

Other People's Contracts

Aditi Bagchi†

Contract law does not adequately account for the harms that we can inflict on third parties by joint agreement. Some terms are prohibited, and some third party interests are protected by independent causes of action. But a wide variety of material interests that are otherwise recognized in law may be burdened by other people's contracts. This Article proposes that ambiguous contract terms be construed to avoid harming third parties.

In some contexts, courts already protect third parties in this way. The doctrinal rule that courts should construe ambiguous terms "reasonably" accommodates this practice but does not invite it. Prevailing contract theory is affirmatively hostile to it. This Article locates the role of contract law in mitigating negative externalities within a broader institutional division of labor. Identifying the function of contract law helps justify an explicit interpretive principle that disfavors terms injurious to third parties.

Introduction.....	212
I. Third Parties In Existing Literature.....	217
II. Public and Private Law, or How We Limit Harm to Others.....	221
A. Epiphenomenal, Essential, Ideological.....	221
B. The State Mandate to Prevent Harm, and the Broad Concept of a Legal Interest.....	225
C. Concentrated and Diffuse Externalities.....	229
D. The Basic Division of Labor.....	229
III. Minimizing Concentrated Externalities in Private Law.....	236
IV. Concentrated Externalities from Merger Agreements.....	246
A. Creditors.....	248
B. Employees.....	250
C. Shareholders.....	252
D. Consumers.....	254
Conclusion.....	255

Introduction

If you and I make a deal that is intended to benefit another person, she has a right to enforce her interests under our agreement as a third party beneficiary.¹ If you and I make a deal that *harms* another person, that deal may be unenforceable – but not usually. Many contracts adversely affect others; few are prohibited. On its face, contract law appears unresponsive to some of the harm contracting parties can do to others by mutual agreement.

Our ability to harm others through contract is defensible, at least in part. In complex societies, much of what we do harms others. If we were never permitted to burden others in the pursuit of our interests, our range of free action would be severely constricted. Our entitlements have to mutually adjust. But the process of mutual adjustment that private law contemplates is inadequate when joint action negatively affects third parties. We rely too much on the blunt instrument of outlawing terms without attending to the effects of *enforceable* agreements.

This Article proposes an interpretive rule that would better protect third party losers in contract: Textual ambiguity should be resolved to avoid compromising the legally-recognized interests of third parties. Courts already do this in some contexts, as in the interpretation of merger agreements, as a result of preferring the most reasonable meaning of ambiguous terms.² This Article defends an interpretive rule that *expressly* considers third party interests, shows how the rule works, and argues for its more consistent application. It defends these theses by reference to the big picture, situating contract law within the broader set of legal rules designed to limit third party harm. The Article argues that, while public law regulates diffuse externalities, private law attends to concentrated externalities. The third party interests at issue in contract are among the concentrated externalities that contract law should mitigate. The proposed interpretive rule is an appropriate tool for that purpose.

One recent controversial case might have benefited from this rule: the suit by holdouts from Argentina’s 2005 and 2010 debt restructuring, *NML Capital, Ltd. v. Republic of Argentina*.³ Argentina defaulted on its debt in 2001, and most creditors eventually accepted new notes worth substantially less than their original notes.⁴ Holdout creditors refused to participate in either of the two debt

† Professor, Fordham University Law School. J.D. Yale Law School; M.Sc. Oxford University; A.B. Harvard College. The paper has benefited from comments by Caroline Gentile, Sean Griffith, Jens Ohlin, Urska Velikonja and participants in workshops at the University of Colorado Law School, Cornell Law School and the AALS Annual Meeting (Section on Jurisprudence).

1. See RESTATEMENT (SECOND) OF CONTRACTS § 304 (1979) (“A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.”).

2. See *infra* Part III.

3. 699 F.3d 246 (2d Cir. 2012).

4. Peter Eavis, *Argentine Debt Dispute Remains Murky Even as London Court Sheds Some Light*, N.Y. TIMES (Feb. 13, 2015), <http://dealbook.nytimes.com/2015/02/13/argentine-debt-dispute-remains-murky-even-as-london-court-sheds-some-light/>.

exchanges.⁵ Argentina proceeded to make payments on the new notes but not on the old notes.⁶ The holdouts then sued under a “*Pari Passu* Clause” that requires their claims be treated equally to those of other unsecured noteholders.⁷ As the Second Circuit observed, citing voluminous scholarly commentary, *Pari Passu* Clauses are ambiguous.⁸ The district court in *NML Capital* read the clause to prevent Argentina from making payments on the new debt without making payments on the original debt. The Second Circuit upheld the district court’s decision to enjoin payment on the new notes, concluding that the contract “manifested an intention to protect bondholders from more than just formal subordination.”⁹ The court read terms of the bond as if each bond were an agreement between *that* individual bondholder and the government of Argentina, notwithstanding the fact that numerous other bondholders had held identical contracts and now held other notes based on their rights under the initial bonds. Nowhere did the appellate court expressly consider the interests of the vast majority of creditors who had accepted cents on the dollars and now stood to lose more, let alone the broader swath of the public that had an interest in avoiding another default by Argentina.¹⁰ Since Argentina could not and cannot pay all creditors in full, it indeed defaulted a second time and has been shut out of international debt markets ever since.¹¹

Third parties are implicated across the full range of contracts. I discuss the case of merger agreements at length below.¹² In another common example, courts should (as some courts already do) read noncompete provisions in employment contracts as narrowly as possible since those provisions undermine not only diffuse consumer interests but also the more concentrated interests of rival firms.¹³

Other examples together demonstrate the breadth of application. Courts already protect the interests of third parties in land transactions by preferring clear allocation of property rights and disfavoring uncertainty about ownership

5. *Id.*

6. *Id.*

7. *See* 699 F.3d 246.

8. *Id.* at 258.

9. *Id.* at 258-59.

10. Today, sovereign debt contracts have a “collective action clause” that allows a super-majority of creditors to amend terms and bind dissenting bondholders. 699 F.3d at 253. In other words, issuers and creditors have found a way to get around the presumptively bilateral character of the bond agreement.

11. *See* Eavis, *supra* note 4.

12. *See infra* Part III.

13. *See, e.g.,* Arthur J. Gallagher & Co. v. Babcock, Nos. 08-290, 08-185, 2011 WL 121891, at *3 (E.D. La. Jan. 10, 2011) (“Louisiana restricts, and narrowly construes, non-competition agreements and similar types of restrictive covenants.”); Goodman Mfg. Co. v. Raytheon Co., No. 98 Civ. 2774 (LAP), 1999 WL 681382, at *7 (S.D.N.Y. Aug. 31, 1999) (“New York courts narrowly construe non-compete provisions.”); Mgmt. Recruiters of Boulder, Inc. v. Miller, 762 P.2d 763, 766 (Colo. App. Ct. 1988) (narrowly construing a non-compete agreement).

over time; that rule benefits future buyers as well as creditors.¹⁴ We should also expect courts reading construction contracts for residential developments to discourage practices and materials that produce latent defects—defects that will ultimately harm the people who live there. Courts should read supply agreements between manufacturers and retailers in ways that are compatible with the statutory employment rights of a supplier’s employees (for example, in terms of chemical exposure and delivery times). They should read subleases as consistent with a sublessor’s obligations to her landlord, and co-op purchase agreements as compatible with the co-op member’s obligations to the cooperative, at least where the subtenant and buyer are on notice of those constraints. Courts should construe patent licenses to preserve the value of other licenses granted by the patent-holder, where each licensee is on notice of other licenses, in the way that bankruptcy courts are sensitive to the effects of secured credit agreements on other creditors.¹⁵ Courts should interpret agreements with auditors and insurance companies to favor reporting and coverage adequate to protect the interests of end-users or future claimants. Courts should narrowly construe confidentiality provisions in settlement agreements where the information is relevant to the claims of future plaintiffs.

Further examples abound in the context of collective bargaining. The ban on secondary boycotts demonstrates a public policy protective of ‘bystander firms’ down the supply chain from firms involved in labor disputes.¹⁶ Collective bargaining agreements could be read to avoid accommodating labor action that involves the disputes of other employers. Given that current law allows for the permanent replacement of employees, collective bargaining settlements could be read to disfavor terms that disadvantage replacement employees, even where an alternative reading would not amount to an actionable unfair labor practice by the union.¹⁷ Civil rights statutes create legal interests in employees that may be

14. See Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 26-34 (2000) (arguing that fixed menu of property types, as opposed to infinitely varied rights determined by contract, reduces costs for third parties who are better able to ascertain status of entitlements).

15. For the claim that secured creditors generate negative externalities for other creditors, see Lucian A. Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1997); Lucian A. Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics*, 82 CORNELL L. REV. 1279 (1996); Steven L. Harris & Charles W. Mooney, Jr., *Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy*, 82 CORNELL L. REV. 1349 (1997). For a defense of priority for secured creditors, see Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807 (1998); Alan Schwartz, *Priority Contracts and Priority in Bankruptcy*, 82 CORNELL L. REV. 1396 (1997). The claim that secured creditors generate externalities for other creditors is most persuasive with respect to nonadjusting creditors. Although licensees negotiate the terms of their contract, the costs of drafting contracts that protect against later licenses that may undermine value in surprising ways is itself an externality.

16. National Labor Relations Act (NLRA) § 8(b)(4)(ii)(B), 29 U.S.C. § 158(b)(4)(ii)(B) (2012). My point here is not an endorsement of this rule in labor law but an elaboration of what should follow from it, under contract law.

17. *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 904 (1938) (permitting permanent replacement of striking employees).

constricted by arbitration terms in collective bargaining agreements. We already see that courts will avoid reading a collective bargaining agreement to forfeit judicial redress for discrimination except where the language waiving legal redress is express and unavoidable.¹⁸

Although courts sometimes engage in the angled interpretation proposed here, they do so inconsistently and rarely invoke an explicit rule. That is because third party losers now fall between various cracks in contract theory.¹⁹ An interpretative rule that protects their interests has not been adequately articulated or defended.

This might be surprising, since much of law is devoted to limiting the harms we impose on others. This is true of private and public law. This shared purpose has led some to question whether there is any meaningful distinction between public and private law, or whether the boundary instead reflects a foundational error by which we mistakenly inoculated some categories of conduct from public scrutiny.²⁰ The general principle that most laws protect us from injury by others has obscured important differences in the kinds of harms that motivate public and private law.

The ultimate aim of this Article is to defend a role for contract interpretation in attenuating negative externalities, but I will make that claim by way of a more general one about the division of labor between public and private law and what it tells us about the role of the common law of contracts. Public law tends to use *ex ante*, untailored rules, especially blanket prohibitions and fixed prices, to regulate diffuse harms to people whose identities are not knowable in advance. Private law relies on more flexible standards that operate *ex post* and allow textured balancing of a limited set of interests—where limited does not mean only two.²¹

We generally think of contracts, torts and property (and related areas like corporations or bankruptcy) as private law subjects but the laws regulating private exchange, tort-like conduct, and property entitlements actually span both public and private law. For example, the laws of employment discrimination²² and securities regulation²³ include some general rules subject to public

18. See *Wright v. Universal Mar. Serv. Corp.*, 525 U.S. 70 (1998) (holding that collective bargaining agreements must clearly and unavoidably waive right to litigate discrimination claim).

19. These are elaborated in Part I, *supra*.

20. The rise of skepticism about the public/private distinction is described in Daniel A. Farber & Philip P. Frickey, *In the Shadow of the Legislature: The Common Law in the Age of the New Public Law*, 89 MICH. L. REV. 875, 884–87 (1991); John Goldberg, *Pragmatism and Private Law*, 125 HARV. L. REV. 1640 (2012); and Duncan Kennedy, *The Stages of the Decline of the Public/Private Distinction*, 130 U. PA. L. REV. 1349 (1982).

21. See *infra* Part II.

22. See Michael Selmi, *Public vs. Private Enforcement of Civil Rights: The Case of Housing and Employment*, 45 UCLA L. REV. 1401 (1998).

23. See MARC I. STEINBERG, SECURITIES REGULATIONS: LIABILITIES AND REMEDIES §§ 9.02-.03 (2005) (identifying SEC rules for which there are implied private rights of action, and others for which there are not).

enforcement alongside private rights of action and related common law tort claims like breach of contract or fraud. Consumer²⁴ and employment²⁵ regulation require certain terms and prohibit others in consumer and employment agreements while general contract law governs enforceable agreements. Environmental regulations prohibit certain conduct and require other conduct by manufacturing firms, but tort and property regimes still based largely on common law dictate civil liability to individuals distinctly harmed by their production methods.²⁶ We cannot delineate the boundaries between public and private law by reference to the kinds of rights or conduct the law regulates. Both public and private law are enlisted to regulate conduct that affects others. We can meaningfully distinguish only between the *methods* deployed by public and private law.

Matching method to purpose, common law contract—that is, the private law part of contract regulation—is appropriately used to attenuate harms to third parties' legally protected interests. Although the rules of property and tort are more obviously enlisted to manage such externalities, contract law is also well-suited for limiting certain kinds of concentrated externalities, namely, those that arise from cooperative conduct between two parties. Scholars generally believe that only the boundaries of contract law reflect third party interests²⁷—boundaries largely set by public law regulation of particular classes of contract, such as consumer or employment agreements. But the rules by which contractual obligations are determined *within* the domain of contract also can and do take third parties into account. Where third party interests are reflected in background legal norms, courts interpret ambiguous agreements in ways that minimize harm

24. See Joseph Singer, *The Rule of Reason in Property Law*, 46 U.C. DAVIS L. REV. 1369, 1423 (2013) (“In addition to basic democratic norms, both statutes and common law evolved in the twentieth century to adopt a core principle of consumer protection.”); see also Paul Diller, *Combating Obesity with a Right to Nutrition*, 101 GEO. L.J. 969, 1005-07 (2013) (discussing interplay of statutory and common law consumer claims against fast food industry).

25. See Marion Crain & Pauline Kim, *A Holistic Approach to Teaching Work Law*, 58 ST. LOUIS U. L.J. 7, 7 (2013) (“Employment Law covers the statutes and common law governing individual rights at work, ranging from minimum standards legislation to judicially created doctrines based in tort and contract law.”); see also Rachel S. Arnow-Richman, *Employment as Transaction*, 39 SETON HALL L. REV. 447, 466 (2009).

26. See Peter Cane, *Using Tort Law to Enforce Environmental Regulations?*, 41 WASHBURN L.J. 427 (2002); Thomas O. McGarity, *Regulation and Litigation: Complementary Tools for Environmental Protection*, 30 COLUM. J. ENVTL. L. 371 (2005); Robert V. Percival, *Environmental Law in the Twenty-First Century*, 25 VA. ENVTL. L.J. 1, 10 (2007) (discussing common-law torts as part of environmental law).

27. See, e.g., Cynthia Estlund, *Something Old, Something New: Governing the Workplace by Contract Again*, 28 COMP. LAB. L. & POL’Y J. 351, 364 (2007) (“Public law sets boundaries on private ordering, for example, through ‘public policy’ limits on enforceability of contracts.”); Eric Liddick, *Give Me Freedom of Contract or Give Me Death: The Obscurity of Article 44(a) of the Louisiana Code of Civil Procedure*, 54 LOY. L. REV. 602, 604 (2008) (“The Supreme Court’s early formulation of this freedom’s boundaries remains equally germane to present day commercial transactions: parties may draft contracts according to their preferences so long as such actions do not conflict with public policy or express legislative limitations.”).

to those third parties.²⁸ This practice may be at odds with our formal theories of contract interpretation but it is consistent with the regulatory method of common law contract.²⁹

Part I situates the argument here against existing contract theory. Part II considers existing perspectives on public and private law and offers an improved account of their division of labor. Part II locates contract law within the broader “strategy” by which private law manages concentrated externalities. I propose that contract law can fulfill this function most effectively if we recognize an interpretive principle that allows courts to construe ambiguous terms in ways that protect third party losers. Part III studies the case of merger agreements and shows how courts already interpret those agreements to minimize concentrated externalities. I recommend that they do so consistently across the full range of contracts.

I. Third Parties In Existing Literature

Who are the third parties to contracts? Third parties are implicated by other people's contracts in a variety of ways. Almost every commercial contract is situated in a market in which other participants are third parties; the prices those parties pay in their own transactions will be affected by the terms of any one contract by others through the price mechanism of supply and demand. Third parties affected by a contract may also include others in a contractual relationship with one of the parties, such as suppliers or downstream buyers. Other relevant third parties may be those with a material interest in how a physical resource at issue in a contract is used, such as neighbors to a property being bought and sold by others. Third parties who willingly or inadvertently insure one of the parties to a contract, as the case of taxpayers in some industries, are also affected by its terms.

Of course, not all of these third parties are equally affected by the contracts of others. In some cases, the marginal effect of any single third party transaction is small; but in some of these cases, the cumulative effect is nevertheless substantial.³⁰ More importantly, there are numerous third party interests that are not legally protected. Famously, where a rival enters an advantageous contract with suppliers or consumers, business competitors may be adversely affected in economic terms, but without legal injury. In economic terms, externalities, or effects on third parties, include the full range of effects irrespective of legal significance. This Article is interested only in the effect of contracts on the

28. See *infra* Parts II (describing the rule) & III (describing the rule's application to merger agreements).

29. See *infra* Part II.

30. For example, Margaret Jane Radin has observed that copyright waivers by individuals en masse has the effect of undermining a publicly enacted scheme of user rights. See MARGARET JANE RADIN, *BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW* 168-70 (2013).

legally-protected interests of third parties.³¹ It does not set out to offer an account of why any kind of material interest should be protected. Instead, it offers an account of how we should protect those interests our legal institutions have already recognized.

One might doubt whether contract terms adversely affecting legally-recognized third party interests are enforceable in the first place. To the extent that a term is simply prohibited, there is no need to incorporate third party interests into interpretation, an exercise that arises only with respect to ambiguous terms in enforceable agreements. But law is limited as a tool, and two of its limitations are the legislative costs of designing well-tailored rules³² and the error costs of judicial decision-making.³³ The legislature undertakes to ban many classes of contracts with negative externalities, but defining these transaction categories in a way that is neither under- nor over-inclusive is so costly as to be unlikely. Judges are empowered to make these calls on a contract by contract basis through the doctrine prohibiting contracts “against public policy.” A loose construction of public policy, however, would make adjudication unpredictable and inconsistent. Instead, judges generally prohibit only classes of contract generally recognized as prohibited or at least as problematic in some way.³⁴ Their judicial restraint is well-advised, but together with legislative restraint, results in the enforceability of agreements that may adversely affect third parties.

If the law cannot fully protect them, might not adversely affected third parties themselves contract to protect their own interests? Of course, in some cases they do.³⁵ Even in these cases, we might have reason to be concerned about the distributional effect of their self-protection. But transaction costs also make it unlikely that they will self-protect. First, third parties to any single transaction are third parties to a near-infinite number of transactions. In many cases, the identities of those whose agreements may have an adverse effect are unknown. Like victims of potential negligent drivers, they cannot undertake to contract with all those who might do them harm. In those cases where a prospective third party has information adequate to propose protective terms to a would-be contractor, their relationship is likely to be unique; the absence of market norms or equilibrium prices increases the probability of bargaining failure. The upshot

31. See *infra* Part II.B for more discussion of the idea of a legally-protected interest.

32. See Matthew C. Stephenson, *The Price of Public Action: Constitutional Doctrine and the Judicial Manipulation of Legislative Enactment Costs*, 118 YALE L.J. 2, 12 (2008) (describing the costs of legislative enactment).

33. See Kurt T. Lash, *Originalism, Popular Sovereignty, and Reverse Stare Decisis*, 93 VA. L. REV. 1437, 1453-60 (2007) (discussing varieties of judicial error).

34. See G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 433, 452 (1993) (“[P]ublic policy defenses are limited to instances when ‘existing laws and legal precedents . . . demonstrate . . . a well defined and dominant policy’ against contract enforcement.”) (citing *United Paperworkers Int’l Union v. Misco, Inc.*, 484 U.S. 29, 44 (1987)).

35. For example, secured creditors contract to limit the ways in which future borrowing by the debtor may undermine secured creditors’ prospects for full recovery.

is that contracts adversely affecting third parties are not and cannot feasibly be banned completely; those third parties cannot always themselves contract to protect their material interests from joint action by others, and even when they can they will have to pay for it, which undermines the value of an existing legal entitlement. The internal rules of contract law, which govern enforceable agreements, are our best bet for mitigating negative externalities from contract.

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. The result is that, although everyone would acknowledge the legitimate interests of third parties, courts do not assign any formal and systematic role to those interests in the exercise of interpretation.

Philosophers of contract tend to take the dyadic (two-party) nature of private litigation, and of contracts in particular, to imply that only the rights and duties of litigants toward each other are relevant to resolving their dispute.³⁶ Public law is supposed to handle justice writ large. Contract law is private law, and contract interpretation is limited to deciphering party intent.³⁷ Contracting parties clearly lack authority to undermine the legal interests of others but those committed to the special moral logic of contract seem to assume that legal rules outside contract protect those interests, either by giving third parties a cause of action against one of the contracting parties or by rendering contracts that run afoul of third party interests unenforceable. As discussed further below, however, not all legal interests burdened by the contracts of others are associated with an independent cause of action or specific restrictions on contracting power.³⁸

For their part, legal economists are focused on externalities, or the costs that people impose on others. In principle, when the burden to others associated with my use of my property exceeds my gain, those harmed will pay me something to stop—something more than my use is worth to me but less than avoiding my use is worth to them. But economists anticipate that people may not negotiate the most efficient use of their entitlements where the costs of bargaining are high

36. See *infra* Part II.A.

37. See, e.g., Peter Benson, *Contract as a Transfer of Ownership*, 48 WM. & MARY L. REV. 1673, 1727 (2007) (asserting that what a contract has transferred is “decided by the parties’ intentions and interests as manifested in their mutual assents, reasonably interpreted, at contract formation”); Brian Langille & Arthur Ripstein, “Strictly Speaking – It Went without Saying”, 2 LEGAL THEORY 63 (1996) (arguing that contract gaps can be filled contextually without deviating from party intent); Seana Shiffrin, *Must I Mean What You Think I Should Have Said?*, 98 VA. L. REV. 159 (2012) (discussing the best interpretation of performance obligation based on what promisors most likely had in mind).

38. See *infra* Part II.B.

and, for this reason, legal rules are necessary to limit harms to others.³⁹ The outer bounds of contract are set to protect third parties.⁴⁰

But economists tend to regard contract law itself, including the rules of interpretation, as the law that governs only those bargains that were successfully made. Shortfalls in contract design are taken to reflect a rational trade-off between the costs of drafting a more complete contract and the risks that attend contractual gaps.⁴¹ Although the rules that govern contract should be forward-looking from an economic perspective, and take into account the effects on the contracting behavior of *future* parties, those rules do not usually reference the interests of third parties as they are affected by the contract at hand. Notwithstanding the breadth of interests incorporated into economic reasoning behind legal rules, legal economists take the rules themselves to direct judges to consider only the contractual intentions of those party to an agreement.⁴²

As a result of the role that each school assigns to contract law within the broader scheme of legal institutions, neither philosophers nor economists writing about contract have adequately accounted for third party interests in contract interpretation. The third party whose legally protected interests are injured through contract was not party to the successful bargain that a contract might otherwise represent. And given the costs of legislative process, her legal interest in a transaction may be too unique to justify invoking the machinery of public law on her behalf. Her injury is a private wrong even where it does give rise to an independent right of action against the contracting parties.⁴³ The prevailing map of contract's location within law is not fine-grained enough to account for her.

A better rendition of contract alongside other legal institutions suggests its proper role in protecting the legal interests of third parties within its domain. The simple interpretive norm recommended here flows naturally from the private law character of common law contract, properly understood: Private law limits *concentrated* externalities. Public law regulates *diffuse* externalities. This division of labor is elaborated in the next Part.

39. This is at least a way to characterize the insight that, where entitlements conflict and bargaining failure is high, "efficiency is promoted by assigning the legal right to the party who would buy" the entitlement in the absence of transaction costs. RICHARD POSNER, *ECONOMIC ANALYSIS OF THE LAW* 52 (1972). My characterization implies that a person harms another when the former uses her entitlement at the expense of the latter's even though the former attaches less value to her use. That is, if I disrupt your sleep in order to sing noisily, I harm you. But if I disrupt your sleep in order to put out a fire noisily, I do not harm you.

40. See MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* 58-61 (1993) (suggesting that negative externalities delineate limits to free contract).

41. See Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 *YALE L.J.* 848 (2010); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 *YALE L.J.* 814 (2006).

42. See Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 *YALE L.J.* 926 (2010) (advocating a formalist approach to interpretation).

43. See *infra* Part II.B.

II. Public and Private Law, or How We Limit Harm to Others

What is the distinction between public and private law? We lack a satisfactory account. Although legal scholars invoke these categories often, existing methods by which we carve up law either do not correspond to our usage of the public/private distinction, or they invest too little or too much in it. Still others regard the very distinction with suspicion.

This Part will discuss existing perspectives on the boundary between public and private law and then offer an alternative account that focuses on the scope of harm. The affirmative account begins in Section B with an overview of how we regulate externalities, highlighting the expansive concept of a legal interest. Section C introduces a distinction between concentrated and diffuse externalities. Section D proposes that public law is better suited for regulating diffuse externalities and is ill-suited to handle concentrated externalities; the latter task is usually and appropriately relegated to private law.

A. Epiphenomenal, Essential, Ideological

Economists have not systematically theorized the boundary between public and private law but they have offered a related analytic boundary between criminal and civil law.⁴⁴ Robert Cooter suggests that criminal law deters absolutely by subjecting criminal activity to a price that no one is expected to willingly pay.⁴⁵ Civil law prices conduct in order to force actors to internalize the costs of their own activity.⁴⁶ Thomas Ulen elaborates on this framework and observes that, among other differences, criminal wrongs “inflict costs on society beyond those imposed on any particular victims,” i.e., victims are “diffuse.”⁴⁷ In this last respect, the suggested economic boundary between criminal and civil law appears to resemble the one proposed in this Article between public and private law.

But the distinction between civil and criminal law does not map onto the private/public one. Statutory and administrative regulations of private activity often impose civil remedies or penalties but still qualify as public law. And even the civil/criminal distinction plays an inconsistent role in regulatory analyses, perhaps because so many regulatory schemes incorporate both civil and criminal elements without apparent regard for a clear division of labor; indeed, some scholars have decried this very tendency.⁴⁸

44. See Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523, 1538-51 (1984) (surveying price and sanction functions of tort, contract, criminal law, and regulation); Thomas Ulen, *The Economics of Corporate Criminal Liability*, 17 MANAGERIAL & DECISION ECON. 351 (1996).

45. Cooter, *supra* note 44, at 1549.

46. *Id.* at 1528.

47. Ulen, *supra* note 44, at 352.

48. See John Coffee, *Paradigms Lost: The Blurring of the Criminal and Civil Law Models — And What Can Be Done About It*, 101 YALE L.J. 1875 (1992) (disfavoring the “encroachment” of criminal law into fields that used to be regarded as civil).

Legal economists have not devoted much time to the categories of public and private law as such, and this may reflect the importance they attach to that distinction. In their view, the difference lies mostly in the method by which public policy is promoted; but the aims are basically the same, and the choice of method highly contingent.⁴⁹

The economic view of private law is at odds with some important features of private law. The two parties in a private law claim control almost everything about how that claim proceeds and its probability of success, starting with whether the claim is brought; they seem, and perceive themselves, to be more than simple agents of public policy. Moreover, legal reasoning is essential to the practice of law, and the reasons judges give for the resolution of tort, contract and property cases have to do with rights and duties that private individuals owe one another. Legal economic explanations of law do not seem to map onto either the internal structure or the language of law.⁵⁰ Legal economists regard the universe of considerations as open at all times—that is, welfare analysis neither prioritizes the interests of any set of persons in a given decision-moment, nor elevates any kind of interest over others. Legal economists distinguish between preferences held more or less intensely, or by many or fewer persons; but the source of utility is not relevant to their analyses. They do not have principled reasons for affording priority to certain interests in the context of a given procedure or decision, as for example, the interests of litigants in the settlement of their own dispute. To be sure, legal economics allows that the legal means appropriate to regulatory ends may vary. But it does not attach normative significance to regulatory method.

The result is that, however illuminating in other respects, legal economics is foundationally ill-suited to explain the distinction between public and private law; it does not take the difference seriously. Its broad outlook presumes the distinction is highly contingent. It treats the bilateral structure of private law, for example, as a peculiarity to be explained rather than as a fundamental feature of our legal system.⁵¹ Legal economists do distinguish pragmatically between

49. For a legal economic discussion of private law's structure, as distinct from other regulation, see STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 262-76 (1987). See also William Lucy, *Method and Fit: Two Problems for Contemporary Philosophies of Tort Law*, 52 MCGILL L.J. 605, 613 (2007) (describing criticisms of legal economic accounts of private law as excessively contingent or ad hoc); Nate Oman, *The Honor of Private Law*, 80 FORDHAM L. REV. 31, 35 (2011) (stating that law and economics "is hostile to divisions between private and public law, preferring to see the whole of the corpus juris through the lens of economic efficiency").

50. See STEPHEN A. SMITH, *CONTRACT THEORY* 14-24, 122-23, 132-34 (2004) (stating that economic explanations of contract law are at odds with the internal point of view and the reasoning of case law); see also JULES L. COLEMAN, *THE PRACTICE OF PRINCIPLE: IN DEFENCE OF A PRAGMATIST APPROACH TO LEGAL THEORY* 13-24 (2001); Benjamin C. Zipursky, *Pragmatic Conceptualism*, 6 LEGAL THEORY 457, 460-63 (2000) (arguing that economic analysis fails to account for bilateral structure of private law). But see Jody S. Kraus, *Transparency and Determinacy in Common Law Adjudication: A Philosophical Defense of Explanatory Economic Analysis*, 93 VA. L. REV. 287, 298-99 (2007) (arguing that economic analysis is consistent with the internal point of view).

51. See Jules L. Coleman, *The Structure of Tort Law*, 97 YALE L.J. 1233, 1248 (1988) (observing that in the tort context, economic analysis views the relationship between victim and tortfeasor

common law and statutory law—they are smitten with the apparent responsiveness of common law reasoning to the economic considerations they champion, in contrast with the erratic outputs of democracy.⁵² But this preference does not rest on any substantive distinction between private and public law. It reflects only a judgment about the quality of decision-making by various state institutions. As legal categories, the concepts of public and private are epiphenomenal.

Unlike legal economists, philosophers of private law take the distinction between public and private law very seriously. They emphasize the bilateral structure of private law—*i.e.*, that private law vindicates private rights held by private persons against one another.⁵³ Individuals do not file claims for compensation from the state (as they do in worker compensation schemes, for example). They instead address their claims against that private person who was responsible for their harm, and their claim is evaluated in the language of responsibility. The duties defendants are alleged to have breached run directly toward the plaintiff. And the remedy is paid directly from the defendant to the plaintiff.

Bilateralism is an important and defining feature of private law (or as I argue below, its method) but it does too much work in some private law accounts. As a distinctive feature, we must be able to account for it; but it need not be the essential feature around which our theories of private law revolve.⁵⁴ In the philosophical literature at present, bilateralism threatens to crowd out the interests and concerns of third parties, denying them any role in determining the rights and duties that two people hold against each other.⁵⁵

This narrow focus on parties to particular disputes follows from the natural law character of some private law theory.⁵⁶ In some views, people in a state of

as “tenuous and radically contingent”); Benjamin C. Zipursky, *Civil Recourse, Not Corrective Justice*, 91 GEO. L.J. 695, 702-09 (2003); *see also* Henry E. Smith & Thomas W. Merrill, 111 YALE L.J. 357 (2001) (describing the ad hoc character of legal economics explanations of property rules).

52. The foundational works on the efficiency of the common law are George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); and Paul H. Rubin, *Why Is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977). *See also* Nuno Garoupa & Carlos Gómez Ligüerre, *The Syndrome of the Efficiency of the Common Law*, 29 B.U. INT’L L.J. 287 (2011) (surveying the legal economic literature on the common law).

53. *See, e.g.*, COLEMAN, *supra* note 50, at 13-23; ERNEST J. WEINRIB, *THE IDEA OF PRIVATE LAW* 114-44 (1995); Benjamin C. Zipursky, *Substantive Standing, Civil Recourse, and Corrective Justice*, 39 FLA. ST. U.L. REV. 299, 304 (2011).

54. Jody Kraus has defended legal economists’ perspective on bilateralism as a second-best institutional arrangement. Jody Kraus, *supra* note 50, at 336-42 (2007).

55. *See* Aditi Bagchi, *Distributive Justice and Contract*, in PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW 197-202 (Klass, Letsas, & Sapra, eds., 2014) (describing and rejecting bilateralism as a reason for excluding considerations of distributive justice from contract regulation); Aditi Bagchi, *Parallel Contract*, 75 U. PITT. L. REV. 139 (2013) (describing the dyadic presumption in contract and its inadequacy in the face of parallel contracts).

56. *See, e.g.*, Nathan Oman, *Promise and Private Law*, 45 SUFFOLK U. L. REV. 935, 955 (2012) (summarizing civil recourse as: “When the social contract forming the state is made, we give to the state our natural right to enforce natural law, and in return the state provides us with a system of private law by which we can exercise our natural right to ‘seek reparation from him that has done’ us

nature have rights against each other that map onto the rights now protected by private law. The state steps in to prevent violence, or alternatively, to vindicate rights that could not be properly adjudicated outside of civil society. To the extent our present rights derive from “natural rights,” one might suppose they are unmediated by public norms and the public interest.

But this natural law cast is at odds with current understandings of the legitimate scope of state power, or even with the necessary mandate of a just state.⁵⁷ There is no reason to believe that rights recognized in positive law (like contract law) are merely derivative from those that might apply in a state of nature. The principles of justice that govern modern society may supply content not only to legal relations between the state and its citizens but also to relations between citizens.

Private law theorists do not expressly deny that the public interest and political values substantiate the bilateral moral relation of private parties, but they do not usually refer to those general values in their elaboration of private moral relations, except at the highest level of generality (as, for example, in the defensibility of a regime of private property).⁵⁸ In their picture of the relationship between private morality and private law, private law is usually called upon to accommodate or support private morality; the content of what is good and right between two people does not seem to turn on anything else happening in law.⁵⁹ Indeed, it is this tendency of private law theory to zoom too closely in upon the two adversaries in a contract dispute that explains the failure of formal theories of contract interpretation to adequately incorporate third party interests. By taking the system of adversarial adjudication of private rights as their starting point, philosophers of private law risk a rather insular picture of private law in which its goals and methods do not reference what is happening in other parts of the law.⁶⁰

wrong.”); see also Daniela Caruso, *Private Law and State-Making in the Age of Globalization*, 39 N.Y.U. J. INT’L L. & POL. 1, 60-62 (2006) (describing the natural law origins and persistent rhetoric of natural rights in private law).

57. See, e.g., JOHN RAWLS, *THE LAW OF PEOPLES* 49 (1999) (rejecting libertarianism).

58. See, e.g., Arthur Ripstein, *The Division of Responsibility and the Law of Tort*, 72 *FORDHAM L. REV.* 1811 (2004) (defending an autonomous private law that upholds resource allocations separately regulated by public principles of justice); Jules Coleman & Arthur Ripstein, *Mischief and Misfortune*, 41 *MCGILL L.J.* 91, 91-93 (1995) (contrasting corrective and distributive justice).

59. See, e.g., Jody Kraus, *The Correspondence of Contract and Promise*, 109 *COLUM. L. REV.* 1603 (2009) (arguing that contract law effectuates natural liberty interests in the promissory power); Daniel Markovits, *Contracts and Collaboration*, 113 *YALE L.J.* 1417 (2004) (describing the relational value of promises and contracts and how they are supported by contract law); Seana Shiffrin, *The Divergence of Contract and Promise*, 120 *HARV. L. REV.* 708 (2007) (arguing that too great a divergence between contract and promise undermines citizens’ ability to behave morally within promissory relationships).

60. For the strongest defense of the autonomy of private law, see WEINRIB, *supra* note 53, at 1, 5, 8, 13. For in-depth treatment of the interface between private law and public values, see Hanoch Dagan, *The Limited Autonomy of Private Law*, 56 *AM. J. COMP. L.* 809, 811-13 (2008).

Other scholars today deny altogether that there is any meaningful distinction between public and private law.⁶¹ They are right to be skeptical about the very ambition of line-drawing. No theoretical account of the distinction between public and private law maps onto our ordinary usage of the terms. For example, in everyday parlance we often refer to any kind of law regulating economic activity as private law, regardless of the method of regulation. That use of language is ideological: Its effect of classifying economic activity, like family life, as private is to shield presumptively even wrongful acts in those spheres from regulation. This Article does not subscribe to any such presumption and denies that the boundary between private and public law is best drawn by reference to the nature of the activity being governed. It might be the case that some kinds of individual and social activities tend to be regulated more heavily by methods associated with private or public law; there is nothing morally compulsory about the matching of method to subject matter and economic activity, in particular, may be regulated in both ways. One of the ambitions of this Article is to redeem the distinction between public and private law in a way that acknowledges an important and intuitive difference, and one that justifies our ongoing use of the terms, but avoids the misleading implications of current usage.

B. The State Mandate to Prevent Harm, and the Broad Concept of a Legal Interest

We can make a more useful distinction between public and private law than the ones now available by shifting away from a focus on the kinds of conduct that law regulates to the kinds of harm different regulatory methods are designed to prevent. Before matching method to purpose, it is helpful first to observe some of the common purposes served by legal intervention more broadly.

In liberal states, one of the primary motives for state action is the prevention of harm. Indeed, judges and scholars of liberalism sometimes invoke harm as the exclusive basis for regulating conduct (the “harm principle”).⁶² The capacity of a state to protect citizens from injury is among its *raison d'être*.

The injuries from which the state protects us are not limited to bodily injury; they include a range of material harms. The vast apparatuses of the criminal and tort regimes are devoted in part to protection of property. That commitment of state resources attests to a general consensus that material resources are important to the pursuit of individual life plans, and liberal states facilitate those

61. See *supra* note 20 and accompanying text.

62. JOHN STUART MILL, ON LIBERTY 13 (Stefan Collini ed., 1989) (“[T]he sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is . . . to prevent harm to others.”). For discussion of the harm principle in relation to law, see H.L.A. HART, LAW, LIBERTY, AND MORALITY (1963), which debates Lord Patrick Devlin on the propriety of enforcing moral norms; and *Lawrence v. Texas*, 539 U.S. 558, 578 (2003), which contrasts legitimate state regulation of harm with illegitimate regulation of non-harmful conduct.

plans by promoting stability and material independence.⁶³ Although the focus of liberal states on harm is associated with a hands-off form of government, this mandate authorizes intervention in numerous spheres of human activity, including areas we might be tempted to regard as “private.”

Private actions often result in harms to others, or negative externalities.⁶⁴ Not all externalities are legally cognizable harms. Most economic harm imposed on competitors in the course of business does not trigger legal redress. Free-standing economic losses not associated with any physical injury are not usually recoverable in tort due to the economic loss doctrine.⁶⁵ People are able to harm others in a variety of ways that do not generate a private right of action. Only when we burden a legally recognized entitlement does the law undertake either to deter us from imposing externalities on others or force compensation. When I refer throughout to “minimizing externalities,” I refer only to minimizing harm to a legal interest.

Although this discussion is limited to harms that implicate legally protected interests, it is not limited to harms that result from actual infringement of established property rights. The notion of a legally protected interest is more expansive. Although we might associate the concept of infringement with full-blown property rights, legal entitlements include interests protected by liability rules.⁶⁶ Property rules protect entitlements in the way that we ordinarily associate with property rights: transfer requires consent of the owner at a mutually agreed price. By contrast, an entitlement protected only by a liability rule allows nonconsensual transfer at a price fixed after the fact by a court in the form of damages.⁶⁷ For example, our legal interest in crossing the street safely gives rise only to a private right of action for damages in tort when a driver fails to exercise reasonable care. Likewise, breach of contract—or “taking” of a contractual entitlement—ordinarily gives rise only to a claim for expectation damages.⁶⁸ Some actions we might not ordinarily characterize as infringement of a legal interest nevertheless create a duty to compensate. The corresponding right to

63. JOHN RAWLS, *A THEORY OF JUSTICE* 93 (1971) (“[T]hrough men’s rational plans do have different final ends, they nevertheless all require for their execution certain primary goods, natural and social.”). Stability and material independence are primary goods that can be applied toward a range of conceptions of the good.

64. See Daniel B. Kelly, *Strategic Spillovers*, 111 COLUM. L. REV. 1641, 1642-44, 1649-51 (2011) (defining and discussing negative externalities).

65. See DAN B. DOBBS, *THE LAW OF TORTS* § 452, at 1282, 1285-87 (2000); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* 251 (1987).

66. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); see also Ian Ayres & J.M. Balkin, *Legal Entitlements as Auctions: Property Rules, Liability Rules, and Beyond*, 106 YALE L.J. 703 (1996); Louis Kaplow & Steven Shavell, *Property Rules versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713 (1996).

67. See Calabresi & Melamed, *supra* note 66, at 1106-10.

68. See IAN AYRES, *OPTIONAL LAW: THE STRUCTURE OF LEGAL ENTITLEMENTS* 12 (2005).

legal recourse reflects a legal interest.⁶⁹ Tortious conduct often merely undermines the utility or value of property without usurping dominion over the property per se. Breaches of contract infringe legal interests broadly conceived before there has been any transfer of a traditional property right.

Legal interests protected by liability rules are not to be taken lightly. The state might refuse to recognize a full-blown property right only because it anticipates that the cost of negotiating its transfer is excessively high, not because it does not deem the interest an important one. For example, we protect people from bodily injury that is the result of careless driving only through liability rules.⁷⁰ Although few interests are more sacrosanct than bodily integrity, protecting that legal interest with a property rule is not practical. It is not possible for car drivers to negotiate consensual transfer of their future victims' interest in bodily integrity. Protecting bodily integrity with a property rule would only serve to criminalize every car accident.

Where we expect compensation for infringement of a legal interest to be inadequate, as in most private suits, the state sometimes supplements one legal regime with another. For example, we supplement private securities litigation with public enforcement actions.⁷¹ The two-prong strategy reflects the distinct value of each regulatory method, not just the limitations of either.⁷² We would not be prepared to swallow the costs of overlapping regulatory methods were we satisfied with the level of deterrence achieved by either standing alone. Some types of securities fraud are criminalized, but there is a great deal of conduct that subjects one to civil liability without the risk of criminal prosecution.⁷³ Hybrid regimes reflect a commitment to increasing substantially the costs of producing externalities even where we are not prepared to criminalize or absolutely deter certain conduct.⁷⁴ They also reveal the overlapping purposes of quite varied enforcement regimes; a single legal interest may motivate a variety of institutional responses.

This institutional variety shows, in turn, that a legal interest may be manifest even where it is not backed by legal recourse—*i.e.*, even when there is

69. See generally Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917) (describing a variety of legal interests and their relation to legal recourse for others' failure to comply with legal duties).

70. See Calabresi & Melamed, *supra* note 66, at 1108.

71. See *supra* note 23 and accompanying text.

72. For the distinct value associated with private rights of action, see H. Miles Foy, III, *Some Reflections on Legislation, Adjudication, and Implied Private Actions in the State and Federal Courts*, 71 CORNELL L. REV. 501, 584-85 (1986); Donald H. Zeigler, *Rights Require Remedies: A New Approach to the Enforcement of Rights in the Federal Courts*, 38 HASTINGS L.J. 665, 678-79 (1987). For the distinct value associated with public rights of action, see Seth Davis, *Implied Public Rights of Action*, 114 COLUM. L. REV. 1, 25-28 (2014).

73. For discussion of public and private enforcement methods in the context of securities regulation, see Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301 (2008).

74. See Mary M. Cheh, *Constitutional Limits on Using Civil Remedies to Achieve Criminal Law Objectives: Understanding and Transcending the Criminal-Civil Law Distinction*, 42 HASTINGS L.J. 1325, 1346 (1991).

no liability rule protection. The concept of a legal interest is not limited to entitlements protected by either a property or liability rule. We should understand the state's mandate to regulate externalities to extend beyond entitlement protection because some commonly accepted methods of deterring externalities do not piggyback on anyone's legal entitlement. For example, taxes on certain harmful behaviors (e.g., smoking) may be intended to benefit either the general public or some group, but those beneficiaries have no legal entitlement in connection with the scheme. The notion of a legal interest is intended to capture material interests that manifest in some legal scheme even where that scheme does not take the form of a legal entitlement.

There is yet another reason we should include burdens on non-entitled legal interests even where those do not amount to legal entitlements in our concept of third party harms. Many legal rules intended to minimize externalities operate as second-best strategies. They reflect the limits of legal institutions. If underlying interests could manifest in entitlements, and those entitlements could be specified precisely at low cost, it would not be necessary to enact a "floating" regime to deter externalities. So, for example, if property rights detailed air quality rights in all space, no additional legislation regulating pollution would be necessary. Each person affected by the pollution could sue to uphold her property right in her little piece of air. Of course, such a method of regulating air quality is absurd: we can neither map our interest in decent air onto legal entitlements, nor could we coordinate millions of suits against a polluter for each trespass. The transaction costs of *ex ante* specification drive the need for a protective regime separate from the normal enforcement of property rights.

This second-best character of many legal rules implies that the boundaries of legal entitlements do not capture the scope of legally protected interests. For example, even if the business judgment rule protects directors from liability for certain kinds of decisions due to the costs of specifying duties and adjudicating their breach, shareholders have a legal interest in more robust deliberative practices.⁷⁵ The enforceable right validates and identifies a legal interest even if it does not perfectly protect it.

The upshot of the discussion so far is that the law does not attempt to insulate us from all harms posed by others. It regulates externalities in order to protect legal interests. Those legal interests extend beyond classic property rights and even other enforceable entitlements.

75. Delaware law "presumes that 'in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.' Those presumptions can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith. If that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders." *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

C. Concentrated and Diffuse Externalities

We can now distinguish between concentrated and diffuse externalities. We usually think of externalities as diffuse, *i.e.*, gains from private conduct are concentrated but their costs are borne by the public at large.⁷⁶ For example, a manufacturer that pollutes does so at private gain but the public at large bears the cost. Some externalities, however, are borne by a subset of the public. For example, if the manufacturer is not just dirty but also loud, only its neighbors will bear the cost of its noise pollution, not the public at large. The smaller the number of persons affected by some private action, the more concentrated the externality. Concentration is a continuous property not just because more or fewer people can be affected but because the proportion of the total externalities generated may be concentrated or diffuse. For example, even air pollution may have disproportionate effects on neighbors. The more disproportionately externalities fall on a small group, the more concentrated the externality.

We should distinguish concentrated and diffuse externalities on another dimension as well. Some externalities fall on persons that are identifiable *ex ante* (before the activity at issue is undertaken) while others are borne by individuals identifiable only after the externality has been generated. As the terminology is used here, an externality is more concentrated where losers are identifiable in advance.

There is no consistent, clear boundary between diffuse and concentrated externalities. Consumers of a mass product might be regarded as diffuse while consumers in a small market might be concentrated. Neighbors of a single plant might be regarded as concentrated while neighbors of all plants utilizing certain machinery might be regarded as diffuse. The aim here is to draw an analytic distinction that I will next map onto distinct regulatory strategies. Of course, an optimal regulatory strategy is no more clear-cut than the underlying features on which it turns.

D. The Basic Division of Labor

We have a variety of methods for dealing with externalities. Ideally, we induce private actors to internalize the costs of their own actions so that they do not “overproduce.” We often do this by way of public regulation. For example, we might impose a tax on conduct that produces externalities, as we do in the case of cigarette taxes. Or we can directly limit a group’s ability to act in harmful ways, as we do in the case of clean air regulations.⁷⁷

76. See NOLAN H. MILLER, NOTES ON MICROECONOMIC THEORY 212 (2006) (“Examples of externalities and public goods tend to overlap. It is hard to say what is an externality and what is a public good. This is as you would expect, since the two categories are really just different ways of talking about goods with non-private aspects.”).

77. For discussion of the complex array of regulatory instruments, and the interplay between tax and traditional liability and property rules, see Andrew Blair-Stanek, *Tax in the Cathedral: Property Rules, Liability Rules, and Tax*, 99 VA. L. REV. 1169 (2013) (arguing that the response to

Still another alternative is to induce people to internalize costs by structuring entitlements in private law just so. For example, through tort law we can make actors pay for the accidents they cause.⁷⁸ That is, we use the right of victims to seek redress for negligently inflicted bodily injury to prevent drivers from driving in a way that is good for them but bad for others. Where social harms are jointly produced, however, it is more costly to induce full internalization of costs in this way.⁷⁹ Although the basic contours of private entitlements are known to persons as they make choices, the precise boundaries of private entitlements are elaborated through the resolution of bilateral disputes.⁸⁰ This *ex post* method does not generate as much clarity as the *ex ante* pronouncements of regulatory standards conveyed by statute or administrative rules, but it allows flexible accommodation between interests that have a stake in a particular part of an entitlement's boundary. The resolution of each dispute adds clarity to those with similar entitlements, but duties in private law remain characteristically vague in comparison to those specified in public law.

Although both public and private law methods of mitigating externalities involve legal rules that are to some extent specified *ex ante*, the enforcement costs of regulation are borne *ex ante* in the case of public regulation and *ex post* in the case of private adjudication. Legislative and administrative action is required to set up any public regulatory scheme. That requires political mobilization by representatives of the adversely affected private groups;⁸¹ successful political bargaining;⁸² allocation of resources to the enforcement

violations of requirements of a tax status may take the form of either property or liability rules); and Mitchell Polinsky, *Controlling Externalities and Protecting Entitlements: Property Right, Liability Rule, and Tax-Subsidy Approaches*, 8 J. LEGAL STUD. 1 (1979) (comparing merits of tax-subsidy approach to those of liability and property rules in limiting externalities).

78. Under a negligence rule, we make people pay for only those accidents that they cause negligently—*i.e.*, only wrongdoers are tortfeasors. A strict liability rule would make people pay more broadly for all the losses they cause, under some socially constructed rules of causation. Cf. GUIDO CALABRESI, *THE COSTS OF ACCIDENTS* (1970) (advocating a tort system that requires tortfeasors to pay all costs of accidents that they cause).

79. See Ellen Bublick, *Comparative Fault to the Limits*, 56 VAND. L. REV. 977 (2003) (describing normative principles that limit comparative fault doctrines).

80. Cf. Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 301-02 (1986) (“An entitlements theory demands that the boundaries of protected domains be ascertainable, not only by judges who must resolve disputes that have arisen, but, perhaps more importantly, by the affected persons themselves before any dispute occurs.”). Although most observers would agree that it is preferable to have clear boundaries set in advance of disputes, those disputes presumably arise because boundaries are in fact not well-delineated and, in these cases, can be settled only through litigation.

81. See, e.g., BRUCE A. ACKERMAN & T. WILLIAM HASSLER, *CLEAN COAL/DIRTY AIR: OR HOW THE CLEAN AIR ACT BECAME A MULTIBILLION-DOLLAR BAIL-OUT FOR HIGH-SULFUR COAL PRODUCERS AND WHAT SHOULD BE DONE ABOUT IT* (1981) (describing mobilization of coal producers and their impact on the implementation of the Clean Air Act); ROBERT KATZMANN, *INSTITUTIONAL DISABILITY: THE SAGA OF TRANSPORTATION POLICY FOR THE DISABLED 150-151* (1986) (describing mobilization of interest groups representing disabled persons and their effect on the regulation of transportation).

82. See MAXWELL L. STEARNS & TODD J. ZYWICKI, *PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW* 112 (2009) (describing the public choice account of legislative bargaining); David Baron & John Ferejohn, *Bargaining in Legislatures*, 83 AM. POL. SCI. REV. 1181 (1989) (presenting a now-standard bargaining model); see also Steven P. Croley, *Theories of Regulation: Interpreting the*

regime;⁸³ gathering of technical expertise and drafting of appropriate regulations.⁸⁴ By contrast, especially in common law systems, private law entitlements that cause parties to internalize the costs of their own conduct are developed through case law. There are few enforcement costs specific to any one sort of externality; costs are absorbed into the judicial system as a whole. Although precedent establishes legal rules of which parties are on notice prior to engaging in conduct, the prospective wrongdoer does not know exactly how much he will have to hand over until after the fact—after the injured party sues and the matter is resolved by court order or settlement.⁸⁵

These differences make public law regulation of particular externalities more costly, on the margin, than private law methods. But implicit regulation through the structure of entitlements generates costs of its own. The fluid, multi-sourced process of case resolution creates inconsistent rules and results. Vague entitlements render liability unpredictable.⁸⁶ In the best case scenario, non-overlapping jurisdiction means courts work out answers to the same questions redundantly.

Public law and private law regulation are thus associated with different kinds of costs. The costs of private law regulation are especially problematic with respect to diffuse externalities while the costs of public law regulation are especially high with respect to concentrated externalities.

The private law method of regulation is inapt for many kinds of diffuse externalities. Practically, where the harm to any single actor is nominal, she lacks incentive to bring suit.⁸⁷ Contingent fee and class action arrangements go some way toward motivating private actors to bear the risks and costs associated with mass litigation, but our system of adversarial adjudication makes it difficult to resolve matters that concern multiple parties at once.⁸⁸ Strict requirements for standing and robust norms of due process make it difficult to impose any final

Administrative Process, 98 COLUM. L. REV. 1, 34-35 (1998) (noting that public choice theory characterizes the regulatory process as a series of “regulatory trades” among “organized subgroups of the citizenry”).

83. See STEPHEN HOLMES & CASS R. SUNSTEIN, *THE COST OF RIGHTS: WHY LIBERTY DEPENDS ON TAXES* (1999) (arguing that enforcement regimes are ineffective without allocation of adequate resources to them).

84. See, e.g., Mark A. Cohen & Paul H. Rubin, *Private Enforcement of Public Policy*, 3 YALE J. ON REG. 167, 187 (1985) (describing the “enormous volume of technical and economic data” required in auto safety regulations).

85. See MITCHEL POLINSKY, *AN INTRODUCTION TO LAW & ECONOMICS* 39-52, 67-74 (2d ed. 1989).

86. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992) (describing various advantages of respective types of legal rules); Thomas Merrill, *Trespass, Nuisance, and the Costs of Determining Property Rights*, 14 J. LEGAL STUD. 13, 24 (1985); Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988) (discussing the effect of vagueness in property entitlements); Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379 (1985).

87. See POSNER, *supra* note 39, at 349-50; Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 111 (2006).

88. See William B. Rubenstein, *A Transactional Model of Adjudication*, 89 GEO. L.J. 371, 418-32 (2001) (describing the nonadversarial character of class action settlements).

judgment on parties without their affirmative consent or participation.⁸⁹ These barriers to binding adjudication on a mass scale mean that unless individual litigants win punitive damages (always a speculative prospect), they are not motivated to litigate most diffuse externalities.⁹⁰

The ad hoc quality of private law adjudication is also especially problematic for diffuse externalities. If the essential trade-off is between flexibility and consistency, private law adjudication's virtue of organic law-making in response to particular facts of developed cases is also its major vice. Judges with limited jurisdiction crafting narrow ex post responses to diffuse externalities are not trying to optimize the allocation of social resources so much as they are trying to restore fairness as between the few litigants before the court. They will take into account details that are important to the equities of a case but may not be so important to the systemic resolution of a social problem.⁹¹ Most importantly, judges will make these calls differently, with the result that a single defendant will be subject to different rules (or different prices for behavior that generates comparable social costs) and similarly situated plaintiffs will be differently compensated. The flexibility of this mode of regulation is a good fit for concentrated externalities, each of which comes with its own rich fact pattern and litigants eager to distinguish themselves from their predecessors and neighbors. But it makes for ad hoc regulation of behaviors that affect many people similarly and simultaneously.

The limited competence of judges gives rise to still another problem with regulating diffuse externalities through the ex post boundary-drawing and price setting of private adjudication. Judges can only offer remedies. These remedies may have the effect of structuring entitlements; they make it possible for individuals to pursue some uses without fear of liability and make it possible for others to pursue recourse for injury. But they can only indirectly require affirmative acts. Positive injunctions are few and far between precisely because they invoke a state power not normally allowed the judicial branch.⁹² Courts are

89. See Howard M. Erichson & Benjamin C. Zipursky, *Consent Versus Closure*, 96 CORNELL L. REV. 265, 267 (2011) (“[C]losure collides with consent”); Alexandra Lahav, *Symmetry and Class Action Litigation*, 60 UCLA L. REV. 1494, 1520 (2013) (“Participation is mostly not available in class actions”); Richard Nagareda, *Embedded Aggregation in Civil Litigation*, 95 CORNELL L. REV. 1105, 1148, 1157 (2010) (arguing that class action litigation alone does not solve problems of consent and closure).

90. See *supra* note 87 and accompanying text.

91. The influence of legal realism has made us comfortable with courts' responsiveness to the particular facts of individual cases, as well as their implicit invocation of larger trends in social values. See Brian Leiter, *Rethinking Legal Realism: Toward a Naturalized Jurisprudence*, 76 TEX. L. REV. 267, 275-76 (1997) (discussing how legal realism holds that judges respond to facts of cases and broad policy objectives). But there is a tension between these commitments. The facts of a case speak to the equities between the parties that may not resonate with broader policy goals. *But see* Hanoach Dagan, *The Realist Conception of Law*, 57 U. TORONTO L.J. 607, 649-51 (2007) (attempting to reconcile engagement with facts and extralegal norms).

92. See Amy Sinden, *In Defense of Absolutes: Combating the Politics of Power in Environmental Law*, 90 IOWA L. REV. 1405, 1443-44 (2005) (describing courts' reluctance to issue affirmative injunctions).

not in the business of crafting solutions to social problems but rather of controlling damage after the fact.⁹³ Large regulatory questions call for large coordinated policy responses and courts cannot deliver those without overstepping their institutional role. Even elected judges were not elected with the mandate to make value-laden large-scale policy choices; their separate powers are limited to resolving cases and controversies (as embodied in the standing requirement).⁹⁴

Just as private law adjudication is ill-suited for regulating diffuse externalities, public law is not usually a promising method of managing concentrated externalities. As noted above, the usual public law responses to externalities are costly because they require *ex ante* state action, usually by the legislative or executive (administrative) branches. Although diffuse externalities raise a host of their own public choice problems, concentrated externalities pose special problems of governance. Concentrated externalities may be first, unlikely to trigger public response; second, difficult to mitigate by general policy; and third, optimistically relegated to markets for correction.

First, there is unlikely to be sufficient political will to solve a problem of concentrated externalities that fall on weak or disorganized parties. The logic of collective action identified by Mancur Olsen might be read to suggest otherwise—concentrated interests are more likely to be organized and less likely to suffer from collective action problems, and therefore well-positioned to exact more than their fair share of attention from political processes.⁹⁵ Congressional activity indeed reflects remarkable solicitude for well-organized and *well-funded* interests, however concentrated.⁹⁶ But these Congressional interventions represent only the pinnacle of state attention. The prospects for organized pressure on behalf of a public law solution depend on the cohesion and clout of the particular group that bears a concentrated externality.

Most concentrated externalities are not borne by people with the resources to extract a legislative solution to their problems. No matter how extensively legislative and administrative activity is distorted by imperfect public decision-making processes, it is the high proportion of resources devoted to solving the

93. See *Brown v. Plata*, 131 S. Ct. 1910, 1954 (2011) (Scalia, J., dissenting) (criticizing the use of structural injunctions because a judge “will inevitably be required to make very broad empirical predictions necessarily based in large part upon policy views.”); ROSS SANDLER & DAVID SCHOENBROD, *DEMOCRACY BY DECREE* (2003) (arguing that injunctions intended to further public policy have not been effective); Alan Chen, *Rights Lawyer Essentialism and the Next Generation of Rights Critics*, 111 MICH. L. REV. 903, 919 (2013) (“Class actions and structural injunctions cannot be sufficiently tailored to produce balanced, context-sensitive solutions to the complex and entrenched nature of the underlying causes of major social problems.”); *But see* OWEN FISS, *THE CIVIL RIGHTS INJUNCTION* (1978) (defending the role of structural injunctions in effectuating constitutional values).

94. See *Sierra Club v. Morton*, 405 U.S. 727, 731-32 (1972).

95. See generally MANCUR OLSEN, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1971).

96. See T. FERGUSON, *GOLDEN RULE: THE INVESTMENT THEORY OF PARTY COMPETITION AND THE LOGIC OF MONEY-DRIVEN POLITICAL SYSTEMS* (1995); W. GREIDER, *SECRETS OF THE TEMPLE* (1989); Richard L. Hall & Frank W. Wayman, *Buying Time: Moneyed Interests and the Mobilization of Bias in Congressional Committees*, 84 AM. POL. SCI. REV. 797 (1990).

problems of a few *relative to their proportion of the population* that is shocking. In absolute terms, most legislative and executive action is still devoted to advancing the public interest broadly construed. Although concentrated interests are better positioned to overcome some hurdles to collective action, the majority lack resources even to seek out legislative or administrative action. Nor do legislative committees and administrative agencies seek them out. Subcommittees and agencies devote their limited resources to investigating and policing the high-profile externalities that motivate their founding. Their priority is understandably to address diffuse harms to the public, not localized discontents.⁹⁷

A second related reason should lead us to expect that public regulation will consistently overlook concentrated externalities: Concentrated externalities are more expensive to regulate by public law than diffuse externalities.⁹⁸ Generality of harm generates regulatory economies of scale. It is more effective to allocate a quantum of regulatory effort for a single problem of overproduction that affects many people than for hundreds of situations that collectively affect a comparable number of people. Although expertise may carry over from one localized problem to another, each concentrated externality comes with its own facts and micro-economy. The cost of developing a tailored regime for each situation is prohibitively high. While courts do something like this through adjudication, the same focused nature of the judicial inquiry that limits the range of tools available to them also renders fact-specific response feasible. As noted above, policymakers expend their resources to solve the problems of small numbers only when the political process is not operating properly.

Concentrated externalities are more expensive to regulate through public law but characterization of an externality as concentrated presumes a particular framing of the problem.⁹⁹ We observed that the line between concentrated and diffuse externalities is vague and depends on definition. Even where the losers from particular decisions, such as the decision of a particular manufacturer to operate a loud machine at night, are concentrated, the type of behavior may be so pervasive that victims from the practice are diffuse. If a few people are bothered by one loud machine, it may be prohibitively expensive to create a

97. For an analysis of the ways in and reasons for which legislatures are responsive to diffuse interests, see DOUGLAS ARNOLD, *THE LOGIC OF CONGRESSIONAL ACTION* (1990); Michael Bailey, *Quiet Influence: The Representation of Diffuse Interests on Trade Policy, 1983-94*, 26 *LEGAL STUD. Q.* 45, 47-50 (2001); and James Stimson, Michael Mackuen & Robert Erikson, *Dynamic Representation*, 89 *AM. POL. SCI. REV.* 543 (1995).

98. I refer to the state costs of regulation rather than the private costs that may result from regulation. However, these costs are related in that the more cheaply and ineptly public rules are designed, the higher the privately-borne costs of regulation.

99. One might compare the difficulties of characterizing third parties as diffuse or concentrated to the problem of defining a market in merger regulation. See James S. Venit, *The Evaluation of Concentrations Under Regulation 4064/89: The Nature of the Beast*, in *INTERNATIONAL MERGERS AND JOINT VENTURES 213* (Barry E. Hawk ed., 1991) (suggesting that vagueness in market definition standards is an important flaw in regulatory analysis). Although a substantial decision in itself, it does not undermine the utility or propriety of that preliminary step in the relevant analysis.

regulatory framework for the isolated noise-maker; and then the next nuisance, and the one after that. But if many people are affected by the industrial practice of using a type of machinery, public regulation can regulate the machinery. Whether a public law response is feasible depends then on whether the circumstantial facts that differentiate particular losers from each other are important to calibrating a state response.

To continue with the example of loud machinery, policymakers might create a regulation that limits noise, fine in proportion to noise, tax the production associated with the noise or—going the private law route—create a tort right for some people affected by the nuisance. A general noise regulation, a fine, or tax all must be promulgated at a high level of generality and applied uniformly to situations that will invariably differ in some respects. When the differences are important to the price the polluter should pay or the compensation to which the loser is entitled, private adjudication is the only way to process those facts and adjust price and remedy accordingly. My initial definition of concentrated externalities as ones that are borne by a few people usually identifiable in advance assumes a high degree of uniformity within the group, just as a diffuse externality is presumed to be one that is largely the same for all those who bear it.

Once a call is made about the significance of variation, we can say those externalities which are deemed relatively homogenous among a concentrated group but disparate as between groups are more expensive to regulate through public law. Those harms are less conducive to a general conduct standard or ex ante pricing (perhaps the noise level should vary depending on location or pitch) and the particular identity of those on whom harm is inflicted may be relevant to its magnitude. In these cases, it would be expensive to devise a highly tailored public regulation that governs behavior ex ante. There are hybrid possibilities: in some cases policymakers can at fairly low cost mitigate some externalities of private behavior through a clear standard (*e.g.*, a speed limit) but can only with difficulty craft standards to govern externalities (*e.g.*, from negligent driving) at the margin.

The final reason we can expect a muted public response to concentrated externalities is that policymakers (and especially legal scholars) are inclined to think that the market will resolve concentrated externalities without intervention. Absent transaction costs, Coasian bargaining would achieve optimal allocation of resources and the distinction between diffuse and concentrated externalities would be irrelevant.¹⁰⁰ Taking those costs into account, since bargaining costs are lower where a limited number of private actors are implicated by the conduct at issue, we might expect those adversely affected by conduct to pay the right person to stop it, at least where externalities are concentrated. Unfortunately, our optimism should be tempered by the probability of bargaining failure in

100. See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 8 (1960); see also GEORGE J. STIGLER, *THE THEORY OF PRICE* 113 (3d ed. 1966).

situations of bilateral monopoly and the limits of contract enforcement.¹⁰¹ It will be costly for adversely affected parties to contract for protection against concentrated externalities and, should they manage contract, the high costs of policing opportunism may render it difficult to enforce any rights they obtain.¹⁰² These transaction costs may not be highly visible to regulators, however, who rationally direct their resources to diffuse externalities for which the prospects of Coasian bargaining are even dimmer.

Those are three reasons (of admittedly mixed realist and functional quality) why public law is an inadequate means for regulating externalities, especially concentrated externalities. Together with the systemic inadequacy of private law to handle diffuse externalities, we have the foundations for a rough division of labor. Where private actions burden legal interests of a large number of anonymous people, we can expect a public regulatory response. Where private actions illegitimately transfer costs to a select and identifiable few, those burdened few are expected to seek recourse through private litigation.

III. Minimizing Concentrated Externalities in Private Law

Public law responds to externalities by taxing (including fines and fees) and by directly policing conduct. Private law induces optimal conduct differently. Conduct that impinges on legally protected interests may result in liability but the amount of liability is not just a function of the conduct and its type, as is normally the case in public law. Instead, the amount of liability turns on wrongful injury to a particular private person, and the amount of damages will reflect facts about the plaintiff and the peculiarities of her situation.¹⁰³ In other words, consequences in public law depend on what you do. By contrast, consequences in private law depend in part on the person whom you harm.

As in public law, the triggering act need not amount to a full-fledged moral wrong. But it must invade someone's protected interest, and—unlike in public law—*she* decides whether to initiate legal action. The plaintiff bears the burden of showing that a duty was breached and (usually) that it resulted in quantifiable damages.¹⁰⁴ The court formally adjudicates that claim as if only the interests of the given plaintiff and defendant are at stake.

101. Bilateral monopoly is present where there is a single seller and single buyer who must reach agreement with each other. It applies where a prospective generator of externalities must agree on the price of forbearance with the unique individual that would be harmed by her activity. See THOMAS MICELI, *ECONOMICS OF THE LAW* 138 (1997) (describing bilateral monopoly).

102. See Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356, 356-61 (1980) (stating that high information costs and monitoring costs make it impossible to negotiate or enforce complete contracts).

103. See Benjamin Zipursky, Palsgraf, *Punitive Damages, and Preemption*, 125 HARV. L. REV. 1757, 1780 (2012) ("[L]iability is rooted in a particular injuring of the plaintiff [and] that injury itself provides an anchor for the determination of the magnitude of deprivation the defendant may face").

104. In tort, plaintiffs must establish the existence of a duty to her from the defendant and show that its breach caused her damages. Similarly, in contract, plaintiff must establish a contractual obligation and show that its breach caused her damages. Plaintiffs bear the burden of establishing these

The pairing of wrongdoer with victim, or plaintiff with defendant, in private litigation is known as its bilateral structure. As discussed above, the outsized role of plaintiffs in private law has led some theorists to conclude that the bilateral structure of private law is not just defining but essential.¹⁰⁵ But though the plaintiff exercises substantial control over the fact and quantum of liability, neither her agency nor her interests are entirely controlling. Whether legislatures and courts recognize a private right of action and the amounts they allow a plaintiff to recover do not reflect any inherent rights she bears as a person or property-holder. The nature of her legal recourse turns instead on how we choose to balance the interests of persons similarly situated against others who are limited by the boundaries of their legal rights. Where the burdens associated with a defendant's actions are concentrated on a few, it might make sense to allow only them (or only one person) to pursue a legal claim. But that legal claim is shaped by the interests of others even when it is litigated in an adversarial dispute between two parties.

One might worry that characterizing private law in this way implies that the litigants are being used to pursue social ends.¹⁰⁶ To the contrary, litigants are using the courts. But courts open their doors with the aim of vindicating a system of rights and responsibilities, not only the rights of the particular few who appear before them. Although the court must decide the merits of a given legal claim by reference to the rights of the litigants, their very (costly) presence in court suggests that those rights have been inadequately specified to date and the way in which the court substantiates them in that instance will be informed by the interests of others. The court allocates losses between two parties with an eye to the entitlements that this immediate allocation implies for the many others not party to the dispute.

As Coase famously observed, the allocation of private entitlements would have only distributional consequences if individuals could resort to them effectively through bargaining.¹⁰⁷ Those distributional consequences are important. But entitlements are not resorted optimally, in any event. The cost of identifying partners for trade and agreeing upon terms is prohibitive. Transaction costs make it necessary to structure entitlements deliberately in a way calculated to minimize negative externalities. The broad default sweep of property rights creates conditions under which individuals have the capacity to create externalities. Those rights are then tempered by offsetting rights in others. The "corrective rights" are protected by liability rules, which can be understood to

elements of their claims by the "preponderance of the evidence." See *Jones v. All Am. Life Ins. Co.*, 325 S.E.2d 237, 241 (N.C. 1985) ("[T]he standard of proof applicable to ordinary civil actions. . . is proof by the preponderance of the evidence"); MCCORMICK ON EVIDENCE § 339 (John William Strong et al. eds., 4th ed. 1992) (stating that the plaintiff's burden of proof in civil cases is generally by preponderance of evidence).

105. See *supra* note 53.

106. See WEINRIB, *supra* note 53, at 40-42 (deploring the use of private law to pursue public policy objectives).

107. See Coase, *supra* note 100.

guard against concentrated externalities, including but not limited to those borne by plaintiffs.

Consider two examples of this dynamic. First, two neighbors with potentially conflicting uses determine whose use will prevail, or who will bear the cost of rendering them compatible. One has a dog that barks continuously. The other has a baby that sleeps a lot. The basic allocation of property rights makes it possible that these two persons will own and use property side-by-side and does not resolve whether the dog-owner may keep a dog that barks as much as it does. A public noise regulation might specify the permitted decibel level. But it might take a nuisance suit to decide the boundaries between the neighbors' property rights. Two aspects of the latter method of specifying entitlements are worth noting. First, adjudication would be more fine-grained than a blanket rule on permissible decibels. Adversarial adjudication could differentiate, for example, between a dog, a rooster or a colicky baby as sources of sound, deeming one more acceptable than another. Second, private law adjudication would decide the immediate question of whether one of the neighbors could continue in a given use but it would also take into account facts about the society in which the neighbors are situated, including its relative valuation of various land uses. Only the noise concerns of the upset neighbor would be on trial but the interests of others in making and avoiding that noise (and similar noise) would be taken into account in deciding the rights of the two neighbors as against one another.

Consider next an employment agreement that prohibits the employee from working for a rival firm within a five mile radius of the employer's firm for five years after the employment relationship ends (a noncompete provision). The very reason for leaving such a condition of employment to the private agreement of the parties, rather than specifying them by regulation or statute, is that the parties may arrive at a better rule for themselves—more informed by their particular facts—than would a third party regulator. But their agreement may be ambiguous about which firms qualify as competitors of the employer, and it may be unclear whether the restriction applies where the employer has terminated the employee without cause. How a court interprets this agreement may be driven primarily by the customary questions centered on party intent. But it may also take into account third party interests, including the interests of consumers and rival firms in a free labor market. The *ex post* and limited nature of the inquiry makes it possible for courts to take into account a rich set of facts in interpreting the restrictive term, and the interests of third party losers may cut in favor of a narrow reading. Notably, courts frequently strike down noncompete clauses as inconsistent with public policy.¹⁰⁸ The relevant public policy interests do not disappear when those clauses are enforceable; though the dispute is bilateral, third party interests should inform the contract's interpretation.

108. See Kyle B. Sill, *Drafting Effective Noncompete Clauses and Other Restrictive Clauses: Considerations Across the United States*, 14 FLA. COASTAL L. REV. 365 (2013) (surveying the enforceability of noncompete provisions in multiple states).

The first example above (in tort) is less controvertible than the second (in contract); the aim of this Article is to extend the logic that explains the first to the second. I argued above that the line between diffuse and concentrated externalities—indeed, even the porous nature of that divide—corresponds to the kinds of harms we expect to be handled by public and private law, respectively. While we tend to regulate diffuse externalities by way of tax and mandatory standards, we regulate concentrated externalities by the contours of private entitlements. Ex ante rules that are deliberately designed to police particular classes of externalities are more cost-effective with respect to diffuse externalities while structured entitlements that we enforce largely through ex post remedial measures are usually the most effective way to limit concentrated externalities.

This way of thinking about externalities helps highlight one obvious respect in which private law rights and duties are “private.” The more localized and specific the harm from a private action, the more likely that we recognize a private right against that harm. We should not expect the public and private distinction to turn on the activity at issue.¹⁰⁹ Since some actions produce concentrated and diffuse social harm, the same activity (e.g., driving) may be regulated by public and private law. Since some externalities are not easily classified as diffuse or concentrated, it is not surprising that there is no sharp line between public and private law in practice, even where a useful analytic and institutional distinction is to be made.

The private law theory literature tends to treat the institutional fact of bilateralism (*i.e.*, remedies available to private individuals against each other) as the essential feature of private law.¹¹⁰ It is certainly a defining feature in that we can usefully identify private law as that which is subject to private adjudication. But however important this may be as a feature to be explained, it is unsatisfactory as an account of why certain rights end up operationalized in this fashion. Even if vindicating rights in this manner effectuates certain values associated with private recourse and private accountability, why do some antisocial behaviors end up generating private rights of action while others are regulated directly? Although myriad considerations speak to the optimal legal form of any public objective, the scope of harm is a natural focus when we think about the substantive distinction between public and private breaches. Thinking about how the optimal policy response to externalities depends on their degree of diffusion helps make sense of the contrasting regulatory methods of direct regulation, on the one hand, and privately justiciable rights, on the other. It also helps makes sense of the private rights of action established in some regulatory

109. Cf. Alon Harel, *Public and Private Law*, in OXFORD HANDBOOK OF CRIMINAL LAW 1040, 1043 (Markus D. Dubber & Tatjana Hörnle eds., 2015) (“The discourse concerning public and private law requires first classifying a certain entity or a certain activity as ‘private’ or as ‘public’ and then it requires drawing normative consequences from this classification.”).

110. See *supra* note 53 and accompanying text.

statutes.¹¹¹ We might expect the quality of public enforcement of a statute to turn on the extent of diffuse externalities. But where policymakers perceive the concentrated externalities to be high in proportion to the diffuse externalities, it may be appropriate to supplement public enforcement with a private enforcement regime. On this view, a private attorney general is not just a substitute for public enforcement: her role is different and targets a separate class of private harms even where the same conduct triggers public and private liability.

Most of the literature on externalities in private law concerns how tort and property rules can be used to reduce externalities. And indeed it is especially intuitive how those regimes operate to induce parties to internalize the social costs of their activity. Property rights are the basis for liability and often that liability turns on the value of the property. Including particular entitlements within the basic sets of rights that come with real property, for example, has the effect of exposing the property holder to liability in rough proportion to its value. Tort law is conceived by many contemporary legal economists as little more than a mechanism by which private individuals are induced to invest in precautions against inefficient externalities.¹¹²

The anti-externality agenda makes an appearance in the contract literature, too. There is a substantial concern with how the rules of contract can limit the externalities imposed by one party on the other by virtue of imperfect enforcement—*i.e.*, the problem of opportunism.¹¹³ There is, however, little attention given to the externalities produced by joint action through contract. Although limiting third party externalities from contract is broadly recognized as a legitimate regulatory function,¹¹⁴ it is regarded as among the reasons for limiting contract altogether. That is, externalities from contract are taken to dictate the boundaries of contract but not the content of contract law.¹¹⁵ Most statutory regulation of contract takes the form of mandatory terms that disallow certain contracts. Even tortious interference with contract (a more limited tort

111. See *supra* notes 22-23 and accompanying text.

112. See William M. Landes & Richard A. Posner, *The Positive Economic Theory of Tort Law*, 15 GA. L. REV. 851, 871-77 (1981); see also Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29, 33 (1972) (“[T]he dominant function of the fault system is to generate rules of liability that if followed will bring about, at least approximately, the efficient—the cost-justified—level of accidents and safety.”).

113. See George Cohen, *Implied Terms and Interpretation in Contract Law*, in 3 ENCYCLOPEDIA OF LAW AND ECONOMICS: THE REGULATION OF CONTRACTS 78, 90 (B. Bouckaert & G. de Geest eds., 2000) (explaining that “the problem of opportunistic behavior is perhaps the key justification for court intervention in contracts” and defining opportunism as “deliberate contractual conduct by one party contrary to the other party’s reasonable expectations based on the parties’ agreement, contractual norms, or conventional morality”).

114. See, e.g., Steven Shavell, *Contractual Holdup and Legal Intervention*, 36 J. LEGAL STUD. 325, 346 (2007) (“There are two standard reasons for legal intervention in contracts: asymmetric information and externalities.”).

115. See ROBERT COOTER & THOMAS ULEN, *LAW & ECONOMICS* 226-27 (5th ed. 2008); TREBILCOCK, *supra* note 40, at 58.

than one might expect) does not prohibit the tortious interference *per se*, but rather prices the externalities *ex post* in tort.¹¹⁶

We do not have a good reason for excluding contract law from the tools by which we vindicate the basic duty of persons not to impose unjustified (that is, legally cognizable) harms on others. Contracts against public policy are already unenforceable, as, of course, are illegal contracts that contravene particular statutes.¹¹⁷ We should not limit our attention to the effects of bilateral agreement on third parties to these exceptional cases. It is an established principle of contract interpretation that agreements should be construed as reasonable.¹¹⁸ This entails more than a speculative reconstruction of party intent. Courts already prefer the substantively reasonable meaning of an ambiguous contract term to one that appears to violate norms of fairness and reciprocity.¹¹⁹ Although courts are appropriately focused on parties' objective intent, their inquiry into the most reasonable construction of that intent is in part an inquiry into how we can understand an agreement such that the agreement is reasonable, *i.e.*, how we can read it as compliant with background duties that parties in contract have toward one another. In this way, the most reasonable interpretation of an agreement already takes into account what people owe each other whether they intended to comply with those duties or not.

Once the concept of reasonableness is released from exclusive reference to actual party intent, the extension proposed here is a natural one: agreements should be read in light of background duties owed third parties as well. This is in many ways an easier case. While scholars might disagree about the authority

116. See RESTATEMENT (SECOND) OF TORTS § 766 (1979).

117. See RESTATEMENT (SECOND) OF CONTRACTS § 178 (1982).

118. *Sutton v. East River Sav. Bank*, 55 N.Y.2d 550, 555 (1982) ("Our goal must be to accord the words of the contract their 'fair and reasonable meaning.'"); see also *Harrah's Entertainment, Inc. v. JCC Holding Co.*, 802 A.2d 294, 313 (Del. Ch. 2002) ("In the event of ambiguity in a heavily negotiated contract, it is generally the most reasonable meaning of the words used . . . to which courts look in order to define contractual rights and duties."); *Wrenfield Homeowners Ass'n v. DeYoung*, 600 A.2d 960, 963 (Pa. 1991) ("The court will adopt an interpretation that is most reasonable and probable"); *Ehlinger v. Hauser*, 758 N.W.2d 476, 488 (Wis. 2008) (resolving a contract's ambiguity in favor of "the most reasonable construction" of the term at issue).

119. See, e.g., *Glenn Distrib. Corp. v. Carlisle Plastics, Inc.*, 297 F.3d 294, 301 (3d Cir. 2002) ("Courts must be mindful to adopt an interpretation of ambiguous language which under all circumstances ascribes the most reasonable, probable, and natural conduct of the parties, bearing in mind the objects manifestly to be accomplished.") (internal citations omitted); *Tessmar v. Grosner*, 23 N.J. 193, 201 (1957) ("Even where the intention is doubtful or obscure, the most fair and reasonable construction, imputing the least hardship on either of the contracting parties should be adopted. . . so that neither will have an unfair or unreasonable advantage over the other."); *Columbia Propane, L.P. v. Wisconsin Gas Co.*, 661 N.W.2d 776, 787 (Wis. 2003) ("In ascertaining the meaning of a contract that is ambiguous, the more reasonable meaning should be given effect on the probability that persons situated as the parties were would be expected to contract in that way as opposed to a way which works an unreasonable result."). The Restatement expressly allows that "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." RESTATEMENT (SECOND) OF CONTRACTS § 207 (1981). Unfortunately, the principle has not caught on outside of limited contexts, such as those involving the provision of public services. See Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1723-24 (1997) (describing situations where the rule has been applied). Zamir is among the few scholars to argue that substantive reasonableness is given inadequate weight in orthodox theories of interpretation.

of individuals to shape their obligations toward other private individuals and the appropriate effect of consent to a transaction, it is clear that parties to a transaction have no authority to revise the entitlements of third parties and third parties have in no way consented to the “alternative private arrangement” that a contract represents. Thus, to the extent background legal interests of third parties are implicated by an agreement, the state is only justified in enforcing that agreement to the extent it adequately respects those legal interests.

The doctrine that agreements against public policy are void already substantiates the essential principle that contract rights are bounded by the interests of others. Courts look to statutes and well-established common law principles to identify the kinds of agreements that impermissibly affect third parties. As discussed in Part I, however, not every agreement that adversely affects a legally protected third party interest can be actually prohibited. The problem of how to deal with enforceable agreements remains. In the case of ambiguous enforceable agreements, the question of interpretation presents itself squarely. Yet the corollary to the general rule against contracts contrary to public policy remains implicit and appears only sporadically: When an ambiguous agreement would adversely affect the legal interests of third parties if interpreted one way but not if interpreted another way, courts should prefer the interpretation that generates fewer negative externalities. The interpretive principle is analogous to the rule of statutory construction that courts will prefer an interpretation that avoids the specter of unconstitutionality,¹²⁰ or the similar rule that statutes in abrogation of the common law will be narrowly construed.¹²¹ Where the terms of an agreement are ambiguous, a party’s rights are to be narrowly construed and obligations expansively construed in light of duties she owes third parties. Similarly, when a party is on notice that her rights and obligations under an ambiguous term adversely affect the legally protected interests of a third party to whom her contracting partner owes a duty, that term too should be construed in light of the background duty.

Such an interpretive rule is not a departure from doctrine or practice. Courts already prefer the most reasonable interpretation of an ambiguous term, and in at least some cases, allow that reasonableness has a substantive component.¹²² The effect of an agreement on others speaks to one aspect of reasonableness. I do not propose that third party interests trump other established maxims of

120. See *Solid Waste Agency of N. Cook County v. Army Corps of Eng’rs*, 531 U.S. 159, 174 (2001) (“We thus read the statute as written to avoid the significant constitutional and federalism questions raised by respondents’ interpretation.”); *Edward J DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988) (“[W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress”).

121. See *Rehberg v. Paulk*, 132 S. Ct. 1497, 1502-03 (2012) (interpreting § 1983 in line with ordinary tort principles); *United States v. Texas*, 507 U.S. 529, 534 (1993) (“Statutes which invade the common law. . . are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident.”).

122. See *supra* note 119, especially *RESTATEMENT (SECOND) OF CONTRACTS* § 207 (1981).

interpretation, each of which also guides a court in the still open-ended reasonableness inquiry. Nor do third party interests become relevant only at the point of hopeless ambiguity, that is, where all those other maxims fail to offer direction. Third party interests are one element in the interpretive canon that properly informs a choice among reasonable meanings of an ambiguous term.

One might worry about the flexibility inherent in such an interpretive principle. And indeed, lawyers and theorists regularly worry about how courts interpret a given ambiguous term, or ambiguous terms generally, because the flexibility and open-ended character of the rule proposed here is already endemic to contract interpretation as we know it. Notions of fairness are as unwieldy as the legal concept of reasonableness through which fairness often rears its head in adjudication; but we are unprepared to part with either notion. Comparatively, the bearing of third party interests is at least constrained by legal norms establishing the content of the legal interests at issue; that is, judges are not free to name and protect any material interest to which they have sympathy. Moreover, the premise of this method is that not all legally protected interests, but only the most concentrated, warrant protection at the late stage of interpretation.

We should also not take the present degree of uncertainty associated with the rule to be inherent to it. The proposed principle will be more predictable in application as precedent builds over time, just as other familiar doctrines like the duty of good faith, mistake, unconscionability and promissory estoppel have all been filled out over time. Each of those doctrines could be articulated in a way that, in the abstract, threatens to engulf a good deal of surrounding doctrine. In reality, each has been developed to fulfill its particular function without compromising the integrity of contract law as a field. Repeated application of an *explicit* rule will put parties on notice in contexts where it is regularly and successfully invoked. It will also guide judges contemplating extensions to new types of contracts.

The principle endorsed here applies only to ambiguous agreements. If some worry that the doctrine is too open-ended, others might be concerned that it does not go far enough. In particular, one might wonder why we should stop at ambiguity: why not interpret all terms to be consistent with third party interests? Instead of striking down terms facially inconsistent with public policy (and protection of third party interests is a prime example of the kind of "public policy" that bounds contract), we could reform such contract terms.

There are some contexts where courts reform terms to render them compliant with public policy, but this does not occur under the guise of interpretation. Overly broad noncompete provisions in employment contracts are sometimes revised by courts to bring them within the bounds of public policy,

rendering them enforceable.¹²³ Similarly, overly broad waivers in standard form contracts that appear to waive liability for intentional conduct are sometimes reformed to waive only liability for negligence.¹²⁴ But in neither context do courts purport to be merely interpreting the agreements before them. The choice to reform the terms is made as an alternative to striking them; it is at the stage of determining the consequence of the agreement the parties made, not at the stage of interpreting it.

Interpretation implies some good faith construction of the contract's language.¹²⁵ Resolving ambiguity by reference to third party interests is not inconsistent with the ordinary practice of interpreting text in that it does not generate a meaning at odds with what a person might independently understand the language in question to mean. Because third party interests are being brought to bear only on ambiguous terms, they operate only as a means by which judges choose among two or more reasonable interpretations.

This is not to suggest that courts are using third party interests only as their basis for a best guess about party's real intentions. Courts already deploy default rules to interpret ambiguous terms, or to supply terms in the face of contractual gaps.¹²⁶ Those default terms can be majoritarian but they are not always what we think most parties in the situation would have preferred. Sometimes a default rule is selected because it promotes the interests of future parties, as in penalty defaults.¹²⁷ Sticky default rules go further in making it affirmatively difficult for parties to contract on terms disfavored by the court.¹²⁸ Default rules and sticky default rules, in particular, are the means by which courts interpret agreements to avoid undermining third party interests.

123. See, e.g., H.B. 173, Gen. Assem., Reg. Sess. (Ga. 2009) (permitting courts to revise restrictive covenant agreements in order to narrow the scope of restrictions instead of striking the restriction altogether).

124. See Anita Cava & Don Wiesner, *Rationalizing a Decade of Judicial Responses to Exculpatory Clauses*, 28 SANTA CLARA L. REV. 611, 612 (1988) (describing how many courts read exculpatory clauses narrowly).

125. In fact, interpretation and construction are sometimes distinguished, with the former but not the latter limited to deciphering communicative intent. See Lawrence Solum, *The Interpretation-Construction Distinction*, 27 CONST. COMMENT 95, 95-96 (2010); Peter Tiersma, *The Ambiguity of Interpretation: Distinguishing Interpretation from Construction*, 73 WASH. U. L.Q. 1095 (1995). But contract doctrine delegates all considerations outside of text to a single stage, usually under the heading of interpretation—sometimes the terms are used interchangeably. See, e.g., *Osborne ex rel. Osborne v. Kemp*, 991 A.2d 1153, 1160 n.21 (Del. 2010); *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 830 (Del. Ch. 2007). And, of course, the essential thrust of the Article is that those considerations appropriately include ones outside of communicative intent. Therefore, I will not engage the interpretation/construction distinction here.

126. See Ian Ayres & Robert Gerner, *Filling the Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

127. *Id.* at 93-94.

128. See Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L. J. 2032, 2087 (2012) (“[S]ticky defaults are metaphorically a kind of way station on the road to mandatory rules. They are quasi-mandatory rules that attempt to produce a constrained separating equilibrium, allowing a reduced number of contractors to opt for legal consequences that lawmakers disfavor.”).

By definition, parties can contract around default terms. Clear terms that leave no room for a public-policy-minded inquiry into reasonableness should either be enforced or not. Using the exercise of contract interpretation to alter the unambiguous meaning of terms merely disguises regulation of exchange and risks, making it illegitimate for lack of transparency and costly for lack of notice.¹²⁹

One might argue that, even limited to ambiguous terms, incorporating the interests of third parties into interpretation is at odds with the private law structure of contract. Once we take into account the interests of others, one might fear, private claims become a tool for vindicating public interest without regard for the moral claims of litigants vis à vis one another.¹³⁰ But the interpretative defaults proposed here are not vulnerable to such a claim. They do not reflect an undifferentiated public interest that asserts itself whenever a person encounters the machinery of the state. These defaults reflect private obligations that individuals have to other private people. The moral claims of those adversely affected by private action are sometimes vindicated by public law and sometimes protected by private law. Concentrated interests vulnerable to joint action by others are not amoral interests; the corresponding duties that protect those interests are moral duties of the sort that are the stuff of private law. They reflect substantive moral constraints not only on the boundaries of free action (in tort) but on the boundaries of free agreement.

The moral basis for reading agreements to avoid concentrated externalities is evident in the moral asymmetry between third party winners and losers. Third party beneficiaries may be vested with rights by a contract only where the parties apparently intended to create such rights.¹³¹ This is fair where those third parties had no baseline, legally cognizable interest at stake. A welfare-maximizing approach to contract might plausibly lift the intentionality requirement even in pursuit of positive externalities if the public benefits exceeded the long-term distortion to private contracting. But that would be a morally arbitrary use of contract that current doctrine correctly eschews.

Third party losers are differently situated because they already have legal claims over one or both parties independent of the parties' intentions. Thus, their interest in a protective reading of the contract should not similarly depend on any expressed intention of the parties. Note that the claim here is not that the agreement would create a new legal right of action in those third parties; they would have to rely on existing legal bases for remedy. The claim is instead that the interests of prospective third party losers appropriately inform the content of an agreement as it controls the rights of contracting parties toward one another.

129. See Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 928 n.3 (2010) (reviewing evidence that most contract disputes turn on interpretation).

130. See WEINRIB, *supra* note 53, at 156.

131. See RESTATEMENT (SECOND) OF CONTRACTS §304 (1981) ("A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.").

Where the harms to third parties from agreements are patterned, it may be possible and appealing actually to ban certain contract terms. But sweeping regulatory rules can be prohibitively costly, on account of both the publicly borne costs of design and the privately borne costs of (inevitably) imperfect design. The common law generally prefers flexible ex post rules in governing contract, and the private law is generally better suited to regulating concentrated externalities. It is logical that contract should be used to mitigate externalities from agreements by way of flexible interpretative standards that make it more costly to produce those externalities.

IV. Concentrated Externalities from Merger Agreements

Not everyone adversely affected by a private agreement between two other people has a legally cognizable interest at stake. Courts should read ambiguous terms in light of background duties only where those duties are already expressed in public policy. Courts should be more vigilant about policing the effects of private agreements on third parties through interpretation (as opposed to legislative regulatory action) where those third party effects are concentrated.

We turn now to the case of merger agreements. At least four classes of third parties may have legally recognized interests that are implicated by a merger agreement: creditors, employees, shareholders and consumers. These groups are of decreasing concentration, and for that reason I will explore their relevance in that order. Creditors are usually the smallest and most fixed set of third parties (though this may not be true if notes are broadly held). Employees are the next group, identifiable and not very numerous in the ordinary case. Shareholders are an intermediate group that is somewhat fluid. Consumers are a much larger set of anonymous persons. The relevant interests of each group are also distinct in their legal source. Creditors have contractual interests at stake. Workers have a mixture of contract and other statutory interests. Shareholders have statutory rights at stake but these rights are largely elaborated through Delaware case law. Finally, consumers' interests are based in federal statute and are backed by an elaborate regulatory infrastructure. On the view proposed here, all else being equal, the more concentrated the adversely affected third party interest, the stickier the protective interpretative default should be.

Before looking more closely at merger agreements, note that the essential analytic point here is applicable across a wide range of contexts. For example, we might extrapolate it to 'interpretation' of fiduciary duties owed by directors and officers toward the corporation. The content of those duties, which might be construed as the terms of their agreements with shareholders, is generally dictated by the interests of shareholders. However, those duties can be and sometimes are construed (that is, limited) to take into account third party interests, like those of creditors or employees. These third party interests are most plausibly part of the analysis when the shareholder interest is itself ambiguous, as where shareholders' interests are divergent. For example, boards defending a

corporation from a hostile takeover are permitted to take into account these interests under *Unocal v. Mesa Petroleum Co.*, but once the shareholder interest has more clearly boiled down to maximization of sale price, under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the board is not permitted to take into account those other interests.¹³² That is consistent with the general thrust of my argument, which is that where terms of an agreement are ambiguous, courts should interpret them in light of interests other than those of parties to the agreement—even where the agreement is one as to corporate form.

Indeed, the principle developed here might help reconcile contractarian views of the corporation with more instrumentalist ones.¹³³ Contractarian theories of the corporation regard it as an arrangement among shareholders designed to solve their principal-agent problems, and the terms we would expect shareholders to agree upon dictate the essence of corporate law.¹³⁴ By contrast, instrumentalist views of the corporation emphasize the legal form and social function of corporations: Law allows their form in order to serve public policy ends.¹³⁵ Although this divergence in perspective is a deep one, understanding that the terms of contracts may not burden the legal interests of third parties offers a theoretical basis for taking into account the interests of creditors, employees and other stakeholders when interpreting the ‘bargain’ struck by shareholders.

I turn now to the more literal agreements that corporations enter with each other at the time of merger or acquisition. These agreements are peculiar in that they often extinguish one of the parties to the agreement, substantially reducing the litigation surrounding the terms of the merger once it has been executed. Most litigation concerning mergers—and almost all mergers are subject to such litigation¹³⁶—alleges breach of fiduciary duty to shareholders. There are also, however, classic contract disputes where a party to a merger agreement declines

132. Compare *Unocal*, 493 A.2d 946, 955 (Del. 1985) (holding that a board defending against a hostile takeover may consider the interests of constituencies other than shareholders), with *Revlon*, 506 A.2d 173, 182 (Del. 1986) (determining that a board should not consider non-stockholder interests when the object is not to protect the corporate enterprise but instead sell it to the highest bidder). See also Stephen M. Bainbridge, *The Geography of Revlon-Land*, 81 *FORDHAM L. REV.* 3277, 3316 (2013).

133. For a more detailed, albeit unsympathetic, overview of major approaches to corporate law, see Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *GEO. L.J.* 439, 444-49 (2001).

134. See STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 27-33 (2002); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 12 (1991).

135. See *PROGRESSIVE CORPORATE LAW* (Lawrence E. Mitchell ed., 1995); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 *WASH. & LEE L. REV.* 1373, 1377-90 (1993).

136. See Matthew D. Cain & Steven M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation* 14 (Jan. 31, 2013) (unpublished manuscript), <http://ssrn.com/abstract=1984758> (finding that “87.3% and 92.1% of all [studied merger] transactions experience[d] litigation in 2010 and 2011”).

to move forward and where the seller survives as a distinct legal entity, as where only assets or a subsidiary has been transferred.¹³⁷

A. Creditors

Creditors are affected by mergers. The legal status of their notes is often affected by the transaction. Even when the resulting entity fully assumes liability for the debt, its value is affected by the financial position of the new entity and the status of creditors' debt relative to other debt.

Courts do not appear especially sympathetic to creditors' interests in mergers. For example, in *Global Asset Capital, LLC v. Rubicon US REIT*,¹³⁸ a buyer sought to enforce a letter of intent agreement against a company that was, at the time, on the verge of insolvency. After the letter of intent had been executed, Rubicon reconsidered and sought to avoid the bankruptcy process contemplated by the letter of agreement. The letter of agreement contained no fiduciary out.¹³⁹ Nevertheless, Rubicon claimed that it retained the right to walk away because of directors' duties to its creditors, who might recover more in an alternative process that did not confer any advantage on Global Asset Capital.

The Delaware court acknowledged that creditors' interests might be part of the conglomeration of corporate interests that directors were supposed to defend, but it rejected any duty to creditors. It held that it had already rejected such a duty in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*.¹⁴⁰ More generally, the court rejected any implied fiduciary out.

My analysis does not directly argue in favor of any particular resolution on the facts of *Global Asset Capital*. But it does favor a rule of interpretation with respect to the preliminary question in that case: was there a binding agreement (the court held yes), and was bankruptcy a condition to all provisions in the agreement, including a duty to bargain in good faith, or only certain terms (the court held the former)? To the extent the text of the agreement was ambiguous on these questions, my analysis recommends taking into account the interests of creditors even in the absence of any default fiduciary out. By contrast, the Delaware court emphasized the non-fiduciary character of Rubicon's obligations to its creditors and the requirement of an express provision creating a fiduciary out only in its analysis of whether the agreement was enforceable against

137. John Coates describes merging parties' practices in anticipation of contract disputes arising from merger agreements. See John Coates, *Managing Disputes through Contract: Evidence From M&A*, 2 HARV. BUS. L. REV. 295 (2012). The frequency and complexity of these mechanisms suggests that firms take seriously the prospect of disputes concerning the terms in merger agreements.

138. C.A. No. 5071-VCL (Del. Ch. Nov. 16, 2009).

139. Fiduciary outs allow the board of a target company to entertain unsolicited offers where necessary to comply with directors' fiduciary duties. See Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops-The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 534 (2008).

140. 930 A.2d 92 (Del. 2007).

Rubicon, not on the question of how the ambiguous terms of that agreement should be read.

Creditors' interests in a merger were also at issue in *Wavedivision Holdings, LLC v. Millennium Digital Media Systems*.¹⁴¹ There the Delaware Chancery court held Millennium in breach of several terms of an asset purchase agreement, including a no-solicitation clause and reasonable best efforts clause. The reasonable best efforts clause required Millennium to obtain approval for the transaction from secured creditors and a group of note holders who could not expect payment from the deal. Creditors were well-represented in the management of Millennium and Millennium ultimately concluded a refinancing/asset transfer with the note holders, terminating the agreement with Wavedivision on the grounds that it failed to obtain consent from creditors.

The court was highly unsympathetic to Millennium's recounting of events and its apparently willful breach of its agreement with Wavedivision. Millennium actively and secretly sought an alternative arrangement with creditors throughout the time it represented to Wavedivision that it was attempting to secure creditor approval.

An interesting question raised by this case is whether the intimate role of creditors throughout the decision-making process of Millennium is among the reasons why Millennium could not invoke their interests to justify pursuit of alternatives to the agreement with Wavedivision. We might think not because the court observed in *Wavedivision* that the initial impulse to pursue a sale agreement with Wavedivision came from Millennium's perceived obligation to senior creditors and because fiduciary outs will generally not be implied. A few small variations in the fact pattern, however, could cast creditors' interests in the sales agreement in a different light. For example, imagine a company in arms-length relations with its creditors prompted by an impending payment deadline to pursue an asset sale, which would require the approval of creditors. Imagine the company is instead offered a refinancing, debt-for-equity arrangement by those creditors. It seems plausible that the scope of its obligations under a non-solicitation clause should be interpreted differently with respect to those creditors than other potential buyers. This is because the agreement with the buyer implicates the interests of creditors' existing contract rights. This argument would be all the more compelling were the creditors not entitled—as was arguably the case with respect to Millennium's note holders—to block the asset purchase by the outside buyer.

Indeed, the one case in which a court seemed sympathetic to creditors was one where the creditors were shut out of the decision-making process related to the merger. (It is really only on such facts that my analysis applies, since to the extent creditors exercise control over the terms of a merger, they are not truly third parties to it.) In *Dawson v. Pittco Capital Partners*,¹⁴² a Delaware Chancery

141. 2010 WL 3706624 (Del. Ch. Sept. 17, 2010).

142. 2012 WL 1564805 (Del Ch. Apr. 30, 2012).

court held that notes held by investors in a now-merged entity had not been validly cancelled. It applied the rule that though “parties to contract are free to provide that contractual rights and obligations will not survive a merger, they must do so in clear and unambiguous terms.”¹⁴³ The effect of the ruling is to make it more difficult for merging parties to derogate the rights of creditors even when those creditors are *also* equity holders in a merging entity. The rule thus limits one strategy by which equity holders in merging corporations might privilege their interests over those of creditors, especially where those creditors are unable to block amendments to LLC agreements initiated by controlling equity holders (even if the controlling equity holders do not amount to a single controlling block subject to fiduciary duties).

Contract creditors may not be the most sympathetic constituency because they are able to price the risk of nonpayment into their initial debt agreements. Nonadjusting creditors would certainly have a better claim to protection. But to the extent we doubt the ability of creditors to price their debt appropriately in response to certain long-term and low-probability events, and to the extent their ordinary recourse in contract is thwarted by the possibility of write-off in bankruptcy, we might sometimes give their interests some weight in the interpretation of ambiguous agreements entered by merging entities.

B. Employees

Employees are affected by mergers in various ways. They have vested interests that are more or less likely to be honored; they have noncontract interests in ongoing employment that are more or less likely to be protected; they are sometimes organized into collective bargaining units that lose their presumptive status of recognition upon merger by the employer.

The Employee Retirement Income Security Act,¹⁴⁴ Multiemployer Pension Plan Amendments Act of 1980¹⁴⁵ and Workers Adjustment and Retraining Notification Act¹⁴⁶ all address in substantial part externalities created by mergers and acquisitions between two corporations for their employees. Some provisions of merger agreements incidentally affect employees; others are inserted for the purpose of complying with separate duties. Interestingly, target companies often negotiate for employee protection beyond that which is required by statute. For example, it is commonplace to have a provision that reads something like: “[Buyer] agrees to maintain benefits for all employees who at date of merger were covered by Welfare Plan of [Target] comparable to those provided to those employees of [Buyer] already employed at date of merger” or “[Buyer] agrees to

143. *Id.* at *18.

144. Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5, 18, 26, 29 and 42 U.S.C.).

145. Pub. L. No. 96-364, 94 Stat. 1208 (codified as amended in scattered sections of 26 and 29 U.S.C.).

146. 29 U.S.C. §§ 2101-09 (2006).

maintain benefits for all retired employees of [Target] comparable to, and in no event less than, the benefits provided by [Target] to those retired employees at date of merger."¹⁴⁷ These same agreements expressly disavow the creation of any third party beneficiaries.

Employees do not, however, have to rely on third party beneficiary status under ERISA. ERISA effectively allows them to pursue a private claim against the new entity in order to avoid certain adverse effects of a merger, regardless of whether merging parties intended employees to have such an enforcement right. Terms in merger agreements that provide for continuity in employee benefits are treated as amendments to a qualified ERISA plan (there is a contrary minority view that views such as amendments as barred by doctrine of estoppels). Beneficiaries of those plans thus have standing to sue on the basis of the merger agreement, even where those agreements expressly disavow any third party beneficiaries.

ERISA protection is limited to vested rights, and so it is limited to employee's contract interests. The court in *Berman v. International Controls Corp.*,¹⁴⁸ held that a term that required the new corporate entity to provide employees "comparable benefits" was unambiguous and that the employer was acting qua employer not as plan fiduciary in amending the plan by way of that merger term. The court held that a health plan instituted by the new employer had enough features in common with the previous plan to qualify as "comparable."¹⁴⁹ The court's ruling was out of line with other jurisdictions in its refusal to subject the merger clause to ERISA on the theory that it was adopted qua employer rather than as fiduciary.

Although other jurisdictions might disagree that the clause did not implicate duties governed by ERISA, the *Berman* court was not anomalous in holding that employees' interests were protected only insofar as they were vested interests governed by ERISA. My account of the role of contract interpretation in mitigating externalities helps show why broader protection may be justified. A contract with a term like "comparable," which seems clearly ambiguous, would be interpreted by reference to employees' interests even if these interests fall outside the technical ambit of ERISA. ERISA together with other statutes recognizes a legal interest that employees have in their employers' ongoing commitment to them, contractual or otherwise. Although courts should not add obligations for the benefit of employees to contracts between merging parties,

147. See, e.g., *Halliburton Co. Benefits Comm. v. Graves*, 463 F.3d 360, 365 (5th Cir. 2006) (finding Halliburton failed to maintain benefits pursuant to terms in merger agreement with Dressler Industries, Inc.).

148. No. 88-6206-CIV-PAINE, 1990 U.S. Dist. LEXIS 16001, at *18 (S.D. Fla. June 28, 1990).

149. See also *Phillips v. Amoco Oil Co.*, 799 F.2d 1464, 1471 (11th Cir. 1986) (holding that fiduciary provisions of ERISA are not implicated with respect to contingent and non-vested future benefits and that the "ERISA scheme envisions that employers will act in a dual capacity as both fiduciary to the plan and as employer.").

where the merging parties themselves have agreed on some protective language, all else being equal, ambiguities should be resolved to protect employee interests.

The ERISA scheme is an interesting mechanism by which a statute sets up a way for private parties to vindicate interests implicated in others' agreements. Because in the merger context one of the parties to the agreement is usually extinguished, there do not seem to be many cases where the meaning of an employee benefits clause is litigated as between the parties. But where that arises, as in the context of an asset sale that transfers liability for some employee benefits, out of which both entities emerge intact, it seems certain that a court would interpret the contract language in line with ERISA obligations even though the plaintiff is not an employee.

C. Shareholders

Of all the third parties affected by mergers, shareholders are the most protected. That may be because they own one of the contracting parties, thus recasting the problem of externalities into one of imperfect agency. But from a legal perspective, the corporation is a continuous legal person distinct from its fluid set of owners. Thus, the costs that it imposes on its owners may be regarded as a negative externality. Shareholders are also a concentrated group that are, at least at any moment, of fixed and finite number. Moreover, more so than creditors, their interests are protected by nebulous fiduciary duties that suffer from precisely the problems of under-specification that trigger separate (second-best) management of externalities.

The basis for most references to shareholders' interests in the context of merger agreement interpretation is *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*¹⁵⁰ That line of cases subjects deal protection measures like lock-up options and no-shop provisions to scrutiny. Such devices may represent breaches of fiduciary duty by directors that adopt them. The implication of my view is that courts should interpret lock-up options and no-shop provisions in the course of disputes between parties to the merger agreement with an eye to the fiduciary duties that constrained one of the parties. Courts do just that.

In *Vector Capital Corp. v. Ness Technology, Inc.*,¹⁵¹ an exclusivity agreement was ambiguous as to whether it prohibited only communications with prospective buyers or whether it also disallowed internal communications about prospective bids. Target Ness had agreed not to "enter [into] discussions" about alternative transactions.¹⁵² The court interpreted the term narrowly because to include a ban on even internal communications would make it impossible for the board to comply with its fiduciary duties.¹⁵³ The court applied reasoning

150. 506 A.2d 173 (Del. 1986).

151. No. 11 Civ. 6259, 2012 WL 913245, at *4 (S.D.N.Y. Mar. 19, 2012).

152. *Id.*

153. *Id.*

analogous to that proposed here, not to resolve an ambiguity but to hold that a term in an exclusivity agreement was unambiguous. The court concluded that the term necessarily applied only to external discussions because

[I]nterpreting the Agreement to prohibit Ness's officers from discussing unsolicited proposals would produce an unreasonable result: Ness would be obligated by contract to violate governing law . . . Contractual provisions that limit full exercise of fiduciary duties are 'invalid and unenforceable' because 'directors [cannot] contract away their fiduciary obligations.' . . . [I]t would be 'commercially unreasonable [and] contrary to the reasonable expectations of the parties' to interpret the contract to require a party to violate its existing business duties. Here, if Ness had agreed not to discuss unsolicited proposals internally, it would have been unable to fulfill its duty under Delaware law of securing the highest sale value for its shareholders . . . Ness would not have knowingly put itself in this position.¹⁵⁴

Courts could extend this logic to other potentially ambiguous terms in merger agreements. Consider the status of standstill agreements under current law. Delaware courts appear to be skeptical of them but have not deemed them per se invalid. They enjoined "don't ask, don't waive" provisions without declaring them against public policy (on grounds that they interfere with directors' ability to fulfill fiduciary duties). It seems likely that courts will not enforce these provisions where the target entertains multiple offers from bidders not subject to a standstill agreement; the effect of the agreement in such cases is merely to block particular bidders from offering higher bids. Using the approach recommended here, courts could interpret these standstill agreements as incorporating a condition that waivers will only be declined where all bids in contention come from buyers subject to similar limitations. Implying such a condition would go some way toward limiting their negative effects under certain conditions while preserving them as a tool for auctioning of a target under appropriate circumstances.¹⁵⁵

The rule might also be applied in the context of side agreements that acquiring firms sometimes enter with executives tendering stocks pursuant to a tender offer, as was the case in *Padilla v. MedPartners, Inc.*,¹⁵⁶ or with a parent corporation of a target subsidiary, as was the case in *Millionerrors Investment Club v. GE, P.L.C.*¹⁵⁷ Those agreements are at risk of violating Section 14(d) of

154. *Id.*

155. The situation described or one similar arose in *In re Ancestry.com, Inc. Stockholders Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012); *In re Complete Genomics, Inc. Stockholder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012); *In re Celera Corp. Stockholders Litig.*, C.A. No. 6304-VCP (Del. Ch. Mar. 23, 2012); *In re RehabCare Grp., Inc. Stockholders Litig.*, C.A. No. 6197-VCL (Del. Ch. Sept. 8, 2011); and *In re Topps Co. Stockholders Litig.*, 926 A.2d 58 (Del. Ch. 2007). See also Christina Sautter, *Promises Made to Be Broken? Standstill Agreements in Change of Control Transactions*, 37 DEL. J. CORP. L. 929 (2013).

156. No. CV98-1092-RSWL, 1998 WL 34073629 (C.D. Cal. July 27, 1998).

157. No. Civ.A.99-781, 2000 WL 1288333, at *5 (W.D. Pa. Feb. 8, 2000).

the Securities Exchange Act of 1934, which implements the all-holder best price rule.¹⁵⁸ Those agreements should be construed to avoid requiring consideration in excess of the tender offer price and as “conditioned” on the tender offer’s success so as to bring them within the ambit of the Section 14(d) rule.

No-shop provisions and prompt notice requirements are almost always ambiguous in the particular actions they prohibit or permit. For example, in *NACCO Industries, Inc. v. applica Inc.*,¹⁵⁹ the court considered pre-contractual contact between the target and another buyer as relevant to the nature of post-contractual contact because the terms were unclear in themselves as to when responsiveness or enthusiastic cooperation amounted to encouragement of an alternative bid. It was also unclear in *NACCO* how much notice is required under a prompt notice clause. To the extent contact with alternative bidders and some degree of secrecy may be essential to obtaining highest value for shareholders, courts may narrowly construe these clauses to avoid requiring breach of fiduciary duty.

Finally, merger agreements often contain ambiguous warranty clauses and ambiguous material adverse effect clauses.¹⁶⁰ One might interpret these in light of shareholder duties by assuming some alignment between the knowledge imputed to shareholders in securities litigation and the knowledge imputed to buyers under these clauses.

None of this is to say that corporations should be granted default fiduciary outs. That position has been expressly rejected by courts thus far.¹⁶¹ But the current practice of enforcing a fiduciary out for which a target has contracted, like the more general principle that contracts against public policy are unenforceable, is only the start of more fully accounting for the interests of shareholders in the interpretation of merger agreements.

D. Consumers

Consumers are the final group considered here. Should their interest also be taken into account in the interpretation of merger agreements? Probably not. Of the various third parties considered here, consumers are the most diffuse. And indeed, there is a robust administrative infrastructure in place for protecting their interests. The Hart-Scott-Rodino Antitrust Improvements Act of 1976 requires merging parties to file a detailed notice to the Federal Trade Commission (FTC) if the proposed transaction exceeds certain size thresholds.¹⁶² The FTC review is

158. 17 C.F.R. § 240.14d-10(a) (2006).

159. 997 A.2d 1 (Del. Ch. 2009).

160. *See, e.g., In re IBP, Inc., S’holders Litig.*, 789 A.2d 14, 56-63, 65-71 (Del. Ch. 2001).

161. *See In re Complete Genomics, Inc. S’holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012) (“[D]irectors of the selling corporation are not free to terminate an otherwise binding merger agreement just because they are fiduciaries and circumstances have changed.”).

162. 15 U.S.C. § 18a (2006).

intended to prevent mergers that will adversely affect consumers. Although critics are sometimes unhappy with the standards applied in FTC review, overlapping jurisdiction among states (internationally as well as within the U.S. federal structure) has mitigated political discontent with any one approach. The basic infrastructure is in place to protect consumers from anticompetitive conduct. Their diffuse stake in mergers is best treated in public law and does not require the support of a private law tool like contract interpretation.

Conclusion

I have made two claims in this Article: first, private law attends to concentrated externalities while public law regulates diffuse externalities. Second, contract law, in keeping with its position within private law, should limit not just the harms imposed by contracting parties on each other but also the harms jointly imposed by contracting parties on third party losers.

The first claim buttresses the second because it assigns to contract a role in the larger institutional scheme by which law protects us from the harms we impose on each other. That role consists of regulating the harms that accompany agreements for exchange. Many of those harms are borne by contracting parties themselves, such as the harms that follow from misrepresentation, coercive conduct, breach, or opportunistic renegotiation. Contract law has long evolved with the aim of limiting those bilateral harms. It is less sensitive to the harms that contracting parties together impose on others. In some cases, injurious terms are banned or give rise to independent rights of actions in others. But not all legal interests are so robustly protected and contract law can help fill a gap in our second-best state of the world.

The two claims of the Article are intuitive. Each has gone unremarked because it falls outside the headlights of dominant theoretical frameworks. The first claim, a proposed division of labor between public and private law, takes the distinction seriously without exaggerating it. In doing so it departs from philosophers, economists, and critical scholars. Legal philosophers tend to see private law as vindicating bilateral moral obligations without any regulatory purpose; the latter is characteristic only of public law. Economists neglect concentrated externalities because they are relatively amenable to private resolution; they underemphasize the reality of bargaining failure and its distributive consequences. The result is an exaggerated faith in private ordering. Other scholars, reacting to the historical biases associated with the distinction, are now loathe to recognize the "reified" categories of public and private at all. The aim of this Article in part has been to give content to the distinction in a way that is useful for matching subject and regulatory method.

My second but primary claim has been about a rule of contract interpretation. I have argued that contract should be enlisted to protect third party losers from the special class of actions that is contract law's core subject. Coordinated action receives all matter of deference on the theory that individuals

are free to control their destiny — or at least, maximize their own welfare as they conceive it. But agreements of exchange often impose costs on third parties. Those costs impinge on a range of legally protected interests. In particular classes of contract, as in merger agreements, these third party effects are obvious and indeed they are accounted for in both regulation and common law principles. Through a process of reflective equilibrium,¹⁶³ we need to revise our understanding of what contract interpretation entails to account for these observed practices. Third party losers would be more explicitly protected if we relaxed our misplaced commitment to interpreting agreements only with reference to the intentions of contracting parties. That narrow bind is least justified where agreements adversely affect the legal interests of third parties.

163. See RAWLS, *supra* note 63, at 48-50 (describing reflective equilibrium as process by which we revise theoretical commitments and our practices in turn until they are in alignment).