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Nonparty Interests in Contract Law

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NONPARTY INTERESTS IN CONTRACT LAW

Omri Ben-Shahar,^{*} David A. Hoffman,^{**} and Cathy Hwang^{***}

ABSTRACT

Contract law has one overarching goal: to advance the legitimate interests of the contracting parties. For the most part, scholars, judges, and parties embrace this *party primacy norm*, recognizing only a few exceptions, such as mandatory rules that bar enforcement of agreements that harm others. This Article describes a distinct species of previously unnoticed contract law rules that advance nonparty interests, which it calls “*nonparty defaults*.”

In doing so, this Article makes three contributions to the contract law literature. First, it identifies nonparty defaults as a judicial technique. It shows how courts deviate from the party primary norm with surprising frequency through a variety of default rules, interpretation practices, and remedies. These defaults are meant to protect nonparties’ interests and benefit society at large. Second, it develops a normative account as to when common law courts adjudicating contract disputes are a suitable forum to identify and advance nonparty interests. Finally, it documents and explains the surprising durability of nonparty defaults, which the parties could, but rarely do, disclaim.

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INTRODUCTION

Contract law is defined by one overarching goal: to advance the contracting parties' legitimate interests.¹ Courts generally enforce the agreements parties choose to enter and the promises they wish to make, providing them the power to form relationships and "effect changes" in their affairs.² Unlike other types of private law rights and obligations, like torts, property, or restitution, contract law often allows parties to ignore the interests of third parties, the community, or the government.

Contract law's focus on the parties' interests extends beyond the substance of contracts and into the rules and doctrines that govern contract enforcement by courts. The cardinal rule of contract interpretation and enforcement is that judges should seek to identify the parties' intent. When intent is ambiguous, judges might turn to a party-centric backstop—the underlying interests of the parties, their backgrounds, and objectives—to figure out what their intent might be.³

This loyalty of contract law to the interests and plans of the contracting parties—what we call the "party primacy norm"—is so tautologically part of the contract law that it is rarely challenged.⁴ Indeed, historical and present-day contract law debates tend to focus on competing and evolving conceptions of the party primacy norm—how to identify and interpret the parties' intent, how to supplement it, and how to grant the parties' interests adequate protection.⁵

¹ 11 RICHARD A. LORD, WILLISTON ON CONTRACTS § 32:2 (4th ed. 2009); 5 TIMOTHY MURRAY, CORBIN ON CONTRACTS § 24.23 (2021).

² Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 806 (1941).

³ Lord, *supra* note 1; Murray, *supra* note 1.

⁴ A few scholars have begun to chip away at aspects of this norm. See, e.g., Aditi Bagchi, *Interpreting Contracts in a Regulatory State*, 54 U.S.F. L. REV. 35 (2020) (justifying intervention in contracts for societal interests); Aditi Bagchi, *Other People's Contracts*, 32 YALE J. ON REG. 211, 243 (2015) [hereinafter Bagchi, *Other People's Contracts*] (arguing that the diffuse social interests should be considered when construing ambiguous contract terms); Cathy Hwang & Matthew Jennejohn, *Contractual Depth*, __ MINN. L. REV. __ (forthcoming 2022) (showing that contract drafters sometimes include the intent of regulators, rather than only the parties themselves, into their contracts); Sarah Winsberg, *Contract's Covert Meddlers* (on file with authors) (nonparty interests in partnership law).

⁵ See, e.g., See, e.g., Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 25–26 (201) [hereinafter Gilson, Sabel, & Scott, *Text and Context*] (describing some of the differences between textualist and contextualist approaches to contract interpretation); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996) (critiquing a contextualist approach); Cathy Hwang, *Collaborative Intent*, __ VA. L. REV. __ (forthcoming 2022) (nothing that "perhaps the longest-standing debate in contract theory is the evidence question: whether judges should consider extrinsic evidence in making their decisions"); Cathy Hwang, *Unbundled Bargains, Multi-Agreement Contracting in Complex Mergers & Acquisitions*, 164 U. PA. L. REV. 1403 (2015) (discussing the debate between textualists and contextualist); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 931–32 (2010) [hereinafter Schwartz & Scott,

Of course, parties' freedom to advance their joint goals is cabined by nonparties' legally protected interests. These limits to the party primacy norm, however, are usually transplants from statutes and principles originating in other areas of the law.⁶ Criminal law instructs contract law not to enforce conspiracies, even they are clearly in the parties' interests; Zoning laws limit the type of leases landlords and tenants may enter; and competition law sets limits on mergers or covenants not to compete. Through the concept of *agreements against public policy* judges evaluating contracts import the regulatory mandates of other bodies of law.

This Article is organized around the observation that the party primacy norm has more exceptions than these familiar mandatory guardrails. We call these exceptions *nonparty defaults*. These are doctrines of contract through which courts construct and shape the scope of contractual obligations to advance nonparties' interests, and do so without direct command from other areas of law and with full permission for the parties to opt out. We show that these nonparty defaults are both abundant and durable.

A court's choice of whether to grant the specific performance remedy for breach provides a good example. Typically, it depends on how well the aggrieved party's interest can be protected by monetary damages.⁷ But in several leading cases, courts have considered the interests of nonparties in the performance of the contract in shaping the remedy. For example, in a landmark case, a Delaware court forced two companies to complete a transaction to protect interests of workers and communities, noting that "[t]he impact of a forced merger on constituencies beyond the stockholders and top managers of [the companies] weighs heavily."⁸

In a rich array of other contexts, courts also take nonparty interest into account. Insurance contracts provide striking examples. Whether to serve interests of auto accident victims, a clean environment, or victims of mass torts, courts (by default) construe the language of liability insurance policies broadly.⁹ While policyholders sometimes benefit from such pro-

Contract Interpretation Redux] (laying out some basic differences between textualist and contextualist interpretation approaches to contract interpretation).

⁶ See, generally, RESTATEMENT (SECOND) OF CONTRACTS, Ch. 8 Introductory Note; § 178(1) (AM. L. INST. 1979) ("A promise of other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable"). A large literature discusses specific legislative policies that set limits to enforcement of contracts. See, e.g., David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979, 988 (2021) (noting that "there is a relatively nascent literature on the externalities of contracts"); Adam B. Badawi, *Harm, Ambiguity, and the Regulation of Illegal Contracts*, 17 GEO. MASON L. REV. 483, 493–95 (2010) (analyzing social costs of illegal contracts in the form of negative externalities).

⁷ RESTATEMENT (SECOND) OF CONTRACTS, § 359 (AM. L. INST. 1979).

⁸ *In re IBP S'holders Litig. v. Tyson Foods*, 789 A.2d 14, 83 (Del. Ch. 2001).

⁹ See, e.g., *Progressive N. Ins. Co. v. Concord Gen. Mut. Ins. Co.*, 864 A.2d 368, 375 (N.H. 2005) (in which the New Hampshire Supreme Court embraced a liberal approach of insurance coverage that "effectively furthers the state's policy of compensating and

coverage interpretation, the main benefits accrue to their victims and to diffuse social interests. It is the desire to promote these nonparty interests that courts expressly invoke as their canon of interpretation.

The article has two primary purposes. The first is to demonstrate the prevalence of nonparty defaults, and the second is to explain and to partially justify their existence. To do so, this article proceeds in three parts. Part I sets the stage. It provides a (very brief) statement of the party primacy norm, its justifications, and its common exceptions. It shows that existing exceptions to the norm are mandatory rules transplanted from other substantive areas of the law. Part II—the heart of the article—then reveals the world of nonparty defaults: it shows how judges use default rules, interpretation norms, and remedial principles to advance nonparty interests in a variety of cases.

In Part III, this article turns to its second purpose: justifying the existence of nonparty defaults. To do so, we address two primary concerns. The first is a normative inquiry: are common law courts adjudicating contract disputes based on records developed by the parties the best institution to promote societal interests? We argue that in using nonparty defaults courts could serve as a useful supplement to legislation in looking out for broader social good. The second is a feasibility concern. Are nonparty defaults worth the candle, given the parties' ability to contract around them? We show that even though parties can disclaim nonparty defaults, many stick—for good reasons. We finally introduce a new way of thinking about the utility of non-mandatory rules: as “first response” aids when new and anticipated problems and emergencies pop up.

This article is not the first to recognize the role of nonparty interests in contract law.¹⁰ But most limits on contracting come from other areas of law—such as bankruptcy, securities, and employment law. Very little attention has been paid to nonparty interests *within* contract law, and even less to non-mandatory rules. Recognizing that nonparty defaults have been shaping contract interpretation and construction, court-designed gap-fillers, and remedies, opens a new lens into the social role of contract law. This article's goal is thus to describe an ongoing phenomenon and

protecting innocent accident victims from financial disaster.” For more examples, see *infra* Part II.B.

¹⁰ See generally MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* (1993); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1723-24 (1997) [hereinafter Zamir, *The Inverted Hierarchy*] (discussion of Rest 207 as a public interest rule); Eyal Zamir (featuring Ian Ayres), *A Theory of Mandatory Rules: Typology, Policy, and Design*, 99 TEX. L. REV. 283, 291 (2020) (“when externalities are the primary concern, procedural interventions will more likely rely on methods that discourage harmful contracting; Kish Parella, *Protecting Third-Parties in Contract*, 58 AM. BUS. L. J. 327 (2021) (tort liability should incorporate third-parties harmed by contract). See also sources cited *note 4, supra*.

understand it, not as a collection of wrong-headed decisions, but as justified and durable common law.

I. THE PARTY PRIMACY NORM

A. What Is the Party Primacy Norm?

Contract law enforces promises for many good reasons: To protect expectation and reliance interests of promisees,¹¹ to enhance the autonomy and individualism of promisors by granting them the power to engage with others and promote their own plans,¹² to do justice between parties in a reciprocal relationship who disagree over their respective claims, and of course to increase the welfare of the parties.¹³ But whether one focuses on efficiency or justice, autonomy or reciprocity, reliance or expectation, or ex-post versus ex-ante concerns, common justifications for the existing rules often circle back to the parties in the transaction. This is the *party primacy norm*.

Contract law helps *the parties*, not outsiders, achieve cooperation. It protects interests, plans, and well-being of the *parties*, not of others. When it operates to remove ambiguity over the terms of the contract—for example, by interpreting and constructing the terms or providing gap-fillers—contract law looks at the interests, the implied intent, and the conduct of the parties as the guiding criterion. Even the exceptions—like the third-party beneficiaries doctrine—are justified because *the parties* so designated them. (At this point, we'll stop italicizing *parties*, but please feel free to read with that emphasis in mind.)

To be sure, contract law is a machinery run by the collective, and it is therefore constrained not to offend collective interests. Agreements the parties make and jointly favor may not be serviced by contract law when they harm society or unduly burden courts. The party primacy norm therefore is restrained by substantive boundaries from numerous other areas of law, primarily public law, and has also some internal mandatory guardrails.

One of the primary illustrations of the party primacy norm is the contract interpretation doctrine. “The primary purpose and function of the court in interpreting a contract is to ascertain and give effect to the parties’ intention” says Williston, because “the cardinal principle of contract interpretation is that the intention of the parties must prevail.”¹⁴ On this

¹¹ L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52 (1936); P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1985).

¹² CHARLES FRIED, *CONTRACT AS PROMISE* ch. 2 (1981).

¹³ Richard A. Posner, *The Ethics and Economics of Enforcing Contracts of Surrogate Motherhood*, 5 J. CONTEMP. HEALTH L. & POL'Y 21, 23 (1989).

¹⁴ Lord, *supra* note 114. *See also* *In re Motors Liquidation Co.*, 460 B.R. 603 (Bankr. S.D.N.Y. 2011) (citing *Hunt, Ltd. v. Lifschultz Fast Freight, Inc.*, 889 F.2d 1274, 1277 (2d

matter, even his contrarian, Corbin, easily concurs.¹⁵ The field of contract law has long debated how exactly to find the parties' intent, how much extrinsic evidence to bring to bear in this inquiry, and whether to trim intent's sails by using objective measures (as in—what might a reasonable party in this situation intend). But these debates are typically framed by the party primacy norm: none of the positions on proper interpretation, construction, or gap-filling in contracts proposes that courts should look beyond the goal, interests, and manifestations of the contracting parties. When courts do look to broader context, such as trade usage, they do so as a heuristic for what the parties presumptively intend.¹⁶ Textualists and contextualists may disagree on what information should courts access in interpreting and enforcing contractual promises and representations, but they agree that the enterprise should serve the parties' interests.¹⁷

The party primacy norm operates at different levels of generality. At the zoomed-in end, courts have in mind these specific parties when giving meaning to the contract. Zooming out, courts contemplate parties *like these*. For example, court might disagree which trade usages and customs are valid evidence for what the parties intended. Because trade usages require courts to identify the relevant trade community and the generality of the custom, defining the scope of a community and incidence of regularity may dictate the result. Exempting new entrants or out-of-town merchants from the dictates of local usages could be justified when these outsiders would not ordinarily know the usage.¹⁸ These kinds of exemptions import a more specific conception of the party primacy norm, closer to *actual*, rather than *constructed*, intent.

B. Justifying the Party Primacy Norm

Cir.1989)). See also Bagchi, *supra* note 10 (“For different reasons, scholars from both philosophical and economic perspectives are drawn to an insular picture of contract interpretation focused exclusively on the parties to contract.”).

¹⁵ 5 TIMOTHY MURRAY, CORBIN ON CONTRACTS § 24.23 (2021).

¹⁶ See JAMES J. WHITE AND ROBERT S. SUMMERS, 1 UNIFORM COMMERCIAL CODE 47 (4th ed. 1995) (past practices are relevant “to determine ‘the meaning of the agreement’ in the first place). UCC § 2-202 cmt.2 identifies the past practices doctrines as means for assuring that “the true understanding of the parties as the agreement will be reached.” See also Zamir, *The Inverted Hierarchy*, *supra* note 10, at 1765-67.

¹⁷ Textualists believe that sophisticated parties who already “embed[ded] as much or as little of the context as they wish in a written, integrated contracts.” See Ronald J. Gilson, Charles F. Sabel and Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 26 (2014). Contextualists, in contrast, favor review of extrinsic evidence to more fully trace “the parties’ real relationship” and advance the “parties’ efforts to govern their transactions efficiently.” *Id.* at 27.

¹⁸ Compare *Flower City Painting Contractors, Inc. v. Gumina Constr. Co.*, 591 F.2d 162 (2d Cir. 1979) (entrant not bound by trade usage), with *Berwick & Smith Co. v. Salem Press*, 117 N.E.2d 825 (Mass. 1954) (party new in the trade bound by trade usage).

The party primacy norm, as its name suggests, puts parties first—often sidelining those not in the deal.

This section discusses the literature's two primary justifications for why the norm sidelines nonparties. The first justification is normative: courts are not well-suited institutionally to account for the interests of people not represented in the litigation. The second is pragmatic: even were courts judicious when blending in nonparty interests, the contracting parties could opt out and undo the protection given to the interests of others.

Establishing these justifications serves as a backdrop to also understand their limits and in turn explore, later in the article, the surprising prevalence of nonparty interests in contract law and their systematic appearance.

1. *Institutional Competence*

Contract law instructs courts to identify the bargain between the parties and enforce it.¹⁹ Because so much of contract law is developed case-by-case, based on records developed by the litigating parties, one justification of the party primary norm is that courts simply see too small and random of a sliver of society's problems to capably look out for the interests of non-parties.²⁰

Of course, there are many reasons to agree that courts are not the best institution to account for the interests of non-parties and of society at large. Their shortcomings are fundamentally due to two factors: the information courts have and their prerogative to determine or arbitrate among social preferences.²¹

First, nonparty interests are varied and many. Courts are therefore unlikely to recognize the full array of affected interests and the full magnitude of such effects. Common law courts are procedurally and practically restricted to evaluate claims raised and argued by the parties and are therefore exposed to the parties' (potentially conflicting) interests, as well as to the social interests that the parties choose strategically to plead. For example, when a coal mine advocates for specific performance of its breached long-term sale-of-coal contract, imploring the court to account for not only lost profits but also the surrounding nonparty interests such as the livelihood of its workers and the entire local community, this litigant is choosing selectively which social value to highlight. Other non-party interests—like the negative environmental impact of coal-based energy, or

¹⁹ Lord, *supra* note 114; and MURRAY, *supra* note 15, § 24.23.

²⁰ Cathy Hwang, *Faux Contracts*, 104 VA. L. REV. 1025, 1068 (2019) (noting that relatively few contracts result in dispute and relatively few disputes end up in court).

²¹ See also Bagchi, *supra* note 10 at 229-36. Bagchi's analysis addresses a similar question—when common law courts are less suited to address societal harms. Bagchi organizes her insights along the distinction between *concentrated* and *diffuse* nonparty interests.

the economic impact on suppliers of alternative sources of fuel—remain obscure in the litigation, especially if they are geographically or temporally remote, or have a less concrete and salient manifestation. If contract law wanted to account for specific non-party interests or for diffuse social impact, some of the affected interests would likely receive less than adequate representation in the litigation.

Second, nonparty interests are complex. Courts adjudicating contractual disputes have a difficult enough job accounting for the private interests involved, the objectives of the parties, their specific circumstances, the practices followed by transactors in such markets, and how to weigh these various instructions. Significant litigation costs are poured into assessment of such aspects. But the sources and records that establish the parties' interests are insufficient and even irrelevant for the task of measuring the anticipated impact on broader nonparty interests.²² Indeed, in regulatory theory, a primary reason to use *ex ante* formulation of rules is the ability of agencies promulgating such commands to collect more information, to survey the interests involved and their intensity, to measure the potential impact of any regime, and to rationally choose the degree of precision or complexity of the rules.²³ Because legislation is “supported by facilities for factual investigation and can be more responsive to the general public” it is widely accepted that the declaration of public policies and setting priorities among them are largely the province of legislators.²⁴ The expertise needed to assess cost and benefit, the various harms and their expected magnitudes, and the arsenal of policy tools to address them, are concentrated within specialized branches of government, not among judges and their clerks.

Third, nonparty interests are also political. Is it the role of courts to determine which social interest to favor, especially when competing interests collide? In other areas of law, courts are accustomed to promoting particular societal values, but they often implementing priorities established explicitly by legislators (or, the Framers!). In the common law of contracts, by contrast, explicit legislative guidance is more rarely available.²⁵ Courts may try to resolve contractual disputes in a manner that appears social, for example when they justify a decision to avoid “social waste.”²⁶ But what

²² Anthony J. Casey & Anthony Niblett, *The Limits of Public Contract Law*, __ LAW & CONTEMP. PROBS. __ (forthcoming 2022). (“the costs inherent in adapting contract law to this new public role outweigh any likely benefits.”) (manuscript on file with authors).

²³ See generally Louis Kaplow, *General Characteristics of Rules*, in *ENCYCLOPEDIA OF L. & ECON.* ch 2 (Gerrit De Geest ed., 1997); Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. Legal. Stud. 357 (1984). More specifically, see Mark A. Cohen and Paul H. Rubin, *Private Enforcement of Public Policy*, 3 YALE J. REG. 167, 187 (1985), the technical requirements in regulating auto safety.

²⁴ RESTATEMENT (SECOND) OF CONTRACTS, § 179 cmt. b (AM. L. INST. 1979).

²⁵ The Uniform Commercial Code is an obvious counter-example, though jurisdictions like California in fact have codified many contract law rules outside of the sale-of-goods context as well.

²⁶ *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (Okla. 1963).

they view as “social waste” could well reflect controversial values, selective norms, and empirical guesswork. When, in this context, the Oklahoma Supreme Court famously chose a specific measure of damages for breach a promise to restore strip-mined land, it measured “social waste” narrowly, as reflected in market prices, ignoring not only non-pecuniary values but also the impact of the chosen remedy on the environment.²⁷ It is only when legislators enshrined nonparty environmental interests in a statute that courts followed the guidance, abandoned the narrow conception of “social waste,” and opted to award damages that account for broader social impact.²⁸ Without such legislative guidance—if, hypothetically, a court refuses to enforce a building sale because of the concern about to the buyer’s intended polluting use—the power of a polity to democratically advance, prioritize, and put predictable order into its societal policies would be undermined.²⁹

Fourth, the regulation of nonparty interests must be comprehensive for it to yield its intended benefits. A court is unlikely to be able to make such a sweeping rule using only the facts at hand in a particular case. At best, courts manage to address a particular manifestation of the nonparty interest at stake. But when the concrete effort relates to a broader underlying interest such as public safety or health, economic growth, or environmental protection, a token success in the litigation outcome could do little to promote the greater goal. For example, when courts interpret auto insurance contracts, they might hope to advance the social goal of a broad compensatory net for auto accident victims, including nonparties to the insurance policy. But creating a broad social insurance requires more information than courts typically have, more planning in addressing its various manifestations, and consistency in the application of specific commands. Without expert engineering of the scheme, it is unlikely to have intended magnitude of impact on the social interest and could inadvertently inflict unintended costs.

Fifth, regulation of nonparty interests through common law innovations needs to account for contracting parties’ response when they subsequently revise their contracts. Courts must anticipate dynamic effects and have little more than their intuition to guide them. We will show, for example, that courts take nonparty interests into account in adjudicating insurance disputes, but of course insurers are often quick to respond by redrafting insurance policies to neutralizes the judicial intervention.³⁰

²⁷ *Id.*

²⁸ *Rock Island Improv. Co. v. Helmerich & Payne*, 698 F.2d 1075 (10th Cir. 1983). For similar cases pointing to legislative developments in choosing cost of completion damages, *see Davis v. Shell Oil Co.*, 795 F. Supp. 381 (W.D. Okla. 1992); *Schneberger v. Apache Corp.*, 890 P.2d 847 (Okla. 1994); *Miller v. C.K.L., Inc.*, 1988 Ohio App. LEXIS 4069 (Ct. App. 1988).

²⁹ See Bagchi, *supra* note 10, at 230-31.

³⁰ See, generally, Daniel Schwarcz, *The Role of Courts in the Evolution of Form Contracts: An Insurance Case Study*, 46 *BYU L. REV.* 471 (2021).

Finally, judicial efforts to promote nonparty interests could beget contract law rules that are less predictable. The rules of contract construction, for example, would become more complex and harder to anticipate *ex ante*.³¹ Different judges may subscribe to different social visions and may reach different priorities among the social interests and in balancing them against the private interests of the parties.³²

Of course, common law method is relatively unpredictable until precedents form to provide guidance and yield predictability. But the consistency needed for such convergence may be elusive, given the multitude of relevant nonparty interests and the likely disagreements about their weight.

For these reasons, many have argued that the primary institutional place to identify and advance non-party interests and make social impact policies effectively is the legislature and not courts.³³ Courts themselves say this.³⁴ Indeed, the institutional adequacy concerns sometimes drive courts to explicitly reject non-party interests in contract law. For example, when a court has to interpret a labor agreement and decide if a plant closing is permitted, it would reject a claim that keeping the plant open is good for the local community. As one court explained, “in the view of this court, formulation of public policy on the great issues involved in plant closings and removals is clearly the responsibility of the legislatures of the states or of the Congress of the United State.”³⁵ When, on the other hand, a legislature has already spoken and has enshrined a particular nonparty interest, courts are willing to subjugate the treatment of the contract to that interest.³⁶

2. *Opting Out of Nonparty Defaults*

³¹ Casey and Niblett, *supra* note 22, at 9 (judicial intervention *ex post* is too haphazard to give parties guidance on how to account for nonparty interests, *ex ante*); see generally, Kaplow, *supra* note 23, at 505 (“More precise laws tend to be desirable as long as information is not prohibitively costly for actors to obtain.”); See also Louis Kaplow, *The Optimal Complexity of Legal Rules*, 11 J.L. ECON. & ORG. 150 (1995).

³² Indeed, in asbestos litigation, for example, a judicial approach to define the term “occurrence” in insurance contracts in a manner that maximizes insurance coverage and provides more social compensation for nonparties has been criticized and described as “judicial legislation,” “inconsistent,” and “result oriented.” *Am. Home Prods. Corp. v. Liberty Mut. Ins. Co.*, 565 F.Supp 1485, 1512 (S.D.N.Y. 1983); *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974 (N.J. 1994).

³³ See *supra* note 36 and accompanying text.

³⁴ See *supra* note 31 and accompanying text.

³⁵ *United Steel Workers of America v. U.S. Steel Corp.*, 631 F.2d 1264, 1282 (6th Cir. 1980).

³⁶ *Rock Island Improv. Co. v. Helmerich & Payne*, 698 F.2d 1075 (10th Cir. 1983) (“The statute declares today, as it did in 1967, that the operator of a strip mine has a duty to reclaim the land and that the state may contract for the work to be done if the operator defaults. The statute makes no exception for cases in which the expenditures for reclamation are disproportionate to the resulting increase in value of the land.”).

Another justification for the party primacy norm is that parties can re-assert the primacy of their own interests by contracting around defaults that do not advance their interests.

Contract law consists almost entirely of default rules—commands that the parties can disclaim in the contract.³⁷ These are the gap-fillers supplied by statutes when a contract is incomplete, the interpretive rules used by courts to supplement the meaning of ambiguous terms, the remedies for breach of a contract, and rules governing circumstances in which a contract is excused.³⁸ The primary normative criterion prescribes rules that maximize the surplus from the parties' relationship.³⁹ These rules provide content to the parties' transaction where needed, and to succeed they have to mimic what the parties would have chosen, or else they would be written out.

While this approach neglects many other valuable conceptions of merit, it has an aura of inevitability. Any attempt to promote objectives other than the joint welfare of the contracting parties (or that of the drafting party), if pursued via default rules, would be futile. The parties can and do opt out and reinstate in their contracts the party primacy provisions.⁴⁰

In a world in which courts advance nonparty interests, parties may not easily opt out *ex ante* because of the difficulty to predict the type of interests that will be promoted. (This is related to the problem of courts having to select among many competing non-party interests.) Against this backdrop—where courts behave erratically and parties are unable to adjust for that unpredictability, *ex post* opt out provides an additional escape hatch. Told to perform the contract in a manner that does not maximize their joint surplus, the parties can still undo this command by renegotiation. Once the court enforces a version of the contract that advances some nonparty interest, the problem of predicting the default vanishes and the parties can surgically opt out, *ex post*, and divide among them the added gain. Such settlements, even if reached after a court judgment, are generally enforceable.

It is immediately apparent that the problem of opt out creates an important limit on courts' ability to advance nonparty interests via default rules. We will see later, in Part II, that courts quite often try to do this. For

³⁷ Omri Ben-Shahar, *Bargaining Power Theory of Default Rules*, 109 COLUM. L. REV. 396 (2009).

³⁸ *Id.*

³⁹ *Id.* at 396-97 (noting that "parties' will . . . are best served by default rules that maximize the contractual surplus."). See also E. ALLEN FARNSWORTH, *CONTRACTS* 486 (4th ed. 2004) (courts may provide terms "that an economist would describe as maximizing the expected value of the transaction"); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 99 (7th ed. 2007) ("[C]ontract law cannot readily be used to achieve goals other than efficiency, as a ruling that fails to interpolate the efficient term will be reversed by the parties in their subsequent dealings").

⁴⁰ For a critical account documenting the vast opt-out phenomenon, see MARGARET JANE RADIN, *BOILERPLATE: THE FINE PRINT, VANISHING RIGHT, AND THE RULE OF LAW* (2013).

example, courts often interpret insurance contracts in a manner that affords more coverage dollars to innocent victims of the policyholder. What stops insurers from redrafting the insurance policies to eliminate the ambiguity that allows courts to interpret them and advance nonparty interests?⁴¹ In some states, such changes must be approved by regulators, and any redrafting that reduces coverage may be blocked.⁴² But also, policyholders, especially those without assets who purchase liability insurance to satisfy regulatory requirements, might be happy to pay lower premiums reflecting the redrafted broader exclusions, since the impact of such opt outs would be felt primarily by their victims. And insurers—more than any other contracting industry—should be able to calculate the actuarial savings from such opt outs and marshal their drafting genius to make the necessary changes in the contracts.

Indeed, insurers have at times done exactly that—redraft standard insurance policies to narrow down the benefit courts sought to secure for nonparties. For example, courts expanded coverage under the liability coverage in homeowners’ insurance to compensate victims of domestic violence. Harms from such intentional acts are usually excluded under the policies, but courts gradually chiseled an expansion of coverage by reinterpreting what counts as “intentional.”⁴³ Courts did that explicitly to benefit victims, viewing them as highly deserving impacted nonparties. Unsatisfied with these results, insurers added “criminal acts” exclusions to their policies, restoring the broad exclusion and erasing the nonparty benefit.⁴⁴ Similarly, when courts, through interpretation of commercial liability insurance policies, expanded coverage for environmental harms to include expenditures on pollution remediation, insurers responded by drafting aggressive pollution exclusions.⁴⁵

This same dynamic—parties renegotiating the terms to trump courts’ deference to societal concerns—was imagined by Judge Posner as a reason not to issue an order of specific performance, advocated for by the plaintiff as the remedy necessary to advance the interests of non-parties (who would benefit from the continued performance of the contract). “[I]t is unlikely that an order of specific performance, if made, would ever actually be implemented” predicted Judge Posner. The parties “can both be

⁴¹ See, generally, Daniel Schwarcz, *The Role of Courts in the Evolution of Form Contracts: An Insurance Case Study*, 46 *BYU L. Rev.* 471 (2021) (demonstrating how insurers redraft standard policies in response to court decisions).

⁴² Even when revisions are approved, the new language requires interpretation, introducing further ambiguity. The specter of uncertainty may chill insurers’ incentives to redraft. See Michelle E. Boardman, *The Unpredictability of Insurance Interpretation*, 82 *LAW & CONTEMP. PROBS.* 27, 29 (2019) (describing the difficulty of redrafting insurance terms).

⁴³ *PICO v. Swanson* 569 NE 2d 906; *Ambassador Ins. Co. v. Montes*, 388 A.2d 603; *Farmers Insurance v. Hastings*, 366 N.W.2d 293.

⁴⁴ ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, *UNDERSTANDING INSURANCE LAW* 441 (5th ed. 2012) (Courts interpret the term *caused intentionally* “to further the public policy of providing financial relief for the victims of torts.”).

⁴⁵ *Id.*, at 511-17.

made better off by negotiating a cancellation of the contract and with it a dissolution of the order of specific performance.”⁴⁶

For these reasons—the prevalence of ex-ante or ex-post opt-outs—laws that seek to advance nonparty interests which conflict with the joint-welfare-maximization of the parties would usually have to utilize regulatory techniques other than default rules, either by making opt out very costly or by prohibiting it altogether. Indeed, as we briefly review next, mandatory rules have long been recognized as the primary method by which contract law advances nonparty interests, and yet the dissatisfaction with such stiff limits to contractual freedom has bred greater support for sticky defaults.

C. Some Traditional Limits to the Party Primacy Norm

We presented the party primacy norm as a fundamental principle of contract law and offered justifications for its universality. The remainder of this article attempts to chip away at this pillar. We begin this undoing here, by noting several widely recognized and obvious “exceptions” to the party primacy norm.

We group these existing exceptions into three categories: mandatory guardrails, parties like these, and third-party beneficiaries. Mandatory guardrails set boundaries for permissible contracting, and often do so to limit negative effects on nonparties. Rules tailored for *parties like these* capture the *ex ante* approach to dispute resolution, whereby courts decide cases with an eye to how the precedents would impact other likely situated parties in future transactions. And third-party beneficiaries doctrine allow nonparties to enforce contracts to which they are not parties. These exceptions allow courts to capture the interests of those who are not party to the contract.

1. Mandatory Guardrails

Contract law usually enforces agreements that comply with the formation rules without regard to their substance, but up to a limit. It does not enforce contracts against public policy—a broad category that primarily includes illegal conduct and transactions that categorically reduce social welfare.⁴⁷ These lines of permissible activity are typically drawn by other substantive areas of law, and limits on enforceable contracts is but one of the tools necessary to achieve their goals. For example, in many jurisdictions, selling one’s own kidneys is deemed impermissible—and so is child labor, prostitution, and trading in illegal substances.⁴⁸

⁴⁶ N. Ind. Pub. Serv. Co. v. Carbon Cty. Coal Co., 799 F.2d 265, 279 (7th Cir. 1986).

⁴⁷ RESTATEMENT (SECOND) OF CONTRACTS, ch. 8, intro. note (AM. L. INST. 1981).

⁴⁸ See, e.g., Henry Hansmann, *The Economics & Ethics of Markets for Human Organs*, 14 J. HEALTH POL. & L. 57 (1989) (describing the laws that outlaw trade in human organs, and arguing that it may be possible to design a system in which human or cadaver organs are

Many of these mandatory guardrails are established because of a concern for nonparty interests, often to protect a diffuse social interest. In fact, concern about externalities is a primary theoretical basis for limits on freedom of contract.⁴⁹ The legal landscape is full of such mandatory limits, originating from the laws that regulate dangerous activities. Criminal law protects social order and the safety of potential victims of crime, and thus a criminal conspiracy punishable and, obviously, unenforceable. Antitrust laws protect consumer welfare, zoning laws promote optimal land use, environmental law limits pollution, child welfare laws guarantee minimum security to children. Contracts to cartelize, misuse, pollute, and abuse harm nonparties and violate public policies, and are thus unenforceable under contract law, if not otherwise illegal.⁵⁰

Even in the absence of explicit legislative prohibitions, contract law has a blanket rule that allowing courts to refuse enforcement of agreements that violate public interests. Courts are invited to exercise discretion to “protect some aspect of the public welfare.”⁵¹ Whether such limits to contracting are “purely the product of the judicial development”⁵² or influenced and motivated by existing legislation, they address harmful conduct not expressly prohibited by the statutes. For example, common law courts have historically developed limits on restraints of trade (including activity not prohibited by antitrust laws), impairment of family relations, and promises to commit a tort.⁵³ In addition, specific contract law enactments, like Article 2 of the Uniform Commercial Code which governs contracts for the sale of goods, include mandatory guardrails. For example, under UCC 2-719(3), an agreement to limit a consumer’s damages for personal injury is “prima facie unconscionable” and thus unenforceable.⁵⁴ Such exemptions from tort liability have the potential to affect not only the well-being of the contracting consumer, but the overall safety of products

traded in a way that is ethically sound and a marked improvement over an outright ban on trade); Kimberly D. Krawiec, *Price and Pretense in the Baby Market*, in *BABY MARKETS: MONEY AND THE NEW POLITICS OF CREATING FAMILIES* (Michelle Bratcher Goodwin ed., 2010) (describing the extralegal world of baby selling); Kimberly D. Krawiec, *Egg Donor Price Fixing and Kamakahi v. American Society for Reproductive Medicine*, 16 *VIRTUAL MENTOR: AMER. MED. ASSOC. J. ETHICS* 57 (2014) (describing oocyte donation, the laws and regulations that surround compensation of donors, and a case in challenging limits on compensation as illegal price-fixing).

⁴⁹ Various justifications typically underlie mandatory rules in contract law, including the protection of weak parties who lack sufficient information or cognitive skills. One of the central justifications—“externalities”—is the concern with the effect of the bargain on nonparties. See, e.g., Lucian Bebchuk, *The Debates over Freedom of Contract in Corporate Law*, 89 *COLUM. L. REV.* 1395 (1989); Oren Bar-Gill & Omri Ben-Shahar, *Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law*, 50 *COMMON MKT. L. REV.* 109, 115 (2013).

⁵⁰ *RESTATEMENT (SECOND) OF CONTRACTS*, § 178(1) & cmt. A (AM. L. INST. 1981).

⁵¹ *Id.* § 179(b).

⁵² *Id.* at ch. 8, intro. note.

⁵³ *Id.* §§ 186, 189, 192.

⁵⁴ *U.C.C. § 2-710(3)* (AM. L. INST. & UNIF. L. COMM’N 1977).

in the market. Similar mandatory limits on exculpatory clauses have been developed by common law courts for contracts not governed by the UCC.⁵⁵

The nonparty interests protected by courts can have a public good aspect. Consider the nonenforceability of noncompete clauses and nondisclosure agreements in employment contracts. These restraints were relatively rare in the past but have become much more common in present times, and recent estimates suggest that over half of American employees sign nondisclosure agreements and a similar percentage sign noncompetes, even in relatively low-wage industries.⁵⁶ Overall, noncompetes and nondisclosure agreements may decrease overall wages, reduce the information workers have about firms, and increase harassment and law breaking that, absent these restraints, would be deterred.⁵⁷ A party who accepts such clauses may be rewarded in other ways and may not be specifically harmed by their inclusion, but when the practice prevails among the labor force, all are worse off. Because each individual contract contributes only trivially to these systemic effects, it is unlikely that a judge would have the basis or competence to determine that *this* contract had occasioned significant externalities. In such public good scenario, policing is generally left to legislatures, which are increasingly willing to prohibit both nondisclosure and noncompete clauses in the public's interest.⁵⁸

It is commonly thought a contract becomes unenforceable on grounds of mandatory public policy if it harms nonparty interests *at the time of the contract formation*.⁵⁹ But not necessarily so. Contracts that seem valid and legal may become unenforceable if subsequent circumstances render their performance socially harmful. Such limit to contractual obligation is in line with a central methodology of contract law, which implies certain limits to less-than-fully-specified contractual rights. Such limits are usually implied from standards of reasonable behavior, good faith, or commercial norms,⁶⁰ and are part of every contract. These limits are ordinarily justified in accordance with the parties' expectations, but they also emerge from nonparty interests.

For example, a recent paper suggested that emergent threats to public health (like Covid) could provide grounds for mandatory limits on

⁵⁵ See, e.g., *Tunkl v. Regents of the Univ. of Cal.*, 60 Cal.2d 92, 98 (Cal. 1963); *Broadley v. Mashpee Neck Marina, Inc.*, 471 F.3d 272 (1st Cir. 2006); See generally RESTATEMENT (SECOND) OF CONTRACTS, § 195 (AM. L. INST. 1981); RESTATEMENT OF CONSUMER CONTRACTS § 5(c) (AM. L. INST., Tentative Draft 2019); Walter Gelhorn, *Contracts and Public Policy*, 35 COLUM. L. REV. 679 (1935).

⁵⁶ David A. Hoffman & Erik Lampmann, *Hushing Contracts*, 97 WASH. U. L. REV. 165, 191 (2019).

⁵⁷ Jason Sockin et al., *Non-Disclosure Agreements and Externalities from Silence*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3900285 (Jan. 20, 2022).

⁵⁸ Hoffman & Lampmann, *supra* note 56, at 187–89.

⁵⁹ RESTATEMENT (SECOND) OF CONTRACTS § 179 cmt d (AM. L. INST. 1981).

⁶⁰ See, e.g., U.C.C. §§ 2-305, 2-306 (UNIF. L. COMM'N 1977).

the enforcement of otherwise permissible terms.⁶¹ The classic example is the 1918 case of *Hanford v. Connecticut Fair Association*, in which parties contracted to “promote and manage a baby show” where “babies were in some manner to be exhibited.”⁶² Public policy did not oppose such shows in principle, but when the polio epidemic struck, the court rescinded the contract so as to protect public health. This was not an exercise in contract interpretation, nor was the decision based on the parties’ interests. Rather, the court viewed performance in the evolving conditions as dangerous and exercised the discretion it has to refuse enforcement of “immoral” contracts or other socially harmful activity.⁶³

Interestingly, the dissent in this case invoked a version of the *institutional competence* argument against this exercise of discretion by the court. Accounting for specific public health threats requires evidence and expertise beyond that of a contract law court, intruding on the legislative domain.⁶⁴

2. *Parties Like These*

In addition to mandatory guardrails, contract law also considers another category of nonparty interests—those of future typical transactors in similar circumstances. This is the conventional *ex ante* orientation of legal rules and precedents—justifying a command that might not be the optimal for the present dispute by its good effects on an entire class of cases that will be governed by it.

In asking how a decision in a case would affect *parties like these*, courts sometimes engage in analysis of incentives. How would future parties’ behavior be shaped by the rule? If, say, a remedy for breach of contract covers some losses but not others, how would it affect parties’ incentives to make reliance investments? Courts may choose a certain damage measure to advance such forward social interests, even when the result in the particular case mis-compensates a party and appears unfair or violates a strict criterion of make-whole damages.⁶⁵

Similarly, courts examine how their decision would affect the overall contracting environment, the costs of entering contracts, and the stability of the market. For example, a remedy of specific performance could be justified because of the danger that, if other suppliers similarly breached and only paid damages, the market for the end product would

⁶¹ Hoffman & Hwang, *The Social Cost of Contract*, *supra* note 6.

⁶² *Hanford v. Conn. Fair Ass’n*, 103 A. 838 (Conn. 1918).

⁶³ *Id.* Notably, the *Hanford* court stated that were the plaintiff to show that gathering babies posed no health risks—social distancing, 1916-style—it could still potentially recover damages. *Id.*

⁶⁴ *Hanford*, 103 A. at 839 (Beach, J., dissenting).

⁶⁵ U.C.C. § 1-305 (AM. L. INST. & UNIF. L. COMM’N 1977); *Tongish v. Thomas*, 840 P.2d 471 (1992).

collapse. “The breach of the contract by one planter differs but in degree from a breach by all.”⁶⁶ The social impact of a one-time decision is negligible; but when multiplied over the numerous such transactions, the overall impact on parties like these becomes measurable and central to a court’s decision.

Or, to take another common dilemma, would a liberal parol evidence rule, which allows the court to consider extrinsic evidence beyond the four corners the written contract, help or disrupt future contracting environments? This specific dilemma—whether to ignore extrinsic evidence regarding the parties’ unwritten intent—demonstrates the potential conflict between the party primacy norm and nonparty interests. Advocates of a party-primacy approach would like courts to be receptive to more evidence so as to more accurately vindicate the parties’ intent.⁶⁷ In contrast, the focus on non-parties—on future transactors facing similar disputes regarding the existence of oral understandings—drives many courts to justify their exclusive focus on the formal contracts as a way to a way to increase certainty and reduce litigation costs.⁶⁸ Indeed, a landmark case like California’s *Masterson v. Sine* offers a dramatic confrontation between the two views.⁶⁹

This concern with the interests of parties like these is fundamental in every area of contract law: whether to enforce preliminary understandings,⁷⁰ when to strike down one-sided fine-print terms,⁷¹ under

⁶⁶ *Curtice Bros. Co. v. Catts*, 72 N.J. Eq. 831 (Ch. 1907).

⁶⁷ Cathy Hwang, *Unbundled Bargains: Multi-Agreement Dealmaking in Complex Mergers and Acquisitions*, 164 U. PA. L. REV. 1403, 1444-45 (2016).

⁶⁸ See, e.g., *Residential Mkt. Group, Inc. v. Granite Inv. Group*, 933 F.2d 546, 548 (7th Cir. 1991) (“There is an eternal tug of war between giving the parties to a contract a right to testify to what they in fact meant . . . and preventing one party from depriving the other of the protection of the written contract Desire for certainty and predictability, perhaps combined with some distrust of juries, has resulted in a presumption that the judge will try to puzzle out the meaning of the contract without recourse to inevitably self-serving, often protracted, and typically inconclusive oral testimony.” (Posner, J.)).

⁶⁹ 68 Cal. 2d 222 (1968), where the majority believed that a liberal interpretive approach would better implement the goals of the present parties, whereas the dissent focused on the harmful effect to future parties, worried that the holding “materially lessens the reliance which may be placed upon written instruments affecting the title to real estate [...] and opens the door, albeit unintentionally to a new technique for the defrauding of creditors.” *Id.* at 231.

⁷⁰ *Empco Mfg. Co. v. Ball-Co Mfg., Inc.*, 870 F.2d 423 (7th Cir. 1989); *Dixon v. Wells Fargo Bank, N.A.*, 798 F. Supp. 2d 336 (D. Mass. 2011). For legal scholarship examine how precontractual liability affects incentives to invest in profitable opportunities and to enter negotiations, see Richard Craswell, *Offer, Acceptance, and Efficient Reliance*, 48 STAN. L. REV. 481 (1996); Avery Katz, *When Should an Offer Stick? The Economics of Promissory Estoppel in Preliminary Negotiations*, 105 YALE L.J. (1996); Lucian Arye Bebchuk & Omri Ben-Shahar, *Precontractual Reliance*, 30 J. LEGAL STUD. 423 (2001).

⁷¹ *William v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (Danaher, J., dissenting).

what circumstances an offer becomes irrevocable,⁷² what rituals constitute an acceptance of shrinkwrap terms,⁷³ whether a party in breach ought to receive any remuneration for partial performance, and more. Consider this last issue—often arising in a context in which an employee or subcontractor quits midway through the performance of the contract and seeks to recover partial pay. Common law courts have historically disagreed on this matter,⁷⁴ but have always justified their views not only by reference to justice between the parties but also by the effect of the rule on *parties like these*—how labor markets would be affected by a partial compensation rule. In the 200-year old classic case of *Britton v. Turner*, the court speculated that denial of any recovery to the breaching employee would be socially harmful, giving an unscrupulous employer the “temptation to . . . drive the laborer from his service, near the close of his term, by ill treatment.”⁷⁵ Other courts reached the counter result, downplaying the make-the-worker-miserable argument and focusing instead on the ability of employers to assemble a stable team of laborers.⁷⁶ And, recognizing that the any remedial is merely a default rules, courts noted how parties could always “by apt and certain words” contract out of it.⁷⁷ Indeed, courts often expect and intend for parties like these to opt out, for example when applying the *contra proferentum* approach to interpretation of insurance contracts. It is the recognition that future parties with drafting sophistication could draft a clearer contract that drives courts to specifically create incentives for redrafting.⁷⁸

In short, courts and commentators routinely engage in this type of ex-ante analysis—how a legal command affects incentives and how it thus regulates behavior of like parties in the market. When done in the context of an existing dispute, the analysis not only looks to the future, it also envisions a population of typical parties with typical interests and looks beyond the possibly atypical interests of the present litigants.

Now, as every law student who sat through 1L contracts knows, this armchair theorizing about the incentive effects of particular decisions on future transactors and forecasting the equilibrium effects of opting out of rules, will often lead to indeterminate discussions. In fact, so vulnerable are courts’ predictions to critique that it is fair to ask if they really are any better at this task than they are at advancing larger social agendas. Is the advancement of the interests of *parties like these* equally subject to institutional competence objections as that of nonparties writ large? This

⁷² *Drennan v. Star Paving Co.*, 51 Cal. 2d 409 (1958) (noting that the goal of inducing reliance can contribute to an irrevocable offer).

⁷³ *Hill v. Gateway 2000*, 105 F.3d 1147 (7th Cir. 1997) (noting that additional terms can become part of contract to reduce transactions costs at formation stage).

⁷⁴ Compare *Stark v. Parker*, 19 Mass. 267 (1824), with *Britton v. Turner*, 6 N.H. 481 (1834).

⁷⁵ *Britton*, 6 N.H. at 494.

⁷⁶ *Stark*, 19 Mass. 267; Robert Gordon, *Britton v. Turner: A Signpost on the Crooked Road to “Freedom” in the Employment Contract*, in *CONTRACT STORIES* (Douglas Baird ed., 2007).

⁷⁷ *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239 (1921)

⁷⁸ RESTATEMENT (SECOND) OF CONTRACTS § 206 (AM. L. INST. 1981).

was in broad strokes the point that Duncan Kennedy made more than forty years ago—and, well, he had a point.⁷⁹

That said, there is one notable difference between the institutional competence arguments made about concern for parties like these and the more expansive civic orientation we defend later in the article. Where courts forecast the effects of their decisions on future commercial participants in markets adjacent to the ones under review, they are at least informed by the current preferences of the parties in those markets who are litigants in the case. This may result in fewer commercially surprising errors.

3. *Third-Party Beneficiaries*

Another apparent limit to the party primacy norm relates to third-party beneficiaries. Contract doctrine permits non-parties who are the intended beneficiaries of contracts by others to initiate enforcement and remedial actions.⁸⁰ This, of course, is not an exception to the party primacy norm, since the third-party beneficiary rules merely provide mechanics to “effectuate the intention of the parties.”⁸¹ In other words, while third-party beneficiaries may have rights, standing to sue, and their own remedies, those are created by the intent of the parties to the contract, thus once again anchoring the doctrine around the party primacy norm.

The idea that rights of third-party beneficiaries exist only when the contracting parties intend them is further reflected in cases involving government contracts. Government contracts benefit the public, but unless clearly stated otherwise, individual nonparties are generally viewed as “incidental” beneficiaries of such contracts who are not entitled to the third-party beneficiary rights.⁸² It is only when a contract involving the governmental manifests a specific intent to give individual members of the public enforceable rights to compensation for its breach that such nonparty remedial rights arise.⁸³

II. NONPARTY DEFAULTS

We ended Part I by identifying pockets of deviations from the party primacy norm—exceptions to the axiom that the sole goal of contract law is the advancement of the parties’ interests. Come to think of it, these exceptions are entirely unexceptional, and in fact reinforce the dominance of the party primacy norm. True, mandatory guardrails do protect interests

⁷⁹ Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

⁸⁰ *Id.* at ch. 14. See, e.g., Melvin Aron Eisenberg, *Third-Party Beneficiaries*, 92 COLUM. L. REV. 1358 (1993); Alan Schwartz & Robert E. Scott, *Third Party Beneficiaries and Contractual Networks*, 7 J. LEGAL ANALYSIS 326 (2015).

⁸¹ RESTATEMENT (SECOND) OF CONTRACTS § 302(1) (AM. L. INST. 1981).

⁸² *Id.* § 315 cmt a.

⁸³ *Berberich v. U.S.*, 5 Cl. Ct. 652 (1984), judgment *aff’d*, 770 F.2d 179 (Fed. Cir. 1985).

of nonparties, but they are largely foreign implants within contract law. That you cannot enforce a contract to murder is not a rule of contract law; it is a by-product of a prohibition originating in criminal law. And rules that serve the interests of “parties like these” can be thought of as an ex-ante embodiment of the party primacy norm, which is to say that they advance a version of the party primacy norm in which the conception of a “party” is a stereotype. Likewise, third-party beneficiary rules implement an extensive conception of parties’ interests, which includes their deliberate wishes to benefit others.

We now come to heart of this article, and what we see as a real exception to the party primacy norm—ways in which courts advance interests of nonparties without direct prohibition or command from other areas of law, and do so in a non-mandatory fashion, using the traditional mainstream techniques of the common law of contracts. We identify a variety of default rules, canons of interpretation and construction, remedial approaches, and other doctrinal tweaks that promote the diffuse interests of other members of society. We call these *nonparty defaults*.

This Part of the article is dedicated to a survey of such nonparty defaults. It is a proof of concept, intended to highlight the existence of this regulatory technique, an exception to the party primacy norm that has previously not received much attention. Later, in part III, we try to reconcile the proven existence of nonparty defaults with our earlier discussion of the justifications to the party primacy norm. How do these rules, that promote nonparty interests in a non-mandatory fashion, survive the problems of institutional competence and opt-out?

In researching the instances of nonparty defaults across contract law, we discovered that many emerge from interpretation and construction of contracts.⁸⁴ We therefore begin this trans-doctrinal survey in part II.A with a general illustration of how non-party interests imbue these doctrines. Part II.B then focuses on the most intense application of nonparty interests—in the interpretation of liability insurance contracts. Part II.C examines another major junction of nonparty interests—the gap-filler remedies courts award for breach of contract. Finally, part III.D suggests that the scope of certain defenses is sometimes shaped by nonparty interests and illustrates this practice via decisions to excuse the performance of a contract that endangers the public.

A. Nonparty Interests as a Canon of Interpretation

⁸⁴ “Interpretation” refers to a search for the meaning the parties gave to the language used, whereas “construction” refers to doctrines courts use in determining the legal operation and consequences of the contract (which begins, but does not end, with interpretation). See MURRAY, *supra* note 15, § 24.3. For simplicity, we will refer henceforth to both practices as “interpretation.”

We said earlier that at the heart of interpretation doctrine sits the party primacy norm. So deeply engrained is the importance of specific intent that courts and hornbooks will often state that enforcement of contracts must be loyal to such manifested intent, even if it is senseless or capricious.⁸⁵ The entire apparatus of figuring out which performance obligations arise from the agreement seems to start and end with what the parties intended, a task that consumes most of the energy of commercial contract litigation.

And yet the contract sometimes affects nonparties, in ways to which courts will attend. This is most obviously the case where one of the parties is the government itself, and a particular interpretative choice will affect the public fisc, or the social welfare aspects that the specific government branch regulates. The First Restatement of Contracts collected cases in this vein and summarized them in a provision on “secondary rules aiding application of standards of interpretation” stating that “Where a public interest is affected an interpretation is preferred which favors the public.”⁸⁶

At the time, numerous cases supported this nonparty-interests interpretation canon, including many that reached the United States Supreme Court, involving contract rights of local governments. Prominent examples involved projects in which municipalities granted private parties licenses to profitably operate ferry lines, bridges, or other utilities. Should the licenses be interpreted to provide exclusivity and to bar the municipality from licensing a competing service? For example, in *Proprietors of Charles River Bridge v. Proprietors of Warren Bridge*,⁸⁷ the owners of the Charles River Bridge (who paid regular sums to Harvard College) sought to interpret their contract with the government to prohibit construction of an adjacent bridge that would decrease their toll revenue. The Supreme Court rejected their position, explaining that such interpretation would undermine the very purpose of contractual enforcement (to advance public benefits). In the words of Justice Taney, though “the rights of private property are sacredly guarded, we must not forget that the community also have rights, and that the happiness and well-being of every citizen depends on their faithful preservation.”⁸⁸ While the parties could have been more explicit about the exclusivity, and have such provision enforced, their silence allowed the court to reach an interpretive outcome not because it is what the parties would have wanted, but “because it is in the public interest to do so.”⁸⁹

A century later, a similar dispute over the exclusivity of a privately run river crossing arrived at the Supreme Court, this time over the meaning

⁸⁵ See, e.g., *Chamberlain v. Parker*, 45 N.Y. 569, 572 (1871) (a party may choose “to erect a monument to his caprice or folly”); MURRAY, *supra* note 15, § 24.9 (enforce meanings “however we may marvel at the caprice”).

⁸⁶ RESTATEMENT (SECOND) OF CONTRACTS § 236(f) (AM. L. INST. 1981).

⁸⁷ 36 U.S. 420 (1837).

⁸⁸ *Id.* at 422.

⁸⁹ Lord, *supra* note 1, at § 32:18.

of an “exclusive ferry license.”⁹⁰ A ferry licensee who, this time, did bargain for an exclusivity clause, asked to court to prohibit the construction of an adjacent bridge that would divert some of the profitable traffic. Does the exclusivity clause apply only to competing transportation by another ferry (the State’s position), or also by a new bridge (the licensee’s position). The Court recognized that the implied intent at the time of entering such contract may well have been to bar any river crossing substitute, including a bridge, because it “would destroy the value of the ferry leases, and so defeat the real object of the leases.”⁹¹ Relying on the *Charles River Bridge* case, the Court held that to overcome an interpretation in favor of the public the alleged meaning cannot be implied and must be explicit. An interpretation based on the *imputed* business purpose of the contract does not suffice.⁹²

Common law courts later found that the government contracts context didn’t quite scratch the nonparty-interests itch. Accordingly, when the Second Restatement arrived fifty years after the first, it contained a new Section 207, standing alone and not relegated to a “secondary” theory:⁹³

“In choosing among the reasonable meanings of a promise or agreement or a term thereof, a meaning that serves the public interest is generally preferred.”

Like the Restatement’s provisions on mandatory sections relating to unenforceability on grounds of public policy,⁹⁴ the public policy interpretation canon left for courts to determine which interests to favor when. Somewhat surprisingly courts have not often cited Section 207, nor have scholarly accounts examined its principle or scope.⁹⁵ However, caselaw did develop in the trajectory that that Section 207 anticipated, applying the nonparty-interests principle as a canon of interpretation.⁹⁶

For example, we earlier discussed the treatment of noncompete clauses as an example of mandatory rules that protect nonparty interest. It turns out that there is another way to lessen the undesirable impact of such clauses: by determining them to be ambiguous and constructing them narrowly. This is what the court did, for example, in interpreting a hotel management contract that contained a 30-year restrictive covenant prohibiting Hilton (the management company) from operating other hotels in the city, except for their airport location.⁹⁷ Later, when Hilton sought to rebuild its airport hotel, they were alleged to be in violation of the non-compete. The court acknowledged that the new facility will increase

⁹⁰ *Larson v. South Dakota*, 278 U.S. 429 (1929).

⁹¹ *Id.* at 434.

⁹² *Id.* at 437.

⁹³ RESTATEMENT (SECOND) OF CONTRACTS § 207 (AM. L. INST. 1981).

⁹⁴ *Id.* at ch. 8.

⁹⁵ Zamir, *The Inverted Hierarchy*, *supra* note 10 (noting this provision, while arguing that public regarding interpretations can dampen externalities).

⁹⁶ See generally MURRAY, *supra* note 15, § 24.25 (discussing § 207)

⁹⁷ *Atlanta Ctr. Ltd. v. Hilton Hotels Corp.*, 848 F.2d 146 (11th Cir. 1988).

competition and would therefore conflict with the purpose of the restrictive covenant, which was “obviously intended to lessen the amount of competition.”⁹⁸ Nevertheless, the court preferred to override this basic interpretive instinct and to follow “an important principle under Georgia law with regard to the interpretation of contracts not to compete” which stands for “a strong public policy disfavoring contractual restraints on competition and trade.”⁹⁹ Not a mandatory guardrail—since a clear statement of restrictive intent would have been enforced—but rather a non-party interests interpretation of a clause susceptible of two meanings.

Or, consider another example, concerning a non-distribution clause. In *Wildmon v. Bernick Universal Pictures*, a “religious leader and arts funding opponent” agreed, after a protracted negotiation, to sign a written contract permitting a “rarely granted interview” with a British documentary producer about his views “in the censorship arena.”¹⁰⁰ The contract contained a non-distribution clause prohibiting the release of the interview in other media outlets. When the producer later attempted to release the documentary on PBS, the court viewed the non-distribution clause as ambiguous and interpreted it so that it “should be read in a way that allows viewership and encourages debate.”¹⁰¹ The interest of the public in access to information won. (Notably, the competing public interest, in advancing a different marketplace of ideas, which Wildmon represented, was not weighed at all.)

A similar interpretive canon resolves disputes over the meaning of arbitration clauses. This federal policy in favor of arbitration has been famously busy lately, requiring state courts to enforce such agreements.¹⁰² Less noticed is how the pro-arbitration policy is advanced via contract interpretation.¹⁰³ For example, in one Title VII case the arbitration agreement did not provide fee shifting, which is otherwise required for a prevailing title VII plaintiff. The clause stated, “You and [Employer] shall each bear respective costs for legal representation at any such arbitration.”¹⁰⁴ The employer asserted that the clause could be augmented with a gap-filler to permit fee shifting. Recognizing that fee shifting was probably *not* the intent of the drafter of the clause, the court nevertheless noted that “the agreement does not affirmatively foreclose the possibility

⁹⁸ *Id.* at 148.

⁹⁹ *Id.* (“when a court is presented with a restrictive covenant that is susceptible of more than one reasonable interpretation, the preferred interpretation is the one that least restricts competition, thereby posing the least affront to the public policy . . .”)

¹⁰⁰ 803 F. Supp. 1167, 1169, 1177 (N.D. Miss. 1992).

¹⁰¹ *Id.* at 1178.

¹⁰² *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011); *Am. Express Co. v. Italian Colors Rest.*, 570 U.S. 228 (2013).

¹⁰³ *Mastro-Buone v. Shearson Lehman Hutton Inc.*, 514 U.S. 52, 62-64 (1995) (arbitration agreement that is silent or ambiguous on arbitrators’ power to grant punitive damages ought to be interpreted with due regard to the federal policy favoring arbitration).

¹⁰⁴ *Gambardella v. Pentec, Inc.*, 2003 WL 22119182 (D. Conn. 2003).

of attorney's fees." Citing Section 207 of the Restatement, the court adopted the canon that "of two competing interpretations, the one which would read the agreement to protect [] important policy choice is the better of the two."¹⁰⁵ Here, the public policy was "encouraging ameliorative lawsuits" and promoting it dictated the default rule.

As Corbin puts it, "many additional cases can be seen in which diverse public interests are favored in the construction of contracts."¹⁰⁶ In most, the courts will first conclude that the relevant contract language is ambiguous, giving room to choose between two or more meanings. And the public interest then becomes, in effect, a gap-filler. These decisions often seem to be reasoned in ad hoc ways, without a great deal of briefing about what constitutes the public interest, or how it would be advanced. However, there is one class of cases where these intuitions are better worked out: insurance contracts. To it, we now turn.

B. Interpretation of Insurance Contracts

Perhaps no other class of contracts have such a pervasive and powerful effect on third parties as liability insurance policies. Individuals who cause significant accidental harm to others rarely have the resources to make their victims whole. But through their auto, home, and professional insurance policies, the compensatory interests of injured parties are protected.¹⁰⁷ Likewise, businesses that sell dangerous products may not have sufficient resources to make injured customers and third parties whole, especially if mass injuries or large diffuse social harms occur, and only through their commercial liability policies may the harm be compensated. Indeed, it is this concern for nonparty interests that makes the purchase of some types of liability insurance *mandatory* for entry into dangerous activities like driving or some types of manufacturing.

Even when liability insurance is required (and surely when it is not), the contractual terms within the insurance policy are mostly non-mandatory. What harms are covered and what obligations the insurer and policyholder have to each other are generally determined by the agreement, subject to mandatory minima set by the law. In constructing the non-mandatory terms of liability insurance contracts, courts regularly and explicitly view the compensatory interest of third-party victims as a significant reason to prefer pro-coverage outcomes. This attention to the interests on nonparties, sometimes referred to in insurance contract law as

¹⁰⁵ *Id.* at 4.

¹⁰⁶ MURRAY, *supra* note 15, § 24.25.

¹⁰⁷ Many injuries in society are covered by sources other than liability insurance policies. Primary among them are first-party life, health, and disability insurance schemes. *See, e.g.,* Jeffrey O'Connell, *Compensation for Injury & Illness: An Update of the Conard-Morgan Tabulations*, 47 OHIO ST. L.J. 913 (1986) (indicating approximately 30% of benefits paid for injuries and illnesses stem from social insurance policies like social security and Medicare; nearly 9% from tort liability; 5% from workers' compensation).

the “financing mechanism for tort compensation,”¹⁰⁸ is a canon of construction, not a mandate. It can only be unleashed if courts find some ambiguity in the contract, and it can often be dialed down although not eliminated by better, less ambiguous, drafting.¹⁰⁹ In the remainder of this section, we demonstrate primary examples of such nonparty defaults.

1. *Victims of Auto Accidents.*

One of the central questions in constructing auto insurance policies is which drivers are covered, and what counts as permission to use a vehicle. Other than the named insured, a typical omnibus clause in auto insurance extends coverage to any person that drives the car “with the permission of the named insured.”¹¹⁰ Courts are often called upon to determine what qualifies as permission, and which non-permitted uses are covered.¹¹¹ Are drivers insured when they ignored explicit restrictions of use?¹¹² Is there coverage under the policy when, for example, the insured’s son permitted a drunk friend to drive the parents’ car?¹¹³

A prominent justification for expanding coverage to include uses that exceed or even violate the permission given by the insured is the desire to afford more insurance dollars for auto accident victims. Under the approach adopted in many states, known as the “Initial Permission Rule,”

¹⁰⁸ TOM BAKER, KYLE D. LOGUE & CAROLYN V. WILLIAMS, *INSURANCE LAW AND POLICY: CASES AND MATERIALS* 417 (5th ed. 2021).

¹⁰⁹ Indeed, the attention to the interests of third-party victims in contract interpretation is discussed by courts as a general principle. *See* *Winding Hills Condominium Ass’n, Inc. v. North American Specialty Ins. Co.*, 752 A.2d 837, 840 (N.J. 2000). Accordingly, because the interest of nonparty victims is present only in the context of liability insurance, courts have held that precedent interpreting terms of liability insurance policies should not be relied on to interpret terms of first-party insurance policies (where the nonparty interest does not exist). “Unlike liability policies, where the public interest in compensation for injured third-parties is a strong factor, in a first-party policy the extent to which insured persons may protect themselves is a matter that rests in their own determination and judgment.” *Port Authority of New York and New Jersey v. Affiliated FM Insurance Company*, 311 F.3d 226, 233 (3rd Cir. 2002).

¹¹⁰ Jay M. Zitter, Annotation, *Omnibus Clause as Extending Automobile Liability Coverage to Third Person Using Car with Consent of Permittee of Named Insured*, 21 A.L.R.4th 1146 (1983).

¹¹¹ KENNETH S. ABRAHAM & DANIEL SCHWARTZ, *INSURANCE LAW & REGULATION* 722 (7th ed. 2020) (noting that courts generally have three approaches to determining when users exceed the permission initially granted: “the liberal, minor deviation, and strict approaches”).

¹¹² For example, in *Odolecki v. Hartford Accident & Indemnity Company*, the Supreme Court of New Jersey held the insured’s son’s friend was within the coverage of an insurance policy despite the fact that the insured owner explicitly told her son not to allow anyone else to drive the car. 55 N.J. 542, 544 (1970). *See also* *Security Mutual Casualty Co. v. Hoff.*, 377 N.E.2d 509 (Ohio 1978) (extending coverage to the girlfriend of the insured’s son despite clear evidence that the son received instructions not to permit anyone else to drive.)

¹¹³ *See* *Lucas v. U.S. Fid. & Guar. Co.*, 113 N.J.L. 491, 492-93 (1934) (no coverage because the policy covers only those with permission who were “give[n] such permission through an *adult* member of his household”).

expansion of coverage beyond the explicit permission granted by the insured reflects societal interest to make the costs of road injuries more widely spread through insurance.¹¹⁴ As New Hampshire Supreme court pointed out, the rule advances policies the state's statutory code and "effectively furthers the state's policy of compensating and protecting innocent accident victims from financial disaster."¹¹⁵ Maine's highest court explained that the rule "implements an underlying legislative policy that, for the protection of the public, liability insurance should follow the automobile under nearly all circumstances."¹¹⁶ Leading commentators emphasize that this is a canon of construction, not a mandate: "promoting victim compensation may be a legitimate goal in interpreting liability insurance contracts."¹¹⁷

A similar dilemma arises in interpreting the contractual clause that limits coverage to accidents "arising out of ownership, maintenance, or use" of a vehicle. Courts are called upon to determine which activities and injuries are covered. Incidents where a victim has been injured by an object thrown from a vehicle, or entirely outside the vehicle after exiting, or during road rage, have been found to be a "use of" the vehicle for purposes of insurance. Here, too, a liberal approach is justified by the goal of advancing nonparty interests. For example, the Supreme Court of Florida determined that when a stranger attacks a driver who refuses to give him a ride, the resulting injury to the driver arises from the use of a motor vehicle, explaining that "[s]uch terms should be construed liberally because their function is to extend coverage broadly."¹¹⁸

The interests of accident victims is a major factor in legislation mandating the inclusion of various clauses in auto insurance, including the omnibus clause.¹¹⁹ Its protection therefore has, in some states, a mandatory status. Since the interest is recognized in all states, the absence of a mandate led courts to advance it through the non-mandatory interpretive canon.¹²⁰

2. *Mass Torts.*

¹¹⁴ See, e.g., *Odolecki*, 264 A.2d at 546-48; *Konrad v. Hartford Acc. & Indem. Co.*, 11 Ill. App. 2d 503, 514-15 (Ill. App. Ct. 1956) ("[I]f the original taking by the user is with the named insured's consent, every act of the user subsequent thereto while he is driving the vehicle is with the named insured's permission"). This approach is not universal. For a survey of narrower permission construction rules adopted in certain states, including ones that do not advance nonparty interests, see Jerry & Richmond, *supra* note 44, at 304-09.

¹¹⁵ *Progressive N. Ins. Co. v. Concord Gen. Mut. Ins. Co.*, 864 A.2d 368, 375 (N.H. 2005).

¹¹⁶ *State Farm Mut. Auto. Ins. Co. v. Est. of Carey*, 68 A.3d 1242, 1247 (Me. 2012).

¹¹⁷ See Tom BAKER & KYLE D. LOGUE, *INSURANCE LAW AND POLICY* 359 (4th ed. 2017).

¹¹⁸ *Novak v. Gov't Emps. Ins. Co.*, 424 So. 2d 178 (Fla. Dist. Ct. App. 1983), *approved*, 453 So. 2d 1116 (Fla. 1984).

¹¹⁹ South Carolina Code Sec. 46-750.31-.32 (Supp.1969); Wisconsin Statutes Ann. Sec. 632.32(3)(a) ("Coverage provided to the named insured applies in the same manner and under the same provisions to any person using any motor vehicle describe in the policy").

¹²⁰ ROBERT E. KEETON AND ALAN I. WIDISS, *INSURANCE LAW* 385-86 (1988).

Compensation of victims of mass torts requires the deep pocket of insurers, but it must be done in conformity with the terms of standard commercial liability insurance policies (CGLs). One of the toughest and most heavily litigated issues in this area, which has fateful implications for much of asbestos litigation, is a timing problem. What must happen during the policy period for it to be “triggered” and provide coverage? Standard liability policies cover injuries from a “bodily injury which takes place during the policy period.” They were drafted with ordinary injuries in mind, where the accident and the resulting harm take place almost simultaneously. They are therefore ambiguous when applied to injuries that are progressive—where the harm is slow to develop, manifesting years after the original exposure—as in the case of asbestos related illnesses. Courts have thus been called upon to give legal effect to the contract term and determine when a latent injury “occurs.” Is it at the very early time of exposure to the harmful product? At the much later time of the manifestation of the illness? Or during the continuous period between exposure and illness, when the disease resides and develops in the victim’s body?

Not surprisingly, since the insurance policy itself does not provide a clear answer to this “trigger” questions, state courts have differed over it. Courts have recognized that constructing the “bodily injury” language to mean only during the period when the diseases is diagnosable would leave many claimants without recovery, because by that late stage many insurers inserted asbestos exclusions to the policies. By contrast, constructing it to occur at the time of exposure and inhalation would also leave claimants with little recovery, because at that early stage many policies had low coverage limits.¹²¹ Some courts chose a “continuous trigger,” which makes funds available from all policies during the entire period from exposure to illness.¹²² While such construction of the term “bodily injury” can be grounded on various rationales, it is also often recognized to be the one that maximizes coverage and provide more funds to compensate tort plaintiffs.¹²³ As one court admitted, “although there are solid arguments to support the manifestation theory, we are bound to broadly construe the

¹²¹ See, e.g., *Stonewall Ins. Co. v. Asbestos Claims Management Corp.*, 73 F.3d 1178, 1193 (2d Cir. 1995). An intermediate approach adopted by a plurality of jurisdictions is the “injury in fact” construction, holding that an injury occurs when the body’s defenses are “overwhelmed.” See, e.g., *American Home Products Corp. v. Liberty Mut. Ins. Co.*, 748 F.2d 760 (2d Cir. 1984).

¹²² *Id.*; *Keene Corp. v. Insurance Co. of North America*, 667 F.2d 1034 (D.C. Cir. 1981).

¹²³ *Keene*, 667 F.2d at 1041, 1043, 1047 (selecting an interpretation of “occurrence” that makes available to victims the deepest possible pocket of financial relief); *Eagle Picher Industries v. Liberty Mutual*, 682 F.2d 12 (1st Cir. 1982) (construing an ambiguous policy language in favor so as “to promote coverage”); *Owens-Illinois, Inc. v. United Insurance Co.*, 138 N.J. 437, 451-52 (1994) (where the court noted that “[t]he court in *Keene*, relied on the presumption of maximizing coverage”); *Winding Hills Condominium Ass’n, Inc. v. North American Specialty Ins. Co.*, 752 A.2d 837, 840 (N.J. 2000) (“the law’s solicitousness for victims of mass toxic torts and other environmental contamination is entirely consistent with choosing that conceptually viable trigger theory affording the greatest ultimate redress.”).

insurance policies to promote coverage.”¹²⁴ This trend is particularly striking because the maximizing-coverage canon seems to override other, more principled attempts at interpretation. A principled construction of timing element of bodily injuries would have increased the available insurance coverage in some cases and reduced it in others.¹²⁵ It is also striking because in other contexts—where the court has to determine the number of occurrences—a different construction of what it means for an injury to occur is adopted, but again it is result oriented: to maximize victim compensation.¹²⁶ Courts unabashedly choose a construction for the purpose of maximizing coverage, sacrificing conceptual consistency in order to advance the social policy of protecting a population of nonparty victims.

3. *Environmental Harms.*

Commercial liability insurance covers “all sums which the insured shall become legally obligated to pay as *damages*.”¹²⁷ What about remediation expenditures? Are these covered *damages*, or—as they are not paid in compensation to victims—are they merely non-covered mitigation efforts? What if such mitigation costs are incurred prior to the harm, or prior to any claim against the policyholder? In general, costs spent to comply with injunctions or preventive regulation, or to mitigate actual or potential harm, do not count as “damages” under the policy and thus not covered by insurance.¹²⁸ But, interestingly, in environmental cases courts “overwhelmingly” apply an exception to this interpretive rule and instead hold that response costs to toxic spills and remediation costs of waste sites

¹²⁴ *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212, 1219-20 (6th Cir. 1980).

¹²⁵ For example, the Second Circuit in *Stonewall*, 73 F.3d 1178, interpreted “occurrence” twice; once resulting in a likely increase in available coverage, and once resulting in a decrease in coverage. *Compare id.* at 1197-1200 (interpreting “occurrence” for bodily injury claims to allow coverage throughout a gradual disease, so long as injury can be shown at each point, thus likely increasing coverage under more policies), *with id.* at 1212-13 (interpreting “occurrence” for property damage claims to constitute separate occurrences, as opposed to a single continuous occurrence, thus reducing coverage because of “per occurrence” deductibles).

¹²⁶ See ABRAHAM AND SCHWARCZ, *INSURANCE LAW AND REGULATION* 529 (5th ed. 2020) (suggesting that courts often focus on victim compensation when assessing the number of occurrences issue).

¹²⁷ See *What Is General Liability Insurance?*, 2 TOXIC TORTS PRAC. GUIDE § 32:4 (May 2021).

¹²⁸ See *e.g.*, *Aetna Cas. & Sur. Co. v. Hanna*, 224 F.2d 499 (5th Cir. 1955) (finding costs spent in litigation regarding intentional failure to comply with an injunction were not recoverable as damages); *Grisham v. Com. Union Ins. Co.*, 951 F.2d 872, 874 (8th Cir. 1991) (affirming a judgment holding that “clean-up costs are not encompassed within the meaning of the word ‘damages’ in the standard form [comprehensive general liability] policies at issue”); *Maryland Cas. Co. v. Armco, Inc.*, 822 F.2d 1348, 1352 (4th Cir. 1987) (“The general comprehensive liability policy between the parties covers ‘damages,’ but not the expenditures which result from complying with the directives of regulatory agencies.”).

are covered as “damages.”¹²⁹ Here, again, the rationale for the pro-coverage construction is a type of nonparty interest—to reduce the negative social impact. Environmental harms are the iconic negative externality, affecting society as a whole. The broad construction of the term “damages” in environmental policies would bring in more insurance money for environmental remediation, and while courts do not explicitly invoke this reason, it is likely the unspoken rationale.¹³⁰

Not always unspoken. Interestingly, this trend of expanding coverage for environmental cleanup costs has developed to the point where some courts are permitting recovery for *voluntary* cleanup, prior to any government order or lawsuit. This is a striking expansion of the meaning of the “legally obligated to pay damages” clause, which is the contractual trigger for the insurer’s duty to indemnify the policyholder. As one court explained

“[i]nsurance coverage in the environmental claims area may be quite different than in other insurance settings. Environmental statutes impose liability, often without fault, on polluters in order to safeguard society in general.”¹³¹

If voluntary cleanup costs are not covered, the court said, “the policyholder would have a strong incentive not to undertake voluntary cleanup which, in turn, would delay cleanup, exacerbate the degree of contamination and increase the ultimate cost of cleanup.” This would “severely impede the ability of the federal and state governments to accomplish cleanup at the thousands of contaminated sites extant.”¹³² The overwhelming nonparty interest has thus shaped the interpretation of the contract.

4. *Intentional Harm.*

¹²⁹ Peter J. Kalis, Thomas M. Reiter and James R. Segerdahl, *Policyholder’s Guide to the Law of Insurance Coverage* 5.03 (1st ed. 1997 & Supp. 2017).

¹³⁰ See *Coakley v. Maine Bonding & Cas. Co.*, 618 A.2d 777 (1992) (holding remedial response costs could be covered, altering the court’s prior interpretation of ‘damages’ under *Desrochers v. New York Cas. Co.* 106 A.2d 196 (1954)); *Boeing Co. v. Aetna Cas. & Sur. Co.*, 784 P.2d 507 (1990). See also FRENCH & JERRY, *INSURANCE LAW AND PRACTICE* 246; Stanzler & Yuen, *Coverage for Environmental Cleanup Costs: History of the Word “Damages” Under CGL Policies*, 16 COLUM. J. ENV’T L. 73 (1991).

¹³¹ *Weyerhaeuser Co. v. Aetna Cas. & Sur. Co.*, 874 P.2d 142, 152 (1994) (allowing for coverage of preemptory cleanup and reversing the trial court’s order as it “create[d] a serious conflict between the local governments’ duty to act promptly in response to statutory liabilities to protect the public health and environment and the duty to preserve the availability of the liability insurance coverage purchased to financially protect the public.”).

¹³² *Id.* (citing TOD I. ZUCKERMAN & MARK C. RASKOFF, *ENVIRONMENTAL INSURANCE LITIGATION* § 3.02, at 3-8 (1992)). See also Mark S. Dennison, *Insured’s Proof that Environmental Cleanup Costs are Covered “Damages” Under CGL Insurance Policy*, 39 AM. JUR. PROOF OF FACTS 3d 483 (2021 update).

Our last example of nonparty defaults in insurance contracts concerns the exclusion of *intentional harms*. All liability insurance policies have such exclusion. In fact, insurance law prohibits coverage for intentional harms, as a matter of longstanding mandatory public policy. But what counts as intentional harm? Here, too, courts differ quite sharply, but the majority view holds that both the act *and* the injurious result have to be intended: “it must be shown that the insured intended by his act to produce the damage which did in fact occur.”¹³³ This is a stricter requirement compared to the standards applied in tort law for this very same activity, where intentionality is found even when the actor did not subjectively desire to produce the actual injury, as long as such result could reasonably be expected.

Why the narrower construction of *intent* in insurance contracts, as compared to tort law? The simple answer: increase coverage to victims. If insurance contract law used the same test as tort law, more harms would be excluded, and more nonparty victims would have been left without redress.¹³⁴ It is the interest that “an innocent third person receives the protection afforded by insurance” that underlies the interpretive canon.¹³⁵

In a striking illustration of this canon, the Supreme Court of New Jersey held that death caused to innocent victims by a deliberate (and criminally punished) arsonist was not intentional. The Court explained that a stricter definition of intent under the contract “is the correct standard for liability insurance cases. Since one purpose of such insurance is to protect injured third parties, as between the liability insurer of a culpable actor and an innocent third party it is the better policy to place the risk of loss with the insurer where intent to injure is unclear.”¹³⁶ Similarly, injuries caused by deliberate injurious acts of drivers (e.g., taxi drivers assaulting passengers) could be covered under their auto liability insurance, again to advance the goal of “compensating innocent victims.”¹³⁷ The same logic is applied in cases of innocent co-insureds—where the policyholder attacks his spouse, who is also a named insured on the policy (thus not quite a “nonparty” to the contract). Courts reason that the spouse’s interest in recovery trumps the insurer’s right to a broad intentional acts exclusion.¹³⁸

¹³³ *Physicians Ins. Co. of Ohio v. Swanson*, 58 Ohio St. 3d 189, 909 (1991) (citing *Eisenman v. Hornberger*, 264 A. 2d 673, 674 (Pa. 1970)); RESTATEMENT OF LAW, LIABILITY INSURANCE, § 45 (AM. L. INST. 2019).

¹³⁴ *Jerry & Richmond*, *supra* note 44.

¹³⁵ *Ambassador Ins. Co. v. Montes*, 388 A.2d 603, 606 (N.J. Sup. Ct. 1978).

¹³⁶ *Id.* at 609. *See also* RESTATEMENT OF LAW, LIABILITY INSURANCE, § 47 cmt g (AM. L. INST. 2019).

¹³⁷ *Nassau Ins. Co. v. Mel Jo-Jo Cab Corp.*, 102 Misc. 2d 455, 463–64 (Sup. Ct.), *aff’d*, 78 A.D.2d 549 (1980); *Huntington Cab Co. v. American Fidelity & Casualty Co.*, 155 F.2d 117 (4th Cir. 1946).

¹³⁸ *See, e.g., Harvey’s Wagon Wheel, Inc. v. MacSween*, 606 P.2d 1095, 1098 (Nev. 1980) (courts are required to interpret the insurance contract broadly and afford the greatest possible coverage to the insured); *St. Paul Fire & Marine Ins. Co. v. Molloy*, 433

From a corrective justice perspective, it is said that victims of intentional wrongs are entitled to receive compensation no less, and perhaps more, than victims of negligent wrongs. Since the tortfeasor's liability insurance is the primary source of recovery, this interest in broad redress justifies the result-oriented narrowing of the contractual exclusion term.¹³⁹ To emphasize, this definition of 'intent' in insurance law is a default rule. Insurers can override it by express instruction. They sometimes do, redrafting the policies to narrow down the coverage of some particularly egregious intentional harms.¹⁴⁰ But much of the nonparty-driven construction is allowed to stand (for reasons that we investigate later).

In sum, insurance contract law helps us demonstrate a variety of contexts in which courts apply a specific principle: interpret and construct the contract in a manner that advances nonparty interests. The specific nonparty interests courts advance are varied but share a common thread. They promote diffuse benefits for society and serve objectives central to the regulatory framework that breeds the liability these insurance contracts cover. Auto insurance is intended to advance the compensation of road victims; Environmental liability insurance is constructed with an eye to the harm-mitigation goals of environmental law; and insurance for mass torts is a primary response to long-tail product harms.

* * *

We reviewed in this section four examples of insurance contract construction guided by a specific nonparty interest—strengthen the financing mechanism of tort compensation. This interest is advanced even if insurers react by increasing premia. It can be, but it is often not, undermined by the redrafting of insurance contracts, as we will later explain. Before ending this insurance illustration, we briefly note that other nonparty interests, apart from broadening victim compensation, are invoked in insurance contract construction, and could have the opposite effect of reducing coverage. For example, courts may interpret ambiguous language to exclude coverage for punitive damages. In liability insurance contracts, these exclusions are mandated by law, prohibiting people from insuring penal liability. But in first-party insurance the exclusions are constructed by courts to limit an injured driver's ability to recover from their insurer the punitive damages assessed against their uninsured injurer. As the *Supreme Court of Arizona* explained, the “social policies” underlying first party coverage for auto-related injuries caused by other uninsured motorists require an “interpretation that furthers public policy” and

A.2d 1135 (MD 1981); *Watson v. United Services Automobile Assoc.*, 566 N.W.2d 683 (Minn. 1997); Willy E. Rice, *Destroyed Community Property, Damaged Persons, and Insurers' Duty to Indemnify Innocent Spouses and Other Co-Insured Fiduciaries: An Attempt to Harmonize Conflicting Federal and State Courts' Declaratory Judgments*, 2 EST. PLAN. & CMTY. PROP. L.J. 63 (2009).

¹³⁹ RESTATEMENT OF LAW, LIABILITY INSURANCE, § 47 cmt f (AM. L. INST. 2019).

¹⁴⁰ See Tom Baker and Kyle Logue, *Insurance Law and Policy* 414 (4th ed.); *Wright v. Allstate Cas. Co.* 797 N.W.2d 531.

excludes punitive damages recovery by the victim.¹⁴¹ The court viewed this principle as superseding the more common *contra proferentum* interpretive canon, of assigning the meaning least favorable to the insurer.¹⁴²

C. Remedies

A breach of contract gives rise to various remedies and, unless the contract states otherwise, the law provides rules to determine which remedy is primary and how to value the underlying harm that damage remedies seek to redress. In general, the common law prefers the award of money damages to the plaintiff over specific performance or other injunctive relief. And among monetary awards, the law prefers remedies that measure the pecuniary loss from non-performance. But there are notable exceptions to this hierarchy, whereby courts favor in-kind remedies, or damages that measure the loss differently. The typical ground for such exceptions is the “inadequacy” of the standard pecuniary damages to make the aggrieved party whole. One typical scenario in which damages are thought to be inadequate is when the subject matter of the contract is “unique” in some sense, namely, when it is difficult to procure a suitable substitute or to assess the damages needed to guarantee such procurement.¹⁴³ Another scenario for varying the default is the presence of an in-kind non-pecuniary interest as a principal contractual purpose.¹⁴⁴

Non-party interests have an important role in the application of these exceptions. We offer several prominent examples how nonparty interests, and especially the diffuse social impact of breach, factor in favor of a particular in-kind redress, including specific performance or compensatory measures tailored to reverse concrete social harms and secure in-kind completion or preservation of a socially valuable outcome. In short, we show that remedies are sometimes bolstered to protect not only the plaintiff's interests, but also nonparties—the presence of nonparty default remedies.

1. *Environmental Harm.*

Private contracts to extract natural resources often impact environmental interests, including wildlife, vegetation, waters, air, and land erosion. For example, when private land is leased for mining with a promise to restore it, some of the methods used by mining companies leave lasting harms, and when these harms are not remediated contract law is called upon to determine the damages owed to the owners.

¹⁴¹ *State Farm v. Wilson*, 782 P.2d 727, 731 (Ariz. 1989).

¹⁴² *Id.* at 733.

¹⁴³ RESTATEMENT (SECOND) OF CONTRACTS § 360 (AM. L. INST. 1981).

¹⁴⁴ E. ALLEN FARNSWORTH, CONTRACTS ____ (4th ed. 2004).

The problem of valuing such harm is a staple of first year contracts courses. What damages should the mining company, having breached its promise to restore the land, pay to the aggrieved owners? The owners usually ask for damages equal to the cost of repairing the damage, whereas the defendant offers to pay a smaller amount—the decline in the property’s market value due to non-restoration. Who can forget the classic case of *Peeryhouse v. Garland Coal Co.*, where a 5-to-4 majority of the Oklahoma Supreme Court awarded the aggrieved property owners \$300 in damages, representing the diminution in value of their property, instead of the \$29,000 it would have taken to repair the damage?¹⁴⁵

The social impact of ravaged tracts of land overtime led courts to broaden their view, recognizing that unrestored land has devastating negative effect on society, and awarding damages to enable landowners to achieve in-kind repair of the land. Twenty years after *Peeryhouse*, a federal court applying Oklahoma law explained that “[a]t the time of *Peeryhouse*, Oklahoma had no stated policy concerning land reclamation after mining operation [. . . and] considered only the economic benefits to the parties.” The court predicted that “the public policy of the state has changed” and, to further this revised environmental policy, it awarded \$375,000 the plaintiffs needed to restore the land, instead of the \$6800 diminution-in-value damages.¹⁴⁶

Notably, such newly discovered sensibility towards the environmental impact did not originate in courts. Oklahoma, for example, passed in 1967 the Oklahoma Open Cut Land Reclamation Act, which made reclamation and conservation of land a “policy of this state.”¹⁴⁷ That statute, like similar ones in other states,¹⁴⁸ did not mandate in-kind restoration remedies for breach by a mining company. Parties to a mining lease could, potentially, place the burden of reclamation on the lessors. Nevertheless, the explicit adoption of the policy operated to change the damages default rule that applies when a promise to restore is breached.

2. *Economic Vitality*

Major business-to-business transactions are the cogwheels of a thriving economy, and their breach—even if compensated—can affect multiple “stake holders”, could lead to loss of jobs and even regional or sectorial decline. When a large client breaches a long-term contract and cancels a large order from a local business, the business would often have to downsize its operations and let many workers go. Similarly, when a merger or takeover agreement is breached numerous parties can be

¹⁴⁵ *Peeryhouse v. Garland Coal Co.*, 382 P.2d 109 (Okla. 1962).

¹⁴⁶ *Rock Island Improv. Co. v. Helmerich & Payne*, 698 F.2d 1075, 1078 (10th Cir. 1983).

¹⁴⁷ 45 OK STAT § 45-722 (2019).

¹⁴⁸ OHIO REV. CODE § 1513.37 (2017); 225 ILL. COMP. STAT. 715/2 (1971); KAN. STAT. ANN. § 49-601–49-624(2014).

affected. The owners of a breached-against business may be fully compensated for their lost profits. But in selecting the remedy for breach, should courts take the broader impact on nonparties into account? Should courts order specific performance, rather than an award of expectation damages (as they sometimes do in long-term requirements contracts¹⁴⁹), to also protect diffuse interests of workers, families, surrounding businesses, and the local economy?

A classic statement of this position comes from *In Re IBP Securities Litigation*.¹⁵⁰ In the case, Tyson and IBP had entered into a merger agreement where (simplifying greatly) Tyson agreed to buy the shares of IBP and take over its operations, becoming the largest meat producer in the country. When economic realities changed, Tyson backed out and breached the agreement. Delaware courts, like other common law jurisdictions, typically grant specific enforcement of a sale contract of such unique asset only when it is the *buyer* who seeks to enforce it, reasoning that the buyer would not be able to find another asset like this in the “market.” (Sellers are usually denied in-kind remedy, because they can resell to another buyer and be compensated for the contract-resale differential in straightforward manner.) In this case it was the seller who sought specific enforcement, and successfully persuaded the court to grant it. Key to the court decision were nonparty interests in the merger. In a landmark decision, Vice Chancellor Strine weighed the disruptive effects of unwinding the contract on a large circle of “constituencies” and explained:

A compulsory order will require a merger of two public companies with thousands of employees working at facilities that are important to the communities in which they operate. The impact of a forced merger on constituencies beyond the stockholders and top managers of IBP and Tyson weighs heavily on my mind. The prosperity of IBP and Tyson means a great deal to these constituencies. I therefore approach this remedial issue quite cautiously and mindful of the interests of those who will be affected by my decision.¹⁵¹

Recognizing that a damages award “can be shaped”, the court nevertheless noted that “the Tyson constituencies would be better served on the whole by a specific performance remedy, rather than a large damages award that did nothing but cost Tyson a large amount of money.”¹⁵² The court reversed the remedial default rule for breach of an M&A contract, from money damages to specific performance, to avoid the economic disruption that breach would cause nonparties. Importantly, this choice was validated by later events, whereby merging parties explicitly contracted

¹⁴⁹ *Curtice Bros. Co. v. Catts*, 72 N.J. Eq. 831 (Ch. 1907); *Laclede Gas Co. v. Amoco Oil Co.*, 522 F.2d 33 (8th Cir. 1975).

¹⁵⁰ *In re IBP S’holders Litig. v. Tyson Foods*, 789 A.2d 14 (Del. Ch. 2001).

¹⁵¹ *Id.* at 83.

¹⁵² *Id.* at 84.

for a specific performance remedy, thus signaling to other courts the utility of this default rule.¹⁵³

This same question—whether to consider the interests of nonparties to justify a specific performance remedy—came up in another casebook classic, *Northern Indiana Public Service Co. v. Carbon County Coal Co.*,¹⁵⁴ albeit with a different result. In that case, the buyer, a power utility, breached a 20-year contract to purchase coal from a Wyoming coal mine. The coal mine was awarded damages of \$181 million—an amount that all parties agreed was a reasonable estimate of the lost profits—but sought instead the remedy of specific performance. Money damages, the seller argued, “will do nothing for the miners who have lost their jobs because the mine is closed and the satellite businesses that have closed for the same reason.”¹⁵⁵

Writing for the Seventh Circuit panel, Judge Posner had no difficulty dismissing this claim. Miners and satellite businesses “are not parties to the contract” nor third-party beneficiaries and therefore “their losses are irrelevant.”¹⁵⁶ Posner recognized that “consequences to third parties of granting an injunctive remedy, such as specific performance, must be considered, and in some cases may require the remedy be withheld.” But he sought to limit the relevance of nonparty interests in the choice of remedy only to a (not fully developed) category of interests accruing to “real parties of interest.”

The Posner opinion in *Carbon County* can be read as a blunt denial of a nonparty default remedy. We bring it here primarily to illustrate how courts could fall on either side of this approach. But a close reading of the opinion suggests that, rather than a categorical rejection of nonparty defaults, it reflects a subtle and receptive view towards such analysis. Indeed, as we further develop below, the rejection in that case, of the specific nonparty interests embodied in regional economic vitality, is sound. For one, an award of specific performance was unlikely to be implemented. Judge Posner predicted it would merely lead to a round of renegotiation for its cancellation (noting that the coal mine already closed down, unlikely to be reopened).¹⁵⁷ This is the problem of ex-post opt-out that we discussed earlier as one of the justifications for the party primacy norm.

Moreover, any calculus of societal interests should not have ended with the interest of the local economy. A 20-year supply of coal to one of Indiana’s largest utility companies would have had other nonparty effects, both environmental and economic. Some of this negative social impact was noted by Judge Posner, explaining that continued production of

¹⁵³ Theresa Arnold, Amanda Dixon, Hadar Tanne, Madison Sherrill, & Mitu Gulati, “*Lipstick on a Pig*”: *Specific Performance Clauses in Action*, 2021 WIS L. REV. 359 (2021).

¹⁵⁴ N. Ind. Pub. Serv. Co. v. Carbon Cty. Coal Co., 799 F.2d 265 (7th Cir. 1986).

¹⁵⁵ *Id.* at 279.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

“uneconomical” coal, which “costs much more to get out of the ground than it is worth . . . would impose costs on society greater than the benefits.”¹⁵⁸ Moreover, the breaching buyer in the case ended up purchasing other sources of energy from other suppliers, thus enhancing the economic vitality of another supply region. And, centrally, the shift of the buyer to other sources of energy potentially reflects the relative environmental and pollution costs of different inputs. It is impractical to expect a court to balance the various competing and large-scale societal impacts in the energy supply chain. This is the *institutional competence* problem that, we noted earlier, justifies contract courts’ submission to the party primacy norm.

3. *Interest of Consumers in the Chain of Distribution.*

Another nonparty interest which courts look to in the choice of remedy is that of consumers and end-users who are affected by upstream supply contracts. Does the resolution of the present dispute and the remedy granted impact the consumers and their ability to be served?

This question came up in *Mississippi Power & Light Co. v. United Gas Pipe Line Co.*, where a supplier of natural gas breached a long-term contract with a utility company by overcharging.¹⁵⁹ Recognizing that such markups are passed through to customers of the utility company, and that increases in the cost of electricity are disruptive to the public, the court issued injunctive relief. The nonparty interest was clear—“to underwrite just and reasonable rates to the consumers of natural gas.”¹⁶⁰ While the aggrieved utility company could be adequately compensated by monetary damages equal to the overcharges, and while it might also subsequently refund the pass-through price increase to its diffuse customers, the court concluded that a negative social impact would nevertheless ensue. “A refund of overcharges sometime in the future could never adequately compensate families living at or close to the poverty line for hardships they would endure as a result of overcharges they would have to pay at present and during the course of litigation.”¹⁶¹

Like in the *Carbon County* decision discussed above, the court noted that it is indeed considering harms to parties in the supply chain who are not part to the contract or the suit, nor are they third party beneficiaries. But the court concluded that even in adjudicating private contract disputes it is *required* to “take into account the vital public interest which may be in

¹⁵⁸ *Id.*

¹⁵⁹ 760 F.2d 618.

¹⁶⁰ *Fed. Power Comm’n v. Tenn. Gas Transmission Co.*, 371 U.S. 145 (1962); *Natural Gas Act of 1938*, 15 U.S.C. § 717.

¹⁶¹ 760 F.2d, at 625. The Mississippi Utility Reform Act of 1983 further declared such policy. See *MISS. CODE ANN. § 77–3–2* (Supp.1984). As the Chairman of the Commission testified in the case, “one of the primary obligations of the new legislation was to prevent charges from being passed on to any consumers before some judicial or administrative determination on the lawfulness of the charges.”

jeopardy.” Such requirement would be “meaningless” if the court were “constrained to consider only the immediate interests of the parties to the contract.”¹⁶² This attention to the importance of public interests in preliminary injunctions is increasingly shared by courts and commentators.¹⁶³ Here, as in the other examples presented above, the social interest is protected not by a mandatory rule. Careful drafting by the parties would probably succeed in overriding the remedial default rules. Nevertheless, as we explain later, it has more than anecdotal impact on nonparty interests.

4. *Social Interests Warranted in the Contract*

Consumer products are increasingly sold with the promise for social value. Cars are warranted to be “green,” food as “fair trade,” and furniture to be “locally made.” What if these assurances turn out to be false? It is increasingly recognized that, while such specialty products are often more expensive, a remedy equal to a refund of the price premium would fall short of making aggrieved buyers whole. To a vegetarian who spent a few extra dollars to purchase plant-based meat substitute, the harm from consuming it and learning that it was made from beef exceeds the pecuniary overcharge. While the harm to buyers is caused by the violation of social interests they cherish, the promotion of which was part of the basis of the bargain, some remedy to redress that harm is obviously needed.

Thus, for example, when Volkswagen sold vehicles branded as “clean diesel” while in fact they emitted toxic gases at high rate and were equipped with cheat devices to pass emissions test, the claims by aggrieved buyers for redress that recognizes their violated environmental interest was taken seriously. In the class action brought by owners of the vehicle, the court approved a settlement that included close to \$5 billion for restoration of environmental harms caused by the vehicles. This included \$2 billion to promote the use of zero emissions vehicles and \$2.7 billion to reduce nitrogen oxides emissions.¹⁶⁴

We view this remedial regime as a method to preserve nonparty interests, albeit ones that the parties themselves sought to advance. It is when the seller explicitly warrants a product to have a specific social or ethical feature that such warranty ought to be backed by a remedy compensating not only for the buyer’s financial loss but also the social interest. Such remedy would lend credibility to the seller’s promise, allow

¹⁶² 760 F.2d, at 625.

¹⁶³ John Leubsdorf, *The Standard for Preliminary Injunctions*, 91 HARV. L. REV. 525, 549 (1978); see also 7 J. MOORE, MOORE’S FEDERAL PRACTICE, § 65.04[1] (2d ed. 1984).

¹⁶⁴ Volkswagen Settlement, at 39-40. Order Granting Final Approval of the 2.0-Liter TDI Consumer and Reseller Dealership Class Action Settlement at 2; In re Volkswagen “Clean Diesel” Mktg., Sales Practices, & Prods. Liab. Litig., No. MDL 2672 CRM (JSC) (N.D. Cal. Oct. 25, 2016), <https://www.cand.uscourts.gov/filelibrary/2867/Order-Granting-Final-Approval-of-Consumer-Sett.pdf> [<https://perma.cc/3EEV-9PLC>].

buyers to take the promise seriously, and fashion contracts as a tool to promote nonparty interests.

A general template for such redress would allow courts to remedy a breach of a social interest warranty with “restoration damages.”¹⁶⁵ This is a monetary award paid not to the plaintiff directly, but instead to restore the underlying social interest that the contract warranted and the breach impaired. A court would have to identify this interest and devise a channel through which the breaching party could contribute to its remediation (as the court did in the VW litigation, by requiring the defendant to invest specific sums in emission-reducing technology). While such damage measure would expand upon the longstanding remedial default rules in contract law, which were traditionally stingy in protecting “emotional distress” arising in such circumstances, it would be suitable for contracts and products that explicitly promise social value.

D. Excuse Doctrines

The various excuse doctrines—impossibility, impracticability, and frustration of purpose—provide courts the opportunity to consider nonparty interests. These doctrines operate as default rules, filling gaps in the allocation of risks that arise from changed circumstances. As with other discharge rules, like the mistake doctrine, courts fill the risk-allocation gaps based on implied intent of the parties¹⁶⁶ or their relative capacity to bear these risks.¹⁶⁷ But nonparty interests could also factor into the outcome.

In Part I above we mentioned the *Hanford* (polio) case, where the parties had not allocated in the contract the costs of a later arriving public risk.¹⁶⁸ *Hanford*’s rule appears to be nondelegable: the contract was rescinded because its performance would harm the public. But in other contexts, an unexpected risk to nonparties can be addressed via a gap-filler. The Restatement (Second) of Contract illustrates this possibility with a contract to ship goods to a foreign country, which is disrupted by a civil war that erupts at the destination and puts incoming ships at risk when approaching the port. “The risk of injury to others is sufficient to make [carrier’s] performance impracticable” and the contract is discharged.¹⁶⁹ Interestingly, the Restatement further adds that if another even more weighty nonparty interest is at stake—for example, if the ship is carrying supplies “vital to the health of the population of the designated port”—the contract will not be

¹⁶⁵ Omri Ben-Shahar & Ariel Porat, *The Restoration Remedy in Private Law*, 118 COLUM. L. REV. 1901 (2018).

¹⁶⁶ *Taylor v. Caldwell*, 122 Eng. Rep. 309 (1863).

¹⁶⁷ RESTATEMENT (SECOND) OF CONTRACTS §§ 261, 154 (AM. L. INST. 1981); U.C.C. § 2-615 (AM. L. INST. & UNIF. L. COMM’N 1977).

¹⁶⁸ See text accompanying notes 62-64.

¹⁶⁹ RESTATEMENT (SECOND) OF CONTRACTS § 261 ill. 7 (AM. L. INST. 1981).

excused.¹⁷⁰ Nonparty interests take center stage and may point at different directions, with courts instructed to find the right balance among them.

The recent Covid epidemic provides an opportunity to examine the prevalence of nonparty interests in shaping the scope of the excuse doctrine. While many cases alleging impracticability are still moving through courts, and mostly focusing on the parties' expectations, one recent case illustrates the nonparties angle.¹⁷¹ In that case, the parties contracted to repair a sidewalk, and specified per diem liquidated damages for every day of delayed performance. During the repair work Covid arrived and construction halted. The repairing party sought to use the public health emergency as an excuse for nonperformance and avoidance of damages. The court agreed, though it was not clear that the Governor's lockdown order compelled the delay. Why? Because, the court reasoned, the contractual provisions "were not intended to incentivize [the parties] to break the law, put lives at risk, and/or exacerbate a public health crisis that is estimated to have caused the deaths of 1 in 347 New York City residents."¹⁷² That is, with sufficiently strong nonparty interests the court expanded the excuse gap-filler to protect them. However, it seems clear from the case that had the parties allocated the risk of a public health crisis differently in the contract, the court would have deferred to that choice.

III. IN (PARTIAL) DEFENSE OF NONPARTY DEFAULTS

Part II showed that courts routinely account for nonparty interests, despite what we described as valid concerns that doing so will be either futile (the opt out problem) or misdirected and even harmful (the institutional competence problem). In this Part, we turn from the descriptive to the normative. If nonparty defaults are really so bad, why do they exist?

A. Institutional Division of Labor

Although there are many good reasons that legislators are often best-suited to looking after social interests,¹⁷³ there are circumstances in which courts are in a comparatively good and sometimes superior position to provide effective protection to widely accepted nonparty interests. We highlight those circumstances here, and then explain further special circumstances where courts can use nonparty defaults to narrowly tailor

¹⁷⁰ *Id.* § 261 ill. 8.

¹⁷¹ Only Props., LLC v. Sylvia Wald & Po Kim Art Gallery, 2020 N.Y. Misc. LEXIS 10706 (N.Y. Sup. Ct. 2020).

¹⁷² *Id.*

¹⁷³ See Bagchi, *supra* note 10; Casey & Niblett, *supra* note 22.

intermediate results that are not readily available to legislators and regulators.

Judicial protection of nonparty interests in contract law is less troublesome when it works as a *complement*, rather than *substitute*, for ex-ante regulation, particularly when legislation uses standard-like objectives, rather than bright line rules. Common law courts assemble the relevant social interests from specific enactments dictated by lawmakers and double-check that these interests are not subjugated by the contract.

For example, when a regulator like the EPA regulates by setting a precise command like rates of impermissible air pollution, courts should refrain from interfering with this regulatory effort. But much environmental regulation does not involve precise particles per liter of air. It leaves enough unspecified domain that allows courts to observe the specific realization of the tradeoff between the relevant interests and resolve disputes in a manner that advances the environmental objectives the law seeks to advance. Thus, where regulators are vague, courts should be emboldened to fill the nonparty gaps.

Courts have done that in various contexts. As we noted, courts are interpreting insurance contracts to allow coverage of environmental cleanup by the policyholder even when done voluntarily, thereby expanding the interpretation of the term “damages.”¹⁷⁴ This expanded meaning deviates from the way the term “damages” is interpreted by courts in other insurance contexts, where it typically does not include voluntary pre-injury mitigation. Why the broader interpretation? Courts and commentators justify it as a strategy to serve the goals of environmental statutes, including the rules that create the environmental liability which the insurance contract protects against.

Or, to take the stripmining environmental example, where the social interest is to reclaim damaged land, it was legislation that initially recognized this interest. Beginning in the 1970s, states addressed the environmental harms caused by stripmining and enacted laws requiring remedial restoration of mined land.¹⁷⁵ Prior to these laws, we saw, courts tended to ignore that social harm when adjudicating contract breach lawsuits brought by owners against mining companies that left the grounds unrestored. Whether to award remedies for the cost of restoration or merely for the decline in the value of the owners’ land was a question that courts historically resolved based on what they regarded as the parties’ interests, ignoring nonparty and social aspects. Ironically, concern for such wider interests was sometimes labeled “economic waste.”¹⁷⁶ But once statutes

¹⁷⁴ See text accompanying notes 131-132, *supra*.

¹⁷⁵ OHIO REV. CODE § 1513.37 (2017); 225 ILL. COMP. STAT. 715/2 (1971); KAN. STAT. ANN. § 49-601-49-624 (2014).

¹⁷⁶ *Peavyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109 (1962) (reference to “economic waste” based on cost and benefit to the parties alone.)

were enacted and the social reclamation interest was recognized, courts reversed the remedial default rule. Explaining that the social policy has changed, judges required breaching companies to pay for the full cost of restoration.¹⁷⁷ Nonparty interests crept into contract law to more fully protect the targets that lawmakers marked. And their implementation in specific cases turned on the facts of each dispute.

A similar pattern undergirds other examples we surveyed in Part II. For example, expanding coverage via interpretation of auto insurance policies advances the widely accepted goal of strict liability tort law and of auto insurance regulation—to spread the cost suffered by road victims broadly. Similarly, the asbestos crisis has led to various regulatory efforts to protect the public from asbestos-related illnesses.¹⁷⁸ These efforts manifest a social policy to give victims various measure of redress. Again, they do not preclude the effort of courts to interpret commercial liability insurance policies in a manner that ultimately affords victims more compensation.

In these and other contexts, laws advancing social interests leave room for courts to advance the same interest in complementary ways. This is a familiar congruity between regulation and the common law, and it has a rich jurisprudential and constitutional underpinning.¹⁷⁹ For example, when the FDA regulates drug warnings, state courts adjudicating tort suits can bolster patient protection by requiring additional warnings.¹⁸⁰ When securities law makes it illegal to engage in manipulation or deception, or when federal and state laws mandate disclosures for various products and activities, courts identify the specific categories of violations, sometimes relying on the contours of common law fraud and contractual misrepresentation to heighten the protection to consumers.

This regulation-versus-common law duality applies in a nuanced manner in the administration of contractual remedies. In many contexts, a breach of contract may also violate statutory prohibitions. When courts refuse to enforce a contract that is against public policy, they still must determine remedial consequences of its partial performance. If, for example, a tenant already occupied an apartment that violates tenancy laws (which are sometimes justified by broader social interests), the parties might dispute the pecuniary results from partial performance. Courts often hold that any remaining obligations depend on the breach of the common law's

¹⁷⁷ *Rock Island Improvement Company v. Helmerich & Payne, Inc.*, 698 F.2d 1075, 1078 (10th Cir. 1983); *Davis v. Shell Oil Co.*, 795 F. Supp. 381 (W.D. Okla. 1992); *Schneberger v. Apache Corp.*, 890 P.2d 847 (Okla. 1994); *Miller v. C.K.L., Inc.*, 1988 Ohio App. LEXIS 4069 (Ct. App. Oct. 6, 1988).

¹⁷⁸ R.D. Brownson, *Current and Historical American Asbestos Regulations*, 53 MONALDI ARCHIVES CHEST DISEASE 181 (1998).

¹⁷⁹ Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE (2020) (arguing that stakeholder interests are advanced by shareholder activism, rather than management actions); Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097 (2020) (showing that shareholder proposals advance stakeholder interests).

¹⁸⁰ *Wyath v. Levine*, 555 U.S. 555 (2009).

implied warranty of habitability.¹⁸¹ In effect, a regime that generally considers nonparty interests in the enforcement of contracts is tweaked to also account for the gravity of such interests vis-à-vis the parties' claims.

But this account—contract rules bolstering preexisting legislative policy—becomes less tractable when interests are harder to pin down.¹⁸² Economic viability of a region is a primary example. Would it be anomalous for courts enforcing private contracts to consider such economic interests? Unlike, say, the environmental impact of coal mining, which is regulated by environmental law and subject to careful measurement of social impact and trade-offs, the macroeconomic impact of a breach of major transaction is harder to evaluate through the lens of specific laws. It would therefore be more objectionable for courts to advance a redistributive goal but serve the economic interests of only a subset stakeholders (workers, shoppers).

Beyond complementing legislated social interests, courts are well positioned to advance nonparty interests in another manner: in scenarios where ex ante rulemaking has not responded yet to new circumstances, especially in cases where rapidly evolving social risks are, effectively, not regulable at the time of performance. *Hanford*—and Covid—offer examples of this problem in action. Regulators, burdened by administrative rules against precipitous action, or political sclerosis, will sometimes fail to offer clear guidance. One party may then seek to take nonparty interests into account when deciding how or whether to perform. Because these choices occur in the shadow of regulatory ambiguity, courts will be forced in effect to judge the asserted public interest in an area of law that ordinarily is outside of their competence. But if courts reject the burden, stating that they lack the ability to adjudicate public interests at all, that would leave rapidly changing social risks rarely cognizable as excuses—a default rule that permits externalizing costs. That would have potentially unfortunate social effects.¹⁸³

In sum, while contract law disputes are probably not the primary platform for resolving social priorities about public policy and for systematically and comprehensively advancing nonparty interests, they do provide a venue to bolster accepted objectives. Accounting for nonparty interests in contract law need not be an affront to democratic policymaking, nor an ad-hoc exercise of judicial activism. Rather, through the incremental approach of the common law, nonparty defaults offer a flexible and adjustable complement to the rulemaking process.

B. Will Nonparty Defaults “Stick”?

¹⁸¹ *Noble v. Alis*, 474 N.E. 2d 109, 112 (Ind. 1985).

¹⁸² Bagchi, *Other People's Contracts*, *supra* note 10, makes a similar point about the relative weight of diffuse and concentrated externalities.

¹⁸³ Hoffman and Hwang, *supra* note 61, at 999-1005.

Perhaps we convinced you that boosting nonparty interests is a task that contract law courts have and should, sometimes, in a modest manner, take up. But why use such technique if the parties can overturn their content via explicit opt-outs? This section addresses the concern of opt-outs.

To start, parties will stick with nonparty defaults if they like them. The parties' interests may incidentally not conflict with those of nonparties, or—stronger—the parties may embrace the external social interests and seek to advance them. One example might be pre-clicked options which some websites offer at checkout, allowing customers to “round up” their payment so that spare change can benefit social interest.¹⁸⁴ Some consumers embrace such defaults, despite the added cost.

Parties similarly stick with contractual nonparty defaults when their private interests are at least partially aligned with the nonparty interests. Insured parties, for example, may be happy to enjoy the expanded liability coverage afforded to them under liability insurance contracts when courts embrace such expansion for its nonparty impact. Even sophisticated commercial parties may refuse to accept a revised policy at the renewal time if told how it specifically reduces their coverage. Or, suppliers may embrace the expanded availability of equitable relief and specific performance afforded to them by the nonparty default, especially when otherwise the damage remedies provide less than make-whole redress. Such added nonparty protections may be reflected in prices, and parties' reluctance to disclaim the protection may, on the margin, cost them. But it is often hard to pin down the incremental price effect a protection.

Alternatively, a party may strategically hold on to the nonparty default and refuse the counterpart's request to opt out, even when it is in its interest to ultimately disclaim them. When these defaults impose disproportionate costs on their counterpart, there is strategic advantage from bargaining hard over the disclaimer. If a default rule entitles a supplier to equitable relief when the client breaches, the supplier may refuse to opt out at the contracting stage, even if it might ultimately agree to release the client from a specific performance remedy.

Another set of reasons why parties will not opt out is the so-called “stickiness” of default rules—frictions that make it difficult to reverse an unwanted default.¹⁸⁵ A growing empirical literature shows that parties often fail to alter or disclaim the defaults even when it seems in their interest to do so.¹⁸⁶ Negotiation could be costly and agreement over alternative

¹⁸⁴ GrubHub and various grocery stores, for instance, encourage consumers to “round up” and give spare change to charity.

¹⁸⁵ Omri Ben-Shahar and John A.E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. L. REV. 651 (2006).

¹⁸⁶ See, e.g., Stephen J. Choi, Mitu Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate*, 67 DUKE L.J. 1 (2017) (finding that parties to sovereign debt contracts use standard provisions even though no parties have a clear understanding what those provisions mean).

provisions may be elusive; the clarity of settled defaults may be valuable, especially given the uncertainty how courts would interpret an opt out;¹⁸⁷ the aspects of the transaction governed by the default may be viewed, ex ante, as low-likelihood and not worth the trouble of renegotiation; and various informational limitations may disrupt the parties assessment of the relative values of the default and its alternatives.¹⁸⁸ Accordingly, when factors contributing to the stickiness of defaults are present, courts' resort to gap fillers that serve nonparty interests may be effective.

Consider, for example, the dynamics of opt out in insurance contracts. It is widely believed that when courts interpret an insurance contract in a manner that expands coverage to the benefit of the policy holder (for example, under the doctrines of *reasonable expectations* and *contra proferentum*) insurers could swiftly respond by repricing the policy, and the policyholder could then choose whether to pay the extra premium or agree to an opt out from that interpretation. Likewise, if courts interpret the insurance policy in a manner that benefits nonparties, it might seem even more straightforward for the insurer to redraft the policy and opt out of such interpretation.

The success of such redrafting depends in part on how protective courts are of their judicially developed nonparty defaults.¹⁸⁹ Consider two forms of court resistance, depending on the specificity of the attempted opt out. When the opt out provision in the contract is highly specific, attempting to override a concrete application of a nonparty default, courts would follow it literally but restrict its effect to that narrow context. Here, each specific application of a nonparty default would have to be met with its own specific and targeted opt out instruction. Conversely, when the opt out technique is general, instructing courts to abandon an entire canon of nonparty interest interpretation, courts might disregard it.

For example, as we showed earlier, courts interpreting the liability coverage under auto insurance policies find that the coverage extends to many scenarios in which the driver did not receive permission from the insured, or in which the driver violated the terms of the permission.¹⁹⁰ Courts apply a blanket of nonparty interest interpretations to the omnibus clause in the contract, which determines which drivers are covered. Because these are default rules, insurers can respond by overriding any of these specific expansions. They could write, for example, that coverage extends only to drivers permitted by the insured, not to those permitted by the

¹⁸⁷ Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105 (2006).

¹⁸⁸ Oren Bar-Gill & Omri Ben-Shahar, *An Information Cost Theory of Default Rules*, 88 U. CHI. L. REV. 581 (2021).

¹⁸⁹ See Boardman, *supra* note 42, for further hurdles to redrafting.

¹⁹⁰ *Odolecki v. Hartford Acci. & Indem. Co.*, 264 A.2d 38 (N.J. 1970); *French v. Hernandez*, 184 N.J. 144, 875 A.2d 943 (2005); *Martusus v. Tartamosa*, 150 N.J. 148, 696 A.2d 1 (1997); *State Farm Mut. Auto. Ins. Co. v. Zurich Am. Ins. Co.*, 62 N.J. 155, 299 A.2d 704 (1973) *Raitz v. State Farm Mut. Auto. Ins. Co.*, 960 P.2d 1179 (Colo. 1998).

insured's permittees (no indirect permissions). And courts would likely follow such instruction. But, unless a separate opt-out instruction is drafted, courts would continue to expand coverage in other factual scenarios. So while courts will be unable to expand coverage to non-permitted drivers, they will expand coverage to, say, permitted drivers who exceeded the terms or duration of their permission.¹⁹¹ In other words, when opt outs are highly specific they would succeed but only in their limited domain; elsewhere, courts might preserve the nonparty-interest interpretation canon.

To overcome this specificity trap, opt outs could be drafted more generally, instructing courts to ignore nonparty interests altogether. An insurer might draft an interpretation term in the policy whereby parties agree that any ambiguity should *not* be resolved by reference to the principle of affording more coverage to third party victims. It is standard practice for contracts to include instructions how to interpret them,¹⁹² and thus insurers can find the necessary legalese to say: "courts, you have to ignore diffuse social interests in interpreting this contract."

Will courts follow such instructions? Not necessarily. It is possible that while courts would view any fact-specific interpretation they issue as a gap-filler that parties may disclaim, they would at the same time embrace the position that a wholesale opt out from the principle of social-interest interpretation is ineffective. Court might take such general instruction as an affront and interference with the methodology by which judges apply their discretion. Indeed, such resistance to blanket overrides of an entire jurisprudence are familiar. For example, common law courts were traditionally hostile to parties instructing courts when to issue the remedy of specific performance.¹⁹³ This is not a mandatory rule; it only requires parties to spend extra drafting effort to achieve such opt out and expand the domain of their chosen remedy.¹⁹⁴ Other times, nonparty defaults can be made sticky by requiring specific disclaimers and blocking the parties' least resistance path to opt out.

Put differently, the law may shield nonparty defaults from opt out by installing costly altering rules.¹⁹⁵ Require more pinpointed and deliberate opt out rituals to successfully override the default rule is a costly altering

¹⁹¹ Id.

¹⁹² Acquisition agreements, for example, often include a variety of clauses that give courts instructions on how interpret the contract. Examples include integration clauses, clauses that disallow oral modification of the contract, and clauses in which the parties agree to waive jury trials or in which parties agree to have their dispute heard in a particular jurisdiction are ready examples.

¹⁹³ *Manchester Dairy Sys. v. Hayward*, 82 N.H. 193 (1926) ("Jurisdiction over the subject matter of a controversy cannot be created or conferred by the agreement of the parties.").

¹⁹⁴ See, e.g., *Grayson-Robinson v. Iris Constr. Corp.* 8 N.Y.2d 133 (1960) (parties can opt into the specific performance remedy by agreeing to arbitration in a forum that applies this remedy more commonly).

¹⁹⁵ Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L.J. 2032 (2012).

rule. Indeed, making defaults stickier has become a battle hymn for consumer protection advocates, hoping that pro-consumer defaults, rather than mandatory rules, could improve social welfare and achieve a more equitable division of the contractual surplus—if only they can be made stickier.¹⁹⁶

C. The Advantage of Default Rules in Advancing Nonparty Interests

If nonparty interests are weighty enough to qualify the party primacy norm and affect the obligation arising out of contracts, why should they be secured via default rule and not attain mandatory status? Our discussion so far in this section addressed the *nonparty* aspect of nonparty defaults, suggesting that it is feasible and even advisable to account for such interests. Let us now say a few words about the *default* aspect of nonparty defaults—using rules that will sometimes (and perhaps often) be reversed by the parties.

First, even disclaimed nonparty defaults have social value like that associated with so-called penalty default rules—the eliciting of information that is valuable to the parties or other potential transactors. For example, a firm disclaiming sustainability default reveals to its clientele this “quality” attribute. True, many disclaimers are done in boilerplate fashion without truly informing customers. But an explicit opt out makes it marginally easier for those who care to distinguish this firm from others that embrace the default. In some circumstances, requiring anti-social firms to opt out could be a more effective sorting mechanism than permitting pro-social firms to opt in. Thus, in place of mandatory rules that compel all parties to align with the nonparty interest, and instead of the party primacy norm that ignores those interests altogether—that is, against an all-or-nothing regime—nonparty defaults implement a self-selection outcome

Second, nonparty defaults are flexible in another dimension: *time*. Legislatures enact mandatory rules after accounting for competing social interests and surmounting multiple veto points. Statutes are meant to last. What’s less well appreciated is that mandatory contract rules have some of the same character. Because mandatory rules are so scarce, they tend to persist over time. That might be because they are deeply rooted in political

¹⁹⁶ Cass R. Sunstein, *Deciding by Default*, 162 U. PA. L. REV. 1, 5 (2013) (“[D]efault rules . . . count as prime ‘nudges,’ understood as interventions that maintain freedom of choice, that do not impose mandates or bans, but that nonetheless incline people’s choices in a particular direction.”) Of course, parties’ other private interests could override even quite sticky nonparty defaults. If, say, the implied warranty of merchantability is expanded to require all consumer products to meet high standards of sustainability, it is quite possible that sellers would successfully invite their less-environmentally-inclined customers to disclaim this feature for a discount. Such ambitious policy in favor of nonparty interests would then have to be cemented by a mandatory status.

and legal traditions, or because they reflect longstanding public law commands. But it might also be because they aren't often challenged by private parties, even those who dare to insert nonconforming clauses. Mandatory contract rules thus tend to ossify in place.

But judge-made default rules, by contrast, emerge constantly and fortuitously, while having short half-lives. Thus, courts can advance nonparty interests (by, say, permitting “liberal” excuse doctrines for hosts of weddings during Covid) without fearing a long-term unintended economic consequence.¹⁹⁷ The post-Covid surge of specific force majeure clauses reallocating risks of nonperformance is a good example: early court decisions fueled by non-party concerns that discharged contractual obligations made way to clauses with more specific express allocation of the risks of closures.¹⁹⁸

This transitory nature of court-generated default jurisprudence is more general but not well-appreciated. Scholars have tended to view optimal default rules, which provide maximal value to transactors, as stable, reflecting a long-term equilibrium. But a growing body of empirical analysis of consumer contracting demonstrates that parties continue to change their reactions to defaults in response to evolving contracting environments and technology.¹⁹⁹ These exogenous forces act on contracting processes constantly, reducing the durability and enjoying the flexibility of judge-made default rules.

Put differently, because mandatory rules are more durable, the costs of getting them wrong in the first instance are high. Where the rule concerns diffuse nonparty interests, it is easy to see why those error costs have discouraged experimentation. But default rules, subject to constant evolutionary pressure, are self-limiting. The use of defaults encourages more adventurous judging by courts, at least where there are reasons to think that the parties have not accounted for an important, exigent, private or social interest in their bargain. Why not offer the parties a new default rule and let them ponder it? As Ms. Frizzle said, “Take chances, make mistakes, and get messy!”²⁰⁰

CONCLUSION

We offered in this article a new way to limit the party primacy norm, which is one of the fundamental pillars of contract law. The limiting

¹⁹⁷ Hoffman and Hwang, *supra* note 61, at 999.

¹⁹⁸ *But see* Robert A. Hillman, *Health Crises and the Limited Role of Contract Law*, 85 L. & CONTEMP. PROBS. (2022), who thinks that these clauses are going to violate mandatory public policy.

¹⁹⁹ *See* Florencia Marotta-Wurgler, *Set in Stone? Change and Innovation in Consumer Standard-Form Contracts*, 88 N.Y.U. L. REV. 241 (2013).

²⁰⁰ A particular citation to the inspirational legal text THE MAGIC SCHOOL BUS would be self-refuting.

principle is nonparty interests, expressed as default rules. We devoted the bulk of the article to demonstrating the existence of nonparty defaults and explaining how they come about and survive.

Nonparty defaults are a conceptual benchmark. They do not fit into any of the existing theories of default rules. They do not maximize the contractual pie; they do not force out private information by inducing opt out; they do not nudge or level the playing field; and they certainly do not mimic the parties' will. They are a different creature, focused on social rather than parties' interests, prodding private contracts towards social good.

This article is a proof of concept. We have seen that nonparty defaults exist and that they are sometimes durable, but we don't quite know how important and widespread they are. We were able to dig out some examples for their adoption, but we are unable to observe the magnitude of their rejection. We have not clearly identified what kind of social interests nonparty defaults serve (must they always be as weighty as we have suggested?) nor what sorts of nonparties get their interests counted. Accordingly, we end the article with two forward looking yearnings.

First, we hope the article will encourage commentators and students of contract law to identify the DNA of nonparty defaults in various areas of transactional law and to show that they are prevalent. Corporate law, for example, is engulfed in a soul-searching inquiry regarding *stakeholderism*—asking whether the mandate to maximize shareholder value (a type of party primacy norm) must be replaced by default rules that permit and even prioritize nonparty interests.²⁰¹ Employment law, to take another example, contains pockets of nonparty defaults, for example in the rules that administer health and retirement plans.²⁰² Such trans-substantive evidence for the nonparty default module would bring it further to the methodological mainstream.

Second, and most importantly, we modestly hope that in crafting new defaults courts and regulators will be emboldened to give nonparty interests greater weight. In a society increasingly experiencing the harms

²⁰¹ See, e.g., Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE (2020) (arguing that many of the corporate initiatives and changes commonly deemed stakeholder-friendly, such as those that promise more environmentally-friendly practices, are driven by shareholder proposals). See also Cathy Hwang, Yaron Nili & Jeremy McClane, *The Lost Promise of Loan Covenants* (manuscript on file with authors) (discussing the debate between shareholder- and stakeholder-centric theories of governance).

²⁰² *Burke v. Eaton Associates, Inc.*, No. 09-CV-648S, slip op. at *2 (W.D.N.Y. Jan. 30, 2012) (apply “traditional rules of contract interpretation as long as they are consistent with federal labor policies”); *Aeronautical Indus. Dist. Lodge 91 of Int’l Ass’n of Machinists & Aerospace Workers, AFL–CIO v. United Techs. Corp.*, 230 F.3d 569, 576 (2d Cir. 2000) (contract should be interpreted to protect the interests of participants in financially distressed ERISA plans); *Sciascia v. Rochdale Village, Inc.* 851 F.Supp.2d 460 (E.D.N.Y. 2012) (traditional rules of contract interpretation apply, provided they are consistent with fair labor policies).

that contracts governed solely by the party primacy norm can bring, the economic analysis of contract law has an opportunity to shift gears. It can show that contract law could become a tool to bolster social objectives. Look around us: the products people purchase through private contracts increasingly seek to preserve social interests—“green”, “fair trade”, “local”, or other humanitarian or cosmopolitan values. If buyers are demanding such accountability, and if sellers are responding by claiming to offer it, contract law should retool and support these expectations. The nonparty defaults identified in this article could help fill this timely role.