestimation should not generally change the legal rule.

348. There is another type of error that the promisee could make—an error ex post in predicting the likelihood that the promisor will fail. If the promisee underestimates this risk, it may not demand assurances when a demand would be appropriate. More troubling is if the promisee overestimates this risk. Then it may demand assurances when it ought not, or demand more than would be adequate (and, either way, take on a risk of breach). *See supra* note 188 and accompanying text.

349. As one expected utility theorist puts it, "if [expected utility theory] is an empirical, testable theory, then it is, in any conventional sense, untrue." ANAND, *supra* note 333, at 19.

350. Useful summaries include Richard H. Thaler, *The Psychology of Choice and the Assumptions of Economics*, *in* QUASI RATIONAL ECONOMICS 137 (1991); JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman et al. eds., 1982) [hereinafter JUDGMENT]; RATIONAL CHOICE, *supra* note 324.

general (they should), and how they should affect adequate assurance in particular.

B. Availability

As discussed earlier, the costs, both internal and external, of information require that we ration rationality—engage, that is, in bounded rationality. In theory, one can economize on information and still come out with the right result; the coin-flip is perhaps the ultimate example. But *how* we economize can greatly affect the sort of result we reach.

Cognitive psychologists have shown that people simplify their analyses by adopting rules of thumb—heuristics—that guide them to conclusions quickly and cheaply. In their most innocuous form, heuristics might indeed work well. For instance, a baseball coach might look at a tall, left-handed recruit and decide that the player should be tried at first base, or a sales clerk might look at two potential customers and serve the better-dressed one first. In each case, the decision was based on incomplete information, but the decision-maker identified some salient attributes and used them to make a preliminary decision.[351]

Less innocently and less accurately, though, the decision-maker may grasp at the most obvious facts first—not the most pertinent, but the most memorable. This has been termed the availability heuristic.[352] If memory and frequency or probability correlate perfectly, then the heuristic works perfectly. But vivid memories may color our recollections too garishly, distorting our perceptions and, through this heuristic, our analyses. To take a trivial example, ask yourself whether there are more words that

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351. Note the word preliminary. Persistent uses of heuristics after newer information has become available shifts into the more invidious stereotyping and bias. For that matter, which factors we deem salient will affect greatly our initial perceptions, and can lead to a range of cognitive errors. For an interesting application of this problem—the representativeness heuristic—see Linda Hamilton Krieger, *The Content of Our Categories: A Cognitive Bias Approach to Discrimination and Equal Employment Opportunity*, 47 STAN. L. REV. 1161, 1200-02 (1995).

352. *See, e.g.*, Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1127-28 (1974); Amos Tversky & Daniel Kahneman, *Availability: A Heuristic for Judging Frequency and Probability*, 5 COGNITIVE PSYCHOL. 207, 208 (1973) [hereinafter Tversky & Kahneman, *Availability*].

start with the letter *k* or that have *k* in the third position. If you chose the former, then welcome to the club; over two-thirds of those tested said that. But in fact about twice as many words in a typical text carry *k* in the third position rather than in the first. Why do most people err here? Because it is easier to recall words that begin with *k* than words that carry *k* inside, so the sharpness of all those words starting with *k* yields the incorrect answer.[353] Or another: When people are asked to judge the frequency of death from a range of causes, they tend to underestimate unspectacular causes of death (stomach cancer, diabetes), while overestimating more sensational causes (tornadoes, floods).[354] And those with personal experiences of disasters generally take greater precautions than those with none, given the same actual risk.[355] Again, the dominant datum overwhelms its recessive mate.

The availability heuristic may affect ex ante risk assessment, but it is not easy to predict how it will have its effect. Some types of risk—non-payment by a buyer, for instance—are all too frequent, and so may by their frequency impress themselves on the minds of promisees. On the other hand, most mercantile risks will not make the front page of the local newspaper. Declining markets, increasing costs, even remote plant closings that impair supply—all are quotidian risks, unlikely to emerge from the gray background of commonplace fact. To be sure, a recent disaster may figure into one's risk calculus, at least in the short run.[356] In the long run, though, silence may breed overoptimism, as quietude, filtered through availability, yields too low an estimate of risk.[357]

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353. *See* Tversky & Kahneman, *Availability*, *supra* note 352, at 211-12. And congratulations if you got it right.

354. *See* Paul Slovic et al., *Facts Versus Fears: Understanding Perceived Risk*, *in* JUDGMENT, *supra* note 350, at 463, 466-67.

355. *See* Neil D. Weinstein, *Effects of Personal Experience on Self-Protective Behavior*, 105 PSYCHOL. BULL. 31 (1989).

356. Though not in the long; if the event is sufficiently rare, its prominence will recede over time, displaced by the disaster *du jour*. On the other hand, if the event is sufficiently salient to attract attention, and sufficiently common to recur before memories of the last have quite faded, then availability may well magnify the effect. Airplane crashes might be a good example of the latter, as, say, Chernobyl is of the former. *See, e.g.*, Baruch Fischhoff, *Cognitive Liabilities and Products Liability*, 1 J. PROD. LIAB. 207, 208 (1977); Noll & Krier, *supra* note 21, at 769-71.

357. *See, e.g.*, Paul Slovic et al., *Response Mode, Framing, and Information-Processing Effects in Risk Assessment*, *in* NEW DIRECTIONS FOR METHODOLOGY OF

A look at adequate assurance cases shows a wide range of possible heuristic effects. Some insecurity arises from rare but spectacular events, which are unlikely to be given sufficient weight unless they have happened recently—in which case they may be overweighted.[358] Much more insecurity is bland but frequent, which again pulls in different directions: is it the frequency or the blandness that will have the greater effect?[359] After all, the great majority of contracts are performed in full, making breach exceptional. Doubt is, however, rather more common. For example, though only a very modest percentage of debts must be written off, a good many accounts receivable—some twenty percent—are paid late.[360] Delinquency is thus in the mind of every credit manager, and, by extension, every credit seller. The very commonness of ultimate payment may well, however, push non-payment to the margin, yielding undervaluation.[361] Insofar as one can generalize, there seems to be a mild move toward undervaluation because of availability for the sorts of risk present in adequate assurance cases, but the effect may not be robust and may reverse for the most salient risks.[362]

SOCIAL AND BEHAVIORAL SCIENCE: QUESTION FRAMING AND RESPONSE CONSISTENCY 21, 24 (Robin M. Hogarth ed., 1982); Valerie S. Folkes, *The Availability Heuristic and Perceived Risk*, 15 J. CONSUMER RES. 13 (1988) (consumer estimates of product risk).

358. *See, e.g.*, Ford Motor Credit Co. v. Alachua Trading Co., 531 So. 2d 982, 984 (Fla. Dist. Ct. App. 1988) (property potentially subject to forfeiture due to illegal drug transaction); Dumesnil, Inc. v. Republic Nat'l Mortgage Co., No. L-83-218 (Ohio Ct. App. Dec. 30, 1983) (§ 251; purported agent of lender convicted of loan fraud).

359. For example, ordinary risks of non-payment.

360. *See, e.g.*, Waugh & Chung, *supra* note 1, at 40 (1992 survey: bad debts as a percentage of sales averaged 0.21%, while delinquent receivables as a percentage of sales averaged 21.7%).

361. A recent study by the Commercial Law League of America speaks to collection frequency. Some 98.1% of all commercial debts are paid. Though the rate of payment drops with delinquency, the drop-off is relatively slow for the first few months. Fully 93.3% of commercial debts overdue by a month were paid, as were 84.9% of those two months overdue. COMMERCIAL LAW LEAGUE OF AMERICA, NATIONAL COMMERCIAL COLLECTION AGENCY ASSOCIATION RELEASES NEW DATA ON COLLECTABILITY: PROBABILITY OF COLLECTING DROPS DRAMATICALLY AFTER ONLY 3 MONTHS DELINQUENT (1996).

362. Cognitive dissonance may also prove relevant. In general, people prefer consistent beliefs to inconsistent beliefs, and thus tend to suppress information that would yield inconsistency were it properly weighted. Thus, for example, workers in hazardous industries generally downplay the risks they face; the riskiness conflicts with our tendency to think ourselves prudent and rational, so they resolve the dissonance by diminishing the perceived risk. *See* George A. Akerlof & William T. Dickens, *The Economic Consequences of Cognitive Dissonance*, 72 AM. ECON. REV.

C. *Over-Optimism*

Optimists are, on the whole, more fun to be around than pessimists. Literature's optimists—Pangloss, Micawber—are endearing and memorable, perhaps more so than their gloomier counterparts. But a moment's reflection reminds us that these literary characters found their optimism more than a little burdensome.[363]

So too with us. Experiment has shown that we are an optimistic lot, consistently underestimating risks and over-estimating advantages. For example, some ninety percent of drivers think that they drive better than average.[364] College students who are about to enter the working world are six times more likely to think they will like their jobs more than average than less than average.[365] Only three percent of consumers think their houses riskier than the average house as to a child's poisoning by drain cleaner.[366] Nor are these biases unique to college students or consumers; merchants and other professionals are quite as prone. For example, manufacturing firms are consistently over-optimistic about expected production.[367]

307, 307-08 (1982). *See generally* LEON FESTINGER, A THEORY OF COGNITIVE DISSONANCE (1957); Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387, 1436 (1983). Here, the promisee may have placed trust and relation at the center of his beliefs—after all, most contracts are performed, and the promisor-to-be may well be someone with whom the promisee has dealt successfully. If so, cognitive dissonance suggests that the promisee will tend to undervalue the risks of non-performance, for they contradict the central values of performance and trust. In contrast, a single-shot transaction between discrete parties would be much less likely to yield dissonance, because the promisee would have less reason to trust the promisor. Salient risks would thus be less dissonant. *See* Schwartz & Wilde, *supra*, at 1436. *But cf.* Gillette, *supra* note 16, at 548-49 (doubting general relevance of cognitive dissonance in commerce).

363. Pangloss ended up a syphilitic wreck and Micawber emigrated to Australia. I leave it to the reader to determine which was the direr fate.

364. *See* Ola Svenson, *Are We All Less Risky and More Skillful Than Our Fellow Drivers Are?*, 47 ACTA PSYCHOLOGICA 143, 146 (1981).

365. *See* Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCHOL. 806, 810 (1980). They are also about six times more likely to think they will own their own homes, seven times less likely to think they will have drinking problems, and nine and one-half times less likely to think they will divorce soon after marriage. *See id.*

366. *See* W. KIP VISCUSI & WESLEY A. MAGAT, LEARNING ABOUT RISK: CONSUMER AND WORKER RESPONSES TO HAZARD INFORMATION 94-95 (1987).

367. *See* Jakob Brochner Madsen, *Tests of Rationality Versus an "Over Optimist" Bias*, 15 J. EXPERIMENTAL PSYCHOL. 587 (1994).

Successful small-firm entrepreneurs tend to be strongly self-assured.[368] And business history is rife with booms, crazes, and manias.[369] Small wonder, then, that the only group that seems consistently to get it right—to get subjective probabilities to mirror objective probabilities—is the clinically depressed.[370] The phenomenon is thus vigorous and prevalent.[371]

That this is so is interesting and, as we shall see, significant. Why this is so is more interesting, though more controverted. Madsen has suggested that over-optimism stems from over-confidence. A good many studies have shown that people, be they students,[372] psychologists,[373] or CIA analysts,[374] tend to have excessive confidence in their decisions—that is, they give too narrow a confidence interval for their probability estimates.[375] As

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368. *See* Satvir Singh, *Personality Characteristics, Work Values and Life Styles of Fast- and Slow-Progressing Small Scale Industrial Entrepreneurs*, 129 J. SOC. PSYCHOL. 801 (1989); *see also, e.g.*, KENNETH R. MACCRIMMON & DONALD A. WEHRUNG, TAKING RISKS (1986); ZUR SHAPIRA, RISK TAKING: A MANAGERIAL PERSPECTIVE (1995); James M. Buchanan & Roger L. Faith, *Entrepreneurship and the Internalization of Externalities*, 24 J.L. & ECON. 95, 98 (1981) (entrepreneurial optimism); Manfred J. Holler et al., *Decisions on Strategic Markets—An Experimental Study*, 8 SCAND. J. MGMT. 133 (1992) (relative success of entrepreneurs with low risk-aversion); Leslie E. Palich & D. Ray Bagby, *Using Cognitive Theory to Explain Entrepreneurial Risk-Taking: Challenging Conventional Wisdom*, 10 J. BUS. VENTURING 425 (1995) (entrepreneurial optimism).

369. For the classic treatment, see CHARLES MACKAY, EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS (Harmony Books 1990) (1841); *see also* CHARLES KINDELBERGER, MANIAS, PANICS, AND CRASHES (1978); *cf.* Fuerbringer, *supra* note 21, at 6 (quoting Alan Greenspan, Chairman of the Federal Reserve Board; stock market may show "irrational exuberance").

370. *See* Lauren B. Alloy & Lyn Y. Abramson, *Judgment of Contingency in Depressed and Nondepressed Students: Sadder but Wiser?*, 108 J. EXPERIMENTAL PSYCHOL. 441 (1979); *see also, e.g.*, Benjamin M. Dykman et al., *Effects of Ascending and Descending Patterns of Success Upon Dysphoric and Nondysphoric Subjects' Encoding, Recall, and Predictions of Future Success*, 15 COGNITIVE THERAPY & RES. 179 (1991).

371. And old; Adam Smith pointed it out long ago. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 124 (Edwin Cannan ed., Modern Library 1994) (1776).

372. *See, e.g.*, Lyle A. Brenner et al., *Overconfidence in Probability and Frequency Judgments: A Critical Examination*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 212 (1996).

373. *See, e.g.*, Stuart Oskamp, *Overconfidence in Case-Study Judgments*, *in* JUDGMENT, *supra* note 350, at 287.

374. *See* R.M. Cambridge & R.C. Shreckengost, *Are You Sure? The Subjective Probability Assessment Test* (CIA 1978), *described in* Sarah Lichtenstein et al., *Calibration of Probabilities: The State of the Art to 1980*, *in* JUDGMENT, *supra* note 350, at 306, 314.

375. *See, e.g.*, Daniel Kahneman & Amos Tversky, *Intuitive Prediction: Biases*

a result, they assign too great a weight to relatively probable events and too low a weight to relatively improbable events. Because most risks are relatively improbable, they are generally undervalued, yielding over-optimism.[376] Alternatively, one might say that overconfidence by definition means too low an expected variance; as we tend to take precautions in order to reduce our variance, we thus underprotect.[377] Another explanation depends on the availability heuristic; if we tend to weight most heavily the information that is most vivid, then we are apt to overweight our own experiences. We are likely to be innocent of most rare events, the occasional Jonah aside. Accordingly, we will underestimate probabilities of events that have not yet happened to us or our friends.[378]

In any event, to the extent that those about to contract are overly optimistic, they will undervalue the risk of breach, and thus will set too low a risk premium. Indeed, they might not set one at all, if their over-optimism proves excessively ebullient. This problem is not irremediable; as discussed below, one can learn to be staid (though not always very well, or for very long).[379]

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and Corrective Procedures, 12 TIMS STUD. MGMT. SCI. 313, 321-26 (1979). For useful reviews of the overconfidence literature, see YATES, *supra* note 339, at 75-107; Baruch Fischhoff, *Debiasing*, *in* JUDGMENT, *supra* note 350, at 422, 439-40. Yates finds that professionals show much less overconfidence than laypeople, but that overconfidence, at least in the probability-range sense, is not infrequent. YATES, *supra* note 339, at 75-107. Indeed, one sees *under*confidence for easy questions. *See* Lichtenstein & Baruch Fischhoff, *Do Those Who Know More Also Know More About How Much They Know?*, 20 ORGANIZATIONAL BEHAV. & HUM. PERFORMANCE 159 (1977); *see also* Dale Griffin & Amos Tversky, *The Weighing of Evidence and the Determinants of Confidence*, 24 COGNITIVE PSYCHOL. 411, 412, 425-28 (1992) (noting that a wide range of occupations are overconfident; easy questions tend to yield underconfidence).

More generally, the very existence of overconfidence has been challenged as a misreading of the data, which, the critics say, simply show perfectly rational regression. *See* Robyn M. Dawes & Matthew Mulford, *The False Consensus Effect and Overconfidence: Flaws in Judgment or Flaws in How We Study Judgment?*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 201 (1996). *But see* Dale W. Griffin & Carol A. Varey, *Towards a Consensus on Overconfidence*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 227 (1996) (responding to and rebutting Dawes & Mulford).

376. *See* Madsen, *supra* note 367, at 589-90. This effect would be exacerbated by cognitive dissonance, the tendency of those faced with conflicting data to suppress the less palatable set. *See supra* note 362; *see also* Gillette, *supra* note 16, at 558.

377. *See* Camerer, *supra* note 340, at 594-95.

378. *See, e.g.*, Slovic, *supra* note 354, at 468-70. Of course, there are countervailing aspects of availability, as discussed above.

379. *See infra* Part V.F.4; *cf.* W.S. GILBERT, RUDDIGORE (1887) (the rapid

And over-optimism might affect one's willingness to invoke the mechanism of assurance; if one thinks the other party likely to pull things together, one will be reluctant to sunder a relation for a notional gain.[380]

D. Prospect Theory

First, a quick reminder of expected utility theory. Those wedded to pure rationality tend to assume that economic actors are risk-neutral; if a person departs from risk-neutrality, she will either forego potentially profitable economic endeavors (risk-aversion) or undertake potentially unprofitable ones (risk-seeking).[381] Two common observations, however, undercut this assumption. First, diminishing marginal utility (a concept dating back to Bernoulli) suggests that remote though large gains will be discounted relative to immediate though small losses.[382] Second, bounded rationality means that some information will be discounted or ignored in decision-making, and the availability heuristic points to the inflation of other, vivid information.[383] Thus the usual economic assumption of risk-aversion.[384]

Prospect theory challenges this assumption. It agrees that people are risk-averse, but only with respect to gains. In contrast to expected utility theory, it holds that people are risk-seeking with respect to losses. Finally, it finds that people react more

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transition— during intermission, evidently—of the evil Sir Despard and the batty Mad Margaret to dull respectability (though Margaret's has not quite taken)).

380. This last effect may, however, be countered by the vividness of the present insecurity.

381. For an example of risk-neutral analysis, together with a defense of its use, see William M. Landes & Richard A. Posner, *The Positive Economic Theory of Tort Law*, 15 GA. L. REV. 851, 867-68 (1981). Profitable and unprofitable here refer to the net expected result, rather than to any particular possible outcome.

382. *See, e.g.*, SHAPIRA, *supra* note 368, at 7-8; Kenneth J. Arrow, *The Theory of Risk Aversion*, *in* ESSAYS IN THE THEORY OF RISK-BEARING 90, 90 (1971). Bernoulli's original observation was in Daniel Bernoulli, *Specimen Theoriae Novae de Mensura Sortis*, 5 COMMENTARII ACADEMIAE SCIENTARUM IMPERIALES PETROPOLITANAE 175 (1738), *reprinted and translated in Exposition of a New Theory on the Measurement of Risk*, 22 ECONOMETRICA 23 (1954).

383. *See, e.g.*, Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. LEGAL STUD., 535, 552-53 (1990).

384. An assumption dating back, as usual, to Adam Smith. ADAM SMITH, THE THEORY OF MORAL SENTIMENTS 212-17 (D.D. Raphael & A.L. Macfie eds., Clarendon Press 1976) (1759). For more recent analyses, see, for example, COOTER & ULEN, *supra* note 242, at 45-47; John W. Pratt, *Risk Aversion in the Small and in the Large*, 32 ECONOMETRICA 122 (1964).

strongly to losses than to gains (loss aversion).[385] To put it more concretely: Most people would prefer a sure gain of $100 to an even chance to win either $200 or nothing (risk aversion). On the other hand, most people would prefer an even chance to lose either $200 or nothing to a sure loss of $100 (risk seeking). And most people would prefer a sure gain of nothing to an even chance to win $100 or lose $100 (loss aversion).[386]

Which is more soundly based in reality: expected utility theory or prospect theory? Experiment supports the latter. For example, when students were asked whether they would prefer an eighty percent chance at gaining £4,000 or a certain gain of £3,000, eighty percent chose the certainty—even though the net value of the uncertain result exceeds that of the certain result. In contrast, when asked whether they would prefer an eighty percent chance at losing £4,000 or a certain loss of £3,000, ninety-two percent chose the less certain loss—even though the net loss or the uncertain result exceeded that of the certain result.[387] This study does not merely show aversion to uncertainty, because the subjects strongly preferred uncertainty when the problem asked about loss. Neither is it wholly consistent with expected utility theory; though both prospect theory and expected utility theory explain the risk aversion with respect to gain, only prospect theory explains the mirrored result for loss. Note also that the effect was more pronounced for loss than for gain, which is consistent with loss aversion.

Prospect theory also may be found in business settings. For instance, foreign exchange managers show loss aversion, as well as other departures from a Bayesian model.[388] Financial planners also seek risk when faced with losses, but certainty when faced with gains.[389] For that matter, organizational actions

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385. *See, e.g.*, Daniel Kahneman & Amos Tversky, *Choices, Values, and Frames*, 39 AM. PSYCHOLOGIST 341, 342 (1984).

386. *See, e.g.*, George A. Quattrone & Amos Tversky, *Contrasting Rational and Psychological Analyses of Political Choice*, 82 AM. POL. SCI. REV. 719, 721 (1988). It should be added that these effects may not obtain when the question is framed in terms of insurance, a point to be discussed later. *See infra* notes 411-20 and accompanying text.

387. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 268 (1979).

388. *See* Benn Steil, *Corporate Foreign Exchange Risk Management: A Study in Decision Making Under Uncertainty*, 6 J. BEHAV. DECISION MAKING 1 (1993).

389. *See* Michael J. Roszkowski & Glenn E. Snelbecker, *Effects of "Framing" on Measures of Risk Tolerance: Financial Planners Are Not Immune*, 19 J.

have been shown to conform to prospect theory.[390] Other studies have shown the same effects.[391]

These results affect our analysis of adequate assurance because, as noted earlier, the principal difficulty with adequate assurance is the gain for the promisor that would result were the parties to have allowed appropriately for the risk.[392] Consequently, any deviations from risk-neutrality may affect whether such a bonus exists. When faced with a range of losses, parties tend to be risk-seeking. Accordingly, a promisee would be expected to prefer a modest risk of a large loss to a certain but small loss, thus yielding undervaluation of the remote risk.

The undervaluation is seemingly exacerbated by the uncertainty that attends adequate assurance. Many of the pertinent standards lack bright lines, instead relying on fact-driven inquiries into reasonableness and adequacy.[393] A prudent lawyer will thus advise her client that adequate assurance carries with

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BEHAVIORAL ECON. 237 (1990).

390. *See* Richard A. D'Aveni, *Dependability and Organizational Bankruptcy: An Application of Agency and Prospect Theory*, 35 MGMT. SCI. 1120 (1989); Avi Fiegenbaum & Howard Thomas, *Attitudes Toward Risk and the Risk Return Paradox: Prospect Theory Explanations*, 31 ACAD. MGMT. J. 85 (1988). For that matter, nations seem to act in accord with prospect theory. *See, e.g.*, Robert Jervis, *Political Implications of Loss Aversion*, 13 POL. PSYCHOL. 187 (1992); Audrey McInerney, *Prospect Theory and Soviet Policy Towards Syria, 1966-1967*, 13 POL. PSYCHOL. 265 (1992).

391. *See, e.g.*, Gerrit Antonides & Nico L. Van der Sar, *Individual Expectations, Risk Perception and Preferences in Relation to Investment Decision Making*, 11 J. ECON. PSYCHOL. 227, 240-41 (1990) (risk-aversion as to gains; investment clubs); Peter C. Fishburn & Gary A. Kochenberger, *Two-Piece von Neumann-Morgenstern Utility Functions*, 10 DECISION SCI. 503, 517 (1979); John C. Hershey & Paul J.H. Schoemaker, *Risk Taking and Problem Context in the Domain of Losses: An Expected Utility Analysis*, 47 J. RISK & INS. 111, 130 (1980); Dan J. Laughhunn et al., *Managerial Risk Preferences for Below-Target Returns*, 26 MGMT. SCI. 1238 (1980) (risk-seeking for losses; corporate managers); Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCI. 453, 454-55 (1981). *See generally* Robert J. Shiller, *Human Behavior and the Efficiency of the Financial System* (last modified Sept. 23, 1997) <http://www.econ.yale.edu/~shiller/ handbook. html> (financial demonstrations of prospect theory).

Insolvency may affect these general findings by increasing risk-taking at all levels. If a manager's stake in a business rests on its survival, then she will be more willing to gamble, whether by extending credit to shaky customers or plunging into risky projects. Potential losses are buffered by bankruptcy, while potential gains inure to the manager. Hence the familiar moral hazard problem created in the shadow of insolvency. *See supra* note 264 and accompanying text.

392. *See supra* Part IV.A.

393. *See supra* Part II.

it some risk of loss, in that improperly invoking adequate assurance may itself prove a breach.[394] The promisee would, however, discount the large-magnitude loss that could result from faulty invocation of adequate assurance more than the smaller loss that would result from failing to invoke it, and thus would be expected to approve adequate assurance's use.[395] In addition, loss aversion may cause a creditor to delay forcing bankruptcy, which a demand for assurance can ultimately yield, because it would prefer to avoid recognizing losses from uncollectible accounts. If it could get some justification from the promisor for its difficulties, then a loss-averse creditor would be predisposed to make some accommodation.[396] In any event, other factors may influence the decision to demand assurance more than does the congeries of risk biases falling under prospect theory.[397]

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394. As, indeed, at least one business law primer for businesspeople already does. *See* LASHBROOKE & SWYGERT, *supra* note 205, at 188, 246-47.

395. Though, if the demand for assurance would cause the promisor to break off any future relations, the promisee might also take into account the loss of future income. Prospect theory suggests that the discount rate will be relatively high, though, because of loss aversion.

396. *See* D'Aveni, *supra* note 390, at 1124.

397. One possibility is regret aversion. Under regret theory, an outcome's result is measured only in part by its own value; a significant part is that value, compared to the outcomes that other choices would have yielded. *See, e.g.*, David E. Bell, *Regret in Decision Making Under Uncertainty*, 30 OPERATIONS RES. 961 (1982); Graham Loomes & Robert Sugden, *Regret Theory: An Alternative Theory of Rational Choice Under Uncertainty*, 92 ECON. J. 805 (1982). Regret—the fear of making the wrong decision—is rather aversive, and so, as experiments have shown, people will pay premiums to avoid it. *See, e.g.*, David E. Bell, *Risk Premiums for Decision Regret*, 29 MGMT. SCI. 1156 (1983); Graham Loomes, *Further Evidence of the Impact of Regret and Disappointment in Choice Under Uncertainty*, 55 ECONOMICA 47 (1988). Making no decision is one means to that end; it is easier to regret a departure from the status quo than to regret its maintenance. *See, e.g.*, Ruth M. Corbin, *Decisions that Might Not Get Made*, *in* COGNITIVE PROCESSES IN CHOICE AND DECISION BEHAVIOR 47, 56-57 (Thomas S. Wallsten ed., 1980) [hereinafter COGNITIVE PROCESSES]; Daniel Kahneman & Amos Tversky, *The Psychology of Preferences*, SCI. AM., Jan. 1982, at 160, 170, 173. As a result, the insecure party is likely to prefer inaction to action as a means of reducing regret, even though inaction may well come at a cost. *See, e.g.*, Steil, *supra* note 388, at 6-8 (discussing regret as an explanation for failure to hedge by foreign exchange managers).

Indeed, regret aversion may explain a good deal of both risk aversion and risk seeking, depending on whether potential regret can be minimized by taking or avoiding risk. *See* Marcel Zeelenberg et al., *Consequences of Regret Aversion: Effects of Expected Feedback on Risky Decision Making*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 148 (1996).

E. Framing

This last, and perhaps most important, cognitive bias stems from yet another assumption of expected value theory: that the manner in which a problem is presented is irrelevant.[398] This assumption seems almost axiomatic; rationality, in the common sense of the word, fits poorly with a highly variant world. Whatever a person's attitude toward risk, she should make the same decision, given a set of probabilities, however the probabilities are presented. A satisfying idea—but once again wrong.

Kahneman and Tversky refer to this cognitive error as a framing problem.[399] This is an offshoot of prospect theory; were people risk-neutral, or were they consistently risk-averse, framing would largely be irrelevant. Because people are variously risk-seeking or risk-averse, how a problem appears might logically affect the outcome. As the examples above showed, experimental subjects choose either the less certain or the more certain outcome, depending on whether the certainty attaches to a loss or a gain. There, however, the problems displayed actual losses or actual gains. What if the problems were substantively identical, but cosmetically different?

The classic study asked two sets of questions of different groups. One group was told that the country was faced with an outbreak of a rare disease, which was expected to kill 600 people. They were asked to choose between two programs to combat the disease. One would definitely save 200 lives, while the other had a one-third probability of saving all 600 lives and a two-thirds probability of saving none. Some seventy-two percent of the group chose the first, consistent with risk-aversion for gains. Another group was told about the same disease and given two choices. If one were chosen, 400 people would definitely die; if the other, there would be a one-third chance that no one would die and a two-thirds chance that all would die. Seventy-eight percent of the group chose the latter, consistent with risk-taking for losses.[400] But note that the two sets of questions are substantively identical, with the same outcomes and probabilities. They

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398. This is referred to as invariance. *See, e.g.*, Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, *in* RATIONAL CHOICE, *supra* note 324, at 69; *see also supra* notes 340-42 and accompanying text.

399. *See, e.g.*, Kahneman & Tversky, *supra* note 385, at 343-44.

400. *See* Tversky & Kahneman, *supra* note 391, at 453-55.

differ only in framing, with the first speaking of lives saved and the second of lives lost—yet the results are almost completely different.[401]

These results are robust, and extend well beyond Psychology 101 students.[402] For example, a series of studies of corporate buyers shows strong framing effects. Buyers base their price targets in large part on gain or loss framing (that is, whether the decision is put aside a potential savings or a potential price hike).[403] Their willingness to take on risk thus varies greatly, depending on the experimental frame.[404] In addition, the buyers' internal frames—whether they see a choice between certainty and risk as based on historical performance, guaranteed performance, a worst-case scenario, or the like—also affected whether the buyers would choose certainty and risk.[405] Financial planners also show a greater propensity to take risks in a loss frame than in a gain frame.[406] Finally, sales managers asked which salesperson to hire will also choose a more or less risky candidate depending on how the hiring decision is framed.[407] Framing thus seems pertinent to commerce.

Adequate assurance implicates framing at two spots: the initial pricing and the later decision whether to seek assurances.

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401. Remarkably, when subjects were given both sets of questions they often came out with different answers, even though they stated that they wanted to be consistent. Indeed, many of the respondents stuck by their choices after the inconsistency was explained to them. *See* Kahneman & Tversky, *supra* note 385, at 343; Tversky & Kahneman, *in* DECISION MAKING, *supra* note 340, at 76.

402. The favorite experimental animal of the psychologist. (I shall refrain from recounting the usual joke about lawyers and rats. If you don't know it, the author will send out a copy on request.)

403. *See* Christopher P. Puto, *The Framing of Buying Decisions*, 14 J. CONSUMER RES. 301 (1987):

404. *See* William J. Qualls & Christopher P. Puto, *Organizational Climate and Decision Framing: An Integrated Approach to Analyzing Industrial Buying Decisions*, 26 J. MARKETING RES. 179 (1989).

405. *See* Christopher P. Puto et al., *Risk Handling Strategies in Industrial Vendor Selection Decisions*, J. MARKETING, Winter 1985, at 89.

406. *See* Roszkowski & Snelbecker, *supra* note 389.

407. *See* Greg W. Marshall et al., *Risk-Taking in Sales-Force Selection Decisions: The Impact of Decision Frame and Time*, 12 PSYCHOL. & MARKETING 265 (1995). This study did show results superficially at odds with prospect theory, in that the sales managers sometimes preferred the riskier candidate in the gain frame and the safer candidate in the loss frame. However, the authors reconcile their results with prospect theory by adding the factor of time; they hypothesize that people discount gain less sharply than loss, which could reverse the preferences. *See id.* at 268-69, 281.

Initially, the promisee is faced with a pricing decision, one that could affect whether the contract goes ahead. This decision could be framed in terms of loss—should the promisee shift the price, thus increasing the likelihood that the deal will not go forward and risking the loss of gains from trade (but decreasing the potential loss in case of breach), or should it leave the price as is, thus letting the deal go forward (but at a higher loss in case of breach)? As most people take risks when problems are framed in terms of losses,[408] we would expect the potential promisee to take the risk of non-performance and charge either no risk premium or too low a risk premium. In contrast, a gain frame would yield the opposite result. The trade is between a certain but lower gain and a less certain but potentially higher gain. Given risk-aversion for gains, the promisee would choose the lower gain and charge a full risk premium.

So which frame is it? Do potential promisees focus on loss rates (thus underpricing risk) or success rates (thus overpricing risk)? Normally one would expect those about to enter into contracts to focus on success; after all, presumably they want to trade in order to gain. But the pricing decision will focus on the consequences of errant pricing—here, the prospect of lost sales. Sales managers, who will figure integrally in these decisions, have strong incentives to increase their sales, rather than to increase collection rates.[409] They are thus likely to focus intently on lost sales, minimizing the gains from improved performance. Then, too, making bad debt allowances and the like requires some sort of attention to potential breach. While the degree of focus may overcome the availability heuristic, the loss frame will promote risk-taking. So framing effects probably promote underpricing risk at the time of contracting.

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408. *See supra* note 385 and accompanying text. One might add that the gain/loss frame is not the only possibility. For example, the result can differ when a problem is framed variously as a threat or an opportunity, the former yielding risk-aversion and the latter risk-taking. *See* Scott Highhouse & Payam Yüce, *Perspectives, Perceptions, and Risk-Taking Behavior*, 65 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 159 (1996).

409. Yielding some classic problems in agency theory. *See, e.g.*, Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Mark Bergen et al., *Agency Relationships in Marketing: A Review of the Implications and Applications of Agency and Related Theories*, J. MARKETING, July 1992, at 1; Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

Framing effects also should deter promiscuous or opportunistic uses of adequate assurance. When the promisor's performance is in question, the promisee inevitably will frame its decisions in terms of loss—do we cut our losses now by demanding assurances, or do we give the promisor some extra time to resolve the situation? By demanding assurances, the promisee imperils future transactions with the promisor, so there is a real risk to a demand. The promisee, framing the problem as a choice of losses, will probably choose, *ceteris paribus,* the riskier option—going ahead with the deal. Only if the comparative risks weigh heavily in favor of adequate assurance will risk-taking be overcome.[410]

There is one last framing issue. One can look at the adequate assurance problem as a question of insurance, with the risk premium either paying for extra liability or credit insurance or providing a self-insurance fund. Would an insurance frame affect the result? Perhaps. In one study, some of the subjects were asked whether they preferred a certain loss of $5 or a one-tenth of one percent chance of losing $5,000, while others were asked whether they would prefer to pay an insurance premium of $5 or bear a one-tenth of one percent chance of losing $5,000. The results should logically be the same, as the expected values are identical. However, sixty-five percent of the subjects chose the certain loss when it was framed as an insurance premium, while only twenty percent chose it when it was framed as a simple loss.[411] Indeed, a sizable minority of the subjects, when asked the problem in the other context, answered it differently—and most

410. Though it should be noted that the potential losses from ceasing a relationship are in the main remote, which might lead to inordinate discounting. *See supra* notes 372-77 and accompanying text. On the other hand, perhaps one should distinguish between the amounts lost following a demand for assurances and a subsequent end to further contracting and the fact of future losses. The amounts lost are remote, but the end of the relationship is immediate and striking. One can imagine a scene in which an irate promisor says, "O.K., you'll get your letter of credit. But this is the last time we'll ever do business!" (Sound of telephone slammed onto cradle.) Indeed, this seems to happen. *See, e.g.,* Jewish Employment & Vocational Serv., Inc. v. Pleasantville Educ. Supply Corp., 220 U.S.P.Q. (BNA) 613, 620 (E.D. Pa. 1982). So the immediacy of a ruptured relationship may have availability effects which overcome the discounting of remote gains.

411. *See* Paul Slovic et al., *Response Mode, Framing, and Information-Processing Effects in Risk Assessment, in* DECISION MAKING, *supra* note 340, at 152, 157.

chose the gamble in the ordinary risk setting and the insurance in the insurance setting.[412] This effect has appeared elsewhere.[413]

The insurance effect has been explained variously. The most obvious explanation hinges on the nature of insurance. When one decides whether to buy insurance, one faces risk squarely. Paying an insurance premium thus rids one of risk, providing an immediate benefit. On the other hand, when the problem is framed in terms of ordinary risk, then the certain loss (otherwise an insurance premium) may not seem to prevent a less attractive possible loss.[414] Prospect theory may also explain the effect. If people are loss-averse, and if they tend to overweight low-probability events, then the insurance effect should also obtain.[415] The insurance frame puts the decision in terms of losing the premium—in other words, the decision is between paying the premium or taking the risk. The loss is typically improbable, which means that it will tend to be overweighted. In addition, losses tend to overshadow gains. Accordingly, the gamble will seem unappealing, and the subject will buy insurance. In contrast, the gambling frame obliges one to decide between a certain loss and a possible loss, starting from the status quo. Under prospect theory, large losses come at a discount, so the small, certain loss will be weighted more strongly and thus will be rejected.[416] Insurance may also evoke the social norm of prudence, thus bypassing many of these cognitive effects.[417]

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412. *See id.* at 157-58.

413. *See, e.g.*, Hershey & Schoemaker, *supra* note 391, at 130; Robin M. Hogarth & Howard Kunreuther, *Ambiguity and Insurance Decisions*, 75 AM. ECON. REV.: PAPERS & PROC. 386 (1985); Paul J.H. Schoemaker & Howard C. Kunreuther, *An Experimental Study of Insurance Decisions*, 46 J. RISK & INS. 603, 616 (1979).

414. *See* Slovic et al., *supra* note 411, at 158.

415. The overweighting of low-probability events is part of prospect theory, with some degree of empirical support behind it. *See, e.g.*, Kahneman & Tversky, *supra* note 387, at 280-84. But against this is our optimistic tendency to undervalue or ignore remote risk. *See supra* Part V.C. The availability heuristic may also figure here, variously elevating or depressing the weight of a risk. All this is not to say that prospect theory is a bundle of contradictions, but, rather, that one might sensibly seek more robust, or at least less inherently conflicting, explanations.

416. *See, e.g.*, Kahneman & Tversky, *supra* note 387, at 285-86. It should be noted that the diminishing marginal weight of losses may affect the insurance frame. The low probability of the uncertain loss may be overweighted, but the high magnitude may be underweighted.

417. *See, e.g., id.* at 286; *see also* Hershey & Schoemaker, *supra* note 391, at 120. On prudence, and the allied virtues of thrift and caution, see, for example, Hirsch, *supra* note 15, at 29-30.

If the promisee uses an insurance frame at the time of contracting, then it might well price the risk of non-performance more accurately than if it uses an ordinary risk frame. As the insurance studies show, the small, certain loss, though ordinarily disfavored (and thus underpriced), is far more acceptable when put in terms of insurance. Should promisees think of these risks as insurable, then, they would tend to price them accurately—indeed, if anything, would overprice them—and thus would have a weak case for adequate assurance.

But promisees are unlikely to look at the risk of default as a problem of insurance. Credit insurance is relatively rare, and tends to be limited to certain credit-heavy industries. Many other types of contractual risk fit poorly, if at all, within conventional liability insurance. The prospect of buying insurance is thus unlikely to be foremost in the mind of a promisee.[418] In contrast, the ordinary liability frame is quite plausible. Default is a more striking event than insurance, in part because of its relative scarcity, and thus is more likely to set the frame. So for the sort of risk dealt with by adequate assurance, insurance framing should not counter undervaluation.[419]

Cognitive psychology, dispelling the overly optimistic assumptions of expected utility theory, thus shows that the promisee is unlikely to evaluate risk accurately at the time of contracting, and will usually err on the side of underestimating infrequent risk. As a result, the main criticism of adequate assurance made earlier—that the contracting parties provided for the risk when they contracted by giving the promisee a risk premium—is undercut, at least for risks outside a confined range. There may well be some risk pricing, but it will be insufficient; some sort of ex post adjustment, albeit a constrained one, might thus efface the underpricing as well as put bounds on

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418. Nor will insurance generally, including self-insurance; though economists find it helpful to speak of self-insuring against risk, businesses would not tend to do so. For common risks, perhaps so; health insurance is a prime example. But default risk less commonly yields an unfortunate result, making more improbable its conscious assessment.

419. In addition, ambiguity may diminish this insurance effect. If a potential insurance customer is uncertain about the risk of loss, it will tend to underprice the premium, though it will not if the risk is certain. *See* Hogarth & Kunreuther, *supra* note 413, at 388-89. Adequate assurance involves both risk and uncertainty, to make the Knightian distinction. *See* KNIGHT, *supra* note 328, at 233-34. Thus, a promisee, responding to the uncertainty of default, will tend to underprice risk.

moral hazard. Not all risks faced by all promisees will be undervalued, though, and so courts should be alert to the possibility that the parties have, explicitly or implicitly, shifted some or all of the risk of non-performance.[420]

F. Critiques and Defenses of Cognitive Analysis

So far, this discussion has rather blithely assumed that cognitive analysis is a fit tool for lawyers to wield. Not all lawyers or economists have admitted that assumption. We should thus examine it.[421]

1. Market Corrections and Paternalism

The first objection is collective. Perhaps individuals act contrary to expected utility theory. But if populations act as though each adheres to expected utility, then perhaps we should base laws on expected utility.[422] Or, put more generally, market forces will correct for any individual deficiencies in decisionmaking.[423] If these assertions are true, they pose an important objection to cognitive psychology; to the extent that the law is supposed to promote an appropriate outcome overall,

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420. *See infra* notes 466-71 and accompanying text.

421. This portion of the article will not consider in detail the methodological criticisms that have from time to time been directed at various parts of the cognitive enterprise. *See, e.g.*, L. Jonathan Cohen, *Are People Programmed to Commit Fallacies? Further Thoughts About the Interpretation of Experimental Data on Probability Judgment*, 12 J. THEORY SOC. BEHAV. 251 (1982); Vernon L. Smith, *Rational Choice: The Contrast Between Economics and Psychology*, 99 J. POL. ECON. 877 (1991). For a useful exchange, see Daniel Kahneman & Amos Tversky, *On the Reality of Cognitive Illusions*, 103 PSYCHOL. REV. 582 (1996); Gerd Gigerenzer, *On Narrow Norms and Vague Heuristics: A Reply to Kahneman and Tversky (1996)*, 103 PSYCHOL. REV. 592 (1996). Cognitive psychology, like any other experimental field, has better moments and worse, and some cognitive research is open to legitimate objection. I have generally chosen either not to refer to doubtful work or to make critiques in passing.

422. The general point about aggregate behavior is a commonplace of economics. *See, e.g.*, GEORGE STIGLER, THE THEORY OF PRICE 6 (1966).

423. *See, e.g.*, Peter Knez et al., *Individual Rationality, Market Rationality, and Value Estimation*, 75 AM. ECON. REV.: PAPERS & PROC. 397, 401 (1985); Schwartz & Wilde, *supra* note 362, at 1425-26. In support, computer simulations of markets populated by the boundedly rational or irrational have converged to Bayesian equilibria. *See* Gode & Sunder, *supra* note 330. *See generally* Charles R. Plott, *Rational Choice in Experimental Markets*, *in* RATIONAL CHOICE, *supra* note 324, at 117 (experimental markets for most heuristic biases).

interference with a market system that works may well perturb a balanced system. Furthermore, impinging on the market raises larger questions about paternalism and autonomy.[424] And *should* the law allow for irrational and presumably inefficient behavior?[425] Better, perhaps, to allow the market to weed out the fecklessly inefficient, giving natural selection a chance to operate.[426]

These objections ought not be tossed aside lightly, but neither are they horribly massive.[427] First, prospect theory and its cognitive kin show that people make both random errors and systematic errors. Whereas random errors may wash out, systematic errors probably will not; accordingly, one can model collective behavior better by using cognitive analysis.[428] Nor will markets clear out error, if systematic error is too firmly entrenched or the market forces are too weak.[429] More to the point, empirical study has shown that markets have not and do not correct adequately for systematic error, save for some super-efficient oddities, so hypothesizing the ideal market may be unproductive.[430]

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424. *See, e.g.*, Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983).

425. In the words of an analyst of disappointment and regret, it may be "that what is currently omitted from expected utility analysis *deserves* to be omitted and that a formal analysis may be exactly what is needed to prevent a decision maker's intuition from forcing economically inefficient decisions." David E. Bell, *Disappointment in Decision Making Under Uncertainty*, 33 OPERATIONS RES. 1, 27 (1985) (emphasis in original).

426. *See, e.g.*, Gillette, *supra* note 383, at 576-78; Jack Hirshleifer, *Economics from a Biological Viewpoint*, 20 J.L. & ECON. 1, 9-10 (1977); Jackson, *supra* note 20, at 1417. On the general assumption of natural selection, see, for example, Friedman, *supra* note 328; Armen A. Alchian, *Uncertainty, Evolution, and Economics Theory*, 58 J. POL. ECON. 211 (1950).

427. *Cf.* THE ALGONQUIN WITS 116 (Robert E. Drennan ed., 1968) (from a book review by Dorothy Parker: "This is not a novel to be tossed aside lightly. It should be thrown with great force.").

428. *See, e.g.*, George A. Akerlof & Janet L. Yellen, *Can Small Deviations from Rationality Make Significant Differences to Economic Equilibria?*, 75 AM. ECON. REV. 708 (1985); Thomas Russell & Richard Thaler, *The Relevance of Quasi Rationality in Competitive Markets*, 75 AM. ECON. REV. 1071, 1074 (1985).

429. *See, e.g.*, John Haltiwanger & Michael Waldman, *Rational Expectations and the Limits of Rationality: An Analysis of Heterogeneity*, 75 AM. ECON. REV. 326 (1985) (concluding that rationality may not dominate market behavior); Ulrich Witt, *Firms' Market Behavior Under Imperfect Information and Economic Natural Selection*, 7 J. ECON. BEHAV. & ORG. 265 (1986) (concluding that profit maximization does not affect survival rate).

430. *See, e.g.*, Russell & Thaler, *supra* note 428, at 1074, 1080-81; Tversky &

Furthermore, using rational choice theory to set legal rules may prove troubling, even if rational choice were to predict outcomes as well as prospect theory. Legal rules guide conduct ex ante, but they also allocate responsibility ex post. If relational theorists are correct—a reasonable assumption for the type of contract germane here—then the main effect of most rules of contract law is ex post.[431] To that extent, they carry some quantum of moral force, for they state what people should do. If the law posits a hopelessly unrealistic world and holds all comers to its standards, the law runs the risk of unfairness.[432] For that matter, the law contains many rules that guard against errors in cognition. Consider, for instance, the defenses of incapacity[433] and infancy.[434] The duty to disclose, albeit limited, also attempts to resolve informational asymmetry.[435] And the implied warranty of merchantability—an example of an information-forcing default rule—overcomes the consumer's tendency to ignore the possibility of product failure.[436] Indeed, consumer protection laws generally tend to mandate clearer and more complete disclosure of pertinent information, thus improving, at least in principle, the

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Kahneman, *supra* note 398, at 91. *See generally* Latin, *supra* note 14, at 1255-57 (surveying literature).

431. On relational contract, see *supra* Part III.A.2.

432. *See, e.g.*, SUNSTEIN, *supra* note 21, at 4; Hasen, *supra* note 21, at 400. On fairness as an element in economic analysis, see, for example, ARTHUR OKUN, EQUALITY AND EFFICIENCY (1975); Daniel Kahneman et al., *Fairness and the Assumptions of Economics*, *in* RATIONAL CHOICE, *supra* note 324, at 101.

The advantages of fairness can be overstated. One theory of default rules—the information-forcing theory—uses an unbalanced result to compel the disclosure of private information. For instance, the *Hadley* rule can be defended because it obliges one who could suffer high consequential damages to let the other side know of the potential harm, thus overcoming the costs of information gathering. *See, e.g.*, DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 147-50 (1994); Ayres & Gertner, *supra* note 281. *But see* Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 CAL. L. REV. 563, 587-98, 604-07 (1992) (questioning informational virtues of *Hadley*). Some information-forcing default rules might attach penalties to normal behavior. And some of our legal rules seem more aspirational than descriptive—certain bits of the traffic code come to mind. Still, the larger point seems worth making—that when aspiration and reality differ too greatly, law's force wanes. Consider Prohibition.

433. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 15(1) (1979).

434. *See, e.g.*, 1 FARNSWORTH, *supra* note 35, §§ 4.2-4.5.

435. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 161 (1979); *see also, e.g.*, COOTER & ULEN, *supra* note 242, at 245-49; Anthony T. Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978).

436. *See* U.C.C. § 2-314 (1995); Ayres & Gertner, *supra* note 281.

cognitive abilities of consumers. So the argument from novelty seems unavailing.

Finally, why not allow the invisible hand to pluck the inefficient from the market? Here, the invisible hand generally wears a mitten. For the market to select against the cognitively inept, their ineptitude must be demonstrated frequently over time, and market participants must have opportunities to learn from their errors. If cognitive failures that give rise to unfortunate results occur infrequently, then learning will be difficult, if not impossible, and the market will have little chance to select for percipience.[437] The general efficiency argument may have some force where learning is possible, a point discussed below.[438] Still, this will not always, or even usually, be true in our context. A rule that does not take into account error may thus injure even those who can learn—and the stubbornness of cognitive error suggests that those will be few. Given the costs of a legal rule driven by pure rational choice, the case for a cognitive component remains strong.

2. Data in Search of a Theory

Another objection rests on the relative novelty of cognitive psychology. It is, some say, confusing and atheoretical; better to wait until firmer foundations have been dug and more convincing theories expounded.[439] When Robert Scott first raised this objection in 1986, though, cognitive psychology was hardly nascent, and another decade's research has continued to bear out its major premises.[440] This is not to proclaim the uniform appeal of cognitive psychology, or the unquestioned confirmation of its premises and conclusions—only that the mass of evidence supporting most, if not all, of these departures from rational choice has become overwhelming.[441]

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437. On learning, see *infra* Part V.F.4.

438. *See infra* notes 466-71 and accompanying text.

439. *See, e.g.*, Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 YALE L.J. 353, 380 (1988); Robert E. Scott, *Error and Rationality in Individual Decision Making: An Essay on the Relationship Between Cognitive Illusions and the Management of Choices*, 59 S. CAL. L. REV. 329, 334 (1986).

440. *See, e.g.*, Hasen, *supra* note 21, at 401.

441. *Cf.* Raymond C. Battalio et al., *Testing Between Alternative Models of Choice Under Uncertainty: Some Initial Results*, 3 J. RISK & UNCERTAINTY 25 (1990)

Nor is the profusion—confusion, perhaps, to critics—of heuristics and the like innately problematic. This objection is not merely aesthetic. As Thomas Kuhn has observed, paradigms often become more and more complex before they are overthrown (as, for instance, the heliocentric model of the universe shortly before Copernicus).[442] Still, which way does it cut? Rational choice theorists, attempting to reconcile their theory with these data, have often introduced odd nips, tucks, gussets, and flaps into what was an elegant system. Though the several theories of cognitive psychology that seek to explain the same data are not wholly consistent, they cohere more than does the revised standard rational choice theory. Nor, for that matter, does the fact of multiple theories doom cognitive psychology. Physics, for example, lacks a grand unified theory of the various types of electromagnetic energy, but physics is not for that reason unreliable and useless. More pertinent is whether prospect theory and other aspects of cognitive psychology explain the data better than their rivals. As the studies discussed above show, they do. One may want an elegant unified theory, here as elsewhere, but one need not spurn anything short of that in the meanwhile.[443]

3. Experiment Versus Reality

In much the same vein, some objectors emphasize the experimental origin of cognitive psychology; until these effects can be shown in the field, goes the argument, they are not well enough grounded to warrant the adoption of the theories based on them.[444] This argument may also have passed its prime, such

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(explaining that data do not support rational choice, but also do not fully support alternative theories, including prospect theory and regret theory).

442. THOMAS S. KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS 67-69 (2d ed. 1970).

443. Consider, after all, the law of contract—a field fairly pullulating with incomplete theories, and, one might argue, richer for the profusion. *See generally* HILLMAN, *supra* note 229.

444. *See, e.g.*, Ebbe B. Ebbesen & Vladimir J. Konecni, *On the External Validity of Decision-Making Research: What Do We Know About Decisions in the Real World?*, *in* COGNITIVE PROCESSES, *supra* note 397, at 21, 42; Gillette, *supra* note 383, at 550-51; Schwartz, *supra* note 439, at 380; Scott, *supra* note 439, at 338 n.25; *cf.* Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCHOL. BULL. 197, 198 (1981) (concluding that discrete studies are inferior to continuous studies).

as it was. A good many empirical studies have looked, not at the ever-curious behavior of college freshmen, but at the behavior of professionals doing their professional tasks.[445] And economists, as Hasen has pointed out, are ill-positioned to make this argument, given the difficulty of testing for expected utility theory.[446] For that matter, a number of studies have used both hypothetical and real consequences (the latter with money riding on the outcome), and have found little, if any, difference between the real and hypothetical experiments.[447] In addition, we do not attack, say, biochemistry, because its results are generally in vitro; experimental science has, at least for the last century or two, made the great bulk of its advances through controlled and simplified experimental models. Confirmation in the field is, of course, good, and even necessary at times, but ought not be the sine qua non of validity.

4. Training Effects

The final objection is more interesting, though only marginally more substantial. Even if cognitive errors occur ordinarily, suggest some objectors, they can be trained away. As Professor Latin has pointed out, "[p]eople can learn to improve some kinds of decisions in some kinds of circumstances; otherwise teachers would be out of work."[448] If people can learn to overcome

445. *See, e.g.*, MACCRIMMON & WEHRUNG, *supra* note 368; SHAPIRA, *supra* note 368; D'Aveni, *supra* note 390; Werner F.M. De Bondt & Richard H. Thaler, *Do Security Analysts Overreact?*, 80 AM. ECON. REV.: PAPERS & PROCS. 52 (1990) (concluding that security analysts show availability heuristic in forecasts); Madsen, *supra* note 367; Puto, *supra* note 403; Qualls & Puto, *supra* note 404; Roszkowski & Snelbecker, *supra* note 389; Steil, *supra* note 388.

446. Hasen, *supra* note 21, at 404-06.

447. *See, e.g.*, David M. Grether & Charles R. Plott, *Economic Theory of Choice and the Preference Reversal Phenomenon*, 69 AM. ECON. REV. 623 (1979); Werner W. Pommerehne et al., *Economic Theory of Choice and the Preference Reversal Phenomenon: A Reexamination*, 72 AM. ECON. REV. 569 (1982); David B. Wiseman & Irwin P. Levin, *Comparing Risky Decision Making Under Conditions of Real and Hypothetical Consequences*, 66 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 241 (1996). It should be added, though, that the magnitude of these effects often decreases as monetary incentives rise. *See, e.g.*, Bruno S. Frey & Reiner Eichenberger, *Economic Incentives Transform Psychological Anomalies*, 23 J. ECON. BEHAV. & ORG. 215, 225-26 (1994); Vernon L. Smith & James M. Walker, *Monetary Rewards and Decision Cost in Experimental Economics*, 31 ECON. INQUIRY 245 (1993).

448. Latin, *supra* note 14, at 1252.

cognitive error, then perhaps we should not mold legal rules to accommodate it; better to provide an incentive for people to learn to reason well.[449]

Indeed, some studies have shown quite substantial learning effects. In one simulated market, preference reversal tended to decline with market experience.[450] Overconfidence (with its corollary, over-optimism) also seems partly subject to training.[451] And there are others.[452] Moreover, in some fields professionals seem to come closer to the Bayesian ideal than do tyros. For example, professional traders show less bias than do MBA students in market simulations.[453] Auditors also seem to make fewer, and lower-magnitude, cognitive errors than is the norm.[454]

Still, effective learning is far from common. As Tversky and Kahneman pointed out early on, it requires accurate and immediate feedback.[455] The feedback must also be robust

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449. *See, e.g.*, Richard E. Nisbett et al., *The Use of Statistical Heuristics in Everyday Inductive Reasoning*, 90 PSYCHOL. REV. 339, 340 (1983); Schwartz, *supra* note 439, at 381-82.

450. *See* Marc Knez & Vernon L. Smith, *Hypothetical Valuations and Preference Reversals in the Context of Asset Trading*, *in* LABORATORY EXPERIMENTS IN ECONOMICS 131 (Alvin E. Roth ed., 1987).

451. *See, e.g.*, Baruch Fischhoff, *Debiasing*, *in* JUDGMENT, *supra* note 350, at 422, 434-35, 437-40.

452. *See, e.g.*, Marc Alpert & Howard Raiffa, *A Progress Report on the Training of Probability Assessors*, *in* JUDGMENT, *supra* note 350, at 294; William Remus et al., *Does Feedback Improve the Accuracy of Recurrent Judgmental Forecasts?*, 66 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 22 (1996).

453. *See* Matthew J. Anderson & Shyam Sunder, *Professional Traders as Intuitive Bayesians*, 64 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 185 (1995). It should be added, though, that the traders were not free from non-Bayesian conduct.

454. *See* James F. Smith & Thomas Kida, *Heuristics and Biases: Expertise and Task Realism in Auditing*, 109 PSYCHOL. BULL. 472, 485-86 (1991). On the other hand, both professional auditors and undergraduate accounting students showed significant departures from Bayesian probability assessments when faced with an audit task. *See* Stephen K. Asare & Arnold Wright, *Normative and Substantive Expertise in Multiple Hypotheses Evaluation*, 64 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 171, 176-78, 180 n.9 (1995). Interestingly, the auditors showed relatively few substantive errors, suggesting a degree of adaptation through experience that corrects for faulty probabilistic evaluation—meta-heuristics, if you will. This finding, generalized to the sale of goods, suggests that cognitive biases may produce attenuated problems with risk assessment, thanks to substantive expertise.

455. *See* Tversky & Kahneman, *in* RATIONAL CHOICE, *supra* note 324, at 90-91; *see also, e.g.*, Hillel J. Einhorn & Robin M. Hogarth, *Confidence in Judgment: Persistence of the Illusion of Validity*, 85 PSYCHOL. REV. 395, 407-15 (1978) (need opportunity to determine the accuracy of hypothesis, feedback, control of extrinsic factors); *cf.* Sarah E. Bonner & Nancy Pennington, *Cognitive Processes and*

enough, and the potential gains great enough, to warrant an investment in learning.[456] Thus the success of weather forecasters, whose feedback is rapid and pointed.[457] Feedback that goes beyond the mere result—for example, including information on the type of behavior to be sought, or the underlying structure of what is being studied—is also more effective than feedback with just the result.[458] But some cognitive errors resist learning,[459] and others seem to be learned.[460] There is also some question whether learning spills over from one sort of problem to another.[461] Moreover, feedback can exacerbate regret aversion, thus further confounding cognitive error.[462] And, given satisficing, feedback can reinforce error; if one meets one's (modest) goals, one may not realize that one failed to make an easy, superior decision.[463]

Knowledge as Determinants of Auditor Expertise, 10 J. ACCT. LITERATURE 1, 34-36 (1991) (stating that outcome feedback is ineffective absent cognitive feedback).

456. *See, e.g.*, Tversky & Kahneman, *in* RATIONAL CHOICE, *supra* note 324, at 91.

457. *See* Allan H. Murphy & Robert L. Winkler, *The Use of Credible Intervals in Temperature Forecasting: Some Experimental Results*, *in* DECISION MAKING AND CHANGE IN HUMAN AFFAIRS 45 (Helmut Jungermann & Gerard de Zeeuw eds., 1977); Allan H. Murphy & Robert L. Winkler, *Subjective Probability Forecasting Experiments in Meteorology: Some Preliminary Results*, 55 BULL. AM. METEOROLOGICAL SOC'Y 1206 (1974).

458. *See, e.g.*, Remus et al., *supra* note 452.

459. For example, "the winner's curse," which is the tendency of successful bidders at auctions to have bid too much, in large part as a result of scattered errors in assessing value. *See, e.g.*, RICHARD THALER, *The Winner's Curse*, *in* THE WINNER'S CURSE 50 (1992). Feedback and experience reduce this effect very little. *See* Peter Foreman & J. Keith Murnighan, *Learning to Avoid the Winner's Curse*, 67 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 170 (1996).

460. One recent study showed that we learn to show greater risk aversion for gains than for losses. *See* James G. March, *Learning to Be Risk Averse*, 103 PSYCHOL. REV. 309 (1996).

461. *See, e.g.*, John H. Kagel & Dan Levin, *The Winner's Curse and Public Information in Common Value Auctions*, 76 AM. ECON. REV. 894 (1986) (explaining that there is no spillover for structurally identical, but cosmetically different tasks). On the other hand, a study of graduate and professional students showed a significant rise in general cognitive skill, correlated to the field of study. *See* Darrin R. Lehman et al., *The Effects of Graduate Training on Reasoning*, 43 AM. PSYCHOLOGIST 431 (1988).

462. *See, e.g.*, Richard P. Larrick & Terry L. Boles, *Avoiding Regret in Decisions with Feedback: A Negotiation Example*, 63 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 87, 95 (1995); Zeelenberg, *supra* note 397, at 156-57.

463. *See, e.g.*, Hillel J. Einhorn, *Learning from Experience and Suboptimal Rules in Decision Making*, *in* COGNITIVE PROCESSES, *supra* note 397, at 1, 6-7.

So learning can overcome some cognitive biases, at least for some tasks. Not exactly an unequivocal result. Varying the result's phrasing, though, suggests a legal function; if some types of people (but not others) can assess risk accurately, given sufficient incentives to do so, then those people might logically be given less scope for adequate assurance. This possibility is discussed further in the conclusion.

VI. CONCLUSION

Adequate assurance of performance was new to commercial statutes when Llewellyn placed it in Article 2 of the U.C.C. Its roots in anticipatory repudiation and allied doctrines were, however, deep, and commercial parties often contracted around the doctrine's absence with default clauses. The Zeitgeist, if there was such a thing for the law of breach, favored adequate assurance, as shown by its generally favorable recognition and its subsequent ensconcement in the Restatement (Second) of Contracts.

The phenomenon is clear enough, and the cases have seldom occasioned controversy. What is less clear, and perhaps more controversial, is the doctrine's place in public policy. Most of the contemporary reasons given, like their more recent counterparts, are not very weighty, because they rest on supposed effects on commerce that seem not to exist. Though there are undoubted virtues to recognizing, say, the abstract justice of the idea, there are undoubted costs as well—the potential for opportunism, the risk of erroneous invocation, the break-up of old relations. The equipoise is disrupted by the effects on the parties after the promisee becomes insecure. Then the promisee must engage in some sort of cost-benefit analysis, determining whether the reduced loss from mitigation is worth the potential forgone from the full performance of the agreement. Adequate assurance makes this calculus possible, as anticipatory repudiation law does not recognize mere uncertainty.

Is this calculus correct? At first blush, no. If the parties are unaware of adequate assurance, but aware of the risks of non-performance, then they would be expected to allow for the risk in the contract. If the contract has priced the risk and allocated it, then it would seem inequitable to allow the promisee to collect its risk premium and then demand additional assurance if the risk

comes about. Indeed, were this not part of the law, the promisee's actions would amount to breach, if not actual duress. Though there remain possible gains from adequate assurance, the case, not perhaps overwhelming before, is now decidedly tenuous.

This argument, however, assumes both that contracting parties are unaware of adequate assurance and that they accurately assess risk. The first assumption seems to be accurate, unless one is represented by counsel (and possibly even then). The second, however, is not. It assumes that the parties to the agreement behave as rational choice theory would have them act. But cognitive psychologists and experimental economists have shown that they do not. A host of cognitive errors—availability, over-optimism, prospect theory, framing—generally point to the tendency to undervalue remote risk, which is exactly the sort involved in most adequate assurance cases. Hence the parties to an agreement are likely to underprice the risk, charging less than the proper risk premium, and so the promisee will not be able to insure fully against the risk. Adequate assurance thus serves as a useful adjunct to the inadequate risk premium.

Is this the end? After all this, we conclude that the old law is just fine? Perhaps not. In general, adequate assurance does seem to do what it is supposed to. But the analysis above indicates that adequate assurance should have some bounds, and provides the means for setting them. There is no need to twiddle with the U.C.C.; its general language can cover a multitude of virtues.[464] Common-law decisions use similarly malleable language. So comment of this sort, if taken account of, can do the trick.

The first point at which to focus is whether the promisee has grounds for demanding assurances. The cases have tended to cluster here, but not necessarily at the right spots. As the cognitive discussion above showed, the case for assurance is strongest where cognitive error is greatest. Should the promisee assess risk accurately, then perhaps adequate assurance is inappropriate. This is all the more true if the promisee is the sort that should be able to correct for this kind of cognitive error; denying such a party the right of adequate assurance would thus

464. Though the official comments to the new adequate assurance section might take this analysis into account.

set up a default rule that would encourage it to learn from its errors. In contrast, a promisee ill-suited to learning should not be subject to a rule that would oblige it to do so. Such a rule seems potentially inefficient, in that the promisee would not otherwise have bargained for it.[465]

There are thus three rather general factors that should be relevant when a judge determines whether a promisee had a reasonable basis for its insecurity. First, the more obvious and lurid the potential risk at the time of contracting, the less inclined a court should be to find adequate assurance permissible. The availability heuristic suggests that risks of these types will not be undervalued and, in fact, may be overvalued. Availability may thus counteract over-optimism and the other heuristic biases tilting toward undervaluation. In contrast, a relatively obscure risk might be undervalued more than the norm, giving greater weight to a demand for assurance. Common risks might move in either direction; though they may well be highly available, they may also be too commonplace to be given sufficient weight. On the other hand, if this particular risk has figured in the contracting parties' past dealings, or in one party's past dealings with others, then availability should triumph, whatever the normal drabness of the risk, and a demand for assurance should be looked at fishily by the courts.

Second, the greater the opportunities for the promisee to have learned to overcome its cognitive biases, the weaker the case for adequate assurance. Though cognitive error is recognized elsewhere in law, the arguments in favor of some normative role for rational choice theory are not entirely unmeritorious. If, therefore, the promisee should have been able to value risk appropriately,[466] then the case can be made that it should be held to have done so. After all, if it actually did, then the forced modification problem applies; if not, perhaps it might be encouraged to do so by the default rule.

How might we determine whether the promisee can be trained? Among the relevant considerations discussed earlier

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465. Thus either driving up transaction costs, as the promisee writes in clauses that would provide the right, or by subjecting the promisee to a suboptimal bargain, if the transaction costs are too high to justify bargaining.

466. Perhaps by handing its operations over to depressed weather forecasters. The business might not be very entrepreneurial, but it would know exactly what risks it was not taking.

was the frequency of the risk. Learning requires a good deal of feedback, so those seldom facing a particular risk will have little if any opportunity to learn to value it. Small businesses should thus be able to invoke adequate assurance more easily than large, and common risks should provoke demands less readily than rare ones. The rapidity of the feedback is also germane. The longer the time between taking on the risk and learning its proper price, the lower the chance for learning.[467] So too the nature of the feedback. If one learns only the result, one is unlikely to overcome a cognitive bias; if, in contrast, one learns the reasons why there was an error and how one might correct for it later, one can, over time, become unbiased.[468] Finally, the promisee must be able to reward learning. There are structural impediments to this, for those who are faced with the information may well have incentives that differ from those of the business. Sales managers are typically rewarded by their sales volumes, rather than by the collection rate, so agency problems may generally impede learning. Still, the possibility exists, and may be real in a few cases.

Third, adequate assurance should not be allowed when it is sought opportunistically. A promisee might have contracted improvidently, and hence might seize upon a fancied concern with the promisor's prospects to demand assurances, hoping that the promisor will not come through. This point is less cognitive than Williamsonian, though bounded rationality[469] makes opportunism possible.[470] And the ordinary desire to maintain relations militates against excessive opportunism, as does the risk that a scanty basis for its invocation will bring on disaster. Still, given the balance, at times delicate, between the virtues and vices of adequate assurance, the increased chances for

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467. This will often be a problem in the sorts of contracts which give rise to demands for adequate assurance, because they usually involve performance over a long period.

468. This may also be difficult for many promisees, as they may well not get enough information to make any sensible risk analyses. Small firms may not have the skill in risk analysis to undertake the task. Finally, the binary nature of many assurance cases—performance or non-performance—lends itself poorly to learning.

469. Itself a cornerstone of Williamsonian economics. *See, e.g.*, Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J.L. & ECON. 453, 458 (1993); Oliver E. Williamson, *The Logic of Economic Organization*, 3 J.L. ECON. & ORG. 65, 67-68 (1988).

470. This danger was pointed out early in the days of adequate assurance. *See* Anderson, *supra* note 22, at 22.

opportunism if relations are breaking down, and the force that looms behind its use, opportunism should be guarded against.

The other area at which the courts might look is the extent of the assurance demanded. This has provoked relatively little controversy, but perhaps a bit more is in order. The optimal amount, putting together the rational critique and the cognitive riposte, is the amount that will offset the cognitive error in underestimating risk. This measure may, however, be more theoretical than practical, given the difficulty of measuring cognitive error on the hoof, as it were. Nor should one be too finicky; second-guessing reasonable business decisions has seldom appealed to courts, and this is not the place to reverse that practice. Nevertheless, when the case for adequate assurance is weak, whether because of availability or learning, the shortfall in the risk premium should be correspondingly slight, and the reasonable demand for assurance modest. Courts should thus look closely at the likelihood that the parties could have priced the risk well at the time of contracting when they decide how closely to look at the nature of the assurance demanded.

These considerations are partly foreign to courts, and may thus be more aspirational than real. Then, too, they would add to the uncertainty of contract litigation, in an area where uncertainty is potentially inefficient. Still, as Arthur Corbin observed, "Certainty is an illusion; but we love our illusions."[471] These guides would perhaps become dangerous if enshrined, or entombed, in statutory text; those multi-factor tests one usually leaves to the constitutional lawyers. But as guides to a court that wrestles with an open-textured statute, they have their uses. They bring a touch of reality to the assaying of reason, taking into account as they do the persistent fallibility of even the astute. One hopes that the insights of cognitive psychology will make inroads here as elsewhere.

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471. Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 187 n.46 (1965).