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# The Limitations of Economic Reasoning in Analyzing Duress

Shawn Bayern<sup>†</sup>

My colleagues and friends, Mark Seidenfeld and Murat Mungan, have made an interesting attempt to reduce the doctrine of duress in contract law to an inquiry about “rent-seeking,” by which they mean attempts to redistribute rather than to produce wealth.<sup>1</sup> There is much truth in their argument, and they are admirably sensitive to many factors that should be, and are, important in contract-modification cases. I do not think they have shown, however, that duress can workably be reduced to a simple formulation in the way they intend—or that even if it could, it would serve the functional or even simply the instrumental goals of contract law to do so.<sup>2</sup>

## DURESS AS RENT SEEKING

Seidenfeld and Mungan’s argument is clear: in judging whether a party’s threat is “wrongful” or “improper” for the purposes of determining whether it constitutes duress,<sup>3</sup> courts—if they intend to maximize social wealth—should decide whether (1) the threatened conduct serves the interests of that party or (2) the threatened conduct is instead motivated only to extract value from the other party. Because a wealth-maximizing legal regime would encourage productivity but discourage investment in redistribution alone, threats of the first type are legitimate, whereas threats of the second type are not.

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<sup>†</sup> Larry & Joyce Beltz Professor, Florida State University College of Law. Copyright © 2015 by Shawn Bayern.

1. Mark Seidenfeld & Murat C. Mungan, *Duress as Rent Seeking*, 99 MINN. L. REV. (forthcoming 2015) (draft on file with author).

2. To be clear, I do not think that the law is or should be motivated only by propositions of efficiency; other concerns, such as morality and policies other than efficiency, can and should be significant. My goal in this essay, however, is to critique an argument that rests on grounds of efficiency merely by showing that it would not achieve its goals. For that limited purpose, the rest of this essay speaks largely in consequentialist terms that seek to promote allocative efficiency, accept the general efficiency of markets, and so on.

3. See RESTATEMENT (SECOND) OF CONTRACTS § 175 (1981).

Accordingly, for example, I might decide to plant several trees in my front yard because I enjoy trees, and I might inform my neighbor that I plan to do so even though I know that my neighbor would prefer that I not; if the neighbor subsequently offers me something of value to induce me not to plant the trees, we would have a legitimate, enforceable contract or exchange.<sup>4</sup> By contrast, if planting trees gives me no value, but I still give my neighbor the opportunity to induce me not to do so, my doing so is improper and constitutes duress—and any contract resulting from a threat to plant trees would therefore be unenforceable. I will call this determination of duress—Seidenfeld and Mungan’s chief proposition—the *Rent-Seeking Test*.

The Rent-Seeking Test captures something important, which is that an element of good faith in contracting and business generally is for parties not to act in ways that do not benefit them except to the extent that the activities extract value from others. Accordingly, for example, in the famous case of *Page v. Page*,<sup>5</sup> Justice Traynor permitted the dissolution of a partnership at will but noted that, “like any other power held by a fiduciary,” the decision to dissolve a partnership “must be exercised in good faith.”<sup>6</sup> Good faith in business law means many things,<sup>7</sup> but one way to conceive Justice Traynor’s requirement of good faith in *Page* is that while partners at will may ordinarily dissolve a partnership for any reason, they cannot time or otherwise orchestrate a dissolution to extract more value from their partners than they were otherwise able to negotiate in the partnership agreement. Thus, Justice Traynor wrote:

A partner may not . . . by use of adverse pressure “freeze out” a co-partner and appropriate the business to his own use. A partner may not dissolve a partnership to gain the benefits of the business for himself, unless he fully compensates his co-partner for his share of the prospective business opportunity.<sup>8</sup>

The Rent-Seeking Test is broadly consistent with this for-

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4. Seidenfeld & Mungan, *supra* note 1, at 13–20.

5. 359 P.2d 41, 44 (Cal. 1961) (citation omitted) (“Even though the Uniform Partnership Act provides that a partnership at will may be dissolved by the express will of any partner, this power, like any other power held by a fiduciary, must be exercised in good faith.”).

6. *Id.*

7. See, e.g., Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006) (outlining multiple meanings of good faith in corporate law).

8. *Page*, 359 P.2d at 44.

mulation of good faith. Under the Rent-Seeking Test, a partner can dissolve a partnership so long as he benefits from doing so in a way other than his “freezing out” of a copartner.

Moreover, Seidenfeld and Mungan very nicely apply their argument to several significant cases. For example, I largely—though not completely—agree with their treatment of the difficult contract-modification case of *Austin Instrument, Inc. v. Loral Corp.*,<sup>9</sup> which I discuss in Part II.C *infra*.

#### DURESS AS BOTH MORE AND LESS THAN RENT SEEKING

The Rent-Seeking Test, however, is not a principled, consistent, or desirable basis for a general law of duress in contract or restitution cases.<sup>10</sup> There are four essential problems with Seidenfeld and Mungan’s argument: (1) the lack of administrability of the Rent-Seeking Test; (2) the promotion of short-run static efficiency at the expense of longer-run dynamic efficiency associated with the assignment of legal entitlements; (3) in contract-modification cases, insufficient attention to the scope of the prior agreement and to the relevance of changed circumstances, and (4) an explicit exception for rent-seeking behavior in contract negotiations that undermines the basis of the Rent-Seeking Test they propose because it rests on an inconsistent distinction between cases in which contracts should be invalidated and those in which they should be upheld. This section considers these problems in turn.

#### THE IMPOSSIBILITY OF IMPLEMENTING THE RENT-SEEKING TEST

To begin to critique Seidenfeld and Mungan’s essay, it is

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9. 272 N.E.2d 533 (N.Y. 1971).

10. It is important to recognize that the function and importance of duress is not limited to contract law. Thus, while duress might be a defense to the enforcement of a breach-of-contract claim, *see* RESTATEMENT (SECOND) OF CONTRACTS § 175 (1981), it might also constitute the basis of a cause of action for restitution as a way to reverse a legally executed transfer. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 14 (2011) (“A transfer induced by duress is subject to rescission and restitution.”). Indeed, in *Austin v. Loral* itself, duress arises as the basis of a restitutionary cause of action to restore prior payments from the threatened party to the threatening party. *See Austin*, 272 N.E.2d at 533 (“The defendant, Loral Corporation, seeks to recover payment for goods delivered under a contract which it had with the plaintiff Austin Instrument, Inc., on the ground that the evidence establishes, as a matter of law, that it was forced to agree to an increase in price on the items in question under circumstances amounting to economic duress.”).

important to recognize a simple feature of the legal landscape: economic duress is not widespread. Their essay suggests an extremely general principle that would invalidate many contracts that would today unproblematically be upheld, but the principle is so broad that it could never appropriately be applied. There are a handful of specific circumstances in which courts will treat a threat to exercise a legal right as sufficient to constitute economic duress; the most important of these cases involve modifications to contracts, which I discuss *infra* in Part II.C. The other circumstances are relatively minor, and under modern law they are essentially treated as special cases; for example, it may be “legal” to file a lawsuit, but the threat to do so is improper if the lawsuit is known to be meritless.<sup>11</sup> The wrongful threat of meritless civil litigation, however, is not a significant example of the general use of legal right to amount to wrongful threats; in fact, it is something of an aberration, perhaps resulting from a reluctance to treat borderline litigation as criminal or tortious.<sup>12</sup>

In any event, Seidenfeld and Mungan’s suggestion that the cases are confused in their treatment of threats in general<sup>13</sup> may overstate the matter. As a descriptive matter, outside the contract-modification context and the other special cases, the cases do not appear to be confused in the way they claim; they simply do not consider there to be a problem. While there may be some cases in which contracts that the law currently upholds should probably be invalidated—like the cases of “distress” that I discuss later in Part II.B, *infra*—Seidenfeld and

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11. See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 14 cmt. h. (“The threat or instigation of legal proceedings in pursuit of a claim known to be unjustified is wrongful *prima facie*; such acts constitute duress, and a transfer induced thereby is voidable.”).

12. Indeed, the case of threats of civil litigation presents a useful counterexample to the application of the Rent-Seeking Test. Suppose *A* has a legitimate legal claim against *B* that *A* nonetheless knows is not worth pursuing, economically speaking, because *A*’s costs of litigation would exceed the (legitimate) proceeds from a judgment. The Rent-Seeking Test would consider it duress, and thus invalidate a contract or exchange, for *A* to threaten litigation in that case. That would be a startling result, because it would undermine *A*’s ability to assert a legitimate legal claim against *B*; *A* would run the risk of duress for seeking to settle the claim by informing *B* that he is considering legitimate litigation. As the Restatement (Third) of Restitution and Unjust Enrichment § 14 cmt. h. nicely puts it: “Subject to limited exceptions, a good-faith threat of legal process, though evidently coercive, must be permissible; so that a transfer induced thereby is not subject to rescission for duress.” *Id.*

13. Seidenfeld & Mungan, *supra* note 1, at 15 (“Unfortunately, courts have not explained what distinguishes those threats that are wrongful from those that are not.”).

Mungan propose too general a response to a problem that the courts have not recognized.

So, for example, consider my initial example involving a decision to plant trees in my front yard that my neighbor doesn't want. The law, very clearly, will not inquire as to whether I have decided to plant these trees just to extract value from my neighbor. Imagine if it did. A contract with my neighbor not to plant the trees would then be subject to a subjective, individualized inquiry into my valuation of trees, and courts are very poorly equipped to conduct such an inquiry. It is important to recognize, despite substantial commentary to the contrary, that modern courts are in fact well-equipped to make many subjective, individualized inquiries—and that they routinely exercise this ability.<sup>14</sup> The particular inquiries that the Rent-Seeking Test calls for, however, are alien in our judicial system because they depend on largely unverifiable propositions of personal value. For example, to determine whether to enforce the contract in the case of the forgone trees, a court would need to determine whether I would derive any value from those trees. Is it even plausible that there would be a case where I could not establish the possibility of that subjective value—enough to avoid invalidating the contract under the Rent-Seeking Test? If not, then the case simply shouldn't be subject to a doctrine of economic duress—and that is precisely the result under the law. The Rent-Seeking Test requires an analysis that is simply unavailable in the real world—specifically, a reliable mechanism to determine parties' valuations of everything without any mechanism for the production of information about such valuations.<sup>15</sup>

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14. See, e.g., Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CALIF. L. REV. 1743, 1749 (2000) (“[C]lassical contract law doctrines lay almost wholly at the objective, standardized, and static poles . . . . In contrast, modern contract law . . . pervasively (although not completely) consists of principles that are individualized, dynamic, multi-faceted, and, in appropriate cases, subjective.”). As an example, modern courts, even in relatively formalist common-law jurisdictions, have had no problem measuring subjective values for the purpose of setting contract damages. See, e.g., *Ruxley Elecs. & Constr. Ltd. v. Forsyth*, 3 All E.R. 268, 273 (1996) (valuing a homeowner's subjective loss in the enjoyment of a swimming pool with a small defect at £2,500).

15. The computation of subjective valuation in *Ruxley, id.*, is narrower, more purposeful, and more tied to plausible valuation. Faced with a real harm that is impossible to measure objectively, the court decided to compute the value subjectively instead of denying damages altogether; it computed these damages based on common sense and probably with reference to the contract price. That is a sound result that American courts should follow more than they have done. But it is very different from subjecting every contract to a de-

It is important to recognize that Seidenfeld and Mungan do not claim that their test is administrable or offer an affirmative argument in favor of its workability, so this part of my response does not in fact critique the internal logic of their argument. It may be that they are simply concerned with elucidating an economic effect in theory. That is fine in theory, but if the question is whether a particular test for duress (like the Rent-Seeking Test) should influence courts' decisions of cases, the administrability of the test is a necessary component of the answer. Regardless of other criteria that a proposed rule meets, if it fails the criterion of administrability then it cannot be adopted as a rule of law. As Mel Eisenberg and I have put it in a recent critique of challenges to the expectation measure in contract law:

In law-and-economics—as opposed to straightforward microeconomics—the formal validity of a model is only a first test. Other tests are whether the legal regime suggested by a model is administrable, whether the model takes institutional considerations into account, and whether implementation of the model would involve more costs than benefits.<sup>16</sup>

There is a deeper problem, too, associated with any attempt to implement the Rent-Seeking Test; it is roughly the problem that Robert Nozick identified in discussing “utility monsters,” or those whom utilitarians might be committed to favoring merely because of their strong preferences.<sup>17</sup> The key determination under Seidenfeld and Mungan’s Rent-Seeking Test is whether a party had a reason to make a threat other than extracting value from another party, but such reasons may be backed—at least for the sort of consequentialists that Seidenfeld and Mungan claim to be—by any sort of phenomenological value. For example, suppose the property owner in the case of the forgone trees derives value from (that is, incorporates into his utility function) the suffering of his neighbor, or values spite, or is characterized by the enjoyment of injustice that ancient Greek philosophers called *pleonexia*.<sup>18</sup> In all those

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termination of whether every party’s “threats” concerning its legal entitlements would in fact enhance or destroy value for that party.

16. Shawn J. Bayern & Melvin A. Eisenberg, *The Expectation Measure and Its Discontents*, 2013 MICH. ST. L. REV. 1, 37 (2013); see also Melvin A. Eisenberg & Brett H. McDonnell, *Expectation Damages and the Theory of Overreliance*, 54 HASTINGS L.J. 1335, 1135–36 (2003) (critiquing an economic argument concerning contract damages in view of “institutional considerations”).

17. ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 41 (1974).

18. Cf. Shawn J. Bayern, *The Significance of Private Burdens and Lost Benefits for a Fair-Play Analysis of Punishment*, 12 NEW CRIM. L. REV. 1, 23 &

cases, the property owner derives value from the planting of the trees and thus satisfies the Rent-Seeking Test. Moreover, these cases complicate the workability of the test; not only do we need to measure subjective valuation of trees, but we must also be sensitive to all potential motivations the property owner has for planting them.

Consider a more specific, complex example: *E*, an environmentalist, wishes to drive out of business *D*, a local dry-cleaning establishment that uses the very toxic perchloroethylene as its cleaning solvent. As a result, *E* makes the following threat to *D*: “If you do not sell me your business by the end of the week at the below-market rate of \$50,000 so that I can immediately shut it down, I will set up a much cheaper dry-cleaning establishment across the street. I won’t make any money doing this, because the ‘green’ solvent is much more expensive than perchloroethylene, but I don’t care; my sole purpose will be to draw business from your store until you go out of business.” Ignoring the potential federal antitrust implications of a business’s seeking to shutter another through predatory pricing,<sup>19</sup> does *E*’s threat pass or fail the Rent-Seeking Test? If *D* concedes to *E*’s threat, then on one hand *E* has extracted value from *D* by threatening to engage in unprofitable behavior; on the other hand, *E* may enjoy driving an environmentally unfriendly operation out of business, or she simply may enjoy running an economically unproductive dry-cleaning business. Even if we could somehow avoid the conceptual difficulties that these questions indicate for the Rent-Seeking Test, how would we ever practically answer the question?

#### THE LONG-RUN EFFICIENCY OF PREALLOCATING ENTITLEMENTS

The Rent-Seeking test faces problems other than its administrability. It is also unsound as an efficiency-promoting test because it would undermine a system of entitlements (under, for example, property law) in favor of a short-run, static criterion of efficiency—that is, whether a single transaction appears, based on an analysis with limited scope, to produce val-

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n. 38 (2009) (discussing potential psychological benefits from injustice); Thomas Morawetz, *Adam, Eve, and Emma: On Criminal Responsibility and Moral Wisdom*, 22 QUINNIPIAC L. REV. 23, 28 (2003) (suggesting that criminals may benefit merely from “even just the satisfaction of having broken a rule”).

19. *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117–18 (1986) (“Predatory pricing may be defined as pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run. . . . [It is] capable of inflicting antitrust injury.”).



ue. The efficiency of a legal rule cannot be decided by evaluating only static, short-run, context-free criteria.

The lack of an existing, sweeping economic-duress doctrine in the case of the forgone trees suggests, if the law is broadly efficient, simply that the law recognizes the longer-run efficiency of property law's allocation of entitlements. I have purchased a right to plant the trees (and thus extract the value that arises from doing so), and enforcing that right is easier (and less expensive) than determining whether I value it subjectively. Legal economists have long recognized, in studying the law and theory of property ownership, that legal property regimes reduce transaction costs by making entitlements clear.<sup>20</sup> Seidenfeld and Mungan's argument would muddy otherwise clear entitlements at very significant cost. Note that every contract would be subject to their test; every contractual offer is an implicit threat to do, or not to do, something, and the Rent-Seeking Test would require that each offer be evaluated for rent-seeking.<sup>21</sup>

There is, however, a class of case—which Professor Melvin Eisenberg has called “distress” rather than “duress”<sup>22</sup>—that is more problematic than the case of the forgone trees. Cases of distress involve one party's taking advantage of another's adventitiously hard position.<sup>23</sup> Ordinarily such cases involve price gouging in some way.<sup>24</sup> Seidenfeld and Mungan's example involving water sold during a hurricane fits this pattern,<sup>25</sup> as does Eisenberg's example of a traveler stranded in the desert who promises his rescuer \$100,000 in exchange for a rescue.<sup>26</sup> These cases are important, and they perhaps represent an area where existing doctrine is wrong not to recognize a potential defense to enforcement.

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20. See ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 81–86 (3d ed. 2000).

21. Existing efficient entitlements may also arise from statutes. For example, labor unions have the right to organize and to strike. But a pure application of the Rent-Seeking Test would perversely prevent all threats by a union to stop work and strike, because doing so would not produce more new value than continuing work. Perhaps that result could be called efficient on an extremely short-run view (in the simple sense that work is more productive than work stoppages), but it would ignore the longer-run efficiencies that the labor statutes offer in correcting a market failure.

22. Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 754–63 (1982).

23. *Id.*

24. See *id.*

25. Seidenfeld & Mungan, *supra* note 1, at 16–18.

26. Eisenberg, *supra* note 22, at 755.

Ironically, however, Seidenfeld and Mungan's analysis gets these cases exactly wrong, even from the perspective of efficiency. While they would complicate enforceability in the case of the forgone trees, they would explicitly *bless* full enforcement of price-gouging contracts made in cases of distress, because in both these cases either the promisee benefits from nonperformance (rescue in the desert is costly) or the threat was simply not to contract (as in the case of the hoarded water in a hurricane).<sup>27</sup> In such cases, however, full enforcement is at best problematic, even from the perspective of efficiency.<sup>28</sup> In the case of adventitious rescue, there is by hypothesis no investment that enforcing the contract can encourage. In both cases, there is hardly a market to speak of; permitting enforcement upholds transfers that are only barely voluntary exchanges, in which—if the good at issue is truly a life-saving supply in an emergency—one side is able to extract unlimited financial value from the other. At best, as in the case of adventitious rescue, there is a bilateral monopoly; at worst, as in the case of the hurricane water, there is a unilateral monopoly. The incentives of contract enforcement on investment in these cases is unlikely to be significant, if for no other reason than that if it were significant, there would be enough of a market to prevent monopoly pricing in the first place. It is no surprise, given the failure of the market in such cases, that many states have passed anti-price-gouging statutes that not only invalidate but also penalize such transfers.<sup>29</sup>

To be clear, my argument is not that any extreme circumstances automatically lead to unconscionable price gouging that should be prohibited. For example, it is no surprise that the

27. See, e.g., Seidenfeld & Mungan, *supra* note 1, at 17–18 (confirming that their test will uphold a price-gouging contract). For the exception regarding threats not to contract, see *infra* Part II.D.

28. It is certainly problematic from other perspectives. See Eisenberg, *supra* note 22, at 756 (“In terms of fairness, our society posits, as part of its moral order, some degree of concern for others.”).

29. E.g., FLA. STAT. 501.160 (“Upon a declaration of a state of emergency by the Governor, it is unlawful . . . for a person or her or his agent or employee to rent or sell or offer to rent or sell at an unconscionable price within the area for which the state of emergency is declared, any essential commodity including, but not limited to, supplies, services, provisions, or equipment that is necessary for consumption or use as a direct result of the emergency.”); N.Y. GEN. BUS. LAW § 396-r (McKinney) (“During any abnormal disruption of the market for consumer goods and services vital and necessary for the health, safety and welfare of consumers, no party within the chain of distribution of such consumer goods or services or both shall sell or offer to sell any such goods or services or both for an amount which represents an unconscionably excessive price.”).

price of emergency supplies should rise in an emergency, and the rise alone does not indicate a problem. As long as there is a functioning market, market contracts should be enforced. But rewarding the rescuer or the water stockpiler with a substantial windfall at the expense of those in a hard position is neither necessary to encourage productive investment nor backed by the general arguments in favor of upholding voluntary exchanges.

To generalize somewhat, our difference on this point may suggest a broader statement of the disagreement I have with Seidenfeld and Mungan: their proposed test for duress is not sensitive to many desirable criteria that courts have ordinarily sought to evaluate when applying the doctrine of duress. Duress vitiates contracts because it undermines voluntariness; it removes one of the principal moral and economic bases for enforcing contracts in the first place—namely, that voluntary exchange is ordinarily both fair and efficient and that precommitment is a useful mechanism for facilitating voluntary exchange. This is why the doctrine of duress ordinarily requires not just that a threat be “improper” (what the Rent-Seeking Test aims to determine) but also of sufficient “gravity.”<sup>30</sup> Though Seidenfeld and Mungan note that their focus is only on the impropriety and not the other elements of duress,<sup>31</sup> they routinely apply their test to invalidate contracts in situations where the threatened party is not under significant pressure. To the extent the Rent-Seeking Test disregards the gravity of threats, it would expand the doctrine of duress to cases in which markets function properly—even while upholding enforcement in those cases where there was barely a market to speak of.

In other words, the Rent-Seeking Test appears to prevent good bargains that achieve value for voluntarily acting parties who have no other way to achieve the same value. In the case of the forgone trees, nobody doubts that I can in fact plant the trees—or set up a precommitment mechanism that will necessarily cause the trees to be planted unless I enter into a contract with my neighbor. Given that, and given that the neighbor wants me not to do so, obtaining a promise from me to avoid planting the trees may have significant value to the neighbor. The neighbor is under very little pressure, however, from my threat. He can calmly consider whether the best use of

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30. E. ALLAN FARNSWORTH, *CONTRACTS* § 4.18 (4th ed. 2004) (discussing the “gravity” requirement).

31. Seidenfeld & Mungan, *supra* note 1, at 11.

his money is to commit the \$5000 to me or to some other purpose. An ordinary market is functioning. Sure, enforcing the contract may cause me to invest in planting trees I don't want in order to make my threat credible to the neighbor, but what is the alternative? Without the possibility of enforcing the contract, Seidenfeld and Mungan apparently hope to remove my incentive to plant the trees in the first place. But this assumes I am rational, that I am aware of and understand the law, and so on. If I do in fact plant the trees (hoping to extract value in ignorance of the Rent-Seeking Test), the Rent-Seeking Test would deny my neighbor the opportunity for a voluntary contract to influence my behavior. Unless Seidenfeld and Mungan are prepared to take away my legal right to plant the trees—in which case their Rent-Seeking Test is irrelevant because I would be threatening to commit a crime, which as they recognize is already prohibited apart from the Rent-Seeking Test<sup>32</sup>—their rule denies a valuable possibility for my neighbor, unless they further assume that every party is rational, fully aware of the law, and so on.

As another example, consider a promisor under very little pressure who agrees to a nonproductive “threat” partly for broader contractual or reputational reasons. For example, take again the case of the forgone trees and suppose the neighbor agrees partly because he doesn't want to have trees blocking his view but also because, in the past, his property has caused a minor nuisance to the planter of the trees and he thinks it's only fair to redress the balance. (Or suppose the consideration for the forgone trees is not money but a reasonable in-kind concession.) If this is the case, the neighbor is under essentially no pressure, and the contract is voluntary. On what basis should one who favors markets void such a contract?

There are two further general economic problems with the Rent-Seeking Test. The first relates to a broad problem in legal-economic reasoning that I recently identified and discussed in an article called *False Efficiencies and Missed Opportunities in Law and Economics*.<sup>33</sup> As I argued in that article, legal-economic arguments often proceed by identifying an activity that is more productive than its absence and then encouraging the law to promote it on the basis that it is productive.<sup>34</sup> Such arguments are incomplete, however, because not all productive

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32. *Id.* at 10–11.

33. Shawn J. Bayern, *False Efficiency and Missed Opportunities in Law and Economics*, 86 TUL. L. REV. 135 (2011).

34. See generally *id.*

activity can occur (given, for example, limits in the perfection of capital markets, credit markets, factor markets, and so on); as a result, promoting a “productive” activity might be specifically inefficient when that activity is compared against other activities that are even more productive.<sup>35</sup> The Rent-Seeking Test suffers from this problem because it conditions a determination of duress merely on whether a party’s threatened activity creates *some* value, versus none. But because not all potentially productive activity can occur, creating *some* value is not a sufficient basis for even an economically motivated argument to distinguish favored from disfavored activity; there must be a broader evaluation of the consequences of a rule. In short, a grain of productivity does not necessarily justify massive investment motivated by redistribution.

Second—more concrete but related to the first problem—a test that asks, more or less, “What would a party have done anyway even if not for the opportunity to extract surplus?” threatens to encourage parties to become, over the long term, like those who would “do things anyway.” Essentially, this concern is just one about courts’ ability to evaluate long-term, rather than short-term, courses of conduct for good-faith action, but the concern is significant. As an analogy, in the rules of baseball, a fielder may not physically interfere with a base-runner except in a (presumably good faith) attempt to field a ball.<sup>36</sup> In theory, a fielder with significant foresight could time his supposedly good-faith “act of fielding the ball” in order to interfere with a runner in a manner that would appear, in short-run terms, to be unavoidable. The same is true of conduct under the Rent-Seeking Test. Unless courts are extremely confident that they can chart a party’s motivations over very long time periods, the test is subject to manipulation. For example, in the case of the forgone trees, even if it were possible to determine a homeowner’s subjective valuation of trees, all a homeowner needs to do to achieve an enforceable contract is to develop a preference for trees. Importantly, the Rent-Seeking Test not only fails to stop such behavior; it also affirmatively encourages it, producing a potentially significant economic distortion.

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35. *Id.* at 142–45.

36. *Official Rules: 2.00 Definition of Terms*, MLB.COM, [http://mlb.mlb.com/mlb/official\\_info/official\\_rules/definition\\_terms\\_2.jsp](http://mlb.mlb.com/mlb/official_info/official_rules/definition_terms_2.jsp) (last visited Jan. 26, 2015) (“OBSTRUCTION is the act of a fielder who, while not in possession of the ball and not in the act of fielding the ball, impedes the progress of any runner.”).

CONTRACT MODIFICATION: NOT ENOUGH OF A  
“SPECIAL CASE”

As I noted earlier, cases of contract modification are probably the most significant cases in which the notion of economic duress arises.<sup>37</sup> Nobody thinks a court would seriously deny enforcement in the case of the forgone trees, but courts might well deny enforcement of a contract modification in which one party has threatened to breach in order to reallocate surplus in his favor. On this topic, Seidenfeld and Mungan deserve significant praise; their argument is appropriately skeptical of the formalistic rules of consideration, like the legal duty rule, that are sometimes thought to govern this area, and it is sensitive to many of the considerations that should matter in contract-modification cases.<sup>38</sup>

Their analysis, however, does not give appropriate weight to the force and scope of the original contract subject to later modification. Contract modification is one of the most difficult problems in contract law, and it is not susceptible to a simple solution that depends only on whether the party threatening breach would benefit from breach. Clearly, the parties could have explicitly allocated the risk of the events that led to the threat of breach by contract; when they have not, the question of implicit allocations of risk arises, just as it does in cases of mistake and unexpected circumstances. A broad inquiry is needed to determine where parties stand after their original contract; simply asking whether one party would actually benefit from breach does not give effect to the parties' intentions under the original contract. To put it differently, Seidenfeld and Mungan's consideration of contract-modification cases runs into the same general problem I discussed in Part II.B, *supra*: in focusing on one short-run economic effect, it neglects broader efficiencies at stake. In this case, what it neglects specifically is the long-run efficiency from the prior contract.<sup>39</sup> To be clear, my argument is not that contract modifications should never be permissible; in fact, I think they should ordinarily be permissible. But it is impossible to decide what is appropriately per-

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37. See *supra* Part II.A.

38. See Seidenfeld & Mungan, *supra* note 1, at 45–50.

39. Cf. Varouj A. Aivazian et al., *The Law of Contract Modifications: The Uncertain Quest for a Bench Mark of Enforceability*, 22 OSGOODE HALL L.J. 173, 175 (1984) (“[D]ynamic efficiency considerations focus on the long-run incentives for contracting parties at large imparted by a set of legal rules. In the modification context, these dynamic efficiency considerations adopt an *ex ante* perspective, rather than the *ex post* perspective implicit in the static efficiency considerations.”).

missible without considering the contracting context in which the parties find themselves.

Consider *Austin v. Loral*.<sup>40</sup> Austin, a subcontractor for Loral on a military contract, threatened to breach its contract to supply parts to Loral for radar sets to be used by the US Navy.<sup>41</sup> Austin claimed that as a result of sharply rising manufacturing costs, it was losing a significant amount of money on the contract and that it could not afford these losses.<sup>42</sup> As a result, Austin stopped performing under the contract and insisted on price increases under the original contract and the award of a second contract on better terms.<sup>43</sup> Loral agreed and made payments; once Austin completed performance, it then sought restitution of those payments, claiming duress.<sup>44</sup>

Seidenfeld and Mungan agree with the New York Court of Appeal (New York's high court), which found duress,<sup>45</sup> rather than the Appellate Division (the intermediate appellate court), which did not.<sup>46</sup> I agree broadly with Seidenfeld and Mungan that the case should turn, at least partly, on whether (1) Austin invented the threat of its breach merely to extract more value from Loral or (2) Austin found itself in legitimate hardship and offered Loral a way to help it avoid a mutually harmful breach.<sup>47</sup> This is a good starting point for the analysis. But I would emphasize different facts from those that Seidenfeld and Mungan emphasize. For example, it appears, under the Rent-Seeking Test, that they would preclude the possibility of duress based on the threat of breach so long as Austin would benefit more from breach than from performance. That is a perverse result and threatens to undermine the original contract; it would mean that any time the price moves against a party or that party is otherwise in a worse situation from performing than from breaching, that party could threaten to hold up performance on a contract without the possibility of their actions' being judged wrongful. In its undermining of the force of contracts, such a result would be breathtakingly inefficient.

Consider, similarly, a hypothetical variation of *Austin* that

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40. 272 N.E.2d 533 (N.Y. 1971).

41. *Austin Instrument Inc., v. Loral Corp.*, 316 N.Y.S.2d 528 (N.Y. App. 1970).

42. *Id.* at 530.

43. *Id.*

44. *Id.* at 531.

45. 272 N.E.2d at 545.

46. 316 N.Y.S.2d at 532-33.

47. Seidenfeld & Mungan, *supra* note 1, at 26-28.

Seidenfeld and Mungan offer: suppose, “given the second contract, [Austin] can achieve economies of scale. Austin can then make money by obtaining expensive but more sophisticated equipment that would allow it to produce each part more quickly and cheaply.”<sup>48</sup> In that case, Seidenfeld and Mungan would find no duress. But this opportunity for Austin to benefit from “economies of scale” from the second contract would, under the Rent-Seeking Test, justify *any* attempt by Austin to extract more value from threatening to breach, because Austin’s behavior would (because of the gain from the economies of scale) not be solely redistributive. This returns us to the problem I identified at the end of Part II.B, *supra*: a small allocative gain does not justify bad-faith action whose force is largely distributive. Who knows what the relationship will be between Austin’s investment in this course of action and the total social gains from it? Austin will be motivated to pursue this possibility simply if its own gains are greater than its own costs. The “economies of scale” from the second contract tell us very little about the efficiency of a modification or its consistency with the original contract’s allocation of risk.

Perhaps in recognition of this point, and in tension with their earlier analysis of it, Seidenfeld and Mungan offer an exception to the Rent-Seeking Test in the case of contract modification. Their exception is apparently that the Rent-Seeking Test should apply, but only after courts award specific performance instead of damages on all contracts.<sup>49</sup> For several reasons, however, this is neither practical nor desirable. For one thing, specific performance may be impossible in many of the cases in which contract modification arises; for example, if Austin truly could not afford to perform the original contract, a decree of specific performance would not be helpful and would not meaningfully change the analysis. Second, specific performance has significant potential costs that need to be weighed against its benefits.<sup>50</sup> It will not do to wave the problem of imperfect remedies away by assuming that courts have perfect remedies at their disposal. Third, specific performance is not a sufficient remedy to avoid the problems that Seidenfeld and Mungan seek for it to avoid, because a suit for specific performance still requires the plaintiffs to incur potentially substan-

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48. *Id.* at 27.

49. *Id.* at 50–51.

50. See generally *Walgreen Co. v. Sara Creek Prop. Co., B.V.*, 966 F.2d 273 (7th Cir. 1992) (Posner, J.) (weighing the costs and benefits of specific performance versus expectation damages).



tial transaction costs, and nothing prevents such costs from being significantly greater than those the defendants must incur if they are sued. Fourth, Seidenfeld and Mungan assume that the parties' "initial agreement" contemplates specific performance rather than damages, but they give no reason for this assumption.<sup>51</sup>

More to the point, however, courts do not already award specific performance in all contracts cases. Perhaps they should do so more often than they do; this would, among other things, undercut most of the unpersuasive and severely problematic arguments that legal economists have made over the years for a "theory of efficient breach," the main force of which is to weigh in *against* specific performance.<sup>52</sup> It would be ironic if inherent in Seidenfeld and Mungan's argument were the proposition that the theory of efficient breach must be incorrect and specific performance must instead be universally available. But to say that is just a rhetorical flourish; my main analytical point is that, without universal adoption in courts of specific enforcement, it is unclear where the Rent-Seeking Test stands as a basis for evaluating contract modifications. Following the logic of Seidenfeld and Mungan's argument, it would be seem to be entirely inapplicable—which would undermine their argument severely because, as I have previously noted, cases of contract modification are the principal cases in which economic duress might be relevant.<sup>53</sup>

How should contract modifications be decided, then? I do not believe there is any simple formula, even if the only goal is to achieve efficiency. Relevant factors include (1) how much circumstances have changed from the initial contract, because modifications (or even just changes to allocations of the contractual surplus) contemplated and ruled out, implicitly or explicitly, by the original contract should not be enforced; and (2) how much the threat of breach restricts the opportunities available to the promisee. The first of these factors matters because of the allocation of risk under the parties' specific contract; the second of these factors matters because of parties' general tendencies—if they are fair-minded and rational—to avoid hold-up problems.

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51. Seidenfeld & Mungan, *supra* note 1, at 51.

52. See Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CALIF. L. REV. 975, 997–1014 (2005) (arguing against the "theory of efficient breach").

53. See *supra* Part II.A.

The good faith of the promisor—the one threatening breach and requesting a modification—also matters, but this must be conceived more broadly than the Rent-Seeking Test would allow (because, again, the Rent-Seeking Test would endorse any modification in which the party threatening breach would prefer breach to performance). Whether the promisor is attempting opportunistically to reallocate surplus, versus asking for a fair modification, should influence the enforceability of a modification, for parties would probably desire for it to do so in the general case—largely because it is broadly fair and efficient to uphold good-faith reallocations.

CONTRACT NEGOTIATION: THE EXCEPTION THAT  
SWALLOWS (AND UNDERMINES) THE RULE

Finally, an even more significant limitation that Seidenfeld and Mungan impose on the Rent-Seeking Test—that it should not apply to ordinary contract modification<sup>54</sup>—shows the problems with that test. The exception they propose also threatens to swallow the rule, because there appears to be no principled basis on which they can distinguish the cases in which the rule applies from the cases in which the exception applies.

Their proposed exception to the Rent-Seeking Test looks simple enough: the Rent-Seeking Test does not apply (to invalidate a contract) when a threat is merely to refuse to conclude a contract, even if such a threat is otherwise “rent-seeking.” Specifically, their explicit exception is for “rent-seeking by threatening to walk away from contract negotiations, leaving the status quo ante.”<sup>55</sup>

This exception is necessary because the Rent-Seeking Test threatens to invalidate many routine and desirable mechanisms for precommitment, including contract negotiations generally. The case that Seidenfeld and Mungan have in mind to justify the exception for “threatening to walk away from contract negotiations” is relatively simple: a buyer offers \$5 for a book, and the seller refuses to sell at that price even though the book is worth less than \$5 to the seller.<sup>56</sup> This refusal is “rent-seeking,” under Seidenfeld and Mungan’s definition, because it simply seeks more of the contractual surplus without any hope of producing wealth.<sup>57</sup> But it is clear that the refusal must be

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54. Seidenfeld & Mungan, *supra* note 1, at 45–49.

55. *Id.* at 39.

56. *Id.*

57. *Id.* at 40–41.

allowed; otherwise, anyone could force a contract simply by offering a price better than the other party's reservation value. For example, if I suspect that the lowest price at which a car dealership would sell a car is \$25,000, I could force the dealership to enter a contract with me by offering \$25,000 to buy the car, thereby preventing the dealership from negotiating with me (or anyone else) further. Such further negotiations would fail the unmodified Rent-Seeking Test.

This exception, however, relies on several arbitrary distinctions. Most importantly, an arbitrary reliance on the *status quo ante* would restore a sort of distinction between acts and omissions to a consequentialist analysis in which it has no place. Seidenfeld and Mungan's exception appears to depend on the proposition that it is worse to destroy \$500 in value than to walk away from an opportunity to create \$500. That is, Seidenfeld and Mungan are concerned about causing harm but not about destroying a mere opportunity for gain. But those purporting to promote economic efficiency should be the first to recognize that there is no principled distinction between those two cases. To a rational, risk-neutral consequentialist, a forgone \$500 opportunity is just as significant as \$500 harm. The *status quo ante*—in effect, the number 0—has no special place in a consequentialist analysis, which is appropriately concerned only with the greatest possible value going forward. Value *ex post*, rather than *ex ante*, is the only driver of consequentialist policy.<sup>58</sup>

Nonetheless, it is easy to see why Seidenfeld and Mungan propose an exception for contract negotiations; without that exception, they would commit themselves to treating most ordinary contractual offers as rent-seeking and thus as cases of duress. After all, every offer is a potential threat, and it is a typical goal in contract negotiations for a rational, self-interested party to extract as much of the contractual surplus as possible.

In addition to being arbitrary, the exception is also not broad enough. Once the need to shield ordinary contract negotiations is recognized, it becomes clear that the simple case of contract negotiations (or a distinction between destroying an opportunity and destroying existing value) is not sufficient to exhaust the appropriate exceptions to the Rent-Seeking Test. Consider a slight variation to the example above involving the

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58. Similarly, it would not be principled to distinguish threats to do nothing from threats to destroy value, because doing nothing may, depending on context, destroy value.

sale of a book: the owner of a book says to the buyer, “If you don’t offer \$12 right now, I’ll destroy the book.” In making this threat, the seller is not threatening merely to “walk away” from contract negotiations, nor is he threatening to restore the *status quo ante*—because if he carries through with the threat, the status of the book will be changed irrevocably. Yet it would be an extreme result if the seller were not able to destroy his own book, or (more realistically) to use a threat of its destruction as a precommitment device to indicate to the buyer the immutability of his own reservation price.<sup>59</sup> And this analysis does not depend on the book’s destruction; it would apply even if the owner of the book merely had said, “If you don’t offer \$12 right now, I promise I will not negotiate with you in the future”—for that would change the status quo ante by eliminating the possibility of potentially profitable negotiations. Likewise for “If you don’t offer \$12 right now, I will lock the book in a mechanical safe from which it cannot emerge for a year.”

Perhaps more importantly, a similar analysis applies to many familiar mechanisms of contract negotiation, such as a so-called *first-price sealed-bid auction* in which a party invites competing bids and agrees to accept the best bid after a single round of bidding, foreclosing all future negotiation.<sup>60</sup> As to any individual bidder, the auctioneer is not threatening to restore the status quo ante; he is artificially threatening to foreclose all opportunity of future negotiation even if such negotiation could be productive *ex post*, and he is doing so merely in the hope of extracting a greater surplus from the auction—not because going with the winner of the first round of bidding is productive on its own. Clearly, the mere use of this popular auction mechanism won’t—and shouldn’t—amount to economic duress.<sup>61</sup>

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59. Moreover, who is to say that the owner doesn’t enjoy—that is, derive some subjective pleasure—from destroying books that he owns? How would a court ever make the determination that the threat carried with it no benefit to the seller? See *supra* Part II.A & II.B.

60. For a recent discussion of this and similar auction mechanisms in the context of business sales, see Jay Kesten, *Adjudicating Corporate Auctions*, 23 *YALE J. REG.* (forthcoming 2015) (arguing that most such mechanisms should be permitted on grounds of efficiency).

61. To elaborate somewhat, all cases where a party makes a precommitment are cases in which that party potentially destroys some value otherwise available to him or her; that is the nature of precommitment, and surely some precommitments are productive (or else contract law is worthless). The Rent-Seeking Test voids only those precommitments that, if carried through, will subtract value from a party’s original position rather than fail to capture the opportunities available to that party. But that distinction cannot matter from the perspective of traditional wealth-maximization, because nothing in rational-actor economics distinguishes the waste of existing value from the waste of

In short, it is arbitrary to single out the status quo ante as a baseline against which changes are to be evaluated. It is not a principled baseline for a consequentialist analysis. As a result, the exception for contractual negotiations is insufficient to prevent a variety of routine and productive precommitment devices. If the exception were expanded, though, it would be hard to know how to rule in a first-price sealed-bid auction but rule out the case of the forgone trees.

#### CONCLUSION

Duress is both more and less than rent-seeking. The Rent-Seeking Test that Seidenfeld and Mungan propose could never be applied, has limited relevance in the most significant cases to which it might apply (those of contract modification), neglects the longer-term efficiencies of both contract law and property law, and requires exceptions that undermine most of its force.

The limitations of Seidenfeld and Mungan's arguments show, perhaps, a problem with their underlying endeavor. It is helpful, as a matter of pure theoretical microeconomic arguments, to isolate economic effects and to derive conclusions about them. Short-run efficiencies of transactions, evaluated in a context-free manner, are theoretically interesting. But as arguments about the law—even if they were presented as partial, incomplete solutions to legal problems—abstract economic analyses often fall short because of concerns about administrability and because they neglect broader efficiencies that incorporate dynamic considerations, context, and long-run effects. These problems are different from those that typical critiques of legal-economic arguments identify; for example, only in passing in this Essay have I made reference to the fact that parties are not fully rational or informed. They reflect problems with the inner logic of many modern legal-economic arguments: in short, they do not in fact produce efficient results.