

Freedom of Contract, Commercial Rationality, and State Cooperation

Simone M. Sepe[†]

This essay defends Alan Schwartz’s intellectual project of liberalizing contract law among commercial parties by integrating consequentialist and deontological perspectives. It responds to two major critiques of Schwartz’s assumptions: the “rationality objection,” which argues that not all merchants are truly sophisticated and therefore require paternalistic protection; and the “moralist objection,” which holds that some transactions are morally objectionable and should not be legally enforced, regardless of their consequences.

To counter the rationality objection, the essay introduces the concept of commercial rationality, arguing that any merchant capable of learning and updating beliefs can reach efficient agreements over time. Limiting freedom of contract for less sophisticated parties hinders this inductive learning process, reducing social welfare and constraining autonomy.

In response to the moralist objection, the essay offers two arguments. First, it emphasizes the state’s dual role as both moral agent and coalition partner in transactions. Merchants who can self-enforce agreements contribute more to contractual value and therefore justify minimal state interference. Second, regardless of the parties’ contributions, denying legal enforcement would unfairly favor those with greater enforcement resources—who can afford self-enforceability—undermining equality of opportunity.

[†] Professor of Law and Finance and Honorable Frank Iacobucci Chair in Capital Markets Regulation, University of Toronto – Faculty of Law and Rotman School of Management; Center for the Philosophy of Freedom – University of Arizona; Yale Law School Center for Private Law; European Corporate Governance Institute. Email: simone.sepe@utoronto.ca. This paper greatly benefited from the comments of Omri Ben-Shahar, Christine Jolls, Daniel Markovits, Saura Masconale, Roberto Pardolessi, Robert Scott, Thomas Christiano, Peter Vanderschraaf, and Gideon Yaffe, as well as other participants at the conference in honor of Alan Schwartz’s career, held at Yale Law School on November 8-9, 2024.

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Introduction

This essay offers new arguments to substantiate Alan Schwartz's normative stance for the liberalization of contract law for commercial parties.¹ To this end, I focus on two foundational assumptions that justify a more permissive contractual legal regime for merchants. First, since merchants are sophisticated parties, they require no paternalistic protection from the state. Second, the normative ethics framework used to evaluate claims about freedom of contract for merchants should be based on the social welfare it produces. While Schwartz's argument is rooted in a utilitarian-welfarist perspective—consistent with his influential contributions to the law and economics of private law—my defense integrates both consequentialist and deontological considerations. Whereas consequentialist reasoning evaluates actions by their outcomes, deontological reasoning assesses them based on duties or principles, regardless of results. This broader approach allows me to address critiques of these assumptions from both ethical standpoints.

Consequentialist critiques contend that categorically equating merchants with sophisticated parties is insufficiently justified.² Merchants form a heterogeneous group, encompassing both large corporations and small sole proprietorships. Therefore, rationality exists on a continuum,³ offering both welfare-dependent and welfare-independent reasons to protect less sophisticated parties. It is argued that asymmetries in sophistication lead to losses in social welfare and unfair transactions. For this reason, a core set of mandatory contract law rules would be socially desirable, thereby limiting contractual freedom. I will refer to this critique as the *rationality objection*.

Shena Shiffrin offers a different, deontological critique.⁴ She argues, as I interpret and extend, that there are welfare-independent, non-paternalistic reasons to restrict freedom of contract when the state, acting as a moral agent, finds a contractual transaction between parties to be incompatible with the community's morality. Such transactions would still be permissible under the framework of promissory morality but without the

1. See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

2. This critique has often been directed at Alan Schwartz in presentations where he assumed the equation: commercial parties = sophisticated parties = rational parties. Although this is a prevalent criticism within the academic community, there is no systematic critical treatment on this issue. For an exception, see Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493 (2010).

3. See HERBERT A. SIMON, *MODELS OF MAN: SOCIAL AND RATIONAL* 99-101 (1957) (introducing the concept of bounded rationality and suggesting that rationality exists on a continuum constrained by cognitive and informational limits); JON ELSTER, *SOUR GRAPES: STUDIES IN THE SUBVERSION OF RATIONALITY* 24-26 (1983) (discussing how rationality is not a fixed state but can vary depending on context).

4. Seana V. Shiffrin, *Paternalism, Unconscionability Doctrine, and Accommodation*, 29 PHIL. & PUB. AFF. 205 (2000).

state's assistance—that is, without legal enforcement. This perspective is general and thus applies even to contracts between merchants. I will refer to this critique as the *moralist objection*.

To the best of my knowledge, these two critiques have not been adequately addressed. My contribution is to demonstrate that neither the rationality objection nor the moralist objection should apply to transactions between merchants. If I am successful in refuting these objections, I will reinforce Alan Schwartz's consequentialist argument for a differentiated contractual regime that allows greater freedom of contract for merchants.⁵

In developing this argument, Schwartz has not only pioneered the development of the law and economics of contracts, but also contributed to make this methodology significantly more robust by grounding it on higher-order developments in theoretical economics, including incentive theory (broadly construed to include the theory of incomplete contracts) and mechanism design.⁶ His argument for liberalizing commercial law is rooted in a Pareto-based welfarist perspective; indeed, if the parties are sophisticated and rational, concluding a contract inherently increases social welfare through a Pareto improvement.⁷ Therefore, assuming there are no externalities,⁸ mandatory restrictions on freedom of contract have two negative effects. First, when the contract remains feasible because such restrictions do not eliminate the contractual surplus, these restrictions will reduce the surplus. Second, in the context of marginal transactions—such as those where the contractual surplus is relatively low due to technological or industry factors—restrictions on freedom of contract may violate the participation constraint, thereby preventing the contract from being

5. Schwarz & Scott, *supra* note 1; see also Alan Schwartz & Simone M. Sepe, *Deregulating Contracts* 101 NOTRE DAME L. REV. (forthcoming 2026), <https://ssrn.com/abstract=5176097> [<https://perma.cc/C7XY-AGAL>].

6. See, e.g., Alan Schwartz & Joel Watson, *The Law and Economics of Costly Contracting*, 20 J. L. ECON. & ORG. 2 (2004); see also Alan Schwartz & Simone M. Sepe, *Economic Challenges for the Law of Contract*, 37 YALE J. REG. 678 (2021) [hereinafter *Economic Challenges*]; Alan Schwartz & Simone M. Sepe, *Contract Remedies for New-Economy Collaborations*, 101 TEX. L. REV. 749 (2023) [hereinafter *Contract Remedies*], where references to this literature can be found.

7. A Pareto improvement occurs when a change makes at least one individual better off without making anyone else worse off, see ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 9-10 (1995) (defining Pareto efficiency and explaining the conditions under which Pareto improvements can be identified). Under standard assumptions in contract theory—namely, that rational contracting parties are subject to the participation constraint and that participation in a contract is voluntary—any mutually agreed-upon contract must satisfy this condition, thus precluding the possibility of a social loss. Cf. BERNARD SALANIÉ, THE ECONOMICS OF CONTRACTS: A PRIMER 122 (2d ed. 2005).

8. More broadly, the assumption here is that there are neither externalities nor other general economic equilibrium factors (e.g., pecuniary externalities) that, for efficiency-related reasons, would necessitate restrictions on the contract space. Schwartz & Sepe, *Economic Challenges*, *supra* note 6; see also Guido Lorenzoni, *Inefficient Credit Booms*, 75 REV. ECON. STUD. 809 (2008).

concluded. In both cases, mandatory rules push the economy below the Pareto-efficient frontier.⁹

In addressing the rationality objection to these conclusions, I will elaborate on the notion of rationality and introduce the new concept of *commercial rationality*. I will argue that any merchant can be presumed to share this form of rationality, and that this presumption is sufficient to guarantee sophistication—thereby refuting the rationality objection. Every merchant endowed with the capacity for learning, memory, and belief updating, can engage in individually efficient transactions. Over time, these capacities lead to an inductive form of rationality that converges with the deductive rationality posited by economic decision theory. Conversely, a paternalistic approach to contract law that seeks to protect less sophisticated parties by restricting freedom of contract hinders this convergence process, leading to negative effects on social welfare and infringing on individuals' autonomy.

In response to the moralist objection, I begin with a preliminary observation and then offer two arguments. My preliminary observation concerns the state's dual perspective: it recognizes the permissibility of private transactions under promissory morality but refuses to provide legal enforcement when such transactions conflict with the polity's moral standards. When the state deems a transaction permissible and is in a coalition with the contracting parties, the key questions are whom it represents within the coalition and how its agency should be aggregated. Finally, the broader justice issue involves evaluating whether non-state enforcement could serve as a just alternative.

The first argument I propose is that, in the absence of externalities affecting third parties, decision-making power between the state and the contracting parties should be allocated based on each party's marginal contribution to the transaction's value.¹⁰ Since commercial parties can execute

9. The focus here is on the theory of contract law, but the same reasoning can extend to other areas of business law—many explored by Alan Schwartz—including bankruptcy, finance, and M&A, as long as no externalities are present, *see, e.g.*, Alan Schwartz, *Bankruptcy Contracting Reviewed*, 109 YALE L.J. 343 (1999); Alan Schwartz, *Bankruptcy-Related Contracting and Bankruptcy Functions*, in RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 363 (Barry E. Adler ed., 2020); Alan Schwartz & Tracy Lewis, *Unenforceable Securitization Contracts*, 37 YALE J. ON REGUL. 164 (2020). Ronald J. Gilson & Alan Schwartz, *An Efficiency Analysis of Defensive Tactics*, 11 HARV. BUS. L.J. 1 (2021); Ronald J. Gilson & Alan Schwartz, *Corporate Control and Credible Commitment*, 43 INT'L REV. L. & ECON. 119 (2015).

10. Specifically, I propose that agency distribution should follow the Shapley value, although other solution concepts from cooperative game theory are also possible. The Shapley value is, in any case, highly general and typically applied to the distribution of payoffs in coalitions. However, as an objective and fair solution concept, it can also be extended to the allocation of rights, including the agency of participants within a coalition. The Shapley value is justified by axioms that ensure fair payoff distribution based on contributions: Efficiency, where the total value is fully allocated among players; Symmetry, where equal contributors receive equal payoffs; Dummy Player, where non-contributors get zero; and Additivity, where a player's value in a combined game is the sum of their values from individual games, *see* Lloyd S. Shapley, *A Value for n -Person Games*, in 2 CONTRIBUTIONS TO THE THEORY OF GAMES 307-17 (H.W. Kuhn & A.W. Tucker eds., 1953).

self-enforceable transactions, their marginal contribution exceeds that of the state, warranting greater agency within the coalition.

The second argument addresses situations where commercial parties lack the resources to make a contract self-enforceable. In these cases, the absence of state enforcement may create distributive inequality, which is morally indefensible. By denying legal enforcement and relying on private enforcement, the state favors resource-rich parties, violating a fundamental principle of the liberal state: ensuring equality of opportunity through its legal framework.¹¹

The remainder of this essay is structured as follows. Part I examines the constraints on freedom of contract, the justifications for and against such restrictions, and outlines the rationality and moralist objections. Part II introduces a theory of commercial rationality to address the rationality objection. Part III presents arguments refuting the moralist objection. Finally, the paper concludes.

I. Freedom of Contract and Its Criticism

Contract law forms the backbone of capitalism. Economies of exchange, production, and investment operate primarily through contracts. However, both contract law and external regulations introduce rigidities that limit the use of contracts.

A. Constraints and Justifications for Liberalization

There are three types of constraints on freedom of contract, each with a distinct rationale.

First, non-contract regulations impose limitations on what parties can agree to, regardless of their level of sophistication. These restrictions are justified on both consequentialist and non-consequentialist grounds. From a consequentialist perspective, the primary concern is the allocative distortions that unrestricted freedom of contract can produce. For instance, banking regulations often limit borrowing capacity because individual contracts, while efficient for the parties involved, may create systemic risks that threaten overall social welfare.¹² Similarly, securities regulations prohibit insider trading, as the resulting unfair distribution could erode investor confidence and reduce their willingness to invest. By curbing insider trading, regulators promote transparent and fair capital markets, fostering

11. See David Clark & Simone M. Sepe, *Contract as Equal Defense* (unpublished manuscript, 2025) (on file with authors).

12. Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 194-98 (2008) (analyzing the systemic risks created by financial transactions that may be individually efficient but harmful to overall social welfare).

investment and economic growth.¹³ Environmental regulations also restrict individually efficient transactions when they generate negative externalities, such as pollution. More generally, there are reasons to limit contractual freedom when systemic factors—such as those at the industry level—are at play. In such cases, restrictions are essential to contain negative externalities and enhance overall efficiency. Alternatively, non-consequentialist justifications impose moral constraints that prohibit certain transactions, such as organ sales, even when those transactions might be efficient from a welfare perspective.¹⁴

I do not dispute the rationale for such restrictions, referred to here as *public policy constraints*. While there may be debate over their timing and scope, I agree that contractual freedom can be *substantively* limited for public policy reasons.¹⁵

Another constraint on freedom of contract arises in transactions between parties of unequal standing, such as between an unsophisticated consumer and a sophisticated producer. These constraints are grounded not only in general principles of contract law but, more importantly, in specific statutes designed to protect weaker parties, such as consumers.¹⁶ This protective regulation, which I refer to as *consumer protection constraints*, is paternalistic in nature and encompasses both substantive¹⁷ and procedural limits.¹⁸ Because these rules govern the relationship between merchants and consumers, they fall outside the scope of this essay, which focuses exclusively on contractual relations between commercial parties.

Public policy restrictions on freedom of contract are primarily justified by their negative general equilibrium effects or incompatibility with

13. Donald C. Langevoort, *Rereading Cady Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319 (1999).

14. Transactions, such as the sale of organs, would clearly violate the Kantian categorical imperative. See IMMANUEL KANT, *GROUNDWORK OF THE METAPHYSICS OF MORALS* 37-42 (Mary Gregor ed. & trans., Cambridge Univ. Press 1997) (1785); see also MICHAEL J. SANDEL, *WHAT MONEY CAN'T BUY: THE MORAL LIMITS OF MARKETS* 9-11 (2012).

15. General equilibrium theory with incomplete markets provides a solid foundation for these justifications, see John Geanakoplos & Herakles Polemarchakis, *Existence, Regularity, and Constrained Suboptimality of Competitive Allocations When Markets are Incomplete*, in 3 *ESSAYS IN HONOR OF KENNETH ARROW* 77 (Walter P. Heller, Ross M. Starr & David A. Starrett eds., 1986). Alongside this, deontological arguments, such as Kant's principle of universality, also support these limitations, see ARTHUR RIPSTEIN, *FORCE AND FREEDOM: KANT'S LEGAL AND POLITICAL PHILOSOPHY* 10-15 (2009).

16. Alan Schwartz, *Regulating for Rationality*, 67 STAN. L. REV. 1373, 1375-76 (2015).

17. Substantive regulation governs the content of contracts to ensure fairness in the rights and obligations of each party. Examples include the Magnuson-Moss Warranty Act, which mandates clarity and fairness in warranty terms, see 15 U.S.C. §§ 2301-2312 (2018). Additionally, Unfair and Deceptive Acts and Practices (UDAP) laws prohibit exploitative or unfair terms, see National Consumer Law Center, *Consumer Protection in the States: A 50-State Report on Unfair and Deceptive Acts and Practices Statutes*, NAT'L CONSUMER L. CTR. (2022), https://www.nclc.org/wp-content/uploads/2022/08/report_50_states.pdf [https://perma.cc/ZZF4-845J].

18. Procedural regulation ensures transparency and fairness in the contract formation process. Examples include the Truth in Lending Act (TILA), requiring clear disclosure of credit terms, see 15 U.S.C. § 1601 (2021). Similarly, the Consumer Leasing Act (CLA) mandates transparent disclosure of lease terms and penalties, see 15 U.S.C. § 1667 (2021).

higher moral principles. Instead, consumer protection constraints address significant epistemic asymmetries between parties, which can undermine the standard Pareto-improvement justification for contracts, assuming all parties are rational and expect mutual benefit from agreements. When one party lacks sufficient understanding or rationality, this assumption breaks down, potentially leading to welfare losses. Furthermore, even if greater contractual freedom could result in welfare improvements, epistemic asymmetry may still justify limitations to promote distributive efficiency.¹⁹ From a non-consequentialist view, limiting freedom of contract may undermine autonomy. However, autonomy requires informed, deliberate choices; if a party lacks full understanding, due to cognitive or other limitations, their consent isn't genuine, justifying restrictions to safeguard self-determination.²⁰

The third limitation on freedom of contract stems from the basic structure of contract law and its procedural restrictions, which I define as *structural contractual constraints*.²¹ Key features such as bargaining, interpretation,²² and remedies²³ are determined by the state, rather than left to party discretion.²⁴ Structural constraints, however, have substantive effects, shaping the framework within which contracts are formed and enforced, and limiting the terms parties can agree upon. For example, rules preventing contracts formed under power imbalances indirectly affect substantive terms (e.g., permissible prices), thereby restricting freedom of contract. These limits, which address how contractual surplus should be distributed, also impact the economic surplus that parties can generate.²⁵ Moreover, when certain remedies or interpretations are prohibited, the potential surplus is reduced, diminishing overall contract efficiency.

19. A Pareto improvement may not maximize total welfare. Utilitarian principles suggest that a more equal distribution of surplus increases welfare by benefiting those with lower utility, due to diminishing marginal returns. KENNETH J. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* 26-28 (2d ed. 1963); AMARTYA SEN, *INEQUALITY REEXAMINED* 45-48 (1992). Fairer distribution fosters social stability and future cooperation, see JOHN RAWLS, *A THEORY OF JUSTICE* 75-76 (rev. ed. 1999).

20. See JOSEPH RAZ, *THE MORALITY OF FREEDOM* 369-372 (1986) (discussing the role of autonomy in contract law); CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* 14-16 (2d ed. 2015) (arguing that true autonomy requires informed consent).

21. Schwartz & Sepe, *supra* note 5.

22. Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 *YALE L.J.* 926 (2010); see also Alan Schwartz & Simone M. Sepe, *Midstream Contract Interpretation*, 99 *NOTRE DAME L. REV.* 611 (2023).

23. See Alan Schwartz, *The Case for Specific Performance*, 89 *YALE L.J.* 271, 306 (1979) (arguing that specific performance should be available to promisees who request it); see also Schwartz & Sepe, *Contract Remedies*, *supra* note 6 at 749.

24. *Id.*

25. Substantive unconscionability imposes limits aimed at equitable surplus distribution, but courts rarely apply it. Scholars debate whether these limits are practically significant or mostly theoretical. See Arthur A. Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 *U. PA. L. REV.* 485, 487-89 (1967); Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 *HARV. L. REV.* 741, 746-48 (1982).

Structural contractual constraints generally apply to all contracting parties, regardless of their sophistication. While these constraints are justified to protect weaker parties, such as consumers, it is debatable whether they should apply to sophisticated parties. Alan Schwartz, together with Robert Scott and more recently with me, has argued that these constraints reduce the potential payoffs for sophisticated parties, thereby lowering overall social welfare.²⁶ This is the main consequentialist argument against structural contractual constraints.

There are also non-consequentialist reasons to oppose these restrictions. Some sophisticated parties can avoid mandatory structural terms by using legal resources to create complex frameworks, while others with fewer resources cannot, leading to inequality of opportunity.²⁷ Additionally, parties have preferences over both substantive and procedural terms, and imposing rigid procedural rules would arbitrarily restrict their autonomy.²⁸ This argument rests on two points: (1) substantive and procedural terms are morally equivalent, as both reflect the parties' autonomous choices; and (2) if substantive terms are enforceable as freely made decisions, procedural terms should be enforceable for the same reason. Concerns about poor procedural choices or unequal bargaining power are misplaced, as courts regularly enforce one-sided contracts with harmful substantive terms.²⁹

The analysis I develop in this essay—which seeks to show that the Schwartzian assumptions underlying the case for liberalizing contract law are immune to certain criticisms not fully addressed in the contract theory literature—is thus directed precisely at these types of structural contractual constraints.

B. Two Unaddressed Criticisms

I share the view that there are both consequentialist and deontological reasons supporting the deregulation of structural contractual constraints for sophisticated parties.³⁰ I do not intend to elaborate further on this point. However, a gap in the literature remains, as certain criticisms to the assumptions supporting these conclusions, to the best of my knowledge, have not been fully addressed. If these assumptions are flawed, the conclusions would not be deductively valid, thereby undermining the normative claim for extending freedom of contract to sophisticated parties.

The first of these criticisms is the *rationality objection*, which challenges the poorly defined concept of *sophisticated parties* and its unclear attributes. When the descriptive basis of a normative framework is vague

26. Schwartz & Scott, *supra* note 1; Schwartz & Sepe, *supra* note 5.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

or imprecise, the resulting normative implications may be undermined.³¹ For those who support this objection, parties cannot be assumed to be sophisticated simply based on their activities (e.g., commercial business) or legal status (e.g., corporations).³² Even if parties engage in similar activities or share the same type of business entity, this does not guarantee that they are epistemic peers or equally rational. One party may be structurally stronger, making the other less sophisticated.³³ As a result, such transactions could face similar issues to those that justify consumer protection constraints. Party sophistication could not be defined categorically; rather, it is a matter of degree.

Just as there are consequentialist and non-consequentialist reasons to limit freedom of contract in consumer transactions, similar reasons could justify structural constraints to protect the weaker party.³⁴ It would be improper to assume that contracts between unequally sophisticated parties will always result in allocative efficiency under the Pareto criterion. Even if such improvements occur, concerns about distributive efficiency—again, similarly to those arising in consumer protection—would justify restricting freedom of contract.³⁵ Additionally, non-consequentialist arguments could apply, asserting that significant epistemic asymmetry undermines the autonomy of the weaker party.³⁶

The second criticism, the *moralist objection*, is non-paternalistic and is well represented by Sheena Shiffrin's position.³⁷ She challenges the law and economics approach to contracts, pioneered by Alan Schwartz, that the state's role in contracts should be assessed and determined based on welfare-dependent reasons. Shiffrin argues that contracts are a communal institution in which the state provides security and enforcement. As an independent moral agent, the state has the right to decide whether to engage in an interaction with contracting parties. By granting enforcement, the state forms a cooperative relationship with the parties but can refuse to

31. Normative claims, such as judgments about what is desirable, depend on a clear understanding of the categories or entities being regulated. See H.L.A. HART, *THE CONCEPT OF LAW* 121-25 (3d ed. 2012) (discussing the relationship between clarity of legal concepts and normative judgments); RONALD DWORKIN, *TAKING RIGHTS SERIOUSLY* 22-24 (1977) (arguing that normative conclusions rely on precise descriptive concepts).

32. Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 495-97 (2010).

33. Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 220-22 (1995) (arguing that structural imbalances, even between similar entities, affect rationality and bargaining power).

34. Cf. *id.*

35. Melvin A. Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741 (1982).

36. JOSEPH RAZ, *THE MORALITY OF FREEDOM* (1986).

37. Shiffrin, *supra* note 4.

cooperate if certain contractual terms conflict with the community's values.³⁸

This approach, according to Shiffrin, is non-paternalistic because contracting parties remain free to regulate their agreements outside the scope of legally enforceable contracts by relying on the system of promissory morality. This freedom is guaranteed, as there are no legal restrictions preventing agents from employing promissory morality in their arrangements.

In the next two sections, I will address these criticisms by developing a theory of commercial rationality and state cooperation in transactions between sophisticated parties. My aim is to demonstrate that the assumptions underlying the argument for liberalizing contract law from structural contractual constraints—the concept of parties' sophistication and the normative desirability of a utilitarian-welfarist approach—are reasonable and immune to both the rationality and moralist objections, and that, consequently, Alan Schwartz's conclusions in favor of freedom of contract are valid.

II. Parties' Sophistication and Rationality

Are commercial parties sophisticated—meaning rational—such that a different set of contract laws might apply to their transactions compared to transactions between unsophisticated parties or those between a sophisticated and an unsophisticated party? What exactly defines a sophisticated party? Specifically, what rationality standards determine whether a party is sophisticated, making the concept descriptively significant with normative implications?

In this section, I will explore various concepts of rationality from the economic and philosophical literatures as they apply to contracting parties and introduce the new concept of *commercial rationality*. I will conclude that the predicate “commercially rational” can be reasonably attributed to any merchant. I will also demonstrate that being commercially rational is *sufficient* to counter the paternalistic argument that relies on the continuous concept of rationality and advocates for state protection of the less rational party against potential exploitation by the more rational party.

A. Which Rationality

Rationality does not have a single definition. The most frequently used notion of rationality in law and economics is that of decision theory, which relies on very strong assumptions that are difficult to meet. Epistemology, on the other hand, offers more general and broader perspectives

38. Although Shiffrin's theory focuses on substantive unconscionability, it is a general framework that can extend to any type of contractual term, including those defined here as structural, provided they are perceived by the community as unfair.

on rationality, raising the question of whether the conditions of decision theory are truly necessary to define rational behavior. So, is a sophisticated commercial party considered rational when it meets the conditions of decision theory or the more permissive conditions of epistemology? There are still other definitions of rationality that consider individuals' cognitive limitations and how they make decisions within these constraints. I will discuss all these forms of rationality.

1. Economic Rationality

In economic theory, rationality refers to a decision-making process where agents, whether individuals or firms, seek to maximize utility or profit based on their preferences, constraints, and available information.³⁹ This framework rests on four assumptions. First, agents' preferences are consistent, meaning they satisfy completeness and transitivity.⁴⁰ Second, agents act to maximize their utility function, which reflects their preferences over various bundles of goods or outcomes.⁴¹ Third, in uncertain situations, rational agents maximize expected utility, calculated as the sum of the utilities of possible outcomes, each weighted by its probability.⁴² Finally, agents *rationally* choose the option that provides the highest utility from the feasible set, considering constraints such as budget, time, or resources.⁴³

When agents are assumed to be economically rational, the underlying assumptions imply that *no exploitation* can occur in voluntary transactions, as each party acts to maximize their utility without the risk of manipulation. It follows that the Pareto criterion applies, so that any voluntary transaction under freedom of contract is presumed to enhance social welfare. In a world of economically rational agents, consumer protection and structural contractual constraints would be inefficient, leaving only public policy constraints as relevant. The key question, however, is whether it is

39. KEN BINMORE, RATIONAL DECISIONS 35-38 (2009); Mas-Colell, Whinston & Green, *supra* note 7, at 11-15.

40. Completeness ensures that for any two options, A and B, the agent can express a preference or remain indifferent. Transitivity means that if the agent prefers A to B and B to C, they must prefer A to C. See ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, *supra* note 7, at 5-7.

41. *Id.* at 51-55.

42. This is captured by the von Neumann-Morgenstern utility function: $E[U] = \sum_i p_i U(x_i)$, where p_i is the probability of outcome x_i , and $U(x_i)$ is the utility of that outcome. Importantly, agents are not required to have perfect information; they can act rationally based on what they know, a concept known as Bayesian rationality, see JOHN VON NEUMANN & OSKAR MORGENSTERN, THEORY OF GAMES AND ECONOMIC BEHAVIOR 17-19 (3d ed. 1953); KEN BINMORE, RATIONAL DECISIONS 120-23 (2009).

43. Preference consistency and utility maximization are fundamental principles, while expected utility theory applies these to uncertainty. Rational choice results from satisfying these conditions, assuming the broad axioms of choice hold. Cf. KEN BINMORE, RATIONAL DECISIONS, *supra* note 42, at 30-32.

reasonable to assume that economic agents consistently meet this standard of rationality.

Unsophisticated consumers do not meet these epistemic standards, and protections, whether legal or arising from competitive forces that offer more favorable terms, are beneficial. But what about merchants acting within their professional domain? Even for these actors, meeting the assumptions of economic rationality is highly implausible. Herbert Simon's concept of bounded rationality suggests that all individuals have limited cognitive capacity, leading to *satisficing* decisions rather than optimal ones.⁴⁴ Behavioral economics reveals how cognitive biases and heuristics—like the availability heuristic and loss aversion—distort rational decision-making.⁴⁵ Empirical findings, such as preference reversals and the endowment effect, indicate that preferences are often inconsistent and context-dependent, violating key assumptions of rational choice theory.⁴⁶ Under uncertainty, agents typically lack perfect information and, even when relying on Bayesian rationality, they often exhibit time-inconsistent behavior, such as hyperbolic discounting, which leads them to favor immediate rewards over future gains.⁴⁷ These critiques highlight that the assumptions of economic rationality are overly idealized, making it an unrealistic model even for commercial actors.

At the aggregate economic level, the issue of economic rationality is more complex. According to one perspective, bounded rationality is the primary source of market incompleteness, leading to inefficiencies in competitive equilibria.⁴⁸ On the other hand, some suggest that competitive markets can behave rationally and efficiently at the aggregate level, even if rationality does not hold at the individual level.⁴⁹ This discussion does not aim to assess these perspectives, although the critique of market incompleteness seems more compelling to me. I want to emphasize that even if collective economic rationality were true, significant gaps would still exist, preventing us from dismissing the argument for restrictions on freedom

44. Simon, *supra* note 3.

45. See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 *ECONOMETRICA* 263, 274-75 (1979); DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2011).

46. See Daniel Kahneman, Jack L. Knetsch & Richard Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 *J. ECON. PERSP.* 193 (1991); Amos Tversky & Richard H. Thaler, *Preference Reversals*, 90 *J. POL. ECON.* 204 (1982).

47. George Loewenstein & Drazen Prelec, *Anomalies in Intertemporal Choice: Evidence and an Interpretation*, 107 *Q.J. ECON.* 573 (1992).

48. MICHAEL MAGILL & MARTINE QUINZII, *THEORY OF INCOMPLETE MARKETS* (2002).

49. This is illustrated by the *law of large numbers*, which posits that individual deviations from rationality may cancel each other out when aggregated across many agents, resulting in market outcomes that reflect “average” rational behavior. See NANCY L. STOKEY & ROBERT E. LUCAS, JR., *RECURSIVE METHODS IN ECONOMIC DYNAMICS* (1989). Similarly, in *representative agent models*, the simplifying assumptions suggest that the collective behavior of many individuals can resemble that of a single rational agent under certain conditions. Cf. ROBERT E. LUCAS, JR., *MODELS OF BUSINESS CYCLES* (1987).

of contract for merchants. For instance, transactions outside competitive markets (e.g., idiosyncratic transactions à la Williamson) would still be subject to paternalistic critiques regarding asymmetries in rationality.⁵⁰ Finally, autonomy-based, non-consequentialist arguments would remain relevant for restricting freedom of contract.

2. Philosophical Rationality

Economic decision theory defines rationality as maximization, while philosophical perspectives offer broader criteria. Philosophers distinguish between theoretical and practical rationality, each providing different frameworks for evaluating decisions. Theoretical rationality involves forming beliefs based on evidence and logic, with various approaches.⁵¹ In *evidentialism*, a belief is rational if supported by available evidence, even if errors arise from credible but misleading information.⁵² *Coherentism* views rationality as the consistency of beliefs within a system.⁵³ *Reliabilism* emphasizes that rational beliefs stem from reliable methods, like empirical research or sound reasoning, allowing for occasional errors as long as an agent generally uses dependable decision-making processes.⁵⁴ Lastly, *Bayesianism* holds that rationality involves updating beliefs in line with Bayes' Theorem when new evidence emerges.⁵⁵

Practical rationality, in contrast, focuses on actions and decisions aimed at achieving goals. Under instrumentalism, rationality is about choosing the most effective means to reach those goals.⁵⁶ Irrationality would only arise only when actions consistently fail to align with the intended goals. Substantive rationality, on the other hand, evaluates not only the means but also the goals themselves.⁵⁷

Some philosophical views, like coherentism or substantive rationality, would consider a commercial party as rational even when economic decision theory would not. For instance, a company prioritizing employee well-

50. OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985).

51. JON ELSTER, *REASON AND RATIONALITY* (2009).

52. LAURENCE BONJOUR, *THE STRUCTURE OF EMPIRICAL KNOWLEDGE* (1985). For example, a merchant relying on a reputable but inaccurate market analysis is still rational, as she acted on the best available evidence at the time.

53. *See id.* For example, a merchant may hold conflicting strategies but isn't irrational unless she ignores contradictions once they become clear.

54. WILLIAM P. ALSTON, *EPISTEMIC JUSTIFICATION: ESSAYS IN THE THEORY OF KNOWLEDGE* (1989).

55. RICHARD JEFFREY, *PROBABILITY AND THE ART OF JUDGMENT* (1992). For example, a merchant maintains rationality by adjusting her strategy based on new sales data, continuously updating her beliefs.

56. JOHN DEWEY, *THE QUEST FOR CERTAINTY* (1929). A merchant may base its decisions on the best available information, even if the outcome is suboptimal.

57. AMARTYA SEN, *RATIONALITY AND FREEDOM* (2002). For example, a merchant who prioritizes ethics may reject a profitable venture that conflicts with her values, which remains rational, even if it doesn't maximize profit.

being over profits may be irrational by economic standards but rational under coherentism if the decision is consistent with the company's core values. While economic theory would call this irrational for not maximizing profit, substantive rationality deems it rational because the decision aligns with moral beliefs. *Reliabilism* would also consider a merchant rational for using certain decision-making protocols, even if they do not maximize profit, if those protocols have proven reliable in the past.

In sum, whether a commercial party is considered sophisticated depends on the definition of rationality applied. This leads to an issue of underdetermination, where different rationality criteria yield different conclusions about the same decision, while there is no clear, independent standard to prefer one over the other.

3. Procedural Rationality

To develop a realistic view of rationality, one must recognize the limitations faced by real-world decision-makers. Economic decision theory assumes unlimited cognitive resources, which is unrealistic. Philosophical models show that rationality varies based on different epistemic commitments. Therefore, they cannot offer a unique criterion for determining when a commercial party is sophisticated enough to make paternalistic state intervention unnecessary. I argue that a practical and realistic approach is to recognize that all economic agents, including merchants, are *boundedly rational*.⁵⁸ This will serve as my working hypothesis.

Herbert A. Simon's concept of bounded rationality emphasizes that humans, constrained by limited information and processing capacity, cannot always make optimal decisions. Aware of these limitations, agents focus on finding satisfactory solutions, leading to *procedural rationality*, which prioritizes the decision-making process over outcomes.⁵⁹ Rather than striving for optimization, agents employ reasonable methods that account for their cognitive constraints, often using satisficing to select options that meet acceptable thresholds.⁶⁰ This model provides a practical framework for decision-making in environments characterized by limited cognitive resources and uncertainty. In commercial contexts as well, where economic optimization is impractical, rationality is shaped by these boundaries.

Procedural rationality has developed various strategies to enhance decision-making. Beyond satisficing, other methods include heuristics, which

58. Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99, 113 (1955); see also Reinhard Selten, *Bounded Rationality*, 146 J. INSTITUTIONAL & THEORETICAL ECON. 649, 649–58 (1990). For a comprehensive and excellent survey on bounded rationality and its related challenges, see John Conlisk, *Why Bounded Rationality?*, 34 J. ECON. LIT. 669, 669–700 (1996).

59. Simon, *supra* note 3.

60. *Id.*

serve as mental shortcuts to simplify complex decisions.⁶¹ Another approach is elimination by aspects, where agents progressively exclude options that fail to meet key criteria.⁶² In uncertain conditions, recognition-primed decision-making draws on past experiences and intuition for swift judgments. Anchoring and adjustment is yet another strategy, where agents begin with an initial estimate (anchor) and revise it based on additional information, though cognitive limitations frequently impede full adjustments.⁶³

4. Organizational Rationality

Procedural rationality applies to individuals, but at the organizational level, it unfolds across several dimensions or levels of the organizational structure. First, cognitive tasks are distributed across the organization based on epistemic criteria like expertise and experience,⁶⁴ as well as economic factors, such as unit costs. Second, individual agents make decisions based on procedural rationality, both in its strict sense and often within the framework of organizational guidelines.⁶⁵ Finally, the units' contributions are aggregated through procedures that lead to a final decision. These dimensions together represent what I will refer to as *organizational rationality*, covering the entire process from task distribution to decision-making.

Organizational rationality supports a stronger form of rationality despite apparent cognitive limitations at the individual level. Complex decision-making tasks that may be cumbersome for individuals can be managed more effectively within organizations.⁶⁶ For example, major decisions such as hiring, strategic planning, or large investments are often made by committees that leverage members' expertise and reduce cognitive load. While individuals may not behave as ideal economic agents according to decision theory due to bounded rationality, the organizational structure compensates for these limitations through the division of cognitive labor,

61. Daniel Kahneman & Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1124-31 (1974). For instance, in finance, investors might follow the heuristic "buy low, sell high" without conducting detailed market analysis.

62. Amos Tversky, *Elimination by Aspects: A Theory of Choice*, 79 PSYCHOL. REV. 281, 281-99 (1972). For example, price or quality criteria.

63. Daniel Kahneman & Amos Tversky, *Judgment Under Uncertainty*, *supra* note 61. For example, in negotiations, the first offer serves as an anchor, influencing subsequent offers even if further information suggests a different value.

64. Every organization divides cognitive labor, but this is especially crucial in large-scale projects, where engineering teams handle technical design, finance teams evaluate costs and budgets, and marketing teams assess customer preferences and market trends. *Cf.* JAMES G. MARCH & HERBERT A. SIMON, *ORGANIZATIONS* (2d ed. 1993).

65. Standard Operating Procedures (SOPs), widely used across industries like healthcare and manufacturing, enable employees to make consistent, time-sensitive decisions that follow organizational standards. In a hospital, for example, SOPs for emergency admissions ensure swift and safe treatment. *Cf., e.g.*, HENRY MINTZBERG, *STRUCTURE IN FIVES: DESIGNING EFFECTIVE ORGANIZATIONS* (1983).

66. HERBERT A. SIMON, *ADMINISTRATIVE BEHAVIOR: A STUDY OF DECISION-MAKING PROCESSES IN ADMINISTRATIVE ORGANIZATIONS* (4th ed. 1997).

information aggregation, and formal decision-making processes. In efficient organizations, the collective decision-making process establishes the practical boundaries of what can be considered rational.⁶⁷

Alan Schwartz is correct in identifying corporations as sophisticated parties in contracts.⁶⁸ At least for large corporations, we can assume that the sophistication of their decision-making closely approximates that of an ideal economic agent. This makes paternalistic objections—such as the need to protect cognitively weaker parties—unjustified. The challenge now is to determine whether rationality can be defined in a way that applies to all commercial parties, not just large corporations, to fully address the paternalistic critique.

B. Commercial Rationality

In this section, I explain why commercial parties over time develop and enhance a form of rationality that I define as commercial rationality. This concept of rationality applies to any merchant, and I argue that a merchant's sophistication can be assumed based on certain conditions that are also reasonably expected to hold. By nature, a merchant has a clear normative goal: conducting business successfully. This goal inherently involves sensitivity to payoffs, as merchants naturally aim for better outcomes in their activities. Therefore, sensitivity to payoffs requires no further justification, as it is intrinsic to any business operation.

The essential conditions I identify and will justify by demonstrating that every merchant exhibits them are (1) the capacity for learning; (2) memory; and (3) a system for updating beliefs. The first two are foundational; without the ability to learn from experience and retain information, a merchant cannot improve decision-making over time. The third condition is required for adjusting strategies based on new information, enabling merchants to refine their understanding of the transactional environment in which they operate.

It is reasonable to assume that every merchant meets these conditions; without them, they could not enter into, or survive in, a competitive

67. Organizational rationality, understood as the rationality of a collective entity, introduces challenges distinct from those present at the individual level. Diverging interests among group members can lead to friction in decision-making processes. This divergence underscores the importance of considering conflicts of interest within the group. However, these issues can be mitigated if the organization establishes an internal incentive structure that minimizes such conflicts. See, e.g., Bengt Holmström, *Moral Hazard in Teams*, 13 *BELL J. ECON.* 324, 325-26 (1982) (analyzing how team-based settings create moral hazard and discussing mechanisms to align individual and collective incentives); KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 23-28 (1974) (discussing the role of organizational structure in resolving conflicts of interest); OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* 75-78 (1975) (examining how internal governance mechanisms address opportunism and align interests within organizations).

68. Schwartz & Scott, *supra* note 1.

market, which is the benchmark in a capitalist economy.⁶⁹ Regarding the capacity for learning, any merchant unable to adapt to changing market conditions (e.g., customer preferences, competitive actions, etc.) would be excluded from the market.⁷⁰ The commercial environment offers constant feedback—through profits, losses, customer reactions, and market trends—compelling merchants to learn and adjust their strategies. A merchant incapable of learning would not be able to operate effectively in this environment.

Memory is also fundamental. Without the ability to retain information from past transactions, customer interactions, and market outcomes, merchants would lack the foundation for informed decision-making. Over time, the accumulation of memories builds the expertise necessary for market interactions. A merchant without memory would struggle in repeated situations, which are required for long-term survival.

Finally, the ability to update beliefs is also essential. A merchant who cannot adjust expectations based on new information would be unable to respond to changing circumstances. Even without formal models, merchants practically update their beliefs. For example, if a product fails to sell, a merchant infers low demand and adjusts accordingly. A merchant unable to revise strategies in response to new market trends or customer feedback would struggle to enter and sustain themselves in a competitive environment. It is therefore reasonable to postulate that this capacity for belief-updating is a trait of any merchant.⁷¹

I argue that these three conditions are *sufficient* for a learning process in which merchants enhance their decision-making over time through experience. Unlike economic rationality, which is based on deduction, commercial rationality is fundamentally inductive; merchants make decisions based on observed outcomes.⁷² Through repeated actions, they identify market patterns, leading to specific forms of procedural rationality—

69. The question arises whether it is valid to assume these conditions when a party operates in a non-competitive environment and is not subject to competitive forces for survival. In such a scenario, the concern becomes less significant, as the protective mechanisms for the merchant would depend less on the assumed level of rationality and more on the market power they hold. Furthermore, it should be noted that these three conditions are by no means guaranteed in the case of consumers.

70. W. Brian Arthur, *Inductive Reasoning and Bounded Rationality*, 84 AM. ECON. REV. 406, 407 (1994) (explaining how agents “learn” by discarding poorly performing hypotheses and generating new ideas).

71. Bayesian updating, while rigorous, demands precise probabilities that are often impractical for merchants. Instead, belief revision methods like the AGM model suffice. See RICHARD JEFFREY, *THE LOGIC OF DECISION* (2d ed. 1983). The AGM model outlines postulates for rational belief revision without relying on exact probabilities, focusing on maintaining logical consistency when incorporating new information, see Carlos E. Alchourrón, Peter Gärdenfors & David Makinson, *On the Logic of Theory Change: Partial Meet Contraction and Revision Functions*, 50 J. SYMB. LOGIC 510, 512-13 (1985). Simple rules, such as adjusting beliefs when contradicted by new evidence while retaining most of the original belief system, provide practical decision-making tools for merchants without complex calculations.

72. See Arthur, *supra* note 69, at 406-08.

heuristics that approximate the deductive reasoning found in rational choice theory. As merchants engage in transactions, they collect data on effective and ineffective strategies. By recognizing which actions consistently yield better payoffs, they develop heuristics to guide future decisions. Continuous (market) feedback further refines these heuristics, increasing their effectiveness over time.⁷³ As their procedural rationality evolves, it increasingly converges with the optimization strategies predicted by rational choice theory.

To understand how convergence to rational choice occurs, consider that initially, merchants have little information about the profitability of contracting with specific members and may assume, for example, that profit is low due to a lack of prior interactions. As they begin engaging in contracts, they observe the outcomes and record the payoffs received. By assumptions (1) and (3), merchants process this new information to reassess their expectations. Merchants make decisions based on their current beliefs about expected payoffs, tending to choose parties and contract terms they believe will maximize their returns. To avoid missing out on potentially more profitable opportunities, they occasionally explore new parties or adjust contract terms, even if these options are not initially expected to yield the highest payoff or, anyway, are riskier. This exploratory behavior allows them to gather information about alternatives they might otherwise overlook.⁷⁴ After each contract execution, merchants observe the actual payoff u_t and compare it to their prior expected payoff $\hat{u}_{t-1}$. They update their beliefs using, for example, a simple updating rule: $\hat{u}_t = \hat{u}_{t-1} + \alpha_t(u_t - \hat{u}_{t-1})$, where α_t is the learning rate (which, perhaps oversimplifying, can also be interpreted as the degree of rationality), a positive value between 0 and 1 that is time-dependent (i.e., reasonably increasing over time). By assumption (3), merchants adjust their expectations based on the difference between observed and expected payoffs. This updating rule ensures that if the observed payoff u_t is higher than the expected payoff $\hat{u}_{t-1}$, the new expectation $\hat{u}_t$ increases, and the other way around.

As merchants accumulate more experiences, their estimates u_t become more accurate, converging toward the true expected payoff $E[u]$. By assumption (2), merchants retain information about past contracts and outcomes, enabling them to calculate average payoffs and identify trends over time. Over time (i.e., asymptotically), as $\hat{u}_t \rightarrow E[u]$,⁷⁵ merchants start consistently choosing the parties and contracts that maximize their

73. GERD GIGERENZER & REINHARD SELTEN, *BOUNDED RATIONALITY: THE ADAPTIVE TOOLBOX* (2001).

74. James G. March, *Exploration and Exploitation in Organizational Learning*, 2 *ORG. SCI.* (1991).

75. The convergence process is underpinned by the Law of Large Numbers, which posits that as the number of observations grows, the sample mean approaches the expected value. This convergence can occur either in probability, as described by the Weak Law of Large Numbers, or almost surely, as per the Strong Law of Large Numbers. Cf. PATRICK BILLINGSLEY, *PROBABILITY AND MEASURE* 5-11 (3d ed. 1995).

expected payoffs. These selective actions represent a reduced form of optimization, achieved through inductive reasoning.⁷⁶

Even if the learning environment evolves over time (e.g., due to regulatory or technological changes), merchants can still achieve higher expected payoffs by continuously updating their beliefs and occasionally exploring new opportunities. This allows them to adapt to shifting equilibria and refine their strategies in response to new information. In fact, changes in the learning environment can be accounted for through the very processes of learning and belief updating, confirming that decisions tend to maximize returns based on current knowledge.⁷⁷

One last note is worth here, focusing on the relationship between commercial, procedural, and organizational rationality. Commercial rationality assumes bounded rationality and procedural rationality. It can thus be viewed as a form of dynamic procedural rationality that develops within a specific domain—the merchant’s business environment—evolving from practical experience. Organizational rationality, when applied to a business entity, is instead a particular form of commercial rationality where capital, K (in its physical, financial, human, and organizational forms), plays a role in enhancing the efficiency of commercial processes. To clarify the role of capital, organizations are expected to exhibit a higher learning rate, α_i , which is capital-dependent, where $\alpha_i'(K) > 0$. Consequently, larger-scale merchants (e.g., corporations) are presumed to be more sophisticated—and thus “more commercially rational”—than smaller-scale merchants (e.g., sole entrepreneurs).

C. The Heterogenous Rationality Objection

As I mentioned, the rationality objection also questions the idea that while parties may be sophisticated, their levels of sophistication differ. Although all merchants display commercial rationality, they do so to varying degrees (i.e., they have different α_i). The key issue is whether these differences justify imposing paternalistic constraints on freedom of contract in commercial contexts. In this section, I will argue that they do not.

There are three potential arguments for restricting freedom of contract based on differences in commercial rationality. First, varying levels of rationality could lead to allocative inefficiency, resulting in contracts with negative surplus (the *allocative claim*). Second, it could cause an unequal distribution of contract surplus, which might discourage future transactions (the *incentive claim*). Third, the unequal distribution of surplus is

76. Cf. Arthur, *supra* note 69, at 408-10; Vincent P. Crawford, *Boundedly Rational versus Optimization-Based Models of Strategic Thinking and Learning in Games*, 51 J. ECON. LIT. 512, 512-27 (2013).

77. Cf. RICHARD S. SUTTON & ANDREW G. BARTO, REINFORCEMENT LEARNING: AN INTRODUCTION (2d ed. 2018).

inherently unfair, regardless of the outcomes (the *fairness claim*). The first two claims are consequentialist, while the third is deontological.

The *allocative claim* is untenable because merchants, regardless of size, typically engage in diversified projects, as Alan Schwartz suggests.⁷⁸ If a merchant with a lower learning rate consistently enters socially inefficient contracts, this contradicts the foundations of commercial rationality, which assumes merchants learn from experience and avoid persistent inefficiencies.⁷⁹ Even if inexperienced merchants engage in risky transactions that result in failure and a loss of social welfare, it is unclear why a court should shield them from inherent business risks, such as concentrating capital in a single deal. These risks are part of entrepreneurial activity, and protecting merchants from them could hinder market efficiency. That some merchants will inevitably fail in the competitive process is part of that process. But it is quite different than saying that less sophisticated merchants systematically enter inefficient contracts, compromising allocative efficiency. This is implausible and contradicts the conditions of commercial rationality.

One might object that the legal risk underlying the paternalist justification is not something merchants learn to manage through regular transactions but only when it materializes.⁸⁰ This risk could arise in relation to an extraordinary transaction (outside the normal course of business) or in cases where similar legal risks are associated with multiple projects already completed, with the risk manifesting only afterward. In such situations, the gradual learning process of commercial rationality may not adequately protect the parties, as they could lose everything if their assessment of legal risk is incorrect. But in the case of extraordinary transactions involving significant stakes, the very *sensitivity to payoff* (a prerequisite of commercial rationality) would drive the parties to invest more in understanding the legal risks involved. Similarly, when a merchant engages in smaller transactions that cumulatively pose significant legal risk, it is expected—again due to payoff sensitivity—that the merchant acquires information about such risks. The issue, therefore, is not about assuming a level of rationality sufficient to address specific legal risks, as these can be understood

78. Schwartz & Scott, *supra* note 1.

79. Since commercial rationality is acquired over time, one might consider a protection regime that is time-dependent. Under such a regime, less experienced parties (those operating in the market for a shorter period) would still be protected by mandatory structural contractual constraints, which would eventually transition into a permissibility regime over time. While this idea is theoretically plausible, it presents several issues. First, there would be a boundary problem that courts would find difficult to administer. At what point would a commercial party be considered sufficiently mature to render structural contractual constraints no longer mandatory? Second, this regime could still disadvantage less commercially mature parties, as more sophisticated counterparts might prefer to contract with more experienced parties to avoid the imposition of these constraints.

80. See Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms*, 88 N.Y.U. L. REV. 170 (2013).

inductively over time. Rather, it is about recognizing the existence of potential legal risks, and I believe this recognition is a reasonable expectation for a merchant meeting the conditions I have outlined. Furthermore, if we assume that smaller merchants, being less diversified, exhibit greater risk aversion, they would be even more inclined to invest *ex ante* in understanding the scope of risks, including legal risks, when significant amounts are at stake.

The allocative claim also fails to account for the strategic behavior of more sophisticated merchants. A party with a higher level of commercial rationality could anticipate judicial intervention favoring the less rational party and adjust pricing to offset any potential loss of appropriable surplus.⁸¹ By structuring the contract and negotiating substantive terms, the more rational party could effectively achieve the same allocative outcome, regardless of the constraints. Additionally, the claim overlooks a critical issue: constraints on freedom of contract may impede marginal transactions—those with low surplus—that could otherwise occur with fewer restrictions.⁸² Structural contractual constraints hinder such transactions, effectively reversing the allocative claim.

The *incentive claim* also fails. When courts intervene *ex post* to limit freedom of contract in favor of less sophisticated parties—essentially providing them with insurance—it may encourage more commercial transactions but distorts the incentives for learning and improving commercial rationality. Since improving decision-making requires effort, this insurance creates moral hazard, leading to underinvestment in commercial rationality.⁸³ Legal interventions that weaken the incentives for merchants to improve ultimately hamper the development of better models, resulting in a less competitive market with less competent merchants.⁸⁴

The *fairness claim*, from a deontological perspective, regarding the unequal distribution of contractual surplus due to different levels of commercial rationality, is indefensible. Unlike consumers who may lack commercial rationality, merchants are assumed to meet the three conditions of commercial rationality, which also apply when a merchant exercises autonomy. The fairness claim cannot, therefore, be separated from

81. Schwartz & Scott, *supra* note 1. This adjustment is feasible whenever the more rational party has adequate bargaining power to do so.

82. Cf., e.g., Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984).

83. Cf. JEAN-JACQUES LAFFONT & JEAN TIROLE, *THE THEORY OF INCENTIVES: THE PRINCIPAL-AGENT MODEL* (2002). Note that, as commercial rationality depends on capital—though less prominently than in organizational rationality—paternalistic protection of the less rational party would decrease the marginal return on capital invested in improving rationality, effectively redistributing resources to less rational merchants, which is not the purpose of commercial law.

84. Even in this case, it is reasonable to expect that the cost of insurance, which the court would assign to the more sophisticated party, would ultimately be passed on to the insured party if initially borne by the former.

considerations of autonomy.⁸⁵ Given the attributes of commercial rationality, it is difficult, if not impossible, to argue that a merchant's decision to enter a contract, even one that deviates from structural constraints, is not a genuine exercise of autonomy. If we accept that a merchant's autonomy is respected, using fairness as a justification for intervention becomes problematic.

One might argue that there is a moral duty to protect individuals from harmful actions (e.g., exploitation), even if those actions are chosen autonomously, or that protecting a merchant's dignity is necessary since freedom of contract could lead to intrinsic wrongs. One could view this as a moral obligation for the state to safeguard the well-being of the weaker merchant, regardless of her preferences. However, this argument collapses when the merchant's interests are well-defined, and she acts upon them autonomously.⁸⁶ Restricting autonomy in such cases undermines self-determination to pursue her own interests.⁸⁷ Nevertheless, as I will discuss next, there may be non-paternalistic reasons to limit autonomy due to fairness reasons, though I will show that this critique is also flawed.

III. State Cooperation in Commercial Contracts

The non-paternalistic critique of freedom of contract, the moralist objection, is independent from the sophistication or rationality of the parties. This critique could justify any contractual restrictions, whether substantive or structural. According to Shiffrin, while parties are free to engage in exchanges, the state can withhold cooperation if a contract contradicts communal morality.⁸⁸

This argument extends to merchants as well, offering a different normative ethics perspective on evaluating the relationship between the state and contracting parties. From a political philosophy standpoint, it challenges Alan Schwartz's position by questioning the reliability of evaluating commercial contracts through a consequentialist (i.e., utilitarian-welfarist) lens. This objection is significant because it fundamentally challenges the consequentialist rationale and is independent of the normative goals of commercial parties, whose interests typically center on the benefits they gain from the transaction.

My critique challenges Shiffrin's position by clarifying the relationship between contracting parties and the state. While I recognize the state as an independent moral agent, I question its right to refuse participation in commercial ventures. I offer a preliminary observation and two arguments against the moralist objection, focusing on what merchants could achieve

85. CHARLES FRIED, CONTRACT AS PROMISE, *supra* note 20.

86. THOMAS CHRISTIANO, THE RULE OF THE MANY: FUNDAMENTAL ISSUES IN DEMOCRATIC THEORY (1996).

87. JOSEPH RAZ, THE MORALITY OF FREEDOM, *supra* note 20.

88. *Id.*

in a pre-state environment using the promissory morality framework that Shiffrin acknowledges as viable and permissible for pursuing their interests.

The preliminary observation addresses the state's moral stance: on the one hand, it recognizes the legitimacy of private transactions (realized through promissory morality); on the other, it refuses to cooperate with transactions that conflict with community values. This suggests that while the state acknowledges the permissibility of such agreements, its decisions must account for the morally permissible positions of other agents, not merely its own. Consequently, the state's reluctance to comply with commercial parties' preferences regarding legal enforceability should be viewed as a disagreement to be resolved through the aggregation of agency among all parties (including the state) involved in the *coalition* seeking to fulfill the transaction.

The first argument concerns agency aggregation: when parties can independently achieve their commercial goals using extracontractual enforcement mechanisms, the state's marginal contribution to the transaction, as measured by the Shapley value, is minimal.⁸⁹ As a result, the state's influence should be limited, allowing the contracting parties greater agency within the arrangement. Generally, commercial parties have a higher Shapley value than the state.

The second argument addresses situations where commercial parties lack sufficient enforcement resources to render the contract self-enforceable. It suggests that when parties lack sufficient enforcement resources to defend their interests against breaches of promissory morality, the state has a moral obligation to equalize these resources through contract law. This ensures equal opportunities for all parties to defend themselves against promissory breach. This approach, which I have elaborated on in a philosophical article,⁹⁰ shifts the focus: when the state refuses to enforce contractual provisions, it perpetuates inequality by disadvantaging parties with fewer enforcement resources. Therefore, concerns about the injustice of individual transactions—potentially due to inequality, as Shiffrin worries—may lead to greater systemic inequality.

Both arguments against the moralist objection lead to the conclusion that, given the weaknesses and defeasibility of such objections, the consequentialist-welfarist criterion for deregulating structural contractual constraints, as argued by Alan Schwartz, is highly robust when applied to commercial parties exhibiting commercial rationality.⁹¹ In non-commercial contracts, however, parties often have a much lower Shapley value than the state, which may have legitimate protective interests in safeguarding unsophisticated parties. These interests can override the parties' relative

89. See Shapley, *supra* note 10.

90. Clark & Sepe, *supra* note 11.

91. Schwartz & Sepe, *supra* note 5.

contributions to the coalition, as well as the rationale for equalizing their rights to defend against promissory breach.

A. Shapley Value and the State

A preliminary question arises here: What kind of relationship exists between contracting parties and the state? I initially defined this relationship broadly as one between members of a coalition (i.e., a grand coalition). In this sense, it could be understood either as a partnership aimed at achieving welfare gains or as a relationship where contracting parties engage with the state, which provides a service—namely legal enforcement, not enforcement in general—under a monopoly. These two perspectives on the relationship between commercial parties and the state remain compatible with the broader concept of a coalition.

The critical issue is whether the coalition between contracting parties and the state is renewed with each contract or whether it constitutes a preexisting coalition in which individual contracts are merely decisions made within the coalition. If, as Shiffrin suggests, the state represents the community, then a coalition already exists between individuals—including contracting parties—and the state. Social contract theory, in its various forms, supports this view: citizens agree to obey laws and contribute (e.g., through taxes) in exchange for public goods, the protection of rights, and the provision of legal enforcement.⁹² In the specific case, one could argue that the coalition between commercial parties and the state preexists, beginning the moment these parties engage in business. The legal infrastructure provided by the state—such as organizational forms for merchants (e.g., the corporate form) and the protection of property rights—is essential to conducting business. In return, the state reserves, through taxation, a share of the merchants' profits, a claim derived from the social contract.

Shiffrin argues that while individuals may engage in private transactions, the state, through judicial interpretation, can refuse enforcement if the terms conflict with community morality. This effectively grants the state a unilateral right to withdraw, thereby disrupting the coalition. I question the morality of exercising this power.

In this context, we are not addressing the externalities a contract might impose on third parties. In such cases, the state could justify declining to participate in the coalition or even prohibiting the transaction altogether on grounds of promissory morality. Such restrictions would then qualify as instances of public policy constraints. However, Shiffrin argues that the state retains the right to avoid complicity even with arrangements it deems permissible. But complicity with what? With an arrangement

92. See JEAN-JACQUES ROUSSEAU, *THE SOCIAL CONTRACT* bk. I, ch. 6 (1762); JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* bk. II, ch. 9, §§ 123-131 (1689); see also JOHN RAWLS, *A THEORY OF JUSTICE* 11-12 (rev. ed. 1999).

permissible under the law but allegedly conflicting with communal morality. This position appears problematic.

If the focus were on substantive terms, such as the sale of organs, the resulting moral externalities, among other considerations, might justify restrictions, and her reasoning might align with non-consequentialist public policy restrictions, which I consider valid.⁹³ Yet her argument is general, and here we are addressing structural terms. Such terms neither harm nor obstruct others, allowing uninvolved individuals to pursue their plans without interference. In the specific case of structural terms, it remains unclear what the moral concerns of the community might be, apart from those of the directly involved parties. In the absence of moral concerns affecting third parties, the state stands on equal moral footing with the contracting parties within the coalition. Interpreting non-complicity as a unilateral power to override the coalition's decisions would unjustifiably elevate the state's moral standing, creating an asymmetry. This would amount to an unwarranted overrepresentation of the state within the coalition, absent any justification for representing interests beyond those of the contracting parties.

To summarize, we are addressing an existing coalition between the contracting parties and the state, where all members reasonably share equal moral standing. The coalition's decision regarding enforceability should reflect the individual agency of its members, which I propose be determined using the Shapley value, a concept from cooperative game theory. The Shapley value ensures fairness, consistency, and respect for each member's contribution by calculating their marginal contribution across all possible coalitions and averaging the value they add.⁹⁴

In a legally enforceable contract, both the contracting parties and the state participate in a coalition. The parties engage in exchanges, while the state provides legal enforcement—although its role may be unnecessary when the parties can self-enforce. This is often the case in commercial

93. Amartya Sen discusses the problem of *moral externality* in scenarios where individuals' preferences regarding others' personal choices create conflicts in a liberal society—particularly when person A's "moral preference" about what person B does in private interferes with B's freedom. This issue can be understood as a moral or offense externality: person A is negatively affected (offended) by person B's action, even if it causes no direct harm to A's material welfare. See Amartya Sen, *The Impossibility of a Paretian Liberal*, 78 J. POL. ECON. 152, 152-57 (1970).

94. See Shapley, *supra* note 10. However, as previously noted, the Shapley value is just one of several solution concepts in cooperative game theory. Others include the core, which identifies outcomes where no subset of players can achieve better payoffs by forming their own coalition, ensuring stability by preventing deviations; the nucleolus, which minimizes the maximum dissatisfaction or "excess" of any coalition by addressing the most significant complaints first; and the bargaining set, which considers potential objections and counter-objections to find stable outcomes. See ROGER B. MYERSON, *GAME THEORY: ANALYSIS OF CONFLICT*, 423-50 (1991). While these concepts primarily address payoff distribution, they can also apply abstractly to the allocation of agency or decision-making power. Each member's share of agency can reflect their marginal contribution to the coalition, mirroring how payoffs are distributed fairly based on individual contributions to collective outcomes.

settings, where contracts are self-enforceable.⁹⁵ For example, commercial reputation acts as an enforcement mechanism: merchants in competitive markets rely on future transactions, and the risk of losing reputation deters breaches.⁹⁶ This also applies to idiosyncratic contracts, where sunk investments make it more costly to exit than to stay due to high redeployment costs.⁹⁷ Additionally, industry-specific customs, as highlighted by Lisa Bernstein, create further enforcement mechanisms,⁹⁸ as do various forms of relational contracts.⁹⁹ However, the situation differs in contracts involving unsophisticated parties or a mix of sophisticated and unsophisticated parties. In such cases, legal enforcement becomes the primary mechanism, significantly raising the state's Shapley value and potentially justifying its greater agency over the contracting parties.

To illustrate how agency in the coalition distributes according to the Shapley value, consider a scenario involving three agents: Party A and Party B (the merchants) and the State (providing legal enforcement). None of the parties can independently generate value—they cannot complete or enforce the transaction alone. Similarly, coalitions between Party A and the State, or Party B and the State, fail to generate value because both merchants are necessary for the transaction. Now assume that Party A and Party B, without the State, generate 80 units of value through self-enforcement mechanisms. When the State joins, it adds 20 units by providing legal enforcement, increasing the coalition's total value to 100 units.

To compute the Shapley value and determine each participant's fair share of the total value, we must consider all possible coalition formations. With three players, there are six possible permutations of the order in which they join the coalition.¹⁰⁰ For each permutation, we calculate the marginal contribution of each participant as they join.

For Party A, in two permutations, it joins first and cannot generate any value alone, resulting in a marginal contribution of 0 units. In one permutation, Party A joins second after Party B, enabling the coalition to generate 80 units, which gives it a marginal contribution of 80 units. In another

95. Not all transactions require legal enforcement, though many do. The analysis here is counterfactual: it focuses not on what parties do without state enforcement (since they typically expect some), but on what they could do in its absence. In such cases, the state's role is reduced, though legal enforcement can still add value.

96. See Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

97. Cf. Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 298-99 (1978).

98. See, e.g., Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1765 (1996).

99. Cf. e.g., George Baker, Robert Gibbons & Kevin J. Murphy, *Relational Contracts and the Theory of the Firm*, 117 Q.J. ECON. 39, 39 (2002); Jonathan Levin, *Relational Incentive Contracts*, 93 AM. ECON. REV. 835 (2003).

100. For 3 players, the number of permutations is given by $3! = 6$.

permutation, Party A joins second after the state, again resulting in a contribution of 0 units. In the final two permutations, Party A joins last after both Party B and the state, neither of which can generate value without it. When Party A joins, the coalition's value increases to 100 units, giving it a contribution of 100 units in each case. Summing across all permutations, Party A's total marginal contribution is 280 units. Party B follows the same pattern as Party A, also totaling 280 units. For the state, in four permutations, it joins before both merchants are present and cannot generate value on its own or with just one party, resulting in 0 units. In the remaining two permutations, the state joins after both Party A and Party B, increasing the value from 80 to 100 units, making its marginal contribution 20 units in each case. Therefore, the State's total contribution across all permutations is 40 units.

To find the Shapley value for each participant, we divide their total marginal contributions by the six possible permutations. For Party A, the Shapley value is $280/6 \approx 46.67$ units. Party B's Shapley value is the same, also 46.67 units. The state's Shapley value is $40/6 \approx 6.67$ units. These results indicate that both Party A and Party B contribute significantly to the total value, accounting for approximately 46.67% each. The State's contribution, while smaller at 6.67%, is necessary for achieving the maximum transaction value of 100 units by providing legal enforcement.

It is important to emphasize that the Shapley value is grounded in fairness and equity—the same principles Shiffrin aims to promote in contract law by defending the right to avoid complicity when contract terms are deemed immoral. However, the Shapley value implicitly demonstrates that if agency is not distributed proportionally to contributions among agents with equal moral standing, it would violate its underlying axioms, resulting in unfair outcomes in collaborations. By ensuring that coalitions reflect reciprocal contributions, the Shapley value prevents any participant, including the state, from exerting disproportionate influence.

According to Shiffrin, the state acknowledges the moral legitimacy of a transaction when the parties can complete it independently through promissory morality, yet it refuses to provide enforcement services. This is puzzling: once the state accepts the normative aims of the contracting parties as morally permissible, it is unclear why it should impose its moral standing on voluntary transactions conducted within a framework of autonomy and consent. Disagreements may arise over certain contract elements, but if these concern less essential aspects, the agency to decide legal enforceability—being an implementation of the coalition's purpose—should reflect the members' relative contributions. The situation differs for unsophisticated parties, who rely heavily on state enforcement to safeguard their interests, or in cases where the state provides public goods, such

as infrastructure, where private incentives are weak or absent.¹⁰¹ In such cases, the state's Shapley value would be high, justifying a larger and potentially dominant role.

B. Equal Defense Theory

Most commercial transactions are self-enforceable, meaning merchants can establish mechanisms—albeit costly—to ensure enforceability. Self-enforceability depends not only on the structure of the contract (e.g., whether it is idiosyncratic and involves sunk costs) or the context (e.g., a competitive market), but also on the enforcement resources available to the parties.¹⁰² When commercial parties have limited enforcement resources and are outside the contexts of self-enforceability, the state's Shapley value could exceed that of the parties. Following the reasoning developed earlier, one might conclude that the state *should* have greater agency and have the right to refuse enforcement in such cases. In this section, I present a concluding argument to demonstrate that this claim is untenable, as it would result in distributive inequality that is morally indefensible.

The issue arises when some parties have more enforcement resources than others, giving them easier access to promissory morality. By enforcement resources, I refer to the means a party has to prevent the breach of a promissory right or to compensate the promisee if a breach occurs.¹⁰³ These resources include the ability to impose physical, reputational, or economic harm on the promisor, as well as to extract compensation. Collateral is also an enforcement resource, though more indirect. For example, if Party A wants to exchange promises with Party B, but Party B lacks the means to enforce Party A's promise, Party B may be unwilling to take the risk. However, if Party A offers property as collateral, Party B can take ownership if the promise is broken, providing the necessary enforcement and enabling the exchange.¹⁰⁴

Without contract law enforcement, these enforcement resources would be distributed unequally. Wealthy merchants would have greater means to enforce their promissory rights, resources unavailable to poorer merchants. Those who are socially and economically connected could threaten reputational harm in ways the isolated cannot. Additionally, the wealthy and well-connected would have more physical and reputational assets to use as collateral. Even when the poor or isolated could offer collateral, the cost would often be disproportionately high.¹⁰⁵ This asymmetry

101. Cf. ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, *supra* note 7, at 350-352.

102. CLARK & SEPE, *supra* note 11.

103. *Id.*

104. *Id.*

105. *Id.* For example, due to the diminishing marginal utility of money, offering a bushel of corn as collateral would be more burdensome for a *poor* merchant than for a wealthy one.

presents a fundamental problem that the state must address: the unequal distribution of enforcement resources between parties, including merchants. This inequality limits some merchants' ability to participate in the social practice of promising or forces them to do so at prohibitive costs and risks.

To illustrate, consider an analogy I developed in another work.¹⁰⁶ Two towns, Allentown and Barbertown, are similar in almost every way, including facing the same level of unjust aggression that requires police intervention. Both have well-respected police departments, but Allentown, being wealthier, has a larger budget, allowing it to purchase non-lethal weapons and provide advanced training for its officers. Barbertown, with a smaller budget, can only equip its officers with standard lethal firearms. As a result, Barbertown officers may be justified in using lethal force in situations where Allentown officers would not, simply because they lack less harmful alternatives. While each act of defense may be justified, a higher-level injustice exists in Barbertown residents being more exposed to lethal force. The broader community has a duty to address this by providing Barbertown with non-lethal options, reducing the severity of harm. Similarly, the state has a duty to reduce the harms citizens face by ensuring the proper enforcement of promissory obligations.¹⁰⁷

This analogy highlights a critical issue that Shiffrin overlooks in her argument that parties can rely on promissory morality without contract enforcement. By selectively refusing enforcement to avoid complicity in a perceived immoral transaction between merchants, the state would expose merchants with fewer enforcement resources and especially the weaker party *in* a given transaction to greater risks of private enforcement, creating injustice both *across* and *within* transactions. The moral and justice implications of these risks far outweigh the concerns that originally motivated the state's refusal to participate.

To address this issue, I introduced the *Equal Defense Theory* of contract, which holds that the state has a duty to reduce inequality caused by unequal enforcement resources.¹⁰⁸ This theory argues that contract law is necessary because it equalizes opportunities to participate in the social practice of promising, ensuring that such participation does not involve asymmetric risks. By providing universal and impartial enforcement, contract law ensures that access to this practice is not dependent on one's resources. In doing so, the state corrects the injustice of unequal opportunity, allowing all individuals—merchants, in this case—to fully participate in transactional relationships.¹⁰⁹

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

Before concluding, I need to extend one of the implications of the theory I developed, assuming contract law already exists, as it does. The focus now shifts to freedom of contract in this sense: if the state is reluctant to provide greater freedom of contract (for example, by imposing structural constraints) while still allowing parties to carry out transactions under the same transactional framework as if those constraints didn't exist, through promissory morality, it exposes parties with fewer enforcement resources to either the risk of inaccessibility¹¹⁰ or participation with greater risks. This creates a serious issue of inequality. In this view, the question of freedom of contract effectively becomes a matter of inequality. The non-paternalistic critique overlooks distributive inequality, resulting in greater injustice if one accepts its claim that the state can refuse to enforce contracts for moral reasons.¹¹¹

Conclusion

Alan Schwartz's intellectual endeavor to theoretically re-found commercial contract law has been an extraordinary undertaking that revitalized a discipline previously confined to pedantic, positivist-exegetical doctrinalism.¹¹² His central normative claim justifies why contract law between merchants should be liberalized, and his reasoning rests on two key assumptions.

First, merchants are sophisticated and therefore rational parties, rendering them immune to paternalistic considerations. Second, the system of contracts should be evaluated based on the economic outcomes it produces. This is not merely a methodological—or some may say ideological—choice rooted in law and economics and the commitment to utilitarian-welfarist consequentialism. Rather, it is the correct methodological choice because society has already made a normative commitment to capitalism, a choice that must be taken for granted. Furthermore, the normative ends of merchants are clear to themselves and to society: they wish to conduct business efficiently and seek profits. Therefore, this is the correct methodological premise, also for considerations of justice understood broadly, and the burden to reject the method is on those who wish to overturn it, not on those who affirm it.

110. Cf. DAVID MILLER, *JUSTICE FOR EARTHLINGS: ESSAYS IN POLITICAL PHILOSOPHY* 119 (2013).

111. This does not deny that injustices exist within the contract law system or that the system often favors parties with greater resources. Thus, the *Equal Defense Theory* would still inherently carry significant elements of injustice. However, the issue here is of a different nature. The comparative justice analysis is between a system where only the wealthy can bypass the contract law framework, leaving others reliant on it, and a system where contract law—despite its inequities—remains accessible to all parties on terms they mutually desire. The former form of injustice is considered far more severe than the latter.

112. I thank the editors for sparing me from providing citations here, thus avoiding any discomfort, though within the relevant scientific community, it is clear who is being referenced.

In this essay, I have addressed current attempts at rejecting these assumptions. The first, a paternalistic critique, claims that rationality is a chimera—at least as conceived by decision theory—and that even sophisticated parties vary in their rationality. Therefore, there are reasons, including welfare-dependent ones, to restrict merchants' contractual freedom to protect less rational parties. The second, a non-paternalistic critique, argues that contracts should be assessed from a broader perspective, not merely focusing on the welfare that parties or society can achieve. It contends that contract law, as an institution, should be analyzed in its political-philosophical dimension, considering the roles of commercial parties alongside the state. According to this view, the state has the right not to support what merchants desire in their transactions and thus the right not to legally enforce contracts for moral reasons.

I argue that both criticisms lack merit. First, I have conceptualized a specific definition of rationality—commercial rationality—that applies to merchants and is derived inductively. It is legitimate to presume merchants are sufficiently rational not to require paternalistic protections. Therefore, measures that restrict contractual freedom would be inefficient—even for rationality-dependent reasons—as they would weaken the quality of merchants and the economy, of which merchants are a constitutive part. Moreover, these restrictions would violate autonomy-based principles.

The second, non-paternalistic critique suggests the state could refuse to enforce contracts for moral reasons while acknowledging that merchants can proceed through self-enforceable transactions (i.e., on their own through promissory morality). I have shown that this critique contradicts *fair* criteria for aggregating the agency of the state and commercial parties. If these parties are recognized as having equal moral status, as they should be, then in transactions that are virtually self-enforceable, the state's marginal contribution is minimal, and so should be its agency in the coalition with commercial parties regarding enforcement decisions. Moreover, the implication of this critique—that it is morally permissible for the state not to enforce contracts—raises concerns about distributive inequality, as it would favor parties with greater enforcement resources. This conclusion is indefensible on both consequentialist and deontological grounds.

Alan Schwartz's work remains robust against these criticisms, which have not been systematically addressed in the literature. This further reinforces the strength of his contributions, which have reconceptualized contract law—an institution central to the functioning of the capitalist economy. His contribution cannot be overstated.